

As of March
2024

Accounting Practices & Procedures Manual

VOL 1

Preamble

Statements of Statutory Accounting Principles

Appendices A and B

VOL 2

Appendices C through G

AIU	1,822	12,349,000
EJK	1,062	85,678,000
HPL	485	8,369,000
KEE	8,569	189,301,000
QOP	6,602	102,698,000
TIK	890	24,697,000
WIG	6,280	76,002,000
AHD	2,436	57,610,000

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Accounting Practices and Procedures Manual

As of March 2024

VOLUME I

PREAMBLE

STATEMENTS OF STATUTORY ACCOUNTING PRINCIPLES

APPENDIX A – EXCERPTS OF NAIC MODEL LAWS

APPENDIX B – INTERPRETATIONS OF STATUTORY ACCOUNTING PRINCIPLES

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ISBN: 978-1-64179-383-4

Printed in Canada

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MAINTENANCE PROCESS

The Statutory Accounting Principles (E) Working Group maintains codified statutory accounting principles (SAP) by concluding on generally accepted accounting principles (GAAP) or addressing new statutory accounting issues. As revisions are adopted, the corresponding agenda items and issue papers are added to the “Updates” section of the current year’s digital version of the *Accounting Practices and Procedures Manual* (Manual).

Email Notification

To receive notification when updates to the Manual are made available, navigate to <https://naicforum.naic.org/statacctupdates.htm> to subscribe to the Statutory Accounting Electronic Updates. The NAIC will retain this database; therefore, if you have previously registered to receive update notices, there is no need to resubmit your request on an annual basis.

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DEDICATION

The *Accounting Practices and Procedures Manual* is dedicated to Norris Clark, California Department of Insurance (retired), Chair of the Codification of Statutory Accounting Principles Working Group, and its successors, the Statutory Accounting Principles and Emerging Accounting Issues (E) Working Groups from September 1994 through July 2004, and to Joseph Fritsch, New York Department of Financial Services (retired), Chair of the Statutory Accounting Principles (E) Working Group from 2004 through December 2012.

Your dedication, leadership, intelligence, and passion were the driving forces behind the creation and continued development of the comprehensive statutory accounting and financial reporting model presented in this publication. Your contributions throughout the years are appreciated and will not be forgotten.

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Accounting Practices and Procedures Manual

As of March 2024

TABLE OF CONTENTS

How to Use This Manual	<u>Page</u> xvii
Summary of Changes to the <i>As of March 2023 Accounting Practices and Procedures Manual</i> ...	xxiii

VOLUME I

Statements of Statutory Accounting Principles (SSAPs)

Completely superseded SSAPs are retained in *Appendix H – Superseded SSAPs and Nullified Interpretations*, which is posted for public reference on the Statutory Accounting Principles (E) Working Group web page at https://content.naic.org/cmte_e_app_sapwg.htm.

<u>SSAP No.</u>	<u>Title</u>	<u>Page</u>
-	Preamble	P-1
1	Accounting Policies, Risks & Uncertainties and Other Disclosures	1-1
2R	Cash, Cash Equivalents, Drafts and Short-Term Investments	2R-1
3	Accounting Changes and Corrections of Errors	3-1
4	Assets and Nonadmitted Assets	4-1
5R	Liabilities, Contingencies and Impairments of Assets	5R-1
6	Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due from Agents and Brokers	6-1
7	Asset Valuation Reserve and Interest Maintenance Reserve	7-1
9	Subsequent Events	9-1
11	Postemployment Benefits and Compensated Absences	11-1
12	Employee Stock Ownership Plans	12-1
15	Debt and Holding Company Obligations	15-1
16R	Electronic Data Processing Equipment and Software	16R-1
17	Preoperating and Research and Development Costs	17-1
19	Furniture, Fixtures, Equipment and Leasehold Improvements.....	19-1
20	Nonadmitted Assets	20-1
21R	Other Admitted Assets	21R-1
22R	Leases	22R-1
23	Foreign Currency Transactions and Translations	23-1
24	Discontinued Operations and Unusual or Infrequent Items	24-1
25	Affiliates and Other Related Parties	25-1
26R	Bonds.....	26R-1
27	Off-Balance-Sheet and Credit Risk Disclosures.....	27-1
29	Prepaid Expenses	29-1
30R	Unaffiliated Common Stock.....	30R-1
32R	Preferred Stock	32R-1
34	Investment Income Due and Accrued	34-1
35R	Guaranty Fund and Other Assessments	35R-1
36	Troubled Debt Restructuring	36-1
37	Mortgage Loans	37-1
38	Acquisition, Development and Construction Arrangements	38-1
39	Reverse Mortgages	39-1
40R	Real Estate Investments	40R-1

Table of Contents

<u>SSAP No.</u>	<u>Title</u>	<u>Page</u>
41R	Surplus Notes	41R-1
42	Sale of Premium Receivables	42-1
43R	Loan-Backed and Structured Securities	43R-1
44	Capitalization of Interest	44-1
47	Uninsured Plans	47-1
48	Joint Ventures, Partnerships and Limited Liability Companies	48-1
49	Policy Loans	49-1
50	Classifications of Insurance or Managed Care Contracts	50-1
51R	Life Contracts	51R-1
52	Deposit-Type Contracts	52-1
53	Property and Casualty Contracts–Premiums	53-1
54R	Individual and Group Accident and Health Contracts	54R-1
55	Unpaid Claims, Losses and Loss Adjustment Expenses	55-1
56	Separate Accounts	56-1
57	Title Insurance	57-1
58	Mortgage Guaranty Insurance	58-1
59	Credit Life and Accident and Health Insurance Contracts	59-1
60	Financial Guaranty Insurance	60-1
61R	Life, Deposit-Type and Accident and Health Reinsurance	61R-1
62R	Property and Casualty Reinsurance	62R-1
63	Underwriting Pools.....	63-1
64	Offsetting and Netting of Assets and Liabilities	64-1
65	Property and Casualty Contracts	65-1
66	Retrospectively Rated Contracts	66-1
67	Other Liabilities	67-1
68	Business Combinations and Goodwill	68-1
69	Statement of Cash Flow	69-1
70	Allocation of Expenses	70-1
71	Policy Acquisition Costs and Commissions	71-1
72	Surplus and Quasi-Reorganizations	72-1
73	Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities	73-1
74	Insurance-Linked Securities Issued Through a Protected Cell.....	74-1
76	Start-Up Costs	76-1
78	Multiple Peril Crop Insurance	78-1
83	Mezzanine Real Estate Loans	83-1
84	Health Care and Government Insured Plan Receivables	84-1
86	Derivatives.....	86-1
90	Impairment or Disposal of Real Estate Investments	90-1
92	Postretirement Benefits Other Than Pensions	92-1
93	Low-Income Housing Tax Credit Property Investments	93-1
94R	Transferable and Non-Transferable State Tax Credits	94R-1
95	Nonmonetary Transactions.....	95-1
97	Investments in Subsidiary, Controlled and Affiliated Entities	97-1
100R	Fair Value	100R-1
101	Income Taxes.....	101-1
102	Pensions.....	102-1
103R	Transfers and Servicing of Financial Assets and Extinguishments of Liabilities .	103R-1
104R	Share-Based Payments	104R-1
105R	Working Capital Finance Investments.....	105R-1

Table of Contents

<u>SSAP No.</u>	<u>Title</u>	<u>Page</u>
107	Risk-Sharing Provisions of the Affordable Care Act	107-1
108	Derivatives Hedging Variable Annuity Guarantees	108-1

INDEX to Statements of Statutory Accounting Principles	1

GLOSSARY to Statements of Statutory Accounting Principles	23

Appendix A – Excerpts of NAIC Model Laws

<u>No.</u>	<u>Title</u>	<u>Page</u>
A-001	Investments of Reporting Entities	A001-1
A-010	Minimum Reserve Standards for Individual and Group Health Insurance Contracts....	A010-1
A-200	Separate Accounts Funding Guaranteed Minimum Benefits Under Group Contracts ..	A200-1
A-205	Illustrative Disclosure of Differences Between NAIC Statutory Accounting Practices and Procedures and Accounting Practices Prescribed or Permitted by the State of Domicile	A205-1
A-225	Managing General Agents	A225-1
A-235	Interest-Indexed Annuity Contracts	A235-1
A-250	Variable Annuities	A250-1
A-255	Modified Guaranteed Annuities	A255-1
A-270	Variable Life Insurance	A270-1
A-440	Insurance Holding Companies	A440-1
A-585	Universal Life Insurance	A585-1
A-588	Modified Guaranteed Life Insurance	A588-1
A-620	Accelerated Benefits	A620-1
A-628	Title Insurance	A628-1
A-630	Mortgage Guaranty Insurance	A630-1
A-641	Long-Term Care Insurance	A641-1
A-695	Synthetic Guaranteed Investment Contracts	A695-1
A-785	Credit for Reinsurance	A785-1
A-791	Life and Health Reinsurance Agreements	A791-1
A-812	Smoker/Nonsmoker Mortality Tables for Use in Determining Minimum Reserve Liabilities	A812-1
A-815	Recognition of Preferred Mortality Tables for Use in Determining Minimum Reserve Liabilities	A815-1
A-817	Preneed Life Insurance Minimum Standards for Determining Reserve Liabilities and Nonforfeiture Values	A817-1
A-818	Determining Reserve Liabilities for Credit Life Insurance Model Regulation	A818-1
A-820	Minimum Life and Annuity Reserve Standards	A820-1
A-821	Annuity Mortality Table for Use in Determining Reserve Liabilities for Annuities	A821-1
A-822	Asset Adequacy Analysis Requirements	A822-1
A-830	Valuation of Life Insurance Policies (Including the Introduction and Use of New Select Mortality Factors)	A830-1

Appendix B – Interpretations of Statutory Accounting Principles

Nullified interpretations (INTs) are retained in *Appendix H – Superseded SSAPs and Nullified Interpretations*, which is posted for public reference on the Statutory Accounting Principles (E) Working Group web page at https://content.naic.org/cmte_e_app_sapwg.htm.

Interpretations of the Emerging Accounting Issues (E) Working Group and Statutory Accounting Principles (E) Working Group

INT No.	Title	Page
00-03	Illustration of the Accounting/Reporting of Deposit-Type Contracts in Accordance with SSAP Nos. 51R, 52 and 56.....	00-03-1
00-20	Application of SEC SAB No. 99, Materiality to the Preamble of the AP&P Manual	00-20-1
00-24	EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee and EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses	00-24-1
00-26	EITF 98-3: Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business	00-26-1
00-28	EITF 99-12: Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination.....	00-28-1
01-18	Consolidated or Legal Entity Level – Limitations on EDP Equipment, Goodwill and Deferred Tax Assets Admissibility	01-18-1
01-25	Accounting for U.S. Treasury Inflation-Indexed Securities	01-25-1
01-31	Assets Pledged as Collateral	01-31-1
02-22	Accounting for the U.S. Terrorism Risk Insurance Program	02-22-1
03-02	Modification to an Existing Intercompany Pooling Arrangement	03-02-1
04-17	Impact of Medicare Modernization Act on Postretirement Benefits	04-17-1
04-21	EITF 02-09: Accounting for Changes that Result in a Transferor Regaining Control of Financial Assets Sold.....	04-21-1
05-05	Accounting for Revenues Under Medicare Part D Coverage	05-05-1
06-02	Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)	06-02-1
06-07	Definition of Phrase “Other Than Temporary”	06-07-1
06-12	Tax Deposits Submitted in Accordance with Section 6603 of the Internal Revenue Service (IRS) Code.....	06-12-1
06-13	EITF 01-2: Interpretations of APB Opinion No. 29	06-13-1
07-01	Application of the Scientific (constant yield) Method in Situations of Reverse Amortization.....	07-01-1
08-05	EITF 02-11: Accounting for Reverse Spinoffs	08-05-1
15-01	ACA Risk Corridors Collectibility	15-01-1
18-03	Additional Elements Under the Tax Cuts and Jobs Act.....	18-03-1
19-02	Freddie Mac Single Security Initiative	19-02-1
20-01	ASUs 2020-04 & 2021-01 – Reference Rate Reform.....	20-01-1
20-06	Participation in the 2020 TALF Program	20-06-1
20-09	Basis Swaps as a Result of the LIBOR Transition	20-09-1
21-01	Accounting for Cryptocurrencies.....	21-01-1
22-01	Freddie Mac When-Issued K-Deal (WI Trust) Certificates.....	22-01-1
22-02	Third Quarter 2022 Through First Quarter 2023 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax	22-02-1
23-01	Net Negative (Disallowed) Interest Maintenance Reserve	23-01-1
23-03	Inflation Reduction Act – Corporate Alternative Minimum Tax	23-03-1
23-04	Scottish Re Life Reinsurance Liquidation Questions	23-04-1

VOLUME II

Appendix C – Actuarial Guidelines

<u>AG No.</u>	<u>Title</u>	<u>Page</u>
	Actuarial Guidelines Table of Contents.....	C-i
	Actuarial Guidelines Overview.....	C-iv
I	Interpretation of The Standard Valuation Law With Respect to the Valuation of Policies Whose Valuation Net Premiums Exceed the Actual Gross Premium Collected.....	AG1-1
II	Reserve Requirements With Respect to Interest Rate Guidelines on Active Life Funds Held Relative to Group Annuity Contracts.....	AG2-1
III	Interpretation of Minimum Cash Surrender Benefit Under Standard Nonforfeiture Law For Individual Deferred Annuities	AG3-1
IV	Actuarial Interpretation Regarding Minimum Reserves for Certain Forms of Term Life Insurance.....	AG4-1
V	Interpretation Regarding Acceptable Approximations For Continuous Functions....	AG5-1
VI	Interpretation Regarding Use of Single Life or Joint Life Mortality Tables 20 June 1983	AG6-1
VII	Interpretation Regarding Calculation of Equivalent Level Amounts	AG7-1
VIII	The Valuation of Individual Single Premium Deferred Annuities	AG8-1
IX	Form Classification of Individual Single Premium Immediate Annuities For Application of the Valuation and Nonforfeiture Laws.....	AG9-1
IX-A	Use of Substandard Annuity Mortality Tables In Valuing Impaired Lives Under Structured Settlements.....	AG9A-1
IX-B	Clarification of Methods Under Standard Valuation Law For Individual Single Premium Immediate Annuities, Any Deferred Payments Associated Therewith, Some Deferred Annuities, and Structured Settlements Contracts.....	AG9B-1
IX-C	Use of Substandard Annuity Mortality Tables in Valuing Impaired Lives Under Individual Single Premium Immediate Annuities	AG9C-1
X	Guideline For Interpretation of NAIC Standard Nonforfeiture Law For Individual Deferred Annuities	AG10-1
XI	Effect of an Early Election By an Insurance Company of an Operative Date Under Section 5-C of the Standard Nonforfeiture Law For Life Insurance.....	AG11-1
XII	Interpretation Regarding Valuation and Nonforfeiture Interest Rates.....	AG12-1
XIII	Guideline Concerning the Commissioners' Annuity Reserve Valuation Method	AG13-1
XIV	Surveillance Procedure For Review of the Actuarial Opinion For Life and Health Insurers	AG14-1
XV	Illustrations Guideline For Variable Life Insurance Model Regulation	AG15-1
XVI	Calculation of CRVM Reserves On Select Mortality and/or Split Interest	AG16-1
XVII	Calculation of CRVM Reserves When Death Benefits Are Not Level	AG17-1
XVIII	Calculation of CRVM Reserves On Semi-Continuous, Fully Continuous or Discounted Continuous Basis.....	AG18-1
XIX	1980 CSO Mortality Table With Ten-Year Select Mortality Factors.....	AG19-1
XX	Joint Life Functions For 1980 CSO Mortality Table.....	AG20-1
XXI	Calculation of CRVM Reserves When (B) Is Greater Than (A) and Some Rules For Determination of (A)	AG21-1
XXII	Interpretation Regarding Nonforfeiture Values For Policies With Indeterminate Premiums.....	AG22-1
XXIII	Guideline Concerning Variable Life Insurance Separate Account Investments.....	AG23-1
XXIV	Guidelines For Variable Life Nonforfeiture Values	AG24-1

Table of Contents

<u>AG No.</u>	<u>Title</u>	<u>Page</u>
XXV	Calculation of Minimum Reserves and Minimum Nonforfeiture Values For Policies With Guaranteed Increasing Death Benefits Based On an Index.....	AG25-1
XXVI	Election of Operative Dates Under Standard Valuation Law and Standard Nonforfeiture Law—June 3, 1989.....	AG26-1
XXVII	Accelerated Benefits	AG27-1
XXVIII	Statutory Claim Reserves For Group Long-Term Disability Contracts With A Survivor Income Benefit Provision	AG28-1
XXIX	Guideline Concerning Reserves of Companies in Rehabilitation.....	AG29-1
XXX	Guideline for the Application of Plan Type to Guaranteed Interest Contracts (GICs) With Benefit Responsive Payment Provisions Used to Fund Employee Benefit Plans	AG30-1
XXXI	Valuation Issues vs. Policy Form Approval.....	AG31-1
XXXII	Reserve for Immediate Payment of Claims	AG32-1
XXXIII	Determining CARVM Reserves For Annuity Contracts With Elective Benefits	AG33-1
XXXIV	Variable Annuity Minimum Guaranteed Death Benefit Reserves.....	AG34-1
XXXV	The Application of the Commissioners Annuity Reserve Method to Equity Indexed Annuities	AG35-1
XXXVI	The Application of the Commissioners Reserve Valuation Method to Equity Indexed Life Insurance Policies	AG36-1
XXXVII	Variable Life Insurance Reserves For Guaranteed Minimum Death Benefits.....	AG37-1
XXXVIII	The Application of the Valuation of Life Insurance Policies Model Regulation.....	AG38-1
XXXIX	Reserves for Variable Annuities With Guaranteed Living Benefits	AG39-1
XL	Guideline For Valuation Rate of Interest For Funding Agreements and Guaranteed Interest Contracts (GICs) With Bail-Out Provisions.....	AG40-1
XLI	Projection of Guaranteed Nonforfeiture Benefits Under CARVM.....	AG41-1
XLII	The Application of the Model Regulation Permitting the Recognition of Preferred Mortality Tables For Use In Determining Minimum Reserve Liabilities	AG42-1
XLIII 2019 Valuations	CARVM For Variable Annuities	AG43a-1
XLIII 2020 Valuations	CARVM For Variable Annuities	AG43b-1
XLIV	Group Term Life Waiver of Premium Disabled Life Reserves	AG44-1
XLV	The Application of the Standard Nonforfeiture Law For Life Insurance to Certain Policies Having Intermediate Cash Benefits	AG45-1
XLVI	Interpretation of the Calculation of the Segment Length With Respect to the Life Insurance Policies Model Regulation Upon a Change in the Valuation Mortality Rates Subsequent to Issue	AG46-1
XLVII	The Application of Company Experience in the Calculation of Claim Reserves Under the 2012 Group Long-Term Disability Valuation Table	AG47-1
XLVIII	Actuarial Opinion and Memorandum Requirements for the Reinsurance of Policies Required to be Valued under Sections 6 and 7 of the NAIC Valuation of Life Insurance Policies Model Regulation (Model #830).....	AG48-1
XLIX	The Application of the Life Illustrations Model Regulation to Policies with Index- Based Interest	AG49-1
XLIX-A	The Application of the Life Illustrations Model Regulation to Policies with Index- Based Interest Sold (On or After December 14, 2020)	AG49A-1
L	2013 Individual Disability Income Valuation Table Actuarial Guideline	AG50-1
LI	The Application of Asset Adequacy Testing to Long-Term Care Insurance Reserves	AG51-1
LII	Variable Annuity Early Adoption	AG52-1

Table of Contents

<u>AG No.</u>	<u>Title</u>	<u>Page</u>
LIII	Application of the Valuation Manual for Testing the Adequacy of Life Insurer Reserves	AG53-1
LIV	Nonforfeiture Requirements for Index-Linked Variable Annuity Products	AG54-1
Actuarial Guidelines – Appendices.....		C-1
	C-1 Appendix to Guidelines—Maximum Reserve Valuation and Maximum Life Policy Nonforfeiture Interest Rates.....	C-3
	C-2 Interpretations of the Emerging Actuarial Issues (E) Working Group with respect to <i>Actuarial Guideline XXXVIII—The Application of the Valuation of Life Insurance Policies Model Regulation</i>	C-41

Appendix D – GAAP Cross-Reference to SAP

<u>Title</u>	<u>Page</u>
Accounting Standards Updates	D-1
Pre-FASB Codification Category A – FASB Statements and Interpretations, APB Opinions, and AICPA Accounting Research Bulletins	D-20
Pre-FASB Codification Category B – FASB Technical Bulletins, FASB Staff Positions, AICPA Industry Audit and Accounting Guides, and AICPA Statements of Position	D-51
Pre-FASB Codification Category C – Consensus positions of the FASB Emerging Issues Task Force and AICPA Practice Bulletins	D-74
Pre-FASB Codification Category D – AICPA Accounting Interpretations	D-120
Nonapplicable GAAP Pronouncements	D-122
FASB Codification to Pre-Codification GAAP	D-134

Appendix E – Issue Papers

Issue Papers Associated with SSAPs Adopted in 2023

(Included in the current year publication.)

<u>IP No.</u>	<u>Title</u>	<u>Page</u>
167	Derivatives and Hedging.....	IP-167-1
168	Updates to the Definition of a Liability	IP-168-1

Issue Papers Associated with SSAPs Adopted Prior to 2023

(Historical issue papers are posted for public reference on the Statutory Accounting Principles (E) Working Group web page at https://content.naic.org/cmte_e_app_sapwg.htm.)

<u>IP No.</u>	<u>Title</u>
1	Consolidation of Majority-Owned Subsidiaries
2	Definition of Cash
3	Accounting Changes
4	Definition of Assets and Nonadmitted Assets
5	Definition of Liabilities, Loss Contingencies and Impairments of Assets
6	Amounts Due from Agents and Brokers
7	Asset Valuation Reserve and Interest Maintenance Reserve
8	Accounting for Pensions
9	Subsequent Events
10	Uncollected Premium Balances
11	Compensated Absences
12	Accounting for Drafts Issued and Outstanding
13	Employers' Accounting for Postemployment Benefits

Table of Contents

<u>IP No.</u>	<u>Title</u>
14	Employers' Accounting for Postretirement Benefits Other Than Pensions
16	Electronic Data Processing Equipment and Software
17	Preoperating and Research and Development Costs
19	Furniture, Fixtures and Equipment
20	Gain Contingencies
21	Bills Receivable for Premiums
22	Leases
23	Property Occupied by the Company
24	Discontinued Operations and Extraordinary Items
25	Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties
26	Bonds, Excluding Loan-Backed and Structured Securities
27	Disclosure of Information about Financial Instruments with Concentration of Credit Risk
28	Short-term Investments
29	Prepaid Expenses (excluding deferred policy acquisition costs and other underwriting expenses, income taxes and guaranty fund assessments)
30	Investments in Common Stock (excluding investments in common stock of subsidiary, controlled, or affiliated entities)
31	Leasehold Improvements Paid by the Reporting Entity as Lessee
32	Investments in Preferred Stock (excluding investments in preferred stock of subsidiary, controlled, or affiliated entities)
33	Disclosures about Fair Value of Financial Instruments
34	Investment Income Due and Accrued
35	Accounting for Guaranty Fund and Other Assessments
36	Troubled Debt Restructurings
37	Mortgage Loans
38	Acquisition, Development and Construction Arrangements
39	Reverse Mortgages
40	Real Estate Investments
41	Surplus Notes
42	Sale of Premium Receivables
43	Loan-backed and Structured Securities
44	Capitalization of Interest
45	Repurchase Agreements, Reverse Repurchase Agreements and Dollar Repurchase Agreements
46	Accounting for Investments in Subsidiary, Controlled and Affiliated Entities
47	Uninsured Plans
48	Investments in Joint Ventures, Partnerships and Limited Liability Companies
49	Policy Loans
50	Classifications and Definitions of Insurance or Managed Care Contracts in Force
51	Life Contracts
52	Deposit-Type Contracts
53	Property Casualty Contracts—Premiums
54	Individual and Group Accident and Health Contracts
55	Unpaid Claims, Losses and Loss Adjustment Expenses
56	Universal Life-Type Contracts, Policyholder Dividends, and Coupons
57	Title Insurance
59	Credit Life and Accident and Health Insurance Contracts
65	Property and Casualty Contracts
66	Accounting for Retrospectively Rated Contracts
67	Depreciation of Property and Amortization of Leasehold Improvements
68	Business Combinations and Goodwill
69	Financial Guaranty Insurance
71	Policy Acquisition Costs and Commissions
72	Statutory Surplus

Table of Contents

<u>IP No.</u>	<u>Title</u>
73	Nonmonetary Transactions
74	Life, Deposit-Type and Accident and Health Reinsurance
75	Property and Casualty Reinsurance
76	Offsetting and Netting of Assets and Liabilities
77	Disclosure of Accounting Policies, Risks & Uncertainties, and Other Disclosures
78	Employee Stock Ownership Plans
80	Debt
81	Foreign Currency Transactions and Translations
82	Stock Options and Stock Purchase Plans
83	Accounting for Income Taxes
84	Quasi-reorganizations
85	Derivative Instruments
86	Securitization
87	Other Admitted Assets
88	Mortgage Guaranty Insurance
89	Separate Accounts
90	Nonadmitted Assets
92	Statement of Cash Flow
94	Allocation of Expenses
95	Holding Company Obligations
96	Other Liabilities
97	Underwriting Pools and Associations Including Intercompany Pools
99	Nonapplicable GAAP Pronouncements
100	Health Care Delivery Assets—Supplies, Pharmaceuticals and Surgical Supplies, and Durable Medical Equipment
101	Health Care Delivery Assets—Furniture, Medical Equipment and Fixtures, and Leasehold Improvements in Health Care Facilities
103	Accounting for the Issuance of Insurance-Linked Securities Issued by a Property and Casualty Insurer through a Protected Cell
104	Reinsurance Deposit Accounting – An Amendment to SSAP No. 62R—Property and Casualty Reinsurance
105	Reporting on the Costs of Start-Up Activities
106	Real Estate Sales – An Amendment to SSAP No. 40—Real Estate Investments
107	Certain Health Care Receivables and Receivables Under Government Insured Plans
108	Multiple Peril Crop Insurance
109	Depreciation of Nonoperating System Software – An Amendment to SSAP No. 16—Electronic Data Processing Equipment and Software
110	Life Contracts, Deposit-Type Contracts and Separate Accounts, Amendments to SSAP No. 51—Life Contracts, SSAP No. 52—Deposit-Type Contracts, and SSAP No. 56—Separate Accounts
111	Software Revenue Recognition
112	Accounting for the Costs of Computer Software Developed or Obtained for Internal Use and Web Site Development Costs
113	Mezzanine Real Estate Loans
114	Accounting for Derivative Instruments and Hedging Activities
116	Claim Adjustment Expenses, Amendments to SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses
118	Investments in Subsidiary, Controlled and Affiliated Entities, A Replacement of SSAP No. 46
119	Capitalization Policy, An Amendment to SSAP Nos. 4, 19, 29, 73, 79 and 82
121	Accounting for the Impairment or Disposal of Real Estate Investments
122	Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities
123	Accounting for Pensions, A Replacement of SSAP No. 8
124	Treatment of Cash Flows When Quantifying Changes in Valuation and Impairments, an Amendment of SSAP No. 43

Table of Contents

<u>IP No.</u>	<u>Title</u>
125	Accounting for Low-Income Housing Tax Credit Property Investments
126	Accounting for Transferable State Tax Credits
127	Exchanges of Nonmonetary Assets, A Replacement of SSAP No. 28—Nonmonetary Transactions
128	Settlement Requirements for Intercompany Transactions, An Amendment to SSAP No.25— Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties
129	Share-Based Payment, A Replacement of SSAP No. 13—Stock Options and Stock Purchase Plans
131	Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment
132	Accounting for Pensions, A Replacement of SSAP No. 89
133	Accounting for Postretirement Benefits Other Than Pensions, A Replacement of SSAP No. 14
134	Servicing Assets/Liabilities, An Amendment of SSAP No. 91
135	Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others
137	Transfer of Property and Casualty Reinsurance Agreements in Run-off
138	Fair Value Measurements
140	Substantive Revisions to SSAP No. 43—Loan-Backed and Structured Securities
141	Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities
143R	Guaranty Fund Assessments
144	Substantive Revisions to SSAP No. 91R: Securities Lending
145	Accounting for Transferable and Non-Transferable State Tax Credits
146	Share-Based Payments with Non-Employees
147	Working Capital Finance Investments
148	Affordable Care Act Section 9010 Assessment
149	Wholly Owned Single Real Estate Property in an LLC
150	Accounting for the Risk-Sharing Provisions of the Affordable Care Act
151	Valuation for Holders of Surplus Notes
152	Short Sales
153	Counterparty Reporting Exception for Asbestos and Pollution Contracts
154	Implementation of Principle-Based Reserving
155	Classification of Money Market Mutual Funds as Cash Equivalents
156	Bonds
157	Use of Net Asset Value
158	Unaffiliated Common Stock
159	Special Accounting Treatment for Limited Derivatives
160	Structured Settlements Acquired as Investments
161	Leases
162	Property and Casualty Reinsurance Credit
163	Working Capital Finance Investment Updates
164	Preferred Stock
165	Levelized Commission
166	Updates to the Definition of an Asset

Appendix F – Policy Statements

Title	Page
NAIC Policy Statement on Maintenance of Statutory Accounting Principles.....	F-1
NAIC Policy Statement on Comments to GAAP & IFRS Exposure Drafts	F-5
NAIC Policy Statement on Statutory Accounting Principles Maintenance Agenda Process	F-6
NAIC Policy Statement on the Impact of Statements of Statutory Accounting Principles on NAIC Publications	F-10
NAIC Policy Statement on Coordination of the Accounting Practices and Procedures Manual and the Annual Statement Blank	F-11
NAIC Policy Statement on Coordination with the Valuation Manual.....	F-13
NAIC Policy Statement on Coordination of the Accounting Practices and Procedures Manual and the Purposes and Procedures Manual of the NAIC Investment Analysis Office	F-14

Appendix G – Implementation Guide for the Annual Financial Reporting Model Regulation

Title	Page
Definitions.....	G-2
General Requirements Related to Filing and Extensions for Filing of Annual Audited Financial Reports and Audit Committee Appointment	G-4
Qualifications of Independent Certified Public Accountant	G-4
Communication of Internal Control Related Matters Noted in an Audit.....	G-10
Requirements for Audit Committees	G-11
Management’s Report of Internal Control over Financial Reporting	G-13
Exemptions and Effective Dates	G-18
Appendix 1.....	G-22

Appendix H – Superseded SSAPs and Nullified Interpretations

Completely superseded SSAPs and nullified interpretations (INTs) are retained in *Appendix H – Superseded SSAPs and Nullified Interpretations*, which is posted for public reference on the Statutory Accounting Principles (E) Working Group web page at https://content.naic.org/cmte_e_app_sapwg.htm.

SSAP No.	Title
8	Pensions
10	Income Taxes
10R	Income Taxes—A Temporary Replacement of SSAP No. 10
13	Stock Options and Stock Purchase Plans
14	Postretirement Benefits Other Than Pensions
18	Transfers and Servicing of Financial Assets and Extinguishments of Liabilities
28	Nonmonetary Transactions
31	Derivative Instruments
33	Securitization
45	Repurchase Agreements, Reverse Repurchase Agreements and Dollar Repurchase Agreements
46	Investments in Subsidiary, Controlled, and Affiliated Entities
75	Reinsurance Deposit Accounting—An Amendment to SSAP No. 62R—Property and Casualty Reinsurance
77	Real Estate Sales—An Amendment to SSAP No. 40—Real Estate Investment
79	Depreciation of Nonoperating System Software—An Amendment to SSAP No. 16—Electronic Data Processing Equipment and Software

Table of Contents

<u>SSAP No.</u>	<u>Title</u>
80	Life Contracts, Deposit-Type Contracts and Separate Accounts, Amendments to SSAP No. 51—Life Contracts, SSAP No. 52—Deposit-Type Contracts, and SSAP No. 56—Separate Accounts
81	Software Revenue Recognition
82	Accounting for the Costs of Computer Software Developed or Obtained for Internal Use and Web Site Development Costs
85	Claim Adjustment Expenses, Amendments to SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses
87	Capitalization Policy, An Amendment to SSAP Nos. 4, 19, 29 and 73
88	Investments in Subsidiary, Controlled and Affiliated Entities, A Replacement of SSAP No. 46
89	Accounting for Pensions, A Replacement of SSAP No. 8
91R	Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities
96	Settlement Requirements for Intercompany Transactions, An Amendment to SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties
98	Treatment of Cash Flows When Quantifying Changes in Valuation and Impairments, an Amendment of SSAP No. 43
99	Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment
106	Affordable Care Act Section 9010 Assessment
<u>INT No.</u>	<u>Title</u>
99-00	Compilation of Rejected EITFs
99-01	Accounting for Tax Benefits of Operating Losses and Tax Credits in Quasi-Reorganizations
99-02	Accounting for Collateral in Excess of Debt Principal
99-03	Accounting for Investment in Subsidiary, Controlled or Affiliated (SCA) Entities with Subsequent Downstream Investment in an Insurance Company
99-04	Recognition of Prepayment Penalties Upon Adoption of Codification
99-10	EITF 97-8: Accounting for Contingent Consideration Issued in a Purchase Business Combination
99-14	EITF 96-19: Debtor's Accounting for a Modification or Exchange of Debt Instruments
99-16	EITF 97-11: Accounting for Internal Costs Relating to Real Estate Property Acquisitions
99-17	EITF 97-12: Accounting for Increased Share Authorizations in an IRS Section 423 Employee Stock Purchase Plan under APB Opinion No. 25
99-18	EITF 97-13: Accounting for Costs Incurred in Connection with a Consulting Contract or an Internal Project That Combines Business Process Reengineering and Information Technology Transformation
99-21	EITF 98-7: Accounting for Exchanges of Similar Equity Method Investments
99-22	EITF 98-8: Accounting for Transfers of Investments That Are in Substance Real Estate
99-23	Disclosure of Premium Deficiency Reserves
99-24	Accounting for Restructuring Charges
99-25	Accounting for Capital Improvements
99-26	Offsetting Pension Assets and Liabilities
99-27	Nonadmitting Installment Receivables
99-28	Accounting for SCA Mutual Funds, Broker-Dealers and Similar Entities Under SSAP No. 46
99-29	Classification of Step-Up Preferred Stock
00-01	Investment in Foreign SCA Entity
00-02	Accounting for Leveraged Leases Involving Commercial Airplanes Under SSAP No. 22—Leases
00-04	Student Loan Insurance
00-05	Exemption to Merger Disclosure in SSAP No. 3

Table of Contents

<u>INT No.</u>	<u>Title</u>
00-06	EITF 97-14: Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested
00-08	EITF 98-5: Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios
00-10	EITF 98-14: Debtor's Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements
00-11	EITF 98-15: Structured Notes Acquired for a Specified Investment Strategy
00-12	EITF 99-4: Accounting for Stock Received from the Demutualization of a Mutual Insurance Company
00-21	Disclose Requirement of SSAP No. 10 Paragraphs 17 & 18
00-22	Application of SSAP No. 10 to Admissibility of Deferred Tax Assets
00-23	Reinsurance of Deposit Type Contracts
00-27	EITF 98-9: Accounting for Contingent Rent
00-29	EITF 99-17: Accounting for Advertising Barter Transactions
00-30	Application of SSAP No. 51 Paragraph 6 to Waiver of Deduction on Flexible Premium Universal Life Insurance Policies
00-31	Application of SSAP No. 55 Paragraph 13 to Health Entities
00-32	EITF 00-8: Accounting by a Grantee for an Equity Instrument to Be Received in Conjunction with Providing Goods or Services
01-01	Application of SSAP No. 6 Paragraph 9.a. to de minimus Receivable Balances of Group Accident and Health Policies
01-03	Assets Pledged as Collateral or Restricted for the Benefit of a Related Party
01-04	SSAP Nos. 18 and 33 and Issues Surrounding Securitizations
01-05	Classification of Accrued Interest on Policy Loans
01-07	EITF 98-2: Accounting by a Subsidiary or Joint Venture for an Investment in the Stock of Its Parent Company or Joint Venture Partner
01-10	EITF 00-1: Investor Balance Sheet and Income Statement Display under the Equity Method for Investments in Certain Partnerships and Other Ventures
01-11	EITF 00-10: Accounting for Shipping and Handling Fees and Costs
01-12	EITF 00-14: Accounting for Certain Sales Incentives
01-14	EITF 00-16: Recognition and Measurement of Employer Payroll Taxes on Employee Stock-Based Compensation
01-16	Measurement Date for SSAP No. 8 Actuarial Valuations
01-17	Accounting for Nonqualified Retirement Plans, Nonvested Ancillary Benefits Within Retirement Plans, and Protected Benefits Such as Early Retirement Subsidies in Retirement Plans
01-19	Measurement of Deferred Tax Assets Associated with Nonadmitted Assets
01-20	Utilization of Tax Planning Strategies for the Admissibility of Deferred Tax Assets
01-21	SSAP Nos. 16R, 19, 68 and 79 – Reestablishment of Previously Expensed Software and Furniture, Fixtures and Equipment and Goodwill
01-22	Use of Interim Financial Statements in Computing Reporting Entity's Investment in Subsidiary Under the GAAP Equity Method
01-23	Prepaid Legal Insurance Premium Recognition
01-24	Application of SSAP No. 46 and 48 to Certain Noninsurance Subsidiary, Controlled or Affiliated Entities
01-26	SSAP No. 51 and Reserve Minimum or Required Amount
01-27	Accounting Change versus Correction of Error
01-28	Margin for Adverse Deviation in Claim Reserve
01-29	SSAP No. 59 and Application to Credit Life
01-32	EITF 01-10: Accounting for the Impact of the Terrorist Attacks of September 11, 2001
01-33	Extension of 9-Month Rule in SSAP No. 62R
02-01	Disclosure Requirements Under SSAP for Differences Between A-785 and Individual State Requirements as a Result of September 11

Table of Contents

<u>INT No.</u>	<u>Title</u>
02-02	SSAP No. 6 and Billing of Premium Before Effective Date
02-03	Accounting for the Impact of the Terrorist Attacks of September 11 th on Commercial Mortgage Loans
02-04	Recognition of CARVM and CRVM Expense Allowances by the Assuming Reinsurer in a Modified Coinsurance Agreement
02-05	Accounting for Zero Coupon Convertible Bonds
02-06	Indemnification in Modeled Trigger Transactions
02-07	Definition of Phrase “Other Than Temporary”
02-08	Application of A-791 to YRT Reinsurance of a Block of Business
02-09	A-785 and Syndicated Letters of Credit
02-10	Statutory Audit Report Notes and the Reporting Requirements Related to Disclosures Containing Multiple Year Information
02-11	Recognition of Amounts Related to Earned but Unbilled Premium
02-15	EITF 00-11: Lessors’ Evaluation of Whether Leases of Certain Integral Equipment Meet the Ownership Transfer Requirements of FASB Statement 13
02-17	EITF 01-13: Income Statement Display of Business Interruption Insurance Recoveries
02-18	Accounting for the Intangible Asset as Described in SSAP No. 8 Paragraphs 9.d.v. and 9.f.
02-19	EITF 01-1: Accounting for a Convertible Instrument Granted or Issued to a Nonemployee for Goods or Services or a Combination of Goods or Services and Cash
02-20	Due Date for Installment Premium Under an Agency Relationship
02-21	Accounting for Prepaid Loss Adjustment Expenses and Claim Adjustment Expenses
03-01	Application of SSAP No. 35 to the Florida Hurricane Catastrophe Fund
03-03	Admissibility of Investments Recorded Based on the Audited GAAP Equity of the Investee when a Qualified Opinion is Provided
03-05	EITF 01-07: Creditor’s Accounting for a Modification or Exchange of Debt Instruments
03-12	EITF 02-4: Determining Whether a Debtor’s Modification or Exchange of Debt Instruments is within the Scope of FASB Statement No. 15
03-16	Contribution of Stock
03-17	Classification of Liabilities from Extra Contractual Obligation Lawsuits
03-18	Accounting for a Change in the Additional Minimum Liability in SSAP No. 8—Pensions (SSAP No. 8)
04-01	Applicability of New GAAP Disclosures Prior to NAIC Consideration
04-02	Surplus Notes Issued by Entities Under Regulatory Action
04-03	Clarification for Calculating the Additional Minimum Pension Liability Under SSAP No. 89—Accounting for Pensions, A Replacement of SSAP No. 8, paragraph 16.f.
04-05	Clarification of SSAP No. 5R Guidance on when a Judgment is Deemed Rendered
04-07	EITF 02-15: Determining Whether Certain Conversions of Convertible Debt to Equity Securities Are Within the Scope of FASB Statement No. 84
04-10	EITF 02-18: Accounting for Subsequent Investments in an Investee after Suspension of Equity Method Loss Recognition
04-12	EITF 03-4: Determining the Classification and Benefit Attribution Method for a “Cash Balance” Pension Plan
04-13	EITF 03-5: Applicability of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software
04-15	EITF 03-07: Accounting for the Settlement of the Equity-Settled Portion of a Convertible Debt Instrument That Permits or Requires the Conversion Spread to Be Settled in Stock (Instrument C of Issue No. 90-19)
04-18	EITF 00-21: Revenue Arrangements with Multiple Deliverables
04-20	EITF 01-08: Determining Whether an Arrangement Contains a Lease
05-04	Extension of Ninety-day Rule for the Impact of Hurricane Katrina, Hurricane Rita and Hurricane Wilma
05-06	Earned But Uncollected Premium

Table of Contents

<u>INT No.</u>	<u>Title</u>
06-14	Reporting of Litigation Costs Incurred for Lines of Business in which Legal Expenses Are the Only Insured Peril
07-03	EITF 06-3: How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross versus Net Presentation)
08-02	EITF 06-8: Applicability of the Assessment of a Buyer's Continuing Investment under FASB Statement No. 66 for Sales of Condominiums
08-03	EITF 06-9: Reporting a Change in (or the elimination of) a Previously Existing Difference between the fiscal Year-End of a Parent Company and That of a Consolidated Entity or between the Reporting Period of an Investor and That of an Equity Method Investee
08-04	EITF 07-3: Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities
08-06	FSP EITF 00-19-2: Accounting for Registration Payment Arrangements
08-07	EITF 07-6: Accounting for the Sale of Real Estate Subject to the Requirements of FASB Statement No. 66 When the Agreement Includes a Buy-Sell Clause
08-08	Balance Sheet Presentation of Funding Agreements Issued to a Federal Home Loan Bank
08-10	Contractual Terms of Investments and Investor Intent
09-03	EITF 08-7: Accounting for Defensive Intangible Assets
09-04	Application of the Fair Value Definition
09-05	EITF 08-3: Accounting by Lessees for Maintenance Deposits
09-08	Accounting for Loans Received under the Federal TALF Program
13-01	Extension of Ninety-Day Rule for the Impact of Hurricane/Superstorm Sandy
13-03	Clarification of Surplus Deferral in SSAP No. 92 & SSAP No. 102
13-04	Accounting for the Risk-Sharing Provisions of the Affordable Care Act
16-01	ACA Section 9010 Assessment 2017 Moratorium
17-01	Extension of Ninety-Day Rule for the Impact of Hurricane Harvey, Hurricane Irma and Hurricane Maria
18-01	Updated Tax Estimates Under the Tax Cuts and Jobs Act
18-02	ACA Section 9010 Assessment Moratoriums
18-04	Extension of Ninety-Day Rule for the Impact of Hurricane Florence and Hurricane Michael
19-01	Extension of Ninety-Day Rule for the Impact of California Camp Fire, Hill Fire and Woolsey Fire
20-02	Extension of Ninety-Day Rule for the Impact of COVID-19
20-03	Troubled Debt Restructuring Due to COVID-19
20-04	Mortgage Loan Impairment Assessment Due to COVID-19
20-05	Investment Income Due and Accrued
20-07	Troubled Debt Restructuring of Certain Debt Investments Due to COVID-19
20-08	COVID-19 Premium Refunds, Limited-Time Exception, Rate Reductions and Policyholder Dividends
20-10	Reporting Nonconforming Credit Tenant Loans
20-11	Extension of Ninety-Day Rule for the Impact of 2020 Hurricanes, California Wildfires and Iowa Windstorms
21-02	Extension of Ninety-Day Rule for the Impact of Hurricane Ida
23-02	Third Quarter 2023 Inflation Reduction Act – Corporate Alternative Minimum Tax

How to Use This Manual

The contents of this Manual are arranged as follows:

Introduction

- Maintenance Process and Ordering Information
- Table of Contents
- How to Use This Manual
- Summary of Changes to Prior Edition of the Manual

Volume I:

- Preamble
- Statements of Statutory Accounting Principles
- Index and Glossary to Statements of Statutory Accounting Principles
- Appendix A – Excerpts of NAIC Model Laws
- Appendix B – Interpretations of Statutory Accounting Principles

Volume II:

- Appendix C – Actuarial Guidelines
- Appendix D – GAAP Cross-Reference to SAP
- Appendix E – Issue Papers Associated with SSAPs Adopted in 2023
- Appendix F – Policy Statements
- Appendix G – Implementation Guide for the Model Audit Rule

Historical Contents:

(Posted for public reference on the Statutory Accounting Principles (E) Working Group web page at https://content.naic.org/cmte_e_app_sapwg.htm.)

- Appendix E – Issue Papers Associated with SSAPs Adopted Prior to 2023
- Appendix H – Superseded SSAPs and Nullified Interpretations

The arrangement of material as indicated above is included in the Table of Contents found at the front of each volume of the Manual. A table of contents also precedes each appendix referencing the material within.

Summary of Changes:

The Summary of Changes outlines changes made to the prior edition of the Manual to create the current year's version. It is divided into three sections: 1) the development of new SSAPs or new SAP concepts to existing SSAPs; 2) SAP clarifications; and 3) revisions to the appendices included in the Manual. The Summary of Changes is a key resource for readers who are looking to identify changes from the prior edition.

Preamble:

Many state insurance regulators consider the Preamble one of the most important sections of the Manual as it provides the foundation for statutory accounting principles (SAP). Some of the significant topics covered in the Preamble include codification project background, statement of concepts, statutory hierarchy, materiality and disclosures.

Statements of Statutory Accounting Principles:

As indicated by the Statutory Hierarchy, the Statements of Statutory Accounting Principles (SSAPs) are the primary authoritative statutory accounting practices and procedures promulgated by the NAIC. These statements are the result of issue papers that have been exposed for public comment and finalized. Finalized issue papers are found in Appendix E and ARE NOT authoritative. While it is not intended that there be any significant differences between an underlying issue paper and the resultant

SSAP, if differences exist, the SSAP prevails and shall be considered definitive. Readers may use the NAIC website to keep abreast of adopted revisions to the SSAPs. Completely superseded SSAPs that are no longer authoritative are moved from the Manual into *Appendix H – Superseded SSAPs and Nullified Interpretations*, which is posted for public reference on the Statutory Accounting Principles (E) Working Group web page at https://content.naic.org/cmte_e_app_sapwg.htm.

Prior to January 1, 2022, the term used to describe a new SAP concept or a new SAP clarification was “substantive” and the term used to describe a SAP clarification was “nonsubstantive.” The new terms will be reflected in materials to describe revisions to statutory accounting principles on a prospective basis and historical documents will not be updated to reflect the revised terms.

The cover page of each SSAP contains a STATUS section that can affect the implementation of each SSAP. The STATUS section contains the following:

TYPE OF ISSUE – SSAPs designated as Common Area apply to all insurers. Although the nomenclature or terms provided in the prescribed annual statement forms may vary among different types of insurers, only one set of nomenclature or terms may have been used in the SSAP. For example, the Statement of Income found in the Property and Casualty Annual Statement shall be considered as synonymous with the Summary of Operations found in the Life and Health Annual Statement.

ISSUED – Date when the SSAP was adopted by the NAIC. SSAPs designated with Initial Draft were adopted by the NAIC Plenary in March 1998 as part of the Codification Project (SSAP Nos. 1-73). The date included for SSAP No. 74, and subsequent SSAPs, denotes when the Statutory Accounting Principles (E) Working Group adopted the SSAP.

EFFECTIVE DATE – Date representing when the SSAP is effective. Many times, there are additional details relative to the transition provided within the SSAP.

AFFECTS/AFFECTED BY – A useful tool for tracking relationships between statements and interpretations is contained within these sections. The “affects” section is used when a SSAP has previously been amended to reflect new SAP concepts or superseded by other issued SSAPs. Nullified INTs are also noted in this section. Readers are referenced to another SSAP in the “affected by” section if the SSAP has been superseded or amended with a new SAP concept or with the issuance of a new SSAP. Text within paragraphs amended with new SAP concepts or superseded may also be “shaded” to notify readers that revised guidance is available.

INTERPRETED BY – This section includes a reference to the applicable interpretation (INT) of statutory accounting principles contained within Appendix B of the Manual which provides interpretative guidance as a result of issues raised by users of the Manual or related GAAP guidance. INTs are generally effective when adopted. Readers should note that the Manual only contains the INTs finalized through year end prior to publication, due to the fact that the Manual is published annually. Readers may use the NAIC website, as indicated on the inside front cover of the Manual, to keep abreast of recently issued INTs.

RELEVANT APPENDIX A GUIDANCE – This section identifies the relevant *Appendix A—Excerpts from NAIC Model Laws* guidance referenced within the SSAP.

Refer to the Relevant Literature and Effective Date and Transition sections of each SSAP for details of the development of new SSAPs or new SAP concepts, as well as changes as the result of SAP clarifications.

Appendix A – Excerpts of NAIC Model Laws:

In most cases, the source document for information included in Appendix A is an NAIC Model Regulation or Law. These Appendices are referenced by specific SSAPs and should only be used in context of the Appendix and the SSAP that references it.

Appendix B – Interpretations of Statutory Accounting Principles:

The Statutory Accounting Principles (E) Working Group (SAPWG) is responsible for responding to SAP questions that generally relate to application, interpretation and clarification. Appendix B includes the final interpretations (INTs) of statutory accounting principles through year end prior to publication. Once an INT is finalized, the related SSAP will contain reference to the applicable INT. Nullified INTs are moved from the Manual into *Appendix H – Superseded SSAPs and Nullified Interpretations*, which is posted for public reference on the SAPWG web page at https://content.naic.org/cmte_e_app_sapwg.htm.

Appendix C – Actuarial Guidelines:

The NAIC Life Actuarial (A) Task Force and Health Actuarial (B) Task Force have been asked on many occasions to assist a particular state insurance department in interpreting a statute dealing with an actuarial topic relative to an unusual policy form or situation not contemplated at the time of original drafting of a particular statute. The Life Actuarial (A) Task Force and Health Actuarial (B) Task Force, in developing interpretations or guidelines, must often consider the intent of the statute, the reasons for initially adopting the statute and the current situation. The Life Actuarial (A) Task Force and Health Actuarial (B) Task Force feel that for those situations which are sufficiently common to all states, the publishing of actuarial guidelines on these topics would be beneficial to the regulatory officials in each state and would promote uniformity in regulation which is beneficial to everyone. To this end, the Life Actuarial (A) Task Force and Health Actuarial (B) Task Force have developed certain actuarial guidelines and will continue to do so as the need arises. The guidelines are not intended to be viewed as statutory revisions but merely a guide to be used in applying a statute to a specific circumstance.

Appendix D – GAAP Cross-Reference to SAP:

As expressed in the Statement of Concepts, SAP utilizes the framework established by U.S. Generally Accepted Accounting Principles (GAAP). Appendix D includes GAAP pronouncements that have been considered in the development of SAP. This listing includes GAAP pronouncements issued through year end prior to publication. This Appendix is a valuable and efficient tool for readers who are interested in the status of a particular GAAP pronouncement in the SAP model.

Appendix E – Issue Papers:

Appendix E includes issue papers associated with SSAPs adopted through year end prior to publication of the Manual. Issue papers are used as the first step in developing new SSAPs and contain a recommended conclusion, discussion and relevant literature section. Issue papers **DO NOT** constitute an authoritative level of statutory accounting, as supported by the statutory hierarchy, and should only be used as reference material. Nevertheless, issue papers are important because they reference the history and discussion of a related SSAP. The “Relevant Statutory Accounting and GAAP Guidance” section of the issue paper contains excerpts of accounting guidance considered, but not necessarily adopted, by the Statutory Accounting Principles (E) Working Group (SAPWG) when forming the conclusions reached in the resultant SSAP. Historical issue papers associated with SSAPs adopted prior to the current year are posted for public reference on the SAPWG web page at https://content.naic.org/cmte_e_app_sapwg.htm.

Appendix F – Policy Statements:

Appendix F includes NAIC policy statements applicable to SAP. These statements provide the basis by which SAP is maintained, documentation of the agenda process and other important issues that affect the Manual.

Appendix G – Implementation Guide for Model Audit Rule:

Appendix G contains the NAIC Implementation Guide for the Model Audit Law. The Implementation Guide has been included for informational purposes only and should not be viewed as a requirement of complying with the *Accounting Practices and Procedures Manual*.

Appendix H – Superseded SSAPs and Nullified Interpretations:

Appendix H contains superseded SSAPs and nullified interpretations and is posted for public reference on the Statutory Accounting Principles (E) Working Group web page at https://content.naic.org/cmte_e_app_sapwg.htm.

How to Use This Manual ...

... to account for a certain item under NAIC SAP

As the SSAPs represent the highest level of NAIC statutory authority, readers should begin their search there. The Index to SSAPs is a useful tool to identify which SSAP(s) address the issue. Once the pertinent SSAP has been identified, it can be used to locate other documents that may also address the issue. On the SSAP cover page, readers will be referred to other SSAPs if there have been substantive changes made to it or INTs if there have been interpretations of the SSAP. Within the body of the SSAP, readers may be referred to Appendix A or C for further guidance. There is a reference located at the end of each SSAP to issue paper(s) used in the development of the SSAP. The DISCUSSION section of the issue paper provides documentation supporting the conclusions reached in the SSAP. As supported by the statutory hierarchy, readers should only utilize the issue papers as support to the SSAP as they ARE NOT authoritative. The Statutory Hierarchy contains a detailed listing of levels of authoritative literature.

... to compare SAP to GAAP for a particular issue

Appendix D is an excellent reference for readers who are interested in determining how SAP addresses an issue that has been adopted by GAAP. Appendix D provides a reference to the SSAP or INT that addresses a particular GAAP pronouncement. As indicated in the Preamble, readers should not utilize GAAP until and unless adopted by the NAIC. Within the body of the applicable SSAP or INT, readers will find documentation as to the reason for adoption, rejection, or adoption with modification of a particular GAAP pronouncement.

... to identify the relationship between the Manual and State law

Once a reader has identified the accounting treatment for a particular transaction or issue within the Manual, one must consider the effect of state law. That is, the Manual is not intended to preempt states' legislative and regulatory authority. It is intended to establish a comprehensive basis of accounting recognized and adhered to if not in conflict with state statutes and/or regulations, or when the state statutes and/or regulations are silent. For instance, if a state prohibits the admission of goodwill, insurers domiciled in that state are required to nonadmit all goodwill instead of following the NAIC guidance contained within *SSAP No. 68—Business Combinations and Goodwill*. Insurers should refer to their state laws and regulations regarding deviations from the Manual.

... to obtain updates to the latest published Manual

Each year there will be modifications to the accounting pronouncements included in the Manual. As such, guidance is subject to the maintenance process. To address this, the NAIC provides updates on the latest information impacting statutory accounting. To learn more about how to obtain updates to the latest published Manual, refer to the Maintenance Process page, which precedes the Table of Contents.

... to learn how changes are made to the Manual and how to stay abreast of such changes

Appendix F contains several NAIC policy statements that document the process by which the Manual will be modified. It also outlines the process by which the Statutory Accounting Principles (E) Working Group (SAPWG) will conduct its business. Users of the Manual can track the development of SAP by attending the national meetings of the SAPWG or through use of the NAIC website at <https://content.naic.org>.

... to contact the NAIC regarding questions about the Manual

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Summary of Changes to the *As of March 2023 Accounting Practices and Procedures Manual* included in the *As of March 2024 Manual*

The following summarizes changes made to the *As of March 2023 Accounting Practices and Procedures Manual* (Manual) and shown in the *As of March 2024* version.

Section 1 summarizes revisions that result in a new SSAP or new SAP concept to statutory accounting principles. Revisions that introduce original or modified accounting principles can be reflected in an existing or new SSAP. When revisions that result in a new SAP concept are made to an existing SSAP, the effective date is identified in the Status section. New SSAPs and new SAP concepts that revise existing SSAPs are commonly accompanied by a corresponding issue paper that reflects the tracked revisions for historical purposes. If language in an existing SSAP is superseded, that language is shaded and the new or revised SSAP is referenced. Completely superseded SSAPs and nullified interpretations are included in Appendix H.

Section 2 summarizes revisions that clarify existing statutory accounting principles. These revisions are characterized as language clarifications which do not modify the original intent of a SSAP, or changes to reference material. Such revisions are depicted by underlines (new language) and strikethroughs (removed language) and will not be tracked in subsequent manuals. Revisions that clarify existing statutory accounting principles are effective when adopted unless a specific effective date is noted.

Section 3 summarizes revisions to the Manual appendices.

PENDING CONTENT ALERT – BOND PROJECT - Effective January 1, 2025

Adopted revisions in 2023 which are effective January 1, 2025, as a result of the ongoing Principles-Based Bond Project are available on the Statutory Accounting Principles (E) Working Group web page at https://content.naic.org/cmte_e_app_sapwg.htm. Revisions specifically impacting SSAP No. 26R—*Bonds*, SSAP No. 43R—*Loan-Backed and Structured Securities*, various other SSAPs, and the annual statement instructions will be documented in the *As of March 2025 Accounting Practices and Procedures Manual*.

1. Revisions that Resulted in a New SSAP or New SAP Concept – Statutory Accounting Principles		
Section	Reference	Description
<i>No revisions that resulted in a new SSAP or new SAP concept were adopted in 2023.</i>		
2. Revisions that Resulted in a SAP Clarification – Statutory Accounting Principles		
Section	Reference	Description
SSAP No. 2R	2023-24	Revisions reject ASU 2016-13, <i>Financial Instruments—Credit Losses</i> and related subsequent ASUs. These revisions reject current expected credit losses (CECL) for statutory accounting.
SSAP No. 5R	2022-01	Revisions clarify the definition of a liability under statutory accounting to be more consistent with recent FASB revisions and are historically documented in <i>Issue Paper No. 168—Updates to the Definition of a Liability</i> .
	2023-11EP	Revisions change “percent” to “%” to maintain consistency throughout the Manual.
	2023-18	Revisions adopt with modification ASU 2016-19, <i>Technical Corrections and Improvements</i> and standardize the terminology used for insurance contracts regarding pension and other post-retirement benefits.

**Summary of Changes to the
As of March 2023 Accounting Practices and Procedures Manual**

	2023-24	Revisions reject <i>ASU 2016-13, Financial Instruments—Credit Losses</i> and related subsequent ASUs. These revisions reject current expected credit losses (CECL) for statutory accounting.
SSAP No. 16R	2023-11EP	Revisions change “percent” to “%” to maintain consistency throughout the Manual.
SSAP No. 20 SSAP No. 21R	2022-11	Revisions include consistency revisions to SSAP No. 20. Revisions to SSAP No. 21R provide more detail on qualifying collateral for collateral loans, require information to support fair value of collateral to be available on request, and provide audit transition guidance for equity collateral.
SSAP No. 22R	2023-24	Revisions reject <i>ASU 2016-13, Financial Instruments—Credit Losses</i> and related subsequent ASUs. These revisions reject current expected credit losses (CECL) for statutory accounting.
SSAP No. 24	2023-06	Revisions reject <i>ASU 2021-10, Government Assistance</i> while incorporating certain disclosures regarding government assistance.
SSAP No. 25	2022-15	Revisions clarify that any invested asset held by a reporting entity which is issued by an affiliated entity, or which includes the obligations of an affiliated entity, is an affiliated investment.
	2023-11EP	Revisions streamline citations to <i>the Purposes and Procedures Manual of the NAIC Investment Analysis Office</i> so they do not reflect a specific location in the P&P Manual or a webpage.
SSAP No. 26R	2023-11EP	Revisions streamline citations to <i>the Purposes and Procedures Manual of the NAIC Investment Analysis Office</i> so they do not reflect a specific location in the P&P Manual or a webpage.
	2023-24	Revisions reject <i>ASU 2016-13, Financial Instruments—Credit Losses</i> and related subsequent ASUs. These revisions reject current expected credit losses (CECL) for statutory accounting.
SSAP No. 30R	2023-11EP	Revisions streamline citations to <i>the Purposes and Procedures Manual of the NAIC Investment Analysis Office</i> so they do not reflect a specific location in the P&P Manual or a webpage.
	2023-23	Revisions clarify that investments that are in-substance residual interests shall be reported on Schedule BA on the dedicated reporting line for residuals.
SSAP No. 32R	2023-11EP	Revisions streamline citations to <i>the Purposes and Procedures Manual of the NAIC Investment Analysis Office</i> so they do not reflect a specific location in the P&P Manual or a webpage.
	2023-23	Revisions clarify that investments that are in-substance residual interests shall be reported on Schedule BA on the dedicated reporting line for residuals.
	2023-24	Revisions reject <i>ASU 2016-13, Financial Instruments—Credit Losses</i> and related subsequent ASUs. These revisions reject current expected credit losses (CECL) for statutory accounting.

**Summary of Changes to the
As of March 2023 Accounting Practices and Procedures Manual**

SSAP No. 34	2022-17	Revisions add additional disclosures in SSAP No. 34 to data capture the gross, nonadmitted and admitted amounts of interest income due and accrued, and to reflect the cumulative amount of paid-in-kind (PIK) interest income included in the current principal balance.
	2023-13	Revisions clarify and incorporate a practical expedient to the paid-in-kind (PIK) interest aggregate disclosure for <i>SSAP No. 34—Investment Income Due and Accrued</i> and proposed annual statement instructions.
	2023-24	Revisions reject <i>ASU 2016-13, Financial Instruments—Credit Losses</i> and related subsequent ASUs. These revisions reject current expected credit losses (CECL) for statutory accounting.
SSAP No. 37 SSAP No. 39 SSAP No. 41R	2023-24	Revisions reject <i>ASU 2016-13, Financial Instruments—Credit Losses</i> and related subsequent ASUs. These revisions reject current expected credit losses (CECL) for statutory accounting.
SSAP No. 43R	2023-02	Revisions incorporate changes to add collateralized loan obligations (CLOs) to the financial modeling guidance and to clarify that CLOs are not captured as legacy securities.
	2023-11EP	Revisions change “percent” to “%” to maintain consistency throughout the Manual.
	2023-12	Revisions for the reporting of residual interests, so that all residuals are captured on the dedicated Schedule BA – Other Long-Term Invested Assets reporting lines.
	2023-24	Revisions reject <i>ASU 2016-13, Financial Instruments—Credit Losses</i> and related subsequent ASUs. These revisions reject current expected credit losses (CECL) for statutory accounting.
SSAP No. 47	2023-07	Revisions adopt with modification <i>ASU 2019-08, Stock Compensation and Revenue with Contracts from Customers</i> to provide guidance on share-based consideration payable to customers.
SSAP No. 48	2023-12	Revisions for the reporting of residual interests, so that all residuals are captured on the dedicated Schedule BA – Other Long-Term Invested Assets reporting lines.
SSAP No. 50 SSAP No. 51R SSAP No. 52	2023-10	Revisions reject <i>ASU 2022-05, Transition for Sold Contracts</i> as not applicable for statutory accounting.
SSAP No. 54R	2023-22	Revisions clarify that gross premium valuation (under <i>A-010, Minimum Reserve Standards for Individual and Group Health</i>) and cash-flow testing (under <i>Actuarial Guideline LI—The Application of Asset Adequacy Testing to Long-Term Care Insurance Reserves</i>) are both required if indicated.
SSAP No. 56	2023-10	Revisions reject <i>ASU 2022-05, Transition for Sold Contracts</i> as not applicable for statutory accounting.
SSAP No. 57 SSAP No. 60	2023-11EP	Revisions change “percent” to “%” to maintain consistency throughout the Manual.
SSAP No. 61R	2023-24	Revisions reject <i>ASU 2016-13, Financial Instruments—Credit Losses</i> and related subsequent ASUs. These revisions reject current expected credit losses (CECL) for statutory accounting.

**Summary of Changes to the
As of March 2023 Accounting Practices and Procedures Manual**

SSAP No. 62R	2023-11EP	Revisions change “percent” to “%” to maintain consistency throughout the Manual.
	2023-24	Revisions reject <i>ASU 2016-13, Financial Instruments—Credit Losses</i> and related subsequent ASUs. These revisions reject current expected credit losses (CECL) for statutory accounting.
SSAP No. 65	2023-11EP	Revisions change “percent” to “%” to maintain consistency throughout the Manual.
SSAP No. 71	2023-10	Revisions reject <i>ASU 2022-05, Transition for Sold Contracts</i> as not applicable for statutory accounting.
SSAP No. 78	2023-11EP	Revisions change “percent” to “%” to maintain consistency throughout the Manual.
SSAP No. 86	2023-11EP	Revisions change SSAP No. 86 references of “Intrinsic Value” to reflect “Volatility Value”. In addition, “percent” is changed to “%” to maintain consistency throughout the Manual.
	2023-10	Revisions reject <i>ASU 2022-05, Transition for Sold Contracts</i> as not applicable for statutory accounting.
	2023-24	Revisions reject <i>ASU 2016-13, Financial Instruments—Credit Losses</i> and related subsequent ASUs. These revisions reject current expected credit losses (CECL) for statutory accounting.
SSAP No. 92	2023-18	Revisions adopt with modification <i>ASU 2016-19, Technical Corrections and Improvements</i> and standardize the terminology used for insurance contracts regarding pension and other post-retirement benefits.
	2023-11EP	Revisions change “percent” to “%” to maintain consistency throughout the Manual.
	2023-21	Revisions to remove the initial transition guidance as the 10-year effective period of the guidance has expired.
SSAP No. 93	2023-11EP	Revisions change “percent” to “%” to maintain consistency throughout the Manual.
SSAP No. 95	2023-07	Revisions adopt with modification <i>ASU 2019-08, Stock Compensation and Revenue with Contracts from Customers</i> to provide guidance on share-based consideration payable to customers.
SSAP No. 97	2023-11EP	Revisions streamline citations to <i>the Purposes and Procedures Manual of the NAIC Investment Analysis Office</i> so they do not reflect a specific location in the P&P Manual or a webpage.
SSAP No. 100R	2022-16	Revisions adopt with modification the fair value measurement guidance from <i>ASU 2022-03, Fair Value Measurement of Restricted Securities</i> to incorporate updated guidance for restricted securities for statutory accounting. The disclosures from ASU 2022-03 were not adopted.
	2023-11EP	Revisions change “percent” to “%” to maintain consistency throughout the Manual.
SSAP No. 101	2023-11EP	Revisions change “percent” to “%” to maintain consistency throughout the Manual.
SSAP No. 102	2023-11EP	Revisions change “percent” to “%” to maintain consistency throughout the Manual.

**Summary of Changes to the
As of March 2023 Accounting Practices and Procedures Manual**

	2023-18	Revisions adopt with modification <i>ASU 2016-19, Technical Corrections and Improvements</i> and standardize the terminology used for insurance contracts regarding pension and other post-retirement benefits.
	2023-21	Revisions to remove the initial transition guidance as the 10-year effective period of the guidance has expired.
SSAP No. 103R	2023-24	Revisions reject <i>ASU 2016-13, Financial Instruments—Credit Losses</i> and related subsequent ASUs. These revisions reject current expected credit losses (CECL) for statutory accounting.
	2023-11EP	Revisions change “percent” to “%” to maintain consistency throughout the Manual.
	2023-18	Revisions adopt with modification <i>ASU 2016-19, Technical Corrections and Improvements</i> and standardize the terminology used for insurance contracts regarding pension and other post-retirement benefits.
SSAP No. 104R	2023-11EP	Revisions change “percent” to “%” to maintain consistency throughout the Manual.
	2023-07	Revisions adopt with modification <i>ASU 2019-08, Stock Compensation and Revenue with Contracts from Customers</i> to provide guidance on share-based consideration payable to customers.
SSAP No. 105R	2022-18	Revisions reject <i>ASU 2022-04, Disclosure of Supplier Finance Program Obligations</i> for statutory accounting.
	2023-24	Revisions reject <i>ASU 2016-13, Financial Instruments—Credit Losses</i> and related subsequent ASUs. These revisions reject current expected credit losses (CECL) for statutory accounting.
SSAP No. 108	2023-11EP	Revisions change “percent” to “%” to maintain consistency throughout the Manual.

3. Revisions to the Appendices

Section	Reference	Description
Appendix A		<i>No revisions impacting this appendix were adopted in 2023.</i>
Appendix B	2023-24 INT 06-07	Revisions to <i>INT 06-07: Definition of Phrase “Other Than Temporary”</i> reject <i>ASU 2016-13, Financial Instruments—Credit Losses</i> and related subsequent ASUs. These revisions reject current expected credit losses (CECL) for statutory accounting.
	2023-05 INT 20-01	Revisions to <i>INT 20-01: ASUs 2020-04, 2021-01 & 2022-06 – Reference Rate Reform</i> which provides a temporary (optional) expedient and exception interpretative guidance to revise the expiration date of the guidance in INT 20-01 to December 31, 2024.
	INT 22-02	Revisions to <i>INT 22-02: Third Quarter 2022 through Second Quarter 2023 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax</i> extend this interpretation for the second quarter 2023 statutory financial statements.
	2022-19 INT 23-01	<i>INT 23-01: Net Negative (Disallowed) Interest Maintenance Reserve</i> provides an 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 will be automatically nullified on January 1, 2026.

**Summary of Changes to the
As of March 2023 Accounting Practices and Procedures Manual**

	2023-04 INT 23-03	<i>INT 23-03: Inflation Reduction Act – Corporate Alternative Minimum Tax</i> provides guidance for CAMT reporting on or after year-end 2023 and addresses accounting, the statutory valuation allowance, admissibility, disclosures, and year-end 2023 transition.
	INT 23-04	<i>INT 23-04: Scottish Re Life Reinsurance Liquidation Questions</i> provides accounting and reporting guidance for entities ceding to the life reinsurer in liquidation.
Appendix C	AG 49-A	Revisions to AG 49-A improve illustrations for indexed universal life (IUL) products with uncapped volatility-controlled funds and a fixed bonus. The guideline applies to policies sold on or after May 1, 2023.
	AG 54	This new guideline specifies the conditions under which an Index-Linked Variable Annuity (ILVA) is consistent with the definition of a variable annuity and exempt from <i>Standard Nonforfeiture Law for Individual Deferred Annuities</i> (#805) and specifies nonforfeiture requirements consistent with variable annuities. The guideline applies to all contracts (including associated riders, endorsements, or amendments) issued on or after July 1, 2024.
Appendix D	Rejected as Not Applicable to Statutory Accounting:	
	2023-08	<i>ASU 2019-07, Codification Updates to SEC Sections</i>
	2023-09	<i>ASU 2020-09, Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762, Debt (Topic 470)</i>
	2023-19	<i>ASU 2018-09, Codification Improvements</i>
	2023-20	<i>ASU 2020-10, Codification Improvements</i>
Appendix E	IP No. 167	<i>Issue Paper No. 167—Derivatives and Hedging</i> details the historical actions of the authoritative guidance resulting in new SAP concepts adopted in August 2022 within <i>SSAP No. 86—Derivatives</i> .
	IP No. 168	<i>Issue Paper No. 168—Updates to the Definition of a Liability</i> documents revisions to <i>SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets</i> to align the definition of a liability with the term utilized by the Financial Accounting Standards Board (FASB).
Appendix F		<i>No revisions impacting this appendix were adopted in 2023.</i>
Appendix G		<i>No revisions impacting this appendix were adopted in 2023.</i>
Appendix H	INT 23-02	<i>INT 23-02: Third Quarter 2023 Inflation Reduction Act – Corporate Alternative Minimum Tax</i> ; Adoption provided guidance for third quarter 2023 CAMT reporting and required disclosures, but not accrual of a liability; automatically nullified on November 16, 2023.

Accounting Practices and Procedures Manual

As of March 2023

VOLUME I

PREAMBLE

STATEMENTS OF STATUTORY ACCOUNTING PRINCIPLES

APPENDIX A – EXCERPTS OF NAIC MODEL LAWS

APPENDIX B – INTERPRETATIONS OF STATUTORY ACCOUNTING PRINCIPLES

Statutory Accounting Principles

Preamble

Section VII Interpreted by: INT 00-20

I. History of Accounting Practices and Procedures Promulgated by the NAIC

A. Background

1. The NAIC, through its committees and working groups, facilitated many projects of importance to the insurance regulators, industry and users of statutory financial information. That was evidenced by the mission statement and charges of the NAIC Accounting Practices and Procedures (E) Task Force of the Financial Condition (E) Committee.

2. The mission of the Accounting Practices and Procedures (E) Task Force was to identify, investigate and develop solutions to accounting problems with the ultimate goal of guiding insurers in properly accounting for various aspects of their operations and to modify the NAIC *Accounting Practices and Procedures Manuals for Property and Casualty Insurance Companies, for Life, Accident and Health Insurance Companies, and for Health Maintenance Organizations* (Accounting Practices and Procedures manuals) to reflect changes necessitated by task force action and to study innovative insurer accounting practices which affect the ability of regulators to determine the true financial condition of insurers.

3. To carry out the mission, the Accounting Practices and Procedures (E) Task Force was charged with carrying out the following initiatives:

- Provide authoritative guidance to insurance regulators on current statutory accounting issues.
- Continue evaluation of statutory accounting principles for purposes of development, expansion and codification.
- Extend evaluation of statutory accounting principles to address areas specific to health entities.
- The Codification of Statutory Accounting Principles (E) Working Group (Statutory Accounting Principles (E) Working Group as of January 1, 2000) will maintain codified statutory accounting principles by providing periodic updates to the guidance which address new statutory issues and new generally accepted accounting principles (GAAP) pronouncements as they develop.

4. The comprehensive guide to statutory accounting principles, composed of the Preamble, the Statements of Statutory Accounting Principles (SSAPs), and the Appendices, was intended to respond to the initiatives noted above. The guide and interpretations of the Emerging Accounting Issues (E) Working Group was referred to as the *Accounting Practices and Procedures Manual* - version effective January 1, 2001 (during the transition period until the 1998 version was no longer maintained and updated by the NAIC). The 1998 version of the *Accounting Practices and Procedures Manual* was maintained and

Preamble

published until December 31, 2000. However, the Manual was not intended to preempt states' legislative and regulatory authority. It was intended to establish a comprehensive basis of accounting recognized and adhered to if not in conflict with state statutes and/or regulations, or when the state statutes and/or regulations are silent.

B. Purpose of Codification

5. The purpose of the codification of statutory accounting principles was to produce a comprehensive guide to SAP for use by insurance departments, insurers, and auditors. Statutory accounting principles, as they existed prior to codification did not always provide a consistent and comprehensive basis of accounting and reporting. The prescribed or permitted statutory accounting model resulted in practices that could have varied from state to state. Insurance companies were sometimes uncertain about what rules to follow and regulators were sometimes unfamiliar with the accounting rules followed by insurers in other states. As a result, insurers' financial statements were not always prepared on a comparable basis.

6. As part of the codification project, it was necessary to revisit principles that had been developed over a long period of time and to consider identified accounting issues not addressed by SAP. In many cases, previously available choices of accounting methods were eliminated. Also considered was the current state of the regulatory environment and the tools developed, such as risk-based capital (RBC). Those financial analytical tools allowed for a reconsideration of the level of conservatism necessary to achieve regulatory objectives.

7. The Codification project resulted in more complete disclosures and more comparable financial statements, making the insurance departments' analysis techniques more meaningful and effective. The project provided examiners and analysts with uniform accounting rules against which companies' financial statements could be evaluated. RBC, an important tool used by the states to measure solvency of insurers, is reported more consistently with the benefit of codification.

C. History of Codification

8. In 1989, the NAIC adopted a Solvency Agenda designed to enhance the ability of state regulators to protect insurance consumers from the financial trauma of insurer insolvency. In recognition of the fact that enhancement of solvency regulation is an ongoing process, the agenda was updated in 1991. Since 1991, most major initiatives of the 1991 Solvency Agenda have been accomplished. They include: 1) revision of the NAIC *Financial Condition Examiners Handbook*, 2) development of a risk-based capital approach to define required levels of capital and surplus, 3) development of a model law on authorized insurer investments, 4) creation of a centralized financial analysis unit to perform comprehensive analysis of insurance companies who may be troubled, 5) development of computerized analytical routines for use by state insurance departments, and 6) creation of an NAIC education fund.

9. The codification project was a direct result of the 1991 Solvency Agenda. The goal was "evaluation of existing statutory accounting principles as presently outlined in the *Accounting Practices and Procedures Manual* for purposes of further development, expansion, and codification."

10. Beginning in 1994, the NAIC's efforts to codify SAP were strengthened and reorganized recognizing the need for expediency. There was both a commitment of substantial financial resources as well as the selection of a team of dedicated regulators who were willing to commit the time and effort necessary to accomplish one of the most significant undertakings that has been faced by the NAIC.

11. Recognition of this effort was given by the AICPA when in 1995 they issued *Statement of Position 95-5—Auditor's Report on Statutory Financial Statements of Insurance Enterprises* (SOP 95-5) so that an auditor's opinion on a "prescribed or permitted" basis could continue until codification was completed. SOP 95-5 states "The codification is expected to result in a hierarchy of statutory accounting

Preamble

practices that will provide a comprehensive basis of accounting that can be applied consistently to all insurance enterprises.” At that time, it was believed that once Codification was effective, in order for certified public accountants (CPAs) to issue opinions on statutory statements, SAP had to be considered an “Other Comprehensive Basis of Accounting” (OCBOA) by the American Institute of Certified Public Accountants (AICPA).

12. Codification is not intended to preempt state legislative and regulatory authority. While Codification is expected to be the foundation of a state’s statutory accounting practices, it may be subject to modification by practices prescribed or permitted by a state’s insurance commissioner. Statutory financial statements will continue to be prepared on the basis of accounting practices prescribed or permitted by the states. As a result, in 1998 the AICPA’s Insurance Companies Committee determined that it will not be necessary for the Auditing Standards Board to grant the Codification status as an OCBOA since it will not be the sole basis for preparing statutory financial statements. Further, auditors will be permitted to continue to provide audit opinions on practices prescribed or permitted by the insurance department of the state of domicile.

D. Result of Codification Project

13. The conceptual framework used in developing and maintaining statutory accounting principles for insurance companies was summarized in the Statutory Accounting Principles Statement of Concepts (Section IV of Preamble). The application of the concepts of conservatism, consistency and recognition assured that guidance developed and codified as part of this project was consistent with the underlying objectives of statutory accounting.

14. The inaugural NAIC Practices and Procedures Manual was developed using the body of statutory accounting principles as prescribed in the statutory hierarchy of accounting guidance (Section V of Preamble), which is incorporated into the Statement of Concepts. The hierarchy provides the guidance for judging the presentation of statutory financial statements in conformance with statutory accounting principles.

15. The principles established through codification were effective January 1, 2001. Accounting changes adopted to conform to the provisions of these statements were reported as adjustments to unassigned funds (surplus) in the period of the change in accounting principle; however, specific effective dates, and transition or grandfathering rules, if any, are contained in each SSAP. Subsequent revisions or the adoption of new SSAPs subsequent to original codification shall follow the adoption and transition guidance detailed within each individual SSAP.

II. Accounting for Insurance Companies

A. Environment

16. Accounting is the process of accumulating and reporting financial information about an economic unit or group of units. Relative to commercial enterprises, the users of accounting information include management, investors, potential investors, lenders, investment analysts, regulators and customers. Although customers of most commercial enterprises have no direct financial interest therein and generally are only concerned with the price to be paid for the product or service purchased, they may use accounting information to make choices as to the entity with which they engage in a business transaction. This is particularly relevant to purchases of insurance products as insurance contracts involve a promise to pay which may extend years into the future. Insurance products may provide benefits well in excess of the purchase price or premium. The benefits ultimately received are almost always greater than the price (premium) paid and can only be estimated at the time the product (policy) is purchased.

17. Insurance is regulated on a state-by-state basis in the United States. Each state has its own regulatory framework generally led by an insurance commissioner. Insurance commissioners are charged

Preamble

with overseeing the financial condition of insurance companies doing business in their jurisdictions and they require meaningful financial, statistical, and operating information about the companies. This financial oversight is designed to help ensure that policyholders and claimants receive the requisite benefits from the policies sold, often times such products having been sold years or decades prior to when the benefits are due. Frequently, this regulatory perspective differs markedly from the perspectives of other users of insurers' accounting information. In recognition of these special concerns and responsibilities, statutory accounting principles have been established by statute, regulation and practice.

B. Statutory Accounting Principles (SAP)

18. In simplest terms, SAP has been those accounting principles or practices prescribed or permitted by an insurer's domiciliary state. Statutory accounting practices have been interspersed in the insurance laws, regulations, and administrative rulings of each state, the accounting practices and procedures manuals, the annual statement instructions, the NAIC *Financial Condition Examiners Handbook*, the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*, and NAIC committee, task force, and working group minutes. In addition, there are many statutory practices widely accepted by both insurers and regulators which have never been codified.

19. SAP is conservative in some respects but not unreasonably conservative over the span of economic cycles, or in recognition of the primary statutory responsibility to regulate for financial solvency. SAP attempts to determine at the financial statement date an insurer's ability to satisfy its obligations to its policyholders and creditors.

C. Comparison of U.S. Generally Accepted Accounting Principles (GAAP) and SAP

20. The objectives of GAAP reporting differ from the objectives of SAP. GAAP is designed to meet the varying needs of the different users of financial statements. SAP is designed to address the concerns of regulators, who are the primary users of statutory financial statements. As a result, GAAP stresses measurement of emerging earnings of a business from period to period, (i.e., matching revenue to expense), while SAP stresses measurement of ability to pay claims in the future. This difference is illustrated by the fact that statutory policy reserves are intentionally established on a conservative basis emphasizing the long-term nature of the liabilities. Under GAAP, the experience expected by each company is used to determine the reserves it will establish for its policies. GAAP reserves may be more or less than the statutory policy reserves. In addition, another primary difference is that GAAP has recognized certain assets which, for statutory purposes, have been either nonadmitted or immediately expensed. For example, policy acquisition costs are expensed as incurred under SAP since the funds so expended are no longer available to pay future liabilities. Insurance company financial statements prepared in accordance with GAAP defer qualifying costs incurred in the successful acquisition of new or renewal insurance contracts and amortize them over the expected life of the insurance contract.

III. Development of Ongoing Accounting Practices and Procedures

21. The mission of the Accounting Practices and Procedures (E) Task Force is to identify, investigate and develop solutions to accounting problems with the ultimate goal of guiding insurers in properly accounting for various aspects of their operations, to modify the NAIC *Accounting Practices and Procedures Manual* to reflect changes necessitated by Task Force action, and to study innovative insurer accounting practices which affect the ability of regulators to determine the true financial condition of insurers.

22. The role of the Accounting Practices and Procedures (E) Task Force is further defined in *Appendix F—Policy Statements* of this Manual.

Preamble

23. The Accounting Practices and Procedures (E) Task Force will accomplish its mission through charges assigned to the following working groups:

- Statutory Accounting Principles (E) Working Group: Responsible for developing and adopting revisions to the Statements of Statutory Accounting Principles (SSAPs). Statutory accounting principles provide the basis for insurers to prepare financial statements for financial regulation purposes, and SSAPs are considered level 1 (highest authority) in the statutory accounting hierarchy. Refer to the Statutory Accounting Principles (E) Working Group Web page (https://content.naic.org/cmte_e_app_sapwg.htm) for specific information and charges.
- Blanks (E) Working Group: Considers improvements and revisions to various annual/quarterly statement blanks to conform to changes made in other areas of the NAIC to promote uniformity in reporting of financial information by insurers and develop reporting formats for other entities subject to the jurisdiction of state insurance departments. Refer to the Blanks (E) Working Group webpage (https://content.naic.org/cmte_e_app_blanks.htm) for specific information and charges.

24. This comprehensive guide to statutory accounting principles, composed of the Preamble, the Statements of Statutory Accounting Principles (SSAPs) and the Appendices, is intended to respond to the mission of the Accounting Practices and Procedures (E) Task Force and the charges of its affiliated working groups as noted above. The Manual is not intended to preempt states' legislative and regulatory authority. It is intended to establish a comprehensive basis of accounting recognized and adhered to if not in conflict with state statutes and/or regulations, or when the state statutes and/or regulations are silent.

IV. Statutory Accounting Principles Statement of Concepts

A. Purpose

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.¹

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.² This document integrates that framework with objectives exclusive to statutory accounting. The NAIC's guidance on SAP is comprehensive for

¹ As stated in the NAIC's constitution, the NAIC is an association of chief insurance regulatory officials of the 50 states, the District of Columbia, American Samoa, Guam, Northern Mariana Islands, Puerto Rico, and U.S. Virgin Islands whose objective is to serve the public by assisting several state insurance supervisory officials, individually and collectively, in achieving the following fundamental insurance regulatory objectives:

1. Maintenance and improvement of state regulation of insurance in a responsive and efficient manner;
2. Reliability of the insurance institution as to financial solidity and guaranty against loss;
3. Fair, just, and equitable treatment of policyholders and claimants.

² The GAAP framework applicable to insurance accounting is set forth in *Statements of Financial Accounting Concepts Five and 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.

Preamble

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.

B. Objectives of Statutory Financial Reporting

30. The primary responsibility of each state insurance department is to regulate insurance companies in accordance with state laws with an emphasis on solvency for the protection of policyholders. The ultimate objective of solvency regulation is to ensure that policyholder, contract holder and other legal obligations are met when they come due and that companies maintain capital and surplus at all times and in such forms as required by statute to provide an adequate margin of safety. The cornerstone of solvency measurement is financial reporting. Therefore, the regulator's ability to effectively determine relative financial condition using financial statements is of paramount importance to the protection of policyholders. An accounting model based on the concepts of conservatism, consistency, and recognition is essential to useful statutory financial reporting.

31. Statutory reporting applies to all insurers authorized to do business in the United States and its territories, and requires sufficient information to meet the statutory objectives. However, statutory reporting as contained in this guide is not intended to preempt state legislative and regulatory authority. The SAP financial statements include the balance sheet and related summary of operations, changes in capital and surplus, and cash flow statements. Because these basic financial statements cannot be expected to provide all of the information necessary to evaluate an entity's short-term and long-term stability, management must supplement the financial statements with sufficient disclosures (e.g., notes to financial statements, management's discussion and analysis, and supplementary schedules and exhibits) to assist financial statement users in evaluating the information provided.

C. Concepts

Conservatism

32. Financial reporting by insurance enterprises requires the use of substantial judgments and estimates by management. Such estimates may vary from the actual amounts for numerous reasons. To the extent that factors or events result in adverse variation from management's accounting estimates, the ability to meet policyholder obligations may be lessened. In order to provide a margin of protection for policyholders, the concept of conservatism should be followed when developing estimates as well as establishing accounting principles for statutory reporting.

33. Conservative valuation procedures provide protection to policyholders against adverse fluctuations in financial condition or operating results. Statutory accounting should be reasonably conservative over the span of economic cycles and in recognition of the primary responsibility to regulate for financial solvency. Valuation procedures should, to the extent possible, prevent sharp fluctuations in surplus.

Consistency

34. The regulators' need for meaningful, comparable financial information to determine an insurer's financial condition requires consistency in the development and application of statutory accounting principles. Because the marketplace, the economic and business environment, and insurance industry products and practices are constantly changing, regulatory concerns are also changing. An effective statutory accounting model must be responsive to these changes and address emerging accounting issues. Precedent or historically accepted practice alone should not be sufficient justifications for continuing to follow a particular accounting principle or practice which may not coincide with the objectives of regulators.

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).

38. Revenue should be recognized only as the earnings process of the underlying underwriting or investment business is completed. Accounting treatments which tend to defer expense recognition do not generally represent acceptable SAP treatment.

39. SAP income reflects the extent that changes have occurred in SAP assets and liabilities for current period transactions, except changes in capital resulting from receipts or distributions to owners. SAP income also excludes certain other direct charges to surplus which are not directly attributable to the earnings process (e.g., changes in nonadmitted assets).

D. Conclusion

40. This document states the fundamental concepts for financial statements presented on the basis of SAP. These concepts summarize the conceptual framework that the NAIC uses in developing and maintaining statutory accounting principles for insurance companies. These concepts will also assure that guidance will be provided consistently with the underlying objectives of statutory accounting and will aid in the review of emerging accounting issues.

41. The multitude of unique circumstances and individual transactions makes it virtually impossible for any codification of accounting principles to be totally comprehensive. Application of SAP, either contained in the SSAPs or defined as GAAP and adopted by the NAIC, to unique circumstances or individual transactions should be consistent with the concepts of conservatism, consistency, and recognition.

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 Codification³ (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 Concepts⁴

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

³ Effective September 15, 2009, the FASB Codification is the source of authoritative U.S. generally accepted accounting principles. As of that date, the FASB Codification superseded all then-existing non-SEC accounting and reporting standards. All other nongrandfathered, non-SEC accounting literature not included in the FASB Codification is nonauthoritative. As of September 15, 2009, AICPA Statements of Position are no longer reviewed as part of the statutory maintenance process as they are no longer considered authoritative GAAP literature. If the AICPA were to address an issue that affects the FASB Codification, an accounting standard update (ASU) would be issued and reviewed for applicability to statutory accounting.

⁴ The Statutory Accounting Principles Statement of Concepts incorporates by reference FASB Concepts Statements Five and 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.

Preamble

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.

VI. Statements of Statutory Accounting Principles

45. This Manual consists primarily of Statements of Statutory Accounting Principles (SSAPs). SSAPs are the primary Accounting Practices and Procedures promulgated by the NAIC. These statements are the result of issue papers that have been exposed for public comment and finalized. Finalized issue papers are in Appendix E. While it is not intended that there be any significant differences between an underlying issue paper and the resultant SSAP, if differences exist, the SSAP prevails and shall be considered definitive.

46. SSAPs designated as Common Area apply to all insurers. Although the nomenclature or terms provided in the prescribed annual statement forms may vary among different types of insurers, only one set of nomenclature or terms may have been used in the SSAP. For example, the Statement of Income found in the Property and Casualty Annual Statement shall be considered as synonymous with the Summary of Operations found in the Life and Health Annual Statement.

47. Once promulgated, statements will only be amended or superseded through the issuance of new SSAP pronouncements. If it is necessary to introduce a new SAP concept that will modify or augment the guidance in an existing SSAP, a new statement will be promulgated and/or the statement will be reissued with “revised” in the title. Changes as a result of clarifying an existing SAP will be included in the existing statement with changes tracked (i.e., new text will be underlined and deleted text as strikethrough) in the next published Manual. Then no changes will be shown after the initial year. A useful tool for tracking of the relationships between statements is contained in the “Status” section of each statement which includes sections labeled “Affects” and “Affected By.” As SSAPs are issued in the future that modify or augment the guidance previously provided, these sections will identify the relationships between statements.

VII. Materiality

48. Those who make accounting decisions and those who make judgments as regulators and auditors continually confront the need to make judgments about materiality. Materiality judgments are primarily quantitative in nature. They pose the question: Is this item large enough for users of the information to be influenced by it? However, the answer to that question will usually be affected by the nature of the item; items too small to be thought material if they result from routine transactions may be considered material if they arise in abnormal circumstances.

Preamble

49. Materiality judgments are concerned with screens or thresholds. Is an item, an error, or an omission large enough, considering its nature and the attendant circumstances, to pass over the threshold that separates material from immaterial items? The more important a judgment item is, the finer the screen should be that will be used to determine whether it is material. For example:

- Circumstances where an accounting adjustment puts an insurer in danger of being in breach of a covenant or regulatory requirement may justify a lower materiality threshold than if its position were stronger. For example, an error resulting from an insurer incorrectly reporting certain nonadmitted assets as admitted assets might be considered material if the classification of those assets as nonadmitted would cause the insurer to trigger an event under the Risk-Based Capital requirements.
- A failure to disclose separately a nonrecurrent item of revenue may be material at a lower threshold than would otherwise be the case if the revenue turns a loss into a profit or reverses the trend of earnings from a downward to an upward trend.
- A miscategorization of assets or liabilities that would not be material in amount to the basic financial statements, but would cause the insurer to trigger an event under the Risk-Based Capital requirements, might be material.
- Amounts too small to warrant disclosure or correction in normal circumstances may be considered material if they arise from abnormal or unusual transactions or events.

50. Almost always, the relative rather than the absolute size of a judgment item determines whether it should be considered material in a given situation. Losses from bad debts that could be shrugged off as routine by a large insurer may threaten the continued existence of a small one. An error in reserve valuation may be material in a small insurer for which it cut earnings in half but immaterial in an insurer for which it might make a barely perceptible ripple in the earnings.

51. Another factor in materiality judgments is the degree of precision that is attainable in estimating the judgment item. The amount of deviation that is considered immaterial may increase as the attainable degree of precision decreases. For example, accounts payable usually can be estimated more accurately than can contingent liabilities arising from litigation or threats of it, and a deviation considered to be material in the first case may be quite trivial in the second.

52. Individual judgments are required to assess materiality. The essence of the materiality concept is clear. The omission or misstatement of an item in a statutory financial statement is material if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the statutory financial statement would have been changed or influenced by the inclusion or correction of the item.

53. The provisions of this Manual need not be applied to immaterial items. *INT 00-20: Application of SEC SAB No. 99, Materiality to the Preamble of the AP&P Manual* provides further information on the application of the concept of materiality.

VIII. Relationship to GAAP

54. As expressed in the Statement of Concepts, SAP utilizes the framework established by GAAP. This Manual 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. GAAP guidance that is not applicable to insurance companies will not be adopted by the NAIC. For those principles that do not differ from GAAP, the NAIC may specifically adopt GAAP guidance to be included in statutory accounting. Elements of the FASB Codification do not become part of SAP until and unless adopted by the NAIC. Future SAP

Preamble

pronouncements will specifically identify any element of the FASB Codification that is to be included in SAP whether in whole, in part, or with modification as well as any rejected GAAP guidance. GAAP guidance which SAP has not yet addressed shall not be considered as providing authoritative statutory guidance.

IX. Relationship to Developments within NAIC

55. Various NAIC committees and their working groups will be involved in issues, at any point in time, which could impact accounting guidance. Recommendations that affect accounting guidance must be referred to the Accounting Practices and Procedures (E) Task Force which has the responsibility for the maintenance of this Manual for determination of appropriate inclusion in SAP.

56. There are instances where the Codification of Statutory Accounting Principles (E) Working Group (Statutory Accounting Principles (E) Working Group as of January 1, 2000) has established an accounting principle in a SSAP but deferred maintenance and update of the detailed guidance to other NAIC task forces and their working groups. Those instances are specifically set forth in the individual SSAPs and include specific guidance for calculation of the Interest Maintenance Reserve (IMR), the Asset Valuation Reserve (AVR), the provision for overdue reinsurance, and periodic update to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*.

57. Changes to statutory accounting principles are not authoritative until approved by the general membership of the NAIC.

X. Permitted Accounting Practices

58. In instances where the domiciliary state regulator is considering approval of a request for an accounting practice that departs from the NAIC *Accounting Practices and Procedures Manual* (Manual) and state prescribed accounting practices, the domiciliary regulator must provide Notice as defined in paragraphs 59-61.

59. No domiciliary state regulatory authority shall grant an approval to use an accounting practice, as described in paragraph 58, unless it provides Notice at least 5 days in advance of such approval.

60. This Notice must disclose the following information regarding the requested accounting practice request to all other states in which the insurer is licensed prior to the financial statement filing date:

- a. The nature and a clear description of the permitted accounting practice request;
- b. The quantitative effect of the permitted accounting practice request with all other approved permitted accounting practices currently in effect as disclosed in *Appendix A-205—Illustrative Disclosure of Differences Between NAIC Statutory Accounting Practices and Procedures and Accounting Practices Prescribed or Permitted by the State of Domicile*, for that insurer in the domiciliary state;
- c. The effect of the requested permitted accounting practice on a legal entity basis and on all parent and affiliated United States insurance companies, if applicable; and
- d. Identify any potential effects on and quantify the potential impact to each financial statement line item affected by the request. The potential impact may be determined by comparing the financial statements prepared in accordance with NAIC SAP and the financial statements incorporating the requested permitted accounting practice.

61. The granting of approval for an accounting practice request by the domiciliary state regulator does not preempt or in any way limit any individual state's legislative and regulatory authority.

XI. Financial Statements

A. Annual Financial Statement

62. Each state requires all insurance companies doing business in that state to file an annual financial statement. All states use the annual statement blank promulgated by the NAIC, but each state retains the authority to make changes in those statements. Changes made by states generally require only supplemental information and do not change the basic financial information.

63. To the extent that disclosures required by a SSAP are made within specific notes, schedules, or exhibits to the annual statement, those disclosures are not required to be duplicated in a separate note. Annual statutory financial statements which are not accompanied by annual statement exhibits and schedules (e.g., annual audit report) shall include all disclosures required by the SSAPs based on the applicability, materiality and significance of the item to the insurer. Certain disclosures, as noted in individual SSAPs, are required in the annual audited statutory financial statements only.

B. Interim Financial Statements

64. Interim financial statements, including quarterly statements, shall follow the form and content of presentation prescribed by the domiciliary state for the quarterly financial statements. The NAIC quarterly statement form has been adopted by each state with minor variations as required by certain states.

65. The interim financial information shall include disclosures sufficient to make the information presented not misleading. It may be presumed that the users of the interim financial information have read or have access to the annual statement for the preceding period and that the adequacy of additional disclosure needed for a fair presentation, except in regard to material contingencies may be determined in that context. Accordingly, footnote disclosure which would substantially duplicate the disclosure contained in the most recent annual statement or audited financial statements, such as a statement of significant accounting policies and practices, details of accounts which have not changed significantly in amount or composition since the end of the most recently completed fiscal year, may be omitted. However disclosure shall be provided where events subsequent to the end of the most recent fiscal year have occurred which have a material impact on the insurer. Disclosures shall encompass, for example, significant changes since the end of the period reported on the last annual statement in such items as: statutory accounting principles and practices, estimates inherent in the preparation of financial statements, status of long term contracts, capitalization including significant new borrowings or modifications of existing financial arrangements, and the reporting entity resulting from business combinations or dispositions. Notwithstanding the above, where material noninsurance contingencies exist, disclosure of such matters shall be provided even though a significant change since year end may not have occurred.

Permitted Practices Advance Notification Requirement Implementation Questions and Answers

1. Q: Why is the issue of permitted accounting practices important?

A: Since the Codification of the NAIC *Accounting Practices and Procedures Manual* (AP&P Manual), there has been continued emphasis on uniformity among the states. With the adoption of Codification, the belief was that permitted accounting practices would be limited. The intent of the policy statement on permitted accounting practices is to provide notification prior to granting permitted accounting practices to other states in which an insurer is licensed. Proactive notification encourages communication between state insurance regulators who share a common interest in the solvency of insurance companies writing business in their state.

2. Q: What is the difference between a permitted accounting practice and a prescribed practice?

A: **Permitted** accounting practices include practices specifically requested by an insurer that depart from NAIC Statutory Accounting Principles (SAP) and state prescribed accounting practices, as described below, and have received approval from the insurer's domiciliary state regulatory authority.

Prescribed accounting practices are those practices that are incorporated directly or by reference by state laws, regulations and general administrative rules applicable to all insurance enterprises domiciled and/or licensed in a particular state. The NAIC AP&P Manual is not intended to preempt states' legislative and regulatory authority. Prescribed accounting practices of the domiciliary state shall be reflected in the statutory financial statements filed with the NAIC. Non-domiciliary states may additionally require insurance entities licensed in their state to file supplementary financial information that details the use of different accounting practices required or allowed by the non-domiciliary state that differs from the AP&P Manual.

If a reporting entity requests an accounting practice that differs from state prescribed accounting practices, but is in accordance with NAIC SAP, advance notice of approval is not required.

3. Q: Does a permitted accounting practice request require approval/consensus from other states before it is granted by the domiciliary state?

A: No, the domiciliary state regulatory authority does not need approval or consensus from other state regulatory authorities to grant a permitted accounting practice. The granting of approval for an accounting practice request by the domiciliary state regulator does not preempt or in any way limit any individual state's legislative and regulatory authority.

If a state does not comply with the advance notice provision but approves a permitted practice, the lack of notice does not invalidate the permitted practice for the reporting entity. In addition, the reporting entity is required to disclose accounting practices that depart from the NAIC accounting practices and procedures, which affect statutory surplus or risk based capital pursuant to *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures*.

4. Q: How does the domestic regulator communicate an insurer's request for a permitted accounting practice to other states?

A: The NAIC can facilitate the communication of this information through the Permitted Practice Database within the Exam Tracking System. In order to develop a repository of all permitted accounting practice notifications, all regulatory authorities should distribute permitted accounting practice notifications using the procedures prescribed by the NAIC members. When providing permitted accounting practice notifications, the regulatory authority will provide the following information in instances where they are considering approval of a request:

- Detailed description of the permitted accounting practice request, including the specific NAIC Statutory Accounting Principles or state prescribed practices from which the practice departs
- Whether the permitted accounting practice was granted the previous year
- The financial statement filing date in which the permitted accounting practice will be reflected and the timeframe for which the permitted accounting practice is granted (e.g., indefinitely, until withdrawn, specific date – month, day, year)
- Explanation for providing less than the required advance notice
- The financial statement line items the permitted accounting practice will affect and the respective financial impact for each line item identified
- The total financial impact to capital and surplus for all approved/requested permitted accounting practices
- The effect of the permitted accounting practice on a legal entity basis and on all parent and affiliated U.S. insurance companies, if applicable
- Whether the permitted accounting practice is approved or the decision is pending

Grandfather Clause: Please note that those permitted accounting practices that have been granted prior to December 2004 for an indefinite time period do not require a new notice to other states and are not required to be filed through the ETS system. If the permitted accounting practice is considered by the state for reaffirmation annually then annual advance notice is required.

5. Q: If a Department of Insurance received a request for a permitted accounting practice from an insurer licensed in only one state, is the Department required to comply with communication requirements outlined in the Preamble?

A: No, an insurer licensed in only one state is not subject to the permitted accounting practices communication policy included in the Preamble. The goal of the permitted accounting practices communication policy is to encourage open communication between state regulatory authorities and promote uniformity. As permitted accounting practices granted to an insurer licensed in only one state would not impact states outside of the domiciliary state, they do not need to be communicated to other regulatory authorities.

6. Q: Are requests for permitted accounting practices kept confidential?

A: The communication of permitted accounting practices will be facilitated through the NAIC's Permitted Practice Database of the Exam Tracking System, which is a confidential, regulator-only system and/or through regulator-to-regulator e-mail exchange.

7. Q: Is a state required to provide advance notification for accounting practices that are explicitly permitted under the AP&P Manual, with the approval of the commissioner?

A: No, for example, a reporting entity is required to obtain domiciliary commissioner approval for a capital contribution as described in *SSAP No. 72—Surplus and Quasi-Reorganizations*, paragraph 8:

8. Notes or other receivables received as additional capital contributions satisfied by receipt of cash or readily marketable securities prior to filing of the statutory financial statement shall be treated as a Type I subsequent event in accordance with *SSAP No. 9* and as such shall be considered an admitted asset based on the evidence of collection and approval of the domiciliary commissioner. To the extent that the notes or other receivables are not satisfied, they shall be nonadmitted.

These types of transactions are not a departure from NAIC SAP and do not require a request for a permitted accounting practice.

8. Q: When will the permitted accounting practices communication policy become effective?

A: The Statutory Accounting Principles (E) Working Group, the Accounting Practices and Procedures (E) Task Force and the Financial Condition (E) Committee held a joint conference call to approve the guidance on November 30, 2004. The policy became effective in December 2004 upon approval by the Executive/Plenary Committee. The policy will be incorporated into the *Accounting Practices and Procedures Manual* and the Financial Regulation Standards and Accreditation (F) Committee will consider such changes to the *NAIC Financial Regulations Standards and Accreditation Manual* during the normal maintenance process.

9. Q: When submitting a permitted accounting practice request, is the financial statement effect quantified for all affiliates, or only those materially affected?

A: It is important that the insurer identify any potential effects on and quantify the potential impact to each financial statement line item on a legal entity basis and on all parent and affiliated U.S. insurance companies, if applicable. The notification from the regulator should only include the effect on a legal entity basis for those entities materially affected positively or negatively by the permitted accounting practice.

Statement of Statutory Accounting Principles No. 1

Accounting Policies, Risks & Uncertainties, and Other Disclosures

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	No other pronouncements
Relevant Appendix A Guidance.....	A-001; A-205

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Accounting Policies and Practices	2
Risks and Uncertainties.....	3
Other Disclosures.....	5
Insurance-Linked Securities.....	6
Supplemental Investment Disclosure.....	7
5GI Security Disclosure.....	7
Subprime Mortgage Related Risk Exposure.....	7
Stress Liquidity Risks	9
Relevant Literature.....	9
Effective Date and Transition	9
REFERENCES.....	9
Relevant Issue Papers	9

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for the disclosure of accounting policies, risks and uncertainties, the use of accounting practices which depart from NAIC statutory accounting practices and procedures, and other disclosures.
2. Separate statements of statutory accounting principles have disclosure requirements specific to the topics addressed in those statements. Additional disclosure requirements not addressed in other statements are included herein.

SUMMARY CONCLUSION

3. Refer to the Preamble for further discussion of disclosure requirements. The disclosures required under paragraph 6 concerning changes in accounting policies shall be made for each financial statement presented. The disclosures required under paragraphs 9, 10, 12, 13, 15 and 16 shall be included in the annual audited statutory financial reports only.

Accounting Policies and Practices

4. Accounting policies are defined as the specific accounting principles and the methods of applying those principles that are utilized in preparing the statutory financial statements.

5. Disclosure shall be made of all accounting policies that affect the assets, liabilities, capital and surplus or results of operations of the reporting entity. The disclosure shall encompass important judgments as to the appropriateness of principles relating to recognition of revenue particularly when selecting between acceptable alternatives, or methods particular to the business.

6. Disclosure of accounting policies shall be made in a separate Summary of Significant Accounting Policies as the initial note in the notes to the financial statements. If the reporting entity has changed the accounting policies since the end of its preceding year, the changes shall be disclosed in the quarterly financial statements.

7. NAIC statutory accounting practices and procedures are those that are set forth in the *Accounting Practices and Procedures Manual*. If a reporting entity employs accounting practices that depart from the NAIC accounting practices and procedures, disclosure of the following information about those accounting practices that affect statutory surplus or risk-based capital, or that result in different statutory accounting reporting (e.g., gross or net presentation, financial statement reporting lines, etc.), shall be made at the date each financial statement is presented:

- a. A description of the accounting practice;
- b. A statement that the accounting practice differs from NAIC statutory accounting practices and procedures¹;
- c. The monetary effect on net income and statutory surplus of using an accounting practice which differs from NAIC statutory accounting practices and procedures; and
- d. If an insurance enterprise's risk-based capital would have triggered a regulatory event had it not used a prescribed or permitted practice, that fact should be disclosed in the financial statements.

These disclosures shall be disclosed in Note 1 as illustrated in Appendix A-205—*Illustrative Disclosure of Differences Between NAIC Statutory Accounting Practices and Procedures and Accounting Practices Prescribed or Permitted by the State of Domicile*. Additionally, a reference to Note 1 shall be included in the individual notes to financial statements impacted by the prescribed or permitted practices as applicable.

8. Disclosure of the following information shall be made about accounting practices when NAIC statutory accounting practices and procedures do not address the accounting for the transaction:

- a. A description of the transaction and of the accounting practice used; and
- b. A statement that NAIC statutory accounting practices and procedures do not address the accounting for the transaction.

¹ This disclosure shall identify whether the practice is a departure from NAIC SSAP or from a state prescribed practice and include the financial statement reporting line(s) predominantly impacted by the permitted or prescribed practice. (Although most practices impact net income or surplus, direct reference to those lines should be avoided. The intent is to capture the financial statement line(s) reflecting the practice which ultimately impacts net income or statutory surplus.) For example, although a permitted practice to admit furniture would increase surplus, this should be disclosed as a permitted practice to SSAP No. 19—*Furniture, Fixtures, Equipment and Leasehold Improvements*, impacting line 21 of the asset page (furniture and equipment) and not line 37 (surplus) of the liabilities and surplus page.

Risks and Uncertainties

9. Companies shall make disclosures in their financial statements about risks and uncertainties existing as of the date of those statements in the following areas:

- a. Nature of operations;
- b. Use of estimates in the preparation of financial statements;
- c. Certain significant estimates; and
- d. Current vulnerability due to certain concentrations.

Nature of Operations

10. Financial statements shall include a summary of the ownership and relationships of the reporting entity and all affiliated companies, and a description of the major products or services the reporting entity sells or provides and its principal markets, including the locations of those markets. If the entity operates in more than one business, the disclosure should also indicate the relative importance of its operations in each business and the basis for the determination (e.g., assets, revenues, or earnings). Disclosures about the nature of operations need not be quantified; relative importance could be conveyed by use of terms such as predominately, about equally, or major.

Use of Estimates in the Preparation of Financial Statements

11. Financial statements shall include an explanation that the preparation of financial statements in conformity with the annual statement instructions and the *Accounting Practices and Procedures Manual* requires the use of management's estimates.

Certain Significant Estimates

12. Disclosure regarding an estimate shall be made when known information available prior to issuance of the financial statements indicates that both of the following criteria are met:

- a. It is at least reasonably possible that the estimate of the effect on the financial statements of a condition, situation, or set of circumstances that existed at the date of the financial statements will change in the near term due to one or more future confirming events; and
- b. The effect of the change would be material to the financial statements.

13. The disclosure shall indicate the nature of the uncertainty and include an indication that it is at least reasonably possible that a change in the estimate will occur in the near term (generally a period of time not to exceed one year from the date of the financial statements). If the estimate involves a loss contingency as defined in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*, the disclosure shall include an estimate of the possible loss or range of loss, or state that such an estimate cannot be made. Reporting entities shall disclose the factors that cause the estimate to be sensitive to change.

Current Vulnerability Due to Certain Concentrations

14. Vulnerability from concentrations arises because an entity is exposed to risk of loss greater than it would have had it mitigated its risk through diversification. Such risks manifest themselves differently, depending on the nature of the concentration, and vary in significance.

15. Financial statements shall disclose the concentrations described in paragraph 16 of this statement if, based on information known to management prior to issuance of the financial statements, all of the following criteria are met:

- a. The concentration exists at the date of the financial statements;
- b. The concentration makes the enterprise vulnerable to the risk of a near-term severe (more than material but less than catastrophic) impact; and
- c. It is at least reasonably possible that the events that could cause the severe impact will occur in the near term.

16. Concentrations, including known group concentrations, described below require disclosure if they meet the criteria of paragraph 15 of this statement. (Group concentrations exist if a number of counterparties or items that have similar economic characteristics collectively expose the reporting entity to a particular kind of risk.) Some concentrations may fall into more than one category:

- a. Concentrations in the volume of business transacted with a particular customer, supplier, or lender. The potential for the severe impact can result, for example, from total or partial loss of the business relationship. For the purposes of this statement, it is always considered at least reasonably possible that any customer will be lost in the near term;
- b. Concentrations in revenue from particular products or services. The potential for severe impact can result, for example, from volume or price changes for a particular source of revenue;
- c. Concentrations in the available sources of labor, services, licenses, or other rights used in the entity's operations;
- d. Concentrations in the market or geographic area in which an entity conducts its operations. The potential for severe impact can result, for example, from negative effects of the economic and political forces within the market or geographic area. For the purposes of this statement, it is always considered at least reasonably possible that operations located outside an entity's home country will be disrupted in the near term.

Going Concern

17. Management for each reporting entity shall evaluate whether there is substantial doubt about an entity's ability to continue as a going concern. Such substantial doubt is determined when relevant conditions and events, considered in the aggregate, indicate that it is probable that an entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued. This initial evaluation shall not take into consideration the potential mitigating effect of management's plans that have not been fully implemented as of that date.

18. Pursuant to paragraph 17, when relevant conditions or events have raised substantial doubt of the reporting entity's ability to continue as a going concern, management for the reporting entity shall evaluate whether its plans to mitigate those concerns and events, when implemented, will alleviate the substantial doubt about the entity's ability to continue as a going concern. The mitigating effect of management's plans shall be considered in evaluating whether the substantial doubt is alleviated only to the extent that information available as of the date that the financial statements are issued indicates both of the following:

- a. It is probable that management's plans will be effectively implemented within one year after the date that the financial statements are issued.
- b. It is probable that management's plans, when implemented, will mitigate the relevant conditions or events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued.

19. If after considering management's plans, substantial doubt about an entity's ability to continue as a going concern is alleviated, the reporting entity shall disclose in the notes to the financial statements the following information:

- a. Principal conditions and events that raised substantial doubt about the entity's ability to continue as a going concern (before consideration of management's plans).
- b. Management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations.
- c. Management's plans that alleviated substantial doubt about the entity's ability to continue as a going concern.

20. If after considering management's plans, substantial doubt about an entity's ability to continue as a going concern is not alleviated, the entity shall include a statement in the notes to the financial statements indicating that there is substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued. Additionally, the reporting entity shall disclose the information in paragraphs 19.a. and 19.b., as well as the management's plans that are intended to mitigate the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern.

21. The going concern evaluation and going concern disclosures discussed in paragraphs 17-19 are required for both interim and annual financial statements. If substantial doubt was determined, and the conditions or events continue to raise substantial doubt about an entity's ability to continue as a going concern in subsequent annual or interim reporting periods, the entity shall continue to provide the disclosures in each subsequent reporting period. In these subsequent periods the disclosures should become more extensive as additional information becomes available about the relevant conditions or events and about management's plans. The entity shall provide appropriate context and continuity in explaining how conditions or events have changed between reporting periods.

22. For the period in which substantial doubt no longer exists (before or after consideration of management's plans), an entity shall disclose how the relevant conditions or events that raised substantial doubt were resolved.

Other Disclosures

23. Reporting entities shall disclose² the following information in the financial statements:

- a. Amounts not recorded in the financial statements that represent segregated funds held for others, the nature of the assets and the related fiduciary responsibilities associated with such assets. One example of such an item is escrow accounts held by title insurance companies; and
- b. The total combined (admitted and nonadmitted) amount of restricted assets by category, with separate identification of the admitted and nonadmitted restricted assets by category, and nature of any assets pledged to others as collateral or otherwise restricted (e.g., not under the exclusive control, assets subject to a put option contract, etc.)³ in the general and

² Disclosure of restricted assets shall be included in the annual financial statements and, pursuant to the Preamble, in the interim financial statements if significant changes have occurred since the annual statement. If significant changes have occurred, the entire disclosure shall be reported in the interim financial statements.

³ The aggregate information captured within this disclosure is intended to reflect the information reported in the Annual Statement Investment Schedules in accordance with the coding of investments that are not under the exclusive control of the reporting entity, including assets loaned to others and the information reported in the General Interrogatories, as well as information on restricted cash, cash equivalents and short-term investments.

separate accounts⁴ by the reporting entity in comparison to total assets and total admitted assets. (Pursuant to SSAP No. 4, paragraph 6, all assets pledged as collateral or otherwise restricted shall be reported in this disclosure regardless if the asset is considered an admitted asset.) This disclosure shall include the following restricted asset categories:

- i. Reported assets subject to contractual obligation for which liability is not shown;
 - ii. Collateral held under security lending agreements;
 - iii. Assets subject to repurchase agreements;
 - iv. Assets subject to reverse repurchase agreements;
 - v. Assets subject to dollar repurchase agreements;
 - vi. Assets subject to dollar reverse repurchase agreements;
 - vii. Assets placed under option contracts;
 - viii. Letter stock or securities restricted as to sale⁵ – excluding FHLB stock;
 - ix. FHLB capital stock;
 - x. Assets on deposit with states;
 - xi. Assets on deposit with other regulatory bodies;
 - xii. Pledged as collateral to the FHLB (including assets backing funding agreements);
 - xiii. Assets pledged as collateral not captured in other categories; and
 - xiv. Other restricted assets.
- c. The amount and nature of any assets received as collateral, reflected as assets within the reporting entity's financial statements, and the recognized liability to return these collateral assets, in the general and separate accounts in comparison to total assets and admitted assets.

24. The financial statements shall disclose forward commitments which are not derivative instruments (e.g., the commitment to purchase a GNMA security two months after the commitment date, or a private placement six months after the commitment date).

Insurance-Linked Securities

25. Reporting entities shall disclose information when they may receive possible proceeds as the issuer, ceding insurer, or counterparty of insurance-linked securities. Insurance-linked securities (ILS) are securities whose performance is linked to the possible occurrence of pre-specified events that relate to insurance risks. While catastrophe bonds (cat bonds) may be the most well-known type of ILS, there are other non-cat-bond ILS, including those based on mortality rates, longevity and medical-claim costs. ILS

⁴ Restricted assets in the separate account are not intended to reflect amounts "restricted" only because they are insulated from the general account or because they are attributed to specific policyholders. Separate account assets shall be captured in this disclosure only if they are restricted outside of these characteristics.

⁵ The nature, description and amount of the restriction are required in the disclosure.

securities may be used by an insurer, or any other risk-bearing entity, in addition to (or as an alternative to) the purchase of insurance or reinsurance. This disclosure shall specifically identify the following:

- a. Whether the reporting entity may receive possible proceeds as the issuer, ceding insurer or counterparty of insurance-linked securities as a way of managing risks related to directly-written insurance risks. This disclosure shall include the number of outstanding ILS contracts, and the aggregate maximum proceeds that could be received as of the reporting date under the terms of the ILS.
- b. Whether the reporting entity may receive possible proceeds as the issuer, ceding insurer, or counterparty of insurance-linked securities as a way of managing risk related to assumed insurance risks. This disclosure shall include the number of outstanding ILS contracts, and the aggregate maximum proceeds that could be received as of the reporting date under the terms of the ILS.

Supplemental Investment Disclosure

26. For the current year, reporting entities shall disclose the information required by *Appendix A-001—Investments of Reporting Entities*. A Summary Investment Schedule and Investment Risk Interrogatories shall be filed with the audited statutory financial statements. The Summary Investment Schedule shall be filed with the annual statement whereas the interrogatories shall be filed as a supplement to the annual statement by April 1 for the applicable reporting period.

27. The Life, Accident and Health and Fraternal annual statement instructions include instructions for completing Schedule 1 Selected Financial Data. This Supplemental schedule is required to be included in the annual audit report for Life, Accident and Health and Fraternal reporting entities.

5GI Security Disclosure

28. For each annual reporting period, include a comparable disclosure to the prior annual reporting period of the number of 5GI securities, by investment type, and the book adjusted carrying value and fair value for those securities. This disclosure is required in the interim, pursuant to the Preamble, if there have been significant changes from the prior annual reporting statement. If significant changes require inclusion in more than one quarterly reporting statement in a single annual reporting year, the comparison period shall continue to reflect the prior annual reporting period.

Subprime Mortgage Related Risk Exposure

29. Reporting entities shall disclose information pertaining to subprime mortgage related risk exposure and related risk management practices, regardless of the materiality of the exposure, in the statutory financial statements. These disclosures are not required in the annual audited financial statements. Although definitions may differ among reporting entities, the following features are commonly recognized characteristics of subprime mortgage loans:

- a. An interest rate above prime to borrowers who do not qualify for prime rate loans;
- b. Borrowers with low credit ratings (FICO scores);
- c. Interest-only or negative amortizing loans;
- d. Unconventionally high initial loan-to-value ratios;
- e. Low initial payments based on a fixed introductory rate that expires after a short initial period, then adjusts to a variable index rate plus a margin for the remaining term of the loan;

- f. Borrowers with less than conventional documentation of their income and/or net assets;
- g. Very high or no limits on how much the payment amount or the interest rate may increase at reset periods, potentially causing a substantial increase in the monthly payment amount, and/or;
- h. Include substantial prepayment penalties and/or prepayment penalties that extend beyond the initial interest rate adjustment period.

30. To the extent such information is available, reporting entities shall consider exposure to subprime mortgage related risk through the following sources:

- a. Direct investments in subprime mortgage loans;
- b. Direct investments in securities with underlying subprime exposure, such as residential mortgage backed securities, commercial mortgage backed securities, collateralized debt obligations, structured securities (including principal protected notes), hedge funds, credit default swaps, and special investment vehicles;
- c. Equity investments in subsidiary, controlled or affiliated entities with significant subprime related risk exposure;
- d. Underwriting risk on policies issued for Mortgage Guaranty or Financial Guaranty insurance coverage.

31. As it relates to the exposure described above, reporting entities shall provide the following information:

- a. A narrative description of the manner in which the reporting entity specifically defines its exposure to subprime mortgage related risk in practice. Disclose the general categories of information considered in determining exposure to subprime mortgage related risk. Differentiation should be made between exposure to unrealized losses due to changes in asset values versus exposure to realized losses resulting from receiving less than anticipated cash flows or due to potential sale of assets to meet future cash flow requirements. Risk management or mitigation strategies shall also be disclosed.
- b. Direct exposure through investments in subprime mortgage loans. Disclose the following information for the aggregate amount of directly held subprime mortgage loans: book adjusted carrying value (excluding accrued interest); fair value; value of land and buildings; any other-than-temporary impairment losses recognized to date; default rate for the subprime portion of the loan portfolio. This information shall be segregated by the categories of Mortgages in the Process of Foreclosure, Mortgages in Good Standing and Mortgages with Restructured Terms.
- c. Direct exposure through other investments. Reporting entities shall consider subprime mortgage related risk exposure through other investments for the following types of investments:
 - i. Residential mortgage backed securities
 - ii. Commercial mortgage backed securities
 - iii. Collateralized debt obligations
 - iv. Structured securities (including principal protected notes)

- v. Equity investments in subsidiary, controlled or affiliated entities with significant subprime mortgage related risk exposure (a general description of the nature and extent of the SCAs exposure should be included)
- vi. Other assets (including but not limited to hedge funds, credit default swaps, special investment vehicles)

Aggregated by the above investment types, reporting entities shall disclose the following: actual cost; book adjusted carrying value; fair value; any other-than-temporary impairment losses recognized to date.

- d. Underwriting exposure to subprime mortgage risk through Mortgage Guaranty or Financial Guaranty insurance coverage. Disclose the following information, by coverage type, related to underwriting exposure on policies issued for Mortgage Guaranty coverage or Financial Guaranty coverage and any other lines of insurance expected to be impacted: the aggregate amount of subprime related losses paid in the current year; the aggregate amount of subprime related losses incurred in the current year; the aggregate amount of subprime related case reserves at the end of the current period; the aggregate amount of subprime related IBNR reserves at the end of the current period.

Stress Liquidity Risks

32. Reporting entities may be requested to complete disclosures pertaining to stress liquidity risks pursuant to inquiries and templates, or variations thereof, included in the *NAIC Financial Condition Examiners Handbook*. These disclosures may be considered confidential, therefore are not captured within the statutory financial statements. As noted in the *NAIC Financial Condition Examiners Handbook*, requests for reporting entities to complete these templates may occur at any time and are not limited to instances of comprehensive statutory examinations.

Relevant Literature

33. This statement adopts *Accounting Principles Board Opinion No. 22, Disclosure of Accounting Policies*, *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins, Chapter 2A, "Comparative Financial Statements," AICPA Statement of Position No. 94-5, Disclosures of Certain Matters in the Financial Statements of Insurance Enterprises*, and *AICPA Statement of Position No. 94-6, Disclosures of Certain Significant Risks and Uncertainties*. The disclosure of certain accounting policies within specific notes to the annual statement is required by the annual statement instructions. This statement also adopts *ASU 2014-15, Presentation of Financial Statements – Going Concern, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*.

Effective Date and Transition

34. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The guidance in paragraphs 17-22, requiring evaluation and disclosure of substantial doubt about an entity's ability to continue as a going concern is effective December 31, 2016, and is required for interim and annual reporting periods thereafter. Early application is permitted. The update to Section 3, Summary Investment Schedule, of Appendix A-001 is effective January 1, 2019.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 77—Disclosure of Accounting Policies, Risks & Uncertainties, and Other Disclosures*

Statement of Statutory Accounting Principles No. 2 – Revised

Cash, Cash Equivalents, Drafts, and Short-Term Investments

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft; Substantively revised December 10, 2016
Effective Date	January 1, 2001; Substantive revisions detailed in Issue Paper No. 155 effective December 31, 2017
Affects.....	Nullifies and incorporates INT 08-10
Affected by.....	No other pronouncements
Interpreted by	INT 21-01
Relevant Appendix A Guidance	None

STATUS	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Cash	1
Cash Equivalents.....	2
Drafts	3
Short-Term Investments.....	4
Disclosures.....	5
Relevant Literature.....	5
Effective Date and Transition	6
REFERENCES.....	6
Other	6
Relevant Issue Papers	6

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles and related reporting for cash, cash equivalents, drafts and short-term investments.

SUMMARY CONCLUSION

Cash

2. Cash constitutes a medium of exchange that a bank or other similar financial institution will accept for deposit and allow an immediate credit to the depositor's account.

3. Cash meets the definition of an asset as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and is an admitted asset to the extent it conforms to the requirements of this statement.

4. If a reporting entity has multiple cash accounts, the net amount of all accounts shall be reported jointly. Cash accounts with positive balances shall not be reported separately from cash accounts with

negative balances. If in the aggregate, the reporting entity has a net negative cash balance, it shall be reported as a negative asset and shall not be recorded as a liability.

5. Also classified as cash for financial statement purposes, although not falling within the definition of cash, are savings accounts and certificates of deposit in banks or other similar financial institutions with maturity dates within one year or less from the acquisition date.

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, derivative instruments shall not be reported as cash equivalents and shall be reported as derivatives on Schedule DB. 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.

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 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 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.)

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.

² 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.

8. Money market mutual funds registered under the Investment Company Act of 1940 and regulated under rule 2a-7 of the Act shall be accounted for and reported as cash equivalents for statutory accounting. Investments in money market mutual funds shall be valued at fair value or net asset value (NAV) as a practical expedient. For reporting entities required to maintain an asset valuation reserve (AVR), the accounting for unrealized capital gains and losses shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. For reporting entities not required to maintain an AVR, unrealized capital gains and losses shall be recorded as a direct credit or charge to surplus. Sales/reinvestments in money market mutual funds are excluded from the wash sale disclosure in *SSAP No. 103R*.

9. Cash pooling is a technique utilized by some companies under common control by which several entities' cash accounts are aggregated for numerous purposes, including liquidity management, optimizing interest or investment returns and reducing investment or banking transaction fees. Cash pools can have numerous functions and structures; however, only those that have obtained domiciliary regulator approval and meet the following requirements are in scope of this statement.

- a. Members or participants in the pool are limited to affiliated entities as defined in *SSAP No. 25—Affiliates and Other Related Parties*.
- b. Investments held by the pool are limited to non-affiliated entities investments (non-affiliated to the insurance reporting entity).
- c. The pool must permit each participant to withdraw, at any time, cash up to the amount it has contributed to the pool. Each participant must own an undivided interest in the underlying assets of the pool in proportion to the aggregate amount of cash contributed. All affiliates' interests in the pool shall be of the same class, with equal rights, preferences, and privileges. All membership interests shall be fully paid and non-assessable and shall have no preemptive, conversion or exchange rights. The liability of a participant's debts and obligations of the pool shall be limited to the amount of its contributions and no participant shall be obligated to contribute money to the pool for any reason other than to participate in the pool's investments. Additionally, participants shall not cover the debits or credits of another participant (commonly referred to as notional cash pooling).
- d. A reporting entity shall receive monthly reports from the pool manager, which identifies the participant's investment (share) in the cash pool and the dollar value of its share of cash, cash equivalents and short-term investments. The reporting entity shall report their total balances in the cash pool on Schedule E – Part 2, utilizing the line number as specified in the annual statement instructions. The reporting entity shall independently if the investments would have qualified as cash, cash equivalents or short-term investments had the entity independently acquired the investments. To the extent the pool holds investments that do not meet the definition of cash, cash equivalents, short-term investments, the pool does not qualify within scope of this statement.
- e. Valuation of assets in the pool shall remain consistent with the valuations required by reported asset type as stipulated in this statement.

Drafts

10. A draft is defined as an order to pay a sum certain in money. It is signed by the drawer (e.g., the insurance company or its agent), and payable to order or bearer (e.g., the policyholder). When the draft is presented to the drawee (i.e., the bank), it is paid only upon approval by the reporting entity.

11. Drafts and checks have different legal characteristics. A check is payable on demand, whereas a draft must be approved for payment by the reporting entity before it is honored by the bank. Because of these different characteristics, a draft meets the definition of a liability as defined by *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*. Outstanding checks are accounted for as a reduction of cash.

12. A reporting entity that utilizes instruments meeting the definition of drafts shall elect one of the following accounting methods:

- a. Draft Issued Method—When a draft is issued, an increase in paid losses and a related decrease in loss reserves is recorded. Drafts that have not been presented for payment and remain outstanding at the balance sheet date are reflected as a liability.
- b. Draft Honored Method—An increase in paid losses and a related decrease in loss reserves is recorded when the draft is presented by the bank to the reporting entity for approval and reimbursement. Consequently, under a draft honored method there is no liability for outstanding drafts.

13. The method elected by a reporting entity to account for drafts issued and outstanding shall remain consistent from year to year. Procedures for changes in the accounting method shall be governed by *SSAP No. 3—Accounting Changes and Corrections of Errors*.

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, derivative instruments shall not be reported as short-term investments and shall be reported as derivatives on Schedule DB.

15. Regardless of maturity date, related party or affiliated investments in scope of *SSAP No. 26R—Bonds*, *SSAP No. 43R—Loan-Backed and Structured Securities*, or that would be reported as “Other Invested Assets” shall be reported as long-term investments if any of the following conditions apply,^{3, 4} 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

³ 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*.

⁴ 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.

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. 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.)

16. All short-term investments shall be accounted for in the same manner as similar long-term investments.

17. Short-term investments 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.

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 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.

19. The financial statements shall disclose the reporting entity's share of the cash pool by asset type (cash, cash equivalents or short-term investments).

20. Refer to the Preamble for further discussion regarding disclosure requirements. The disclosures in paragraph 18.b. and paragraph 18.d. of this statement shall be included in the annual audited statutory financial reports only.

Relevant Literature

21. [Effective December 31, 2023, this statement rejects ASU 2016-13 Financial Instruments—Credit Losses \(Topic 326\), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses \(Topic 326\), Derivatives and Hedging \(Topic 815\), and Leases \(Topic 842\), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments. Companies should continue to apply the relevant statutory accounting impairment](#)

[guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.](#)

Effective Date and Transition

~~21~~²². 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. Guidance in paragraph 6 of this statement related to terms reset at predefined dates was previously included within *INT 08-10: Contractual Terms of Investments and Investor Intent* and was effective for periods beginning December 5, 2008. This substantively revised statement, as detailed in Issue Paper No. 155 regarding treatment of money market mutual funds as cash equivalents, is effective on a prospective basis beginning December 31, 2017.

~~22~~²³. Revisions permitting cash liquidity pools that meet the specific criteria are effective May 20, 2020, for reporting entities with qualifying cash pools. Reporting entities with cash liquidity pools that do not meet the requirements for reporting within scope of this standard are not permitted to be reported as cash equivalents or short-term investments and shall be reported as a prescribed or permitted practice. (Prior to this adoption date, there was no guidance permitting cash liquidity pools to be captured in scope of this standard.) For reporting entities that will have to reclassify qualifying cash liquidity pools to a cash equivalent from a different investment schedule, the reporting entity may elect to complete these reclassifications effective January 1, 2021, with early adoption permitted.

REFERENCES

Other

- Purposes and Procedures Manual of the NAIC Investment Analysis Office

Relevant Issue Papers

- Issue Paper No. 2—Definition of Cash
- Issue Paper No. 12—Accounting for Drafts Issued and Outstanding
- Issue Paper No. 28—Short-Term Investments
- Issue Paper No. 155—Classification of Money Market Mutual Funds as Cash Equivalents

Statement of Statutory Accounting Principles No. 3

Accounting Changes and Corrections of Errors

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Nullifies and incorporates INT 00-05 and INT 01-27
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Change in Accounting Principle	2
Change in Accounting Estimate.....	2
Correction of an Error.....	2
Impact on Historical Schedules.....	3
Mergers	3
Disclosures.....	3
Relevant Literature.....	4
Effective Date and Transition	4
REFERENCES.....	4
Relevant Issue Papers	4

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for changes in accounting, which include changes in accounting principles, estimates, and reporting entities, and for corrections of errors in previously issued financial statements.

SUMMARY CONCLUSION

2. An accounting change is defined as a change in an accounting principle, an accounting estimate, or the reporting entity. The correction of an error in previously issued financial statements is not deemed to be an accounting change. The treatment of a change resulting from an insurance department examination will depend on whether the change resulted from a correction of an error, a change in accounting principle, or a change in estimate.

Change in Accounting Principle

3. A change in accounting principle results from the adoption of an accepted accounting principle, or method of applying the principle, which differs from the principles or methods previously used for reporting purposes. A change in the method of applying an accounting principle shall be considered a change in accounting principle.

4. A characteristic of a change in accounting principle is that it concerns a choice from among two or more statutory accounting principles. However, a change in accounting principle is neither (a) the initial adoption of an accounting principle in recognition of events or transactions occurring for the first time or previously immaterial in their effect, nor (b) the adoption or modification of an accounting principle necessitated by transactions or events that are clearly different in substance from those previously occurring.

5. The cumulative¹ effect of changes in accounting principles shall be reported as adjustments to unassigned funds (surplus) in the period of the change in accounting principle. The cumulative effect is the difference between the amount of capital and surplus at the beginning of the year and the amount of capital and surplus that would have been reported at that date if the new accounting principle had been applied retroactively for all prior periods.

Change in Accounting Estimate

6. Changes in estimates used in accounting are necessary consequences of periodic presentations of financial statements which require estimating the effects of future events. Examples of items for which estimates are necessary include service lives of depreciable assets and changes in loss reserve estimates for property and casualty companies. Accounting estimates change as new events occur, as more experience is acquired, or as additional information is obtained.

7. A change in accounting estimate shall be included in the statement of income in the period when the change becomes known.

8. If the effect of a change in accounting principle is inseparable from the effect of a change in accounting estimate, then the change shall be considered as a change in accounting estimate for purposes of applying the accounting principles set forth in this statement.

Correction of an Error

9. Accounting errors in financial statements result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared. In contrast, a change in accounting estimate results from new information, or subsequent developments and, accordingly, from better insight or improved judgment. Thus, an error is distinguished from a change in estimate.

10. If a reporting entity becomes aware of a material accounting error in a previously filed financial statement after it has been submitted to the appropriate regulatory agency, the entity shall file an amended financial statement unless otherwise directed by the domiciliary regulator. Correction of all accounting

¹ If additional changes are identified in subsequent quarters of a fiscal year related to a change in accounting principles recognized initially during the first quarter, such changes shall be considered part of the cumulative effect of the change in accounting principle. The cumulative effect is the difference between the amount of capital and surplus at the beginning of the year and the amount of capital and surplus that would have been reported at that date if the new accounting principle had been applied retroactively for all prior periods. For example, adjustments to an amount recorded as of January 1, 2001, would be recorded as changes in accounting principle rather than corrections of an error through the period of 2001.

errors in previously issued financial statements, for which an amended financial statement was not filed, shall be reported as adjustments to unassigned funds (surplus) in the period an error is detected.

Impact on Historical Schedules

11. Changes which do not affect assets, liabilities, revenues, expenses, or surplus but which materially affect historical information in the financial statement supplemental schedules (e.g., Schedule P for property and casualty insurers or Schedule O for life and accident and health insurers) shall be reflected in the current year's schedules with appropriate notations made directly to the affected schedules and in the notes to the financial statements.

Mergers

12. For mergers, prior years' amounts in the annual statement shall be restated as if the merger had occurred as of January 1 of the prior year. Additionally, restatement shall be required for the two most recent years included in the Five-Year Historical Summary. The Five-Year Historical Summary shall include a footnote indicating that the other three years have not been restated. A reporting entity that merges with an entity which effectively is a shell company² (i.e., the reporting entity has no outstanding underwriting liabilities) shall be exempt from prior year restatement.

Disclosures

13. Disclosure of material changes in accounting and correction of errors shall include:

- a. A brief description of the change, encompassing a general disclosure of the reason and justification for change or correction;
- b. The impact of the change or correction on net income, surplus, total assets, and total liabilities for the two years presented in the financial statements (i.e., the balance sheet and statement of income and operations);
- c. The effect on net income of the current period for a change in estimate that affects several future periods, such as a change in the service lives of depreciable assets or actuarial assumptions affecting pension costs. Disclosure of the effect on those income statement amounts is not necessary for estimates made each period in the ordinary course of accounting for items such as uncollectible accounts; however, disclosure is recommended if the effect of a change in the estimate is material;
- d. Changes in accounting that are changes in reserve valuation basis as described in *SSAP No. 51R—Life Contracts*, which have elected phase-in provided for in the *Valuation Manual*, Section VM 21, shall also include in the change in accounting disclosures information regarding the application of any phase-in as provided for in SSAP No. 51R; and
- e. When subsequent financial statements are issued containing comparative restated results as a result of the filing of an amended financial statement, the reporting entity shall disclose that the prior period has been restated and the nature and amount of such restatement.

14. Refer to the Preamble for further discussion regarding disclosure requirements.

² When one of the entities is a "shell company," the prior year amounts shall only consist of the "non-shell company." The merger with a shell entity shall be reflected as of January 1 of the current year.

Relevant Literature

15. This statement rejects *ASU 2016-03, Intangibles—Goodwill and Other, Business Combinations, Consolidation, Derivatives and Hedging; Accounting Research Bulletin No. 51, Consolidated Financial Statements; FASB Interpretation No. 46, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51; and FASB Statement No. 94, Consolidation of All Majority-Owned Subsidiaries, an amendment of ARB 51, with related amendments of APB Opinion No. 18 and ARB No. 43, Chapter 12.*

16. This statement rejects paragraphs 1-19 and 26-27 of *Accounting Principles Board Opinion No. 9, Reporting the Results of Operations*, which address the treatment of extraordinary items and prior period adjustments and the related *AICPA Accounting Interpretations, Reporting the Results of Operations: Unofficial Accounting Interpretations of APB Opinion No. 9*. This statement also rejects *Accounting Principles Board Opinion No. 20, Accounting Changes, AICPA Accounting Interpretations, Accounting Changes: Accounting Interpretations of APB Opinion No. 20, FASB Interpretation No. 20, Reporting Accounting Changes under AICPA Statements of Position, an interpretation of APB Opinion No. 20 and FASB Statement No. 154, Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3 (FAS 154). FASB Statement No. 16, Prior Period Adjustments*, is rejected as corrections of errors in previously issued financial statements are reported as adjustments to unassigned funds (surplus).

Effective Date and Transition

17. This statement is effective for years beginning January 1, 2001. The guidance in the footnote to paragraph 5 was originally contained within *INT 01-27: Accounting Change versus Correction of Error* and was effective October 16, 2001. The guidance in the footnote to paragraph 12 was originally contained within *INT 00-05: Exemption to Merger Disclosure in SSAP No. 3* and was effective June 12, 2000.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 1—Consolidation of Majority-owned Subsidiaries*
- *Issue Paper No. 3—Accounting Changes*

Statement of Statutory Accounting Principles No. 4

Assets and Nonadmitted Assets

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Supersedes SSAP No. 87 with guidance incorporated August 2011; Nullifies and incorporates INT 01-03
Affected by.....	No other pronouncements
Interpreted by.....	INT 01-31; INT 23-03
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Assets Pledged as Collateral or Otherwise Restricted	2
Disclosure	3
Relevant Literature.....	3
Effective Date and Transition	3
REFERENCES.....	3
Relevant Issue Papers	3

SCOPE OF STATEMENT

1. This statement establishes the definition of an “asset” for use in statutory accounting and establishes the criteria for consistent treatment of nonadmitted assets.

SUMMARY CONCLUSION

2. For purposes of statutory accounting, an asset shall be defined as: a present right of an entity to an economic benefit. An asset has two essential characteristics: (a) it is a present right, and (b) the right is to an economic benefit.¹ These assets shall then be evaluated to determine whether they are admitted.² The criteria used is outlined in paragraph 3.

¹ *FASB Statement of Financial Accounting Concepts No. 8, 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.

² 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, 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.

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.

Assets Pledged as Collateral or Otherwise Restricted

6. Assets that are pledged to others as collateral or otherwise restricted (not under the exclusive control of the insurer, subject to a put option contract, etc.) shall be identified in the investment schedules pursuant to the codes in the annual statement instructions, disclosed in accordance with *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures*, reported in the general interrogatories, and included in any other statutory schedules or disclosure requirements requesting information for assets pledged as collateral or otherwise restricted. Restricted assets should be reviewed to determine admitted or nonadmitted assets status in the statutory financial statements per the terms of their respective SSAPs. Asset restrictions may be a factor in determining the admissibility of an asset under a respective SSAP³. However, determining that a restricted asset is an admitted asset does not eliminate the statutory requirements to document and identify the asset as one that is pledged as collateral or otherwise restricted.

7. Assets pledged as collateral are one example of assets that are not under the exclusive control of the insurer, and are therefore restricted, even if the assets are admitted under statutory accounting guidelines (e.g., the asset is substitutable and/or other related SSAP conditions are met). As such, the asset shall be coded as pledged in the investment schedules pursuant to the annual statement instructions, disclosed in accordance with SSAP No. 1, reported in the general interrogatories, and included in any other statutory schedules or disclosure requirements requesting information for assets pledged as collateral or otherwise restricted.

³ An example of such a situation is detailed in footnote 2 pertaining to assets restricted by the action of a related party. This is only a single example and each restricted asset would need to be reviewed to ensure it qualifies as an admitted asset.

Disclosure

8. The financial statements shall disclose if the written capitalization policy and the resultant predefined thresholds changed from the prior period and the reason(s) for such change.

Relevant Literature

9. This statement incorporates the definition of an asset from *FASB Statement of Financial Accounting Concepts No. 8, Chapter 4, Elements of Financial Statements*, paragraphs E16-E18.

Effective Date and Transition

10. 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*. Guidance reflected in paragraphs 3, 5 and 8, incorporated from SSAP No. 87, was originally effective for years beginning on and after January 1, 2004. The guidance in footnote 2 to paragraph 2 was originally contained within *INT 01-03: Assets Pledged as Collateral or Restricted for the Benefit of a Related Party* and was effective June 11, 2001.

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*

Statement of Statutory Accounting Principles No. 5 – Revised

Liabilities, Contingencies and Impairments of Assets

STATUS

Type of Issue.....	Common Area
Issued	Initial draft; Substantively revised October 18, 2010
Effective Date	January 1, 2001; Substantive revisions December 31, 2011
Affects.....	Nullifies and incorporates INT 04-01 and INT 08-06
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SUMMARY CONCLUSION	1
Liabilities	1
Joint and Several Liabilities.....	2
Loss Contingencies or Impairments of Assets.....	2
Tax Contingencies	3
Gain Contingencies.....	4
Guarantees	4
Financial Instruments with Characteristics of Both Liabilities and Equity	7
Disclosures.....	8
Relevant Literature.....	10
Effective Date and Transition	11
REFERENCES.....	12
Relevant Issue Papers	12

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⁺ future sacrifices of economic benefits arising from present obligations of a particular entity to~~

⁺ ~~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.~~

~~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 liability² 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 probable¹ 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.

Joint and Several Liabilities

5. Joint and several liability arrangements for which the total obligation amount under the arrangement is fixed³ at the reporting dates shall be measured and reported as the sum of:

- a. The amount the reporting entity agreed to pay on the basis of the agreements among its co-obligors, and
- b. Any additional amount the reporting entity expects to pay on behalf of its co-obligors. When an amount within management's estimate of the range of a loss appears to be a better estimate than any other amount within the range, that amount shall be the additional amount included in the measurement of the obligation. If no amount within the range is a better estimate than any other amount, then the midpoint shall be used.

6. Although the total amount of the obligation of the entity and its co-obligors must be fixed at the reporting date to be within the scope of this statement, the amount that the reporting entity expects to pay on behalf of its co-obligors may be uncertain at the reporting date.

Loss Contingencies or Impairments of Assets

~~6-7.~~ For purposes of implementing the statutory accounting principles of loss contingency or impairment of an asset described below, the following additional definitions shall apply:

- a. Probable—The future event or events are likely to occur;
- b. Reasonably Possible—The chance of the future event or events occurring is more than remote but less than probable;

² 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.

³ Examples of items within the scope of this guidance include debt arrangements, other contractual obligations, and settled judicial litigation and judicial rulings. Loss contingencies, guarantees, pension and other postretirement benefit obligations and taxes are excluded from this guidance and shall be accounted for under the statutory accounting provisions specific to those topics.

- c. Remote—The chance of the future event or events occurring is slight.

~~7.8.~~ A loss contingency or impairment of an asset is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an enterprise that will ultimately be resolved when one or more future event(s) occur or fail to occur (e.g., collection of receivables).

~~8.9.~~ An estimated loss from a loss contingency or the impairment of an asset shall be recorded by a charge to operations if both of the following conditions are met:

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

~~9.10.~~ This accounting shall be followed even though the application of other prescribed statutory accounting principles or valuation criteria may not require, or does not address, the recording of a particular liability or impairment of an asset (e.g., a known impairment of a bond even though the VOS manual has not recognized the impairment).

~~10.11.~~ Additionally, in instances where a judgment, assessment or fine has been rendered against a reporting entity, there is a presumption that the criteria in paragraph ~~8.9.a.~~ and ~~8.9.b.~~ have been met. A judgment is considered “rendered” when a court enters a verdict, notwithstanding the entity’s ability to file post-trial motions and to appeal. The amount of the liability shall include the anticipated settlement amount, legal costs, insurance recoveries and other related amounts and shall take into account factors such as the nature of the litigation, progress of the case, opinions of legal counsel, and management’s intended response to the litigation, claim, or assessment.

~~11.12.~~ When the condition in paragraph ~~8.9.a.~~ is met with respect to a particular loss contingency, and the reasonable estimate of the loss is a range, which meets the condition in paragraph ~~8.9.b.~~, an amount shall be accrued for the loss. When an amount within management’s estimate of the range of a loss appears to be a better estimate than any other amount within the range, that amount shall be accrued. When, in management’s opinion, no amount within management’s estimate of the range is a better estimate than any other amount, however, the midpoint (mean) of management’s estimate in the range shall be accrued. For purposes of this paragraph, it is assumed that management can quantify the high end of the range. If management determines that the high end of the range cannot be quantified, then a range does not exist, and management’s best estimate shall be used.

~~12.13.~~ The use of the midpoint in a range will be applicable only in the rare instance where there is a continuous range of possible values, and no amount within that range is any more probable than any other. This guidance is not applicable when there are several point estimates which have been determined as equally possible values, but those point estimates do not constitute a range. If there are several point estimates with equal probabilities, management should determine their best estimate of the liability.

Tax Contingencies

~~13.14.~~ 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~~14.a.-~~13~~14.c.

Gain Contingencies

~~14~~15. A gain is defined as an increase in surplus which results from peripheral or incidental transactions of a reporting entity and from all other transactions and other events and circumstances affecting the reporting entity except those that result from revenues or investments by owners. If, on or before the balance sheet date, (a) the transaction or event has been fully completed, and (b) the amount of the gain is determinable, then the transaction or event is considered a gain, and is recognized in the financial statements. The definition of a gain excludes increases in surplus that result from activities that constitute a reporting entity's ongoing major or central operations or activities. Because investment activities are central to an insurer's operations, increases in surplus that result from such investment activities are excluded from the definition of gains. Revenues are inflows or other enhancements of assets of a reporting entity or settlements of its liabilities (or a combination of both) from providing products, rendering services, or other activities that constitute the reporting entity's ongoing major or central operations. Investments by owners include any type of capital infused into the surplus of the reporting entity.

~~15~~16. A gain contingency is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain (as defined in the preceding paragraph) to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur (e.g., a plaintiff has filed suit for damages associated with an event occurring prior to the balance sheet, but the outcome of the suit is not known as of the balance sheet date). Gain contingencies shall not be recognized in a reporting entity's financial statements. However, if subsequent to the balance sheet date but prior to the issuance of the financial statements, the gain contingency is realized, the gain shall be disclosed in the notes to financial statements and the unissued financial statements should not be adjusted to record the gain. A gain is generally considered realizable when noncash resources or rights are readily convertible to known amounts of cash or claims to cash.

Guarantees

~~16~~17. A guarantee contract is a contract that contingently requires the guarantor to make payments (either in cash, financial instruments, other assets, shares of its stock, or provision of services) to the guaranteed party based on changes in the underlying that is related to an asset, a liability, or an equity security of the guaranteed party. Commercial letters of credit and loan commitments, by definition, are not considered guarantee contracts. Also excluded from the definition are indemnifications or guarantees of an entity's own performance, subordination arrangements or a noncontingent forward contract. This definition could include contingent forward contracts if the characteristics of this paragraph are met.

~~17~~18. The following guarantee contracts are not subject to the guidance in paragraphs ~~20-26~~21-27 and paragraphs ~~33-36~~34-37:

- a. Guarantees already excluded from the scope of SSAP No. 5R;
- b. Guarantee contracts accounted for as contingent rent;

- c. Insurance contract guarantees, including guarantees embedded in deposit-type contracts;
- d. Contracts that provide for payments that constitute a vendor rebate by the guarantor based on either the sales revenue or the number of units sold by the guaranteed party;
- e. A guarantee or indemnification whose existence prevents the guarantor from being able to either account for a transaction as the sale of an asset that is related to the guarantee's underlying or recognize in earnings the profit from that sale transaction;
- f. Registration payment arrangements; and
- g. A guarantee that is accounted for as a credit derivative instrument at fair value under *SSAP No. 86—Derivatives*, as described in paragraph 62.e. of SSAP No. 86.

~~18,19.~~ The following types of guarantees are exempted from the initial liability recognition in paragraphs ~~20-26~~21-27, but are subject to the disclosure requirements in paragraphs ~~33-36~~34-37:

- a. Guarantee that is accounted for as a derivative instrument, other than credit derivatives within SSAP No. 86;
- b. Guarantee for which the underlying is related to the performance of nonfinancial assets that are owned by the guaranteed party, including product warranties;
- c. Guarantee issued in a business combination that represents contingent consideration;
- d. Guarantee in which the guarantor's obligation would be reported as an equity item;
- e. Guarantee by an original lessee that has become secondarily liable under a new lease that relieved the original lessee from being the primary obligator;
- f. Guarantees (as defined in paragraph ~~16~~17) made to/or on behalf of directly or indirectly wholly-owned insurance or non-insurance subsidiaries⁴; and
- g. Intercompany and related party guarantees that are considered "unlimited" (e.g., typically in response to a rating agency's requirement to provide a commitment to support).

The exemptions for paragraphs ~~18~~19.f. and ~~18~~19.g. do not apply in situations in which a reporting entity has provided a financial guarantee or commitment to support a subsidiary, controlled or affiliated entity (SCA), and the SCA's equity is negative (see paragraph ~~25~~26).

~~19,20.~~ With the exception of the provision for guarantees made to/or on behalf of a wholly-owned subsidiaries in paragraph ~~18~~19.f. and "unlimited" guarantees in paragraph ~~18~~19.g., this guidance does not exclude guarantees issued as intercompany transactions or between related parties from the initial liability recognition requirement. Thus, unless the guarantee is provided on behalf of a wholly-owned subsidiary or considered "unlimited," guarantees issued between the following parties are subject to the initial recognition and disclosure requirements:

⁴ The exclusion for wholly-owned subsidiaries includes guarantees from a parent to, or on behalf of, a direct wholly-owned insurance or non-insurance subsidiary as well as guarantees made from a parent to, or on behalf of, an indirect wholly-owned insurance or non-insurance subsidiary. The "wholly-owned" exclusion in paragraph 18.f. does not include guarantees issued from one subsidiary to another subsidiary, regardless if both subsidiaries are wholly-owned (directly or indirectly) by a parent company.

- a. Guarantee issued either between parents and their subsidiaries or between corporations under common control;
- b. A parent's guarantee of its subsidiary's debt to a third party; and
- c. A subsidiary's guarantee of the debt owed to a third party by either its parent or another subsidiary of that parent.

~~20~~21. At the inception of a guarantee, the guarantor shall recognize in its statement of financial position a liability for that guarantee. Except as indicated in paragraph ~~22~~23, the objective of the initial measurement of the liability is the fair value⁵ of the guarantee at its inception.

~~21~~22. The issuance of a guarantee obligates the guarantor (the issuer) in two respects: (a) the guarantor undertakes an obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur (the noncontingent aspect) and (b) the guarantor undertakes a contingent obligation to make future payments if those triggering events or conditions occur (the contingent aspect). Because the issuance of a guarantee imposes a noncontingent obligation to stand ready to perform in the event that the specified triggering event occurs, the provisions of paragraph ~~89~~89 should not be interpreted as prohibiting the guarantor from initially recognizing a liability for that guarantee even though it is not probable that payments will be required under that guarantee.

~~22~~23. In the event that, at the inception of the guarantee, the guarantor is required to recognize a liability under paragraph ~~89~~89 for the related contingent loss, the liability to be initially recognized for that guarantee shall be the greater of (a) the amount that satisfies the fair value objective as discussed in paragraph ~~202~~21 or (b) the contingent liability amount required to be recognized at inception of the guarantee by paragraph ~~89~~89. For many guarantors, it would be unusual for the contingent liability under (b) to exceed the amount that satisfies the fair value objective at the inception of the guarantee.

~~23~~24. The offsetting entry pursuant to the liability recognition at the inception of the guarantee depends on the circumstances in which the guarantee was issued. Examples include:

- a. If the guarantee was issued in a standalone transaction for a premium, the offsetting entry would be the consideration received.
- b. If the guarantee was issued in conjunction with the sale of assets, a product, or a business, the overall proceeds would be allocated between the consideration being remitted to the guarantor for issuing the guarantee and the proceeds from that sale. That allocation would affect the calculation of the gain or loss on the sale transaction.
- c. If a residual value guarantee were provided by a lessee-guarantor when entering into an operating lease, the offsetting entry would be reflected as prepaid rent, which would be nonadmitted under SSAP No. 29.
- d. If a guarantee were issued to an unrelated or related party for no consideration on a standalone basis, the offsetting entry would be to expense.

~~24~~25. Except for the measurement and recognition of continued guarantee obligations after the settlement of a contingent guarantee liability described in paragraph ~~26~~27, this standard does not describe

⁵ As practical expedients, when a guarantee is issued in a standalone arm's-length transaction, the liability recognized at the inception of the guarantee should be the premium received or receivable by the guarantor. When a guarantee is issued as part of a transaction with multiple elements, the liability recognized at the inception of the guarantee should be an estimate of the guarantee's fair value. In that circumstance, guarantors should consider what premium would be required by the guarantor to issue the same guarantee in a standalone arm's-length transaction.

in detail how the guarantor's liability for its obligations under the guarantee would be measured subsequent to initial recognition. The liability that the guarantor initially recognized in accordance with paragraph 2021 would typically be reduced (as a credit to income) as the guarantor is released from risk under the guarantee. Depending on the nature of the guarantee, the guarantor's release from risk has typically been recognized over the term of the guarantee (a) only upon either expiration or settlement of the guarantee, (b) by a systematic and rational amortization method, or (c) as the fair value of the guarantee changes (for example, guarantees accounted for as derivatives). The reduction of liability does not encompass the recognition and subsequent adjustment of the contingent liability recognized under paragraph 89 related to the contingent loss for the guarantee. If the guarantor is required to subsequently recognize a contingent liability for the guarantee, the guarantor shall eliminate any remaining noncontingent liability for that guarantee and recognize a contingent liability in accordance with paragraph 89.

~~25~~.26. In situations in which a reporting entity has provided a financial guarantee or commitment to support a subsidiary, controlled or affiliated entity (SCA), and the reporting entity's share of losses in the SCA exceed the equity method carrying amount of the SCA (resulting in a negative equity value in the SCA), the reporting entity shall recognize the greater impact of (i) the then-current fair value liability for the guarantee, or (ii) the negative equity position, limited to the maximum amount of the financial guarantee or commitment provided by the reporting entity. (This guidance requires the recognition of a guarantee liability for guarantees captured in paragraphs 1819.f. and 1819.g. when negative equity exists in an SCA.) The guidance in paragraphs 2021 through 2627 shall be followed for the recognition of a contingent liability and a noncontingent liability, as applicable.

~~26~~.27. After recognition and settlement of a contingent guarantee liability in accordance with paragraph 89, a guarantor shall assess whether remaining potential obligations exist under the guarantee agreement. If the guarantor still has potential obligations under the guarantee contract, the guarantor shall recognize the remaining noncontingent guarantee that represents the current fair value of the potential obligation remaining under the guarantee agreement. This noncontingent guarantee liability shall be released in accordance with paragraph 2425.

Financial Instruments with Characteristics of Both Liabilities and Equity

~~27~~.28. Issued, free-standing financial instruments with characteristics of both liability and equity shall be reported as a liability to the extent the instruments embodies an unconditional obligation of the issuer. (Pursuant to SSAP No. 86, embedded features in derivative contracts shall not be separated from the host contract for separate recognition.) Free-standing financial instruments that meet any of the criteria below meet the definition of a liability:

- a. A mandatorily redeemable financial instrument shall be classified as a liability unless the redemption is required to occur only upon the liquidation or termination of the issuing reporting entity.
- b. A financial instrument, other than an outstanding share, that at inception both: 1) embodies an obligation to repurchase the issuer's equity shares or is indexed to such an obligation, and 2) requires or may require the issuer to settle the obligation by transferring assets.
- c. Obligations that permit the holder to require the issuer to transfer assets.
- d. A financial instrument is a liability if the issuer must settle the obligation by issuing a variable number of its equity shares and the obligation's monetary value is based solely or predominantly on: 1) a fixed monetary amount, 2) variation in something other than the fair value of the issuer's equity shares, or 3) variations inversely related to changes in the fair value of the issuer's equity shares.

- e. Instruments in which the counterparty (holder) is not exposed to the risks and benefits that are similar to those of a holder of an outstanding share of the entity's equity shall be classified as a liability.

~~28~~29. If a free-standing financial instrument will be redeemed only upon the occurrence of a conditional event, redemption of that instrument is conditional and, therefore, the instrument does not meet the definition of mandatorily redeemable financial instrument. However, that financial instrument shall be assessed each reporting period to determine whether circumstances have changed such that the instrument meets the definition of a mandatorily redeemable instrument (that is, the event is no longer conditional). If the event has occurred, the condition is resolved, or the event has become certain to occur, the financial instrument shall be reclassified as a liability.

~~29~~30. The classification of a free-standing financial instrument as a liability or equity shall only apply to the instrument issuer. Holders or purchasers of such instruments shall refer to the appropriate investment statement for valuation and reporting.

Disclosures

~~30~~31. Disclose the following information for each joint and several liability arrangements accounted for under paragraph 5. If co-obligors are related parties, disclosure requirements in *SSAP No. 25—Affiliates and Other Related Parties* also apply.

- a. The nature of the arrangement including: 1) how the liability arose, 2) the relationship with co-obligors, and 3) the terms and conditions of the arrangements.
- b. The total outstanding amount under the arrangement, which shall not be reduced by the effect of any amounts that may be recoverable from other entities.
- c. The carrying amount, if any, of the entity's liability and the carrying amount of a receivable recognized, if any.
- d. The nature of any recourse provisions that would enable recovery from other entities of the amounts paid, including any limitations on the amounts that might be recovered.
- e. In the period the liability is initially recognized and measured or in a period the measurement changes significantly: 1) the corresponding entry, and 2) where the entry was recorded in the financial statements.

~~31~~32. If a loss contingency or impairment of an asset is not recorded because only one of the conditions in paragraph ~~89~~89.a. or ~~89~~89.b. is met, or if exposure to a loss exists in excess of the amount accrued pursuant to the provisions described above, disclosure of the loss contingency or impairment of the asset shall be made in the financial statements when there is at least a reasonable possibility that a loss or an additional loss may have been incurred. The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made. (Disclosures for tax contingencies as identified in paragraph ~~13~~14 shall be completed as instructed within SSAP No. 101.)

~~32~~33. Disclosure is not required of a loss contingency involving an unasserted claim or assessment when there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable.

~~33~~34. Certain loss contingencies, the common characteristic of each being a guarantee, shall be disclosed in financial statements even though the possibility of loss may be remote. Examples include (a) guarantees of indebtedness of others, and (b) guarantees to repurchase receivables (or, in some cases,

to repurchase related properties) that have been sold or otherwise assigned. The disclosure of those loss contingencies, and others that in substance have the same characteristics, shall be applied to statutory financial statements. The disclosure shall include the nature and amount of the guarantee. Consideration shall be given to disclosing, if estimable, the value of any recovery that could be expected to result, such as from the guarantor's right to proceed against an outside party.

~~34.~~35. A guarantor shall disclose the following information about each guarantee, or each group or similar guarantees (except product warranties addressed in paragraph ~~36~~37), even if the likelihood of the guarantor's having to make any payments under the guarantee is remote. In addition, the nature of the relationship to the beneficiary of the guarantee or undertaking (affiliated or unaffiliated) shall also be disclosed:

- a. The nature of the guarantee, including the approximate term of the guarantee, how the guarantee arose, and the events and circumstances that would require the guarantor to perform under the guarantee, the ultimate impact to the financial statements (specific financial statement line item) after the settlement of the contract guarantee if action under the guarantee was required (e.g., increase to the investment, dividends to stockholder, etc.) and the current status (that is, as of the date of the statement of financial position) of the payment/performance risk of the guarantee. For example, the current status of the payment/performance risk of a credit-risk-related guarantee could be based on either recently issued external credit ratings or current internal groupings used by the guarantor to manage its risk. An entity that uses internal groupings shall disclose how those groupings are determined and used for managing risk.
- b. The potential amount of future payments (undiscounted) the guarantor could be required to make under the guarantee. That maximum potential amount of future payments shall not be reduced by the effect of any amounts that may possibly be recovered under recourse or collateralization provisions in the guarantee (which are addressed under (d) below). If the terms of the guarantee provide for no limitation to the maximum potential future payments under the guarantee, that fact shall be disclosed. If the guarantor is unable to develop an estimate of the maximum potential amount of future payments under its guarantee, the guarantor shall disclose the reasons why it cannot estimate the maximum potential amount.
- c. The current carrying amount of the liability, if any, for the guarantor's obligations under the guarantee (including the amount, if any, recognized under paragraph ~~89~~90), regardless of whether the guarantee is freestanding or embedded in another contract.
- d. The nature of (1) any recourse provisions that would enable the guarantor to recover from third parties any of the amounts paid under the guarantee and (2) any assets held either as collateral or by third parties that, upon the occurrence of any triggering event or condition under the guarantee, the guarantor can obtain and liquidate to recover all or a portion of the amounts paid under the guarantee. The guarantor shall indicate, if estimable, the approximate extent to which the proceeds from liquidation of those assets would be expected to cover the maximum potential amount of future payments under the guarantee.

~~35.~~36. An aggregate compilation of guarantee obligations shall include the maximum potential of future payments of all guarantees (undiscounted), the current liability (contingent and noncontingent) reported in the financial statements, and the ultimate financial statement impact based on maximum potential payments (undiscounted) if performance under those guarantees had been triggered.

~~36.~~37. As product warranties are excluded from the initial recognition and initial measurement requirements for guarantees, a guarantor is not required to disclose the maximum potential amount of

future payments. Instead the guarantor is required to disclose for product warranties the following information:

- a. The guarantor's accounting policy and methodology used in determining its liability for product warranties (Including any liability associated with extended warranties).
- b. A tabular reconciliation of the changes in the guarantor's aggregate product warranty liability for the reporting period. That reconciliation should present the beginning balance of the aggregate product warranty liability, the aggregate reductions in that liability for payments made (in cash or in kind) under the warranty, the aggregate changes in the liability for accruals related to product warranties issued during the reporting period, the aggregate changes in the liability for accruals related to preexisting warranties (including adjustments related to changes in estimates), and the ending balance of the aggregate product warranty liability.

~~37.~~38. The financial statements shall contain adequate disclosure about the nature of any gain contingency. However, care should be exercised to avoid misleading implications as to the likelihood of realization.

~~38.~~39. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

~~39.~~40. This statement adopts *FASB Statement No. 5, Accounting for Contingencies* (FAS 5), and 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.

~~40.~~41. This statement adopts with modification *FASB Interpretation No. 45: Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, an interpretation of *FASB Statements No. 5, 57, and 107* and rescission of *FASB Interpretation No. 34* (FIN 45), *FASB Interpretation No. 45-3, Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Grated to a Business or Owner* (FSP FIN 45-3), and *FASB Staff Position FAS 133-1 and FIN 45-4, Disclosures about Credit Derivatives and Certain Guarantees, An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45* (FSP FAS 133-1 and FIN 45-4). Statutory Modifications to FIN 45 include initial liability recognition for guarantees issued as part of intercompany or related party transactions, assessment and recognition of non-contingent guarantee obligations after recognition and settlement of a contingent obligation and revise the GAAP guidance to reflect statutory accounting terms and restrictions. Under this statement, intercompany and related party guarantees (including guarantees between parents and subsidiaries) should have an initial liability recognition unless the guarantee is considered "unlimited" or is made to/or on behalf of a wholly-owned subsidiary. (An example of an intercompany "unlimited" guarantee would be a guarantee issued in response to a rating agency's requirement to provide a commitment to support.) In instances in which an "unlimited" guarantee exists or a guarantee has been made to/or on behalf of a wholly-owned subsidiary, this statement requires disclosure, pursuant to the disclosure requirements adopted from FIN 45. The adoption of FIN 45 superseded the previously adopted guidance in *FASB Interpretation No. 34, Disclosure of Indirect*

Guarantees of Indebtedness of Others, An interpretation of FASB Statement No. 5. This statement also adopts Accounting Principles Board Opinion No. 12, Omnibus Opinion—1967, paragraphs 2 and 3 with the modification that AVR, IMR and Schedule F Penalty shall be shown gross. Appropriation of retained earnings discussed in paragraph 15 of FAS 5 is addressed in *SSAP No. 72—Surplus and Quasi-Reorganizations*.

~~41.~~42. This statement adopts with modification the guidance in paragraphs 7-11 of *FSP EITF 00-19-2, Accounting for Registration Payment Arrangements*. This guidance specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision for a financial instrument, other agreement, should be separately recognized and measured in accordance with *FAS 5, Accounting for Contingencies*. The guidance in *FSP EITF 00-19-2* is modified as follows:

- a. Registration payment arrangements meet the definition of a loss contingency in accordance with paragraph ~~78.~~
- b. Financial instruments shall be accounted for in accordance with the statutory accounting principles for that specific asset type. Registration payment arrangement obligations shall be separate from the measurement and recognition of financial instruments subject to such arrangements.
- c. Transition revisions resulting from application of this guidance shall be accounted for as a change in accounting principle pursuant to *SSAP No. 3—Accounting Changes and Corrections of Errors*. In accordance with *SSAP No. 3*, the cumulative effect of changes in accounting principles shall be reported as adjustments to unassigned funds in the period of change in the accounting principles.

~~42.~~43. This statement rejects *ASU 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*.

44. Effective December 31, 2023, this statement rejects *ASU 2016-13 Financial Instruments—Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB’s issuance of ASU 2016-13 and other related ASUs.*

Effective Date and Transition

~~43.~~45. 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*.

~~44.~~46. The guidance in paragraph ~~40~~11 related to when a judgment is considered rendered was originally contained in *INT 04-05: Clarification of SSAP No. 5R Guidance on when a Judgment is Deemed Rendered* and was effective September 12, 2004. The guidance for guarantees included within paragraphs ~~16-26~~17-27 and ~~34-36~~35-37 shall be applicable to all guarantees issued or outstanding as of December 31, 2011. Thereafter, disclosure of all guarantees shall be annually reported, with interim reporting required for new guarantees issued, and/or existing guarantees when significant changes are made. Guidance in

paragraph ~~41~~⁴² was previously reflected within *INT 08-06: FSP EITF 00-19-2, Accounting for Registration Payment Arrangements* and was effective September 22, 2008.

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](#)

Not for Distribution

Statement of Statutory Accounting Principles No. 6

Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Nullifies and incorporates INT 99-27, INT 01-01, INT 02-02 and INT 02-20
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Determination of Due Date	2
Impairment.....	2
Wash Transactions	3
Disclosures.....	3
Effective Date and Transition	3
REFERENCES.....	4
Relevant Issue Papers	4
EXHIBIT A – NONADMITTANCE OF PREMIUM RECEIVABLES (PARAGRAPH 9.a.).....	5

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for direct and group billed uncollected premiums, bills receivable for premiums, and amounts due from agents and brokers (collectively referred to as agents).
2. This statement does not address uncollected and deferred premiums for life considerations.

SUMMARY CONCLUSION

3. Premium transactions conducted directly with the insured result in uncollected premium balances.
4. Bills receivable, which are generally interest bearing, are used by reporting entities as a method of financing premiums.
5. Amounts due from agents result from various transactions ranging from premiums collected by the agents on behalf of the reporting entity to amounts advanced to the agent by the reporting entity to finance agency operations.

6. Uncollected premium balances, bills receivable for premiums, and amounts due from agents meet the definition of an asset as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement¹. Premiums owed by agents shall be reflected net of commissions, if permitted by the contract. Balances resulting from advances to agents, which are primarily encountered in the life insurance industry, are nonadmitted if (a) the amounts are in the form of unsecured loans or advances, (b) the contractual terms for repayment are through application of future renewal commissions and/or other credits, or (c) the terms of repayment do not provide readily available cash for the satisfaction of policyholder liabilities.

Determination of Due Date

7. The due date for all premium balances addressed by this statement is determined as follows:
- Original and deposit premiums—governed by the effective date of the underlying insurance contract and not the agent/reporting entity contractual relationship;
 - Endorsement premiums—governed by the effective date of the insurance policy endorsement;
 - Installment premiums—governed by the contractual due date of the installment from the insured;
 - Audit premiums and retrospective premiums—governed by insurance policy or insurance contract provisions. If the due date for receivables relating to these policies is not addressed by insurance policy provisions or insurance contract provisions, any uncollected audit premium (either accrued or billed) is nonadmitted.
8. The provisions of paragraph 7 shall be applied to all balances due except those arising from force placed insurance obtained by a lender for collateral protection, certain policies, known as Trustee Sales Guarantees (TSGs), issued by title insurance companies to lenders on defaulted real estate loans and crop/hail policies. For forced placed insurance policies, the due date for purposes of applying paragraph 9 shall be the date of billing. For TSGs, the due date for purposes of applying paragraph 9 shall be the expiration of the grace period given to the defaulted debtor, which is provided by statute. Crop/hail premiums are considered installment premiums in accordance with paragraph 7 and accordingly, the due date for purposes of applying paragraph 9 shall be governed by the contractual due date of the installment.

Impairment

9. Nonadmitted amounts are determined as follows:
- Uncollected Premium—To the extent that there is no related unearned premium, any uncollected premium balances which are over ninety days due shall be nonadmitted. If an installment premium is over ninety days due, the amount over ninety days due plus all future installments that have been recorded on that policy shall be nonadmitted²;

¹ Premiums billed prior to the effective date do not meet the definition of an asset per SSAP No. 4. Therefore, an asset/receivable should not be recognized on the financial statements until the effective date of the underlying policy/contract (i.e. the effective date of the contract gives rise to the entity's right). The mailing of a premium billing has no determination in the reporting of such premiums as an asset. Additionally, advance premiums are only recognized when the reporting entity receives cash payment for premiums prior to the effective date of the contract. In the event that the reporting entity bills and receives payment for premiums prior to the effective date, the reporting entity will recognize the receipt of cash with a corresponding credit to advance premiums (in this case a receivable is not recognized as the payment is received prior to the effective date).

² Installment premiums include monthly billed premiums on group accident and health policies. For group accident and health contracts, the existence of a nonadmitted *de minimus* over ninety-day balance would not cause future installments that have been recorded on that policy to also be nonadmitted. The *de minimus* over ninety-day balance itself shall be treated as nonadmitted as it is over ninety days old, and pursuant to paragraph 10, the entire current balance is subject to a collectability analysis.

- b. Bills Receivable—Bills receivable shall be nonadmitted if either of the following conditions are present:
 - i. If any installment is past due, the entire bills receivable balance from that policy is nonadmitted; or
 - ii. If the bills receivable balance due exceeds the unearned premium on the policy for which the note was accepted, the amount in excess of the unearned premium is nonadmitted.
- c. Agents' Balances—The uncollected agent's receivable on a policy by policy basis which is over ninety days due shall be nonadmitted regardless of any unearned premium;
 - i. If amounts are both payable to and receivable from an agent on the same underlying policy, and the contractual agreements between the agent and the reporting entity permit offsetting, the nonadmitted portion of amounts due from that agent shall not be greater than the net balance due, by agent;
 - ii. If reconciling items between a reporting entity's account and an agent's account are over ninety days due, the amounts shall be nonadmitted.

10. After calculation of nonadmitted amounts, an evaluation shall be made of the remaining admitted assets in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*, to determine if there is impairment. If, in accordance with *SSAP No. 5R*, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. If it is reasonably possible a portion of the balance is uncollectible and is therefore not written off, disclosure requirements outlined in *SSAP No. 5R* shall be followed.

11. Amounts classified as nonadmitted assets collected subsequent to the date of the statutory financial statements shall not be used to adjust the nonadmitted asset otherwise calculated.

Wash Transactions

12. Amounts due from agents (affiliated or nonaffiliated) that are collected prior to the date of the financial statements and then repaid to the agent by the reporting entity or one of the reporting entity's affiliates subsequent to the date of the financial statements shall be accounted for in accordance with the substance of the transaction (a wash transaction) and not its form. Accordingly, the payments received shall be accounted for as deposits and a liability shall be established for the same amount. The amounts due shall be reestablished as an asset and subjected to asset collectibility and nonadmitted asset calculations using the original due date of the receivable.

13. Short-term financing by third parties shall also be considered a wash transaction if the substance of the transaction is to avoid the nonadmitted asset principle set forth in this statement.

Disclosures

14. Refer to the Preamble for further discussion regarding disclosure requirements.

Effective Date and Transition

15. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The guidance in the footnote to paragraph 6 was originally contained within *INT 02-02: SSAP No. 6 and Billing of Premium Before Effective Date*

and was effective March 18, 2002. The guidance in the footnote to paragraph 9 was originally contained within *INT 01-01: Application of SSAP No. 6 Paragraph 9.a. to de minimus Receivable Balances of Group Accident and Health Policies* and was effective March 26, 2001. Guidance in Exhibit A—Nonadmittance of Premium Receivables (paragraph 9.a.) was originally included in *INT 99-27: Nonadmitting Installment Receivables* and was effective December 6, 1999.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 6—Amounts Due From Agents and Brokers*
- *Issue Paper No. 10—Uncollected Premium Balances*
- *Issue Paper No. 21—Bills Receivable For Premiums*

Not for Distribution

EXHIBIT A – NONADMITTANCE OF PREMIUM RECEIVABLES (PARAGRAPH 9.a.)

The application of paragraph 9.a. (uncollected installment premium) can be illustrated through the following journal entries:

Worker's compensation policy written on 1/1/X1 for \$120,000 billed on installment basis at the end of each month.

Required Journal Entries:

1/1/X1	Installments booked but deferred and not yet due	120,000	
	Written premium		120,000
	Change in unearned premium reserve	120,000	
	Unearned premium reserve		120,000
	<i>Initial journal entry written on effective date of policy</i>		
1/30/X1	Premiums in course of collection	10,000	
	Installments booked but deferred and not yet due		10,000
	Unearned premium reserve	10,000	
	Change in unearned premium reserve		10,000
	<i>Monthly journal entry to record installments</i>		

Balance of accounts on 4/30/X1:

Installments booked but deferred and not yet due	80,000
Unearned premium reserve	80,000
Premiums in course of collection	40,000
Written premium	120,000
Change in unearned premium reserve	80,000
Earned premium	40,000

If no collections have been made as of 4/30/X1 then paragraph 9.a. would stipulate that the entire balance of \$40,000 residing in the premiums in course of collection account would be nonadmitted. As the installments receivable and unearned premium reserve offset one another, no further amounts would be deemed nonadmitted at this point. In fact, as long as any of the premiums in course of collection account are 90 days past the contractual due date of the installment, then all subsequent installment billings would automatically be nonadmitted (i.e., May, June, July receivables of \$10,000).

Statement of Statutory Accounting Principles No. 7

Asset Valuation Reserve and Interest Maintenance Reserve

STATUS

Type of Issue..... Life, Accident and Health
Issued Initial Draft
Effective Date January 1, 2001
Affects..... No other pronouncements
Affected by..... No other pronouncements
Interpreted by..... INT 23-01
Relevant Appendix A Guidance None

STATUS	1
SCOPE OF STATEMENT	1
SUMMARY CONCLUSION	1
Effective Date and Transition	2
REFERENCES	2
Other	2
Relevant Issue Papers	2

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for an asset valuation reserve (AVR) and an interest maintenance reserve (IMR) for life and accident and health insurance companies, excluding separate accounts. Separate account AVR/IMR reporting is addressed in *SSAP No. 56—Separate Accounts*.

SUMMARY CONCLUSION

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 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 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.

Effective Date and Transition

4. 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**Other**

- NAIC Annual Statement Instructions for Life and Accident and Health Insurance Companies

Relevant Issue Papers

- *Issue Paper No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*

Not for Distribution

Statement of Statutory Accounting Principles No. 9

Subsequent Events

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 22-02; INT 23-03
Relevant Appendix A Guidance None

STATUS	1
SCOPE OF STATEMENT	1
SUMMARY CONCLUSION	1
Key Terms.....	1
Recognition Guidance.....	2
Disclosures.....	3
Relevant Literature.....	4
Effective Date and Transition	4
REFERENCES	4
Relevant Issue Papers	4

SCOPE OF STATEMENT

1. This statement defines subsequent events and establishes the criteria for recording such events in the financial statements and/or disclosing them in the notes to the financial statements. The conclusions in this statement apply to both quarterly and annual statement filings.

SUMMARY CONCLUSION

Key Terms

2. Subsequent events shall be defined as events or transactions that occur subsequent to the balance sheet date, but before the issuance of the statutory financial statements and before the date the audited financial statements are issued, or available to be issued. The issuance of the statutory financial statements includes not only the submission of the quarterly and annual statement but also the issuance of the audit opinion by the reporting entity's certified public accountant.

3. Material subsequent events shall be considered either:

- a. Type I – Recognized Subsequent Events: Events or transactions that provide 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;

- b. Type II – Nonrecognized Subsequent Events: Events or transactions that provide evidence with respect to conditions that did not exist at the balance sheet date but arose after that date.
4. **Financial statements are issued:** Financial statements are considered issued when they are widely distributed to shareholders and other financial statement users for general use and reliance in a form and format that complies with SAP.
5. **Financial statements are available to be issued:** Financial statements are considered available to be issued when they are complete in a form and format that complies with SAP and all approvals necessary for issuance have been obtained, for example, from management, the board of directors, and/or significant shareholders. The process involved in creating and distributing the financial statements will vary depending on an entity's management and corporate governance structure as well as statutory and regulatory requirements. An entity that has a current expectation of widely distributing its financial statements to its shareholders and other financial statement users shall evaluate subsequent events through the date that the financial statements are issued. All other entities shall evaluate subsequent events through the date that the financial statements are available to be issued.

Recognition Guidance

6. An entity shall recognize in the financial statements the effects of all material Type I subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Any changes in estimates resulting from the use of such evidence shall be recorded in the financial statements unless specifically prohibited, (e.g., subsequent collection of agents balances over 90 days due when determining nonadmitted agents balances as prohibited by *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*).
7. For material Type I subsequent events, the nature and the amount of the adjustment shall be disclosed in the notes to the financial statements only if necessary to keep the financial statements from being misleading.
8. Material Type II subsequent events shall not be recorded in the financial statements, but shall be disclosed in the notes to the financial statements. For such events, an entity shall disclose the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made.
9. An entity also shall consider supplementing the historical financial statements with pro forma financial data. Occasionally, a nonrecognized subsequent event may be so significant that disclosure can best be made by means of pro forma financial data. Such data shall give effect to the event as if it had occurred on the balance sheet date. In some situations, an entity also shall consider presenting pro forma statements. If an event is of such a nature that pro forma disclosures are necessary to keep the financial statements from being misleading, disclosure of supplemental pro forma financial data shall be made including the impact on net income, surplus, total assets, and total liabilities giving effect to the event as if it had occurred on the date of the balance sheet.
10. Identifying events that require adjustment of the financial statements under the criteria stated in the conclusion calls for the management of the entity to exercise judgment and accumulate knowledge of the facts and circumstances surrounding the event. For example, a loss on an uncollectible agent's balance as a result of an agent's deteriorating financial condition leading to bankruptcy subsequent to the balance sheet date would be indicative of conditions existing at the balance sheet date, thereby requiring the recording of such event to the financial statements before their issuance. On the other hand, a similar loss resulting from an agent's major casualty loss such as a fire or flood subsequent to the balance sheet date would not be indicative of conditions existing at the balance sheet date and recording of the event to the

financial statements would not be appropriate. However, this is a Type II subsequent event which would require disclosure in the notes to the financial statements.

11. The following are examples of Type I recognized subsequent events:

- a. If the events that gave rise to litigation had taken place before the balance sheet date and that litigation is settled, after the balance sheet date but before the financial statements are issued or are available to be issued, for an amount different from the liability recorded in the accounts, then the settlement amount should be considered in estimating the amount of liability recognized in the financial statements at the balance sheet date.
- b. Subsequent events affecting the realization of assets, such as receivables and inventories or the settlement of estimated liabilities, should be recognized in the financial statements when those events represent the culmination of conditions that existed over a relatively long period of time. For example, a loss on an uncollectible trade account receivable as a result of a customer's deteriorating financial condition leading to bankruptcy after the balance sheet date but before the financial statements are issued or are available to be issued ordinarily will be indicative of conditions existing at the balance sheet date. Thus, the effects of the customer's bankruptcy filing shall be considered in determining the amount of uncollectible trade accounts receivable recognized in the financial statements at the balance sheet date.

12. The following are examples of Type II nonrecognized subsequent events:

- a. Sale of a bond or capital stock issued after the balance sheet date but before financial statements are issued or are available to be issued
- b. A business combination that occurs after the balance sheet date but before financial statements are issued or are available to be issued
- c. Settlement of litigation when the event giving rise to the claim took place after the balance sheet date but before financial statements are issued or are available to be issued
- d. Loss of plant or inventories as a result of fire or natural disaster that occurred after the balance sheet date but before financial statements are issued or are available to be issued
- e. Losses on receivables resulting from conditions (such as a customer's major casualty) arising after the balance sheet date but before financial statements are issued or are available to be issued
- f. Changes in the fair value of assets or liabilities (financial or nonfinancial) or foreign exchange rates after the balance sheet date but before financial statements are issued or are available to be issued
- g. Entering into significant commitments or contingent liabilities, for example, by issuing significant guarantees after the balance sheet date but before financial statements are issued or are available to be issued

Disclosures

13. In addition to the disclosure of subsequent events as required throughout this statement, for annual and interim reporting periods, reporting entities shall disclose the dates through which subsequent events have been evaluated for statutory reporting and for audited financial statements along with the dates the statutory reporting statements and the audited financial statements were issued, or available to

be issued. In the audited financial statements, reporting entities shall specifically identify subsequent events identified after the date subsequent events were reviewed for statutory reporting.

14. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

15. The above guidance was originally adopted to be consistent with the AICPA *Statement on Auditing Standards No. 1*, Section 560, *Subsequent Events*. In 2009, *FASB Statement No. 165, Subsequent Events* (FAS 165), was adopted for statutory accounting. The adoption of this guidance should not result in significant changes in the subsequent events that an entity reports, through either recognition or disclosure, in its financial statements. FAS 165 introduced the concept of available to be issued and requires additional disclosures on the dates for which an entity evaluated subsequent events as well as the date the financial statements were issued, or available to be issued. Guidance within ASU 2010-09 (modifications to Subtopic 855-10 in the FASB Codification) has been rejected for statutory accounting.

Effective Date and Transition

16. 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*. Changes adopted as a result of FAS 165, are effective for years ending on and after December 31, 2009.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 9—Subsequent Events*

Statement of Statutory Accounting Principles No. 11

Postemployment Benefits and Compensated Absences

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	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	2
Sabbatical Leave and Other Similar Benefits	3
Sick-Pay Benefits.....	3
Deferred Compensation Arrangements Accounted for Individually	4
Consolidated/Holding Company Plans	4
Disclosures.....	4
Relevant Literature.....	4
Effective Date and Transition	5
REFERENCES.....	5
Relevant Issue Papers	5

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for postemployment benefits and for compensated absences.
2. The scope of this statement includes:
 - a. All forms of postemployment benefits that meet the conditions in paragraph 5.
 - b. Split-dollar life-insurance arrangements if the arrangement is, in substance, an individual deferred compensation contract.
 - c. Other deferred compensation contracts.
 - d. Compensated Absences.
3. The scope of this statement does not include:
 - a. Benefits paid to active employees other than compensated absences.

- b. Benefits paid at retirement or provided through a pension or postretirement benefit plan, including special or contractual termination benefits payable upon termination from a pension or other postretirement plan. Guidance for these benefits is addressed in SSAP No. 102 and SSAP No. 92 respectively.
- c. Individual deferred compensation contracts, if those contracts taken together are equivalent to a defined benefit pension plan or other postretirement plan. Guidance for these benefits is addressed in SSAP No. 102 and SSAP No. 92 respectively.
- d. Other postemployment benefits that do not meet the conditions in paragraph 5. Such postemployment benefits shall be assessed as contingent liabilities in accordance with SSAP No. 5R.
- e. Stock compensation plans accounted for under *SSAP No. 104R—Share-Based Payments*.

SUMMARY CONCLUSION

4. Postemployment benefits are all types of benefits provided by an employer to former or inactive employees or agents, their beneficiaries, and covered dependents, after employment but before retirement. Those benefits include, but are not limited to, salary continuation, supplemental unemployment benefits, severance benefits, disability-related benefits (including workers' compensation), job training and counseling, continuation of benefits such as health care benefits and life insurance coverage, and special or contractual termination benefits payable before retirement and that are not payable from a pension or other postretirement plan. Compensated absences include, but are not limited to, benefits such as vacation, sick pay, sabbatical leave and other similar benefits, and holidays.

5. A reporting entity shall accrue a liability for postemployment benefits and for employees' compensation for future absences if all of the following conditions are met:

- a. The reporting entity's obligation relating to compensated absences and postemployment benefits is attributable to employees' services already rendered;
- b. The obligation relates to rights that vest¹ or accumulate²;
- c. Payment is probable; and
- d. The amount can be reasonably estimated.

6. A liability for amounts to be paid as a result of employees' rights to compensated absences shall be accrued, considering anticipated forfeitures, in the year in which earned. Furthermore, the definition of a liability does not limit an employer's liability for compensated absences solely to rights to compensation for those absences that eventually vest. The definition also encompasses a constructive obligation for reasonable estimable compensation for past services that, based on the employer's past practices, probably shall be paid and can be reasonably estimated.

7. Individual facts and circumstances must be considered in determining when nonvesting rights to compensated absences are earned by services rendered. The requirement to accrue a liability for nonvesting rights to compensated absences depends on whether the unused rights expire at the end of the

¹ In this statement, vested rights are those for which the reporting entity has an obligation to make payment even if an employee terminates; thus, they are not contingent on an employee's future service.

² For purposes of this statement, accumulate means that earned but unused rights to compensated absences may be carried forward to one or more periods subsequent to that in which they are earned, even though there may be a limit to the amount that can be carried forward.

year in which earned, or accumulate and carried forward to succeeding years, thereby increasing the benefits that would otherwise be available in those latter years. If the rights expire, a liability for future absences shall not be accrued at year-end because the benefits to be paid in subsequent years would not be attributable to employee services rendered in prior years. If unused rights do accumulate and increase the benefits otherwise available in subsequent years, a liability shall be accrued to the extent that it is probable that employees will be paid in subsequent years for the increased benefits attributable to the accumulated rights and the amount can be reasonably estimated.

8. A reporting entity shall accrue a liability for employees' compensated absences and postemployment benefits reimbursable under service agreements with an affiliate, if all of the conditions of paragraph 5 are met.

9. Postemployment benefits provided to employees or agents in connection with their termination can include special termination benefits and contractual termination benefits. Special termination benefits are defined as those that are offered only for a short period of time in exchange for employees' voluntary termination of service; contractual termination benefits are defined as those required by the terms of a plan only if a specified event, such as a facility closing, occurs. An employer that offers special termination benefits to employees or agents shall recognize a liability and an expense when the employees or agents accept the offer and the amount can be reasonably estimated. An employer that provides contractual termination benefits shall recognize a liability and an expense when it is probable that employees or agents will be entitled to benefits and the amount can be reasonably estimated. The cost of such termination benefits shall include the amount of any lump-sum payments and the present value of any expected future payments.

Sabbatical Leave and Other Similar Benefits

10. An entity may provide its employees with a benefit in the form of a compensated absence known as a sabbatical leave (sabbatical) whereby the employee is entitled to paid time off after working for an entity for a specified period of time. During the sabbatical, the individual continues to be a compensated employee and is not required to perform any duties for the entity. This issue is limited to those arrangements under which the sabbatical or other similar benefit arrangement is unrestricted (i.e., the employee is not required to perform any direct or indirect services for or on behalf of the entity during the absence). Arrangements in which employees are required to engage in research or public service to enhance the reputation of or otherwise benefit the entity are not within the scope of this statement.

11. An employee's right to a compensated absence under a sabbatical or other similar benefit arrangement (a) that requires the completion of a minimum service period and (b) in which the benefit does not increase with additional years of service accumulates pursuant to paragraph 5.b. of this statement for arrangements in which the individual continues to be a compensated employee and is not required to perform duties for the entity during the absence. Therefore, assuming all of the other conditions of paragraph 5 are met, the compensation cost associated with a sabbatical or other similar benefit arrangement should be accrued over the requisite service period.

Sick-Pay Benefits

12. The employer's actual administration of sick-pay benefits shall determine the appropriate accounting. In accounting for compensated absences, the form of an employer's policy for compensated absences shall not prevail over actual practices. If sick-pay benefits are treated as compensated absences (e.g., employees are paid sick leave benefits even though absences are not the result of illness, or employees are allowed to take compensated terminal leave for accumulated unused sick-pay benefits prior to retirement), they shall be captured within paragraph 5. Otherwise, an employer is not required to accrue a liability for nonvesting accumulating rights to receive sick-pay benefits (compensation for an employee's absence due to illness). This statement does not prevent an employer from accruing a liability for such non-vesting, accumulating sick-pay benefits if the criteria in paragraph 5 is met.

Deferred Compensation Arrangements Accounted for Individually

13. To the extent the terms of a contract attribute all or a portion of the expected future benefits to an individual year of the employee's service, the cost of those benefits shall be recognized in that year. To the extent the terms of the contract attribute all or a portion of the expected future benefits to a period of service greater than one year, the cost of those benefits shall be accrued over that period of the employee's service in a systematic and rational manner. If elements of both current and future services are present, only the portion applicable to the current services shall be accrued.

14. Some deferred compensation contracts provide for periodic payments to employees or their surviving spouses for life with provisions for a minimum lump-sum settlement in the event of the early death of one or all of the beneficiaries. The estimated amount of future payments to be made under such contracts shall be accrued over the period of active employment from the time the contract is entered into.

15. The amounts to be accrued periodically under paragraph 13 shall result in an accrued amount at the full eligibility date equal to the then present value of all of the future benefits expected to be paid. Such estimates shall be based on the life expectancy of each individual concerned (based on the most recent mortality tables available) or on the estimated cost of an annuity contract rather than on the minimum payable in the event of early death. At the end of that period the aggregate amount accrued shall equal the then present value of the benefits expected to be provided to the employee, any beneficiaries, and covered dependents in exchange for the employee's service to that date.

Consolidated/Holding Company Plans

16. The employees of many reporting entities are eligible for certain compensated absence and postemployment benefits granted by a parent company or holding company. An entity with employees who are eligible for those benefits and is not directly liable for those related obligations shall recognize an expense equal to its allocation from the parent company or holding company of the benefits earned during the period. A liability shall be established for any such amounts due but not yet paid.

17. The reporting entity shall disclose in the financial statements that its employees participate in a plan sponsored by the holding company for which the reporting entity has no legal obligation. The amount of expense incurred and the allocation methodology utilized by the provider of such benefits shall also be disclosed. If the reporting entity is directly liable for the benefits, then the requirements outlined in paragraphs 2-15 shall be applied.

Disclosures

18. If it is not practicable to estimate, and therefore, not accrue the liability under paragraph 5 (i.e., conditions 5.a., 5.b. and 5.c. are met but condition 5.d. is not), that fact and the reasons therefore shall be disclosed in the financial statements.

19. For special or contractual termination benefits within scope of this standard (special or contractual termination benefits outside of SSAP No. 92 or SSAP No. 102), the reporting entity shall complete the disclosures in SSAP No. 92, paragraphs 66.a., 66.b., 66.g. and 66.p., as applicable.

20. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

21. This statement adopts:

- a. *FASB Statement No. 43, Accounting for Compensated Absences* (FAS 43),

- b. *FASB Statement No. 112, Employers' Accounting for Postemployment Benefits: an amendment of FASB Statements No. 5 and 43,*
 - c. *FASB Statement No. 88, Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits, as modified by FAS 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (FAS 158), paragraph 15 regarding guidance for termination benefits,*
 - d. *FASB Statement No. 132(R), Employers' Disclosures about Pensions and Other Postretirement Benefits, as modified by FAS 158, paragraphs 5(a), 5(b), 5(h), 5(g) and 8(m) to address disclosure requirements related to termination benefits, and*
 - e. *APB 12: Omnibus Opinion, paragraphs 6, 6A and 7.*
22. This statement adopts with modification:
- a. *FASB Emerging Issues Task Force Issue No. 06-2—Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43 with modification that the changes resulting from the adoption of EITF 06-2 are in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors.*

Effective Date and Transition

23. 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. 11—Compensated Absences*
- *Issue Paper No. 13—Employers' Accounting for Postemployment Benefits*

Statement of Statutory Accounting Principles No. 12

Employee Stock Ownership Plans

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	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Leveraged ESOPs	2
Nonleveraged ESOPs.....	2
Pension Reversion ESOPs	2
Issues Related to Accounting for Income Taxes.....	3
Disclosures.....	3
Relevant Literature.....	4
Effective Date and Transition	4
REFERENCES.....	4
Relevant Issue Papers	4

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for the plan sponsors' accounting for Employee Stock Ownership Plans (ESOPs).

SUMMARY CONCLUSION

2. An ESOP is an employee benefit plan that is described by the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code of 1986 as a stock bonus plan, or a combination stock bonus and money purchase pension plan, designed to invest primarily in employer stock. For such plans, reporting entities shall adopt AICPA *Statement of Position 93-6, Employers' Accounting for Employee Stock Ownership Plans* (SOP 93-6) except that debt obligations of ESOPs shall be reported consistent with *SSAP No. 15—Debt and Holding Company Obligations*, and the related income tax effects shall be accounted for consistent with *SSAP No. 101—Income Taxes*, as further clarified in this statement. There are two basic forms of ESOPs: leveraged and nonleveraged. A summary of the financial reporting for each is provided below.

Leveraged ESOPs

3. A leveraged ESOP borrows money to acquire shares of the employer company (sponsor). The money may be borrowed from the plan sponsor or from an outside lender, with or without a guarantee from the plan sponsor. The debt usually is collateralized by the employer's shares. Debt obligations of an ESOP shall be reported as borrowed money by company sponsors, except when the ESOP has both the ability and intent to satisfy the debt from sources other than dividends on the company stock, contributions from the company or the sale or exchange of the company's securities.
4. The sponsor shall record the issuance of shares or the sale of treasury shares to an ESOP when it occurs. The consideration recorded for the stock issued is unearned compensation and the unearned ESOP shares shall be recorded as a separate reduction of unassigned funds (surplus).
5. The unearned shares initially held by the ESOP in a suspense account are called suspense or unallocated shares. As the debt is repaid (generally from employer contributions and dividends on the employer's stock), suspense shares are released and must be allocated to individual accounts as of the end of the ESOP's fiscal year. As ESOP shares are committed to be released, unearned ESOP shares shall be credited and, depending on the purpose for which the shares are released, either (a) compensation cost, (b) dividends payable, or (c) compensation liabilities shall be charged consistent with SOP 93-6.
6. Because employers control the use of dividends on unallocated shares, dividends on unallocated shares are not considered dividends for financial reporting purposes (although such dividends are generally subject to normal dividend requirements under state statutes or regulations). Dividends on unallocated shares used to pay debt service shall be reported as a reduction of debt or of accrued interest payable. Dividends on unallocated shares paid to participants or added to participant accounts shall be reported as compensation cost. Dividends on allocated shares shall be charged to unassigned funds (surplus).
7. If the ESOP sells the suspense shares and uses the proceeds to repay the debt, the employer shall report the release of the suspense shares as a credit to unearned ESOP shares based on the cost of the shares to the ESOP, charge debt and accrued interest payable, and recognize the difference in paid-in capital. However, if there is a difference between the amount paid to an outside lender and the net carrying amount of the debt, such difference shall be reported as a capital gain or loss on extinguishment of debt and, accordingly, shall be charged to operations and disclosed in the financial statements with other disclosures required by paragraph 17.
8. If an employer reacquires the suspense shares from the ESOP, the purchase of the shares shall be accounted for as a treasury stock transaction consistent with SOP 93-6.

Nonleveraged ESOPs

9. Employers with nonleveraged ESOPs shall report compensation cost equal to the contribution called for in the period under the plan.
10. Employers with nonleveraged ESOPs shall charge dividends on shares held by the ESOPs to unassigned funds (surplus), except that dividends on suspense account shares of pension reversion ESOPs shall be accounted for the same way as dividends on suspense account shares of leveraged ESOPs.

Pension Reversion ESOPs

11. Pension reversion ESOPs are created by transferring the assets of a defined benefit pension plan to existing or newly created ESOPs and may be leveraged or nonleveraged. Pension reversion ESOPs shall be accounted for consistent with SOP 93-6.

Issues Related to Accounting for Income Taxes

Leveraged ESOPs

12. The amount of ESOP-related expense for a leveraged ESOP for a period may differ from the amount of the ESOP-related income tax deduction (prescribed by income tax rules and regulations) for that period. Differences shall be reported in accordance with SSAP No. 101 and result in either of the following situations:

- a. The fair value of shares committed to be released differs from the cost of those shares to the employee stock ownership plan.
- b. The timing of expense recognition is different for income tax and financial reporting purposes.

13. The tax effect of the difference, if any, between the cost of shares committed to be released and the fair value of the shares shall be recognized as income tax expense or benefit in the income statement.

14. The tax benefit of tax-deductible dividends on allocated and unallocated ESOP shares shall be recognized in the income statement.

Nonleveraged ESOPs

15. Reporting entities with nonleveraged ESOPs may accrue compensation cost for financial reporting purposes earlier than the cost is deductible for income tax purposes. Accruing the compensation cost earlier for financial reporting purposes creates a temporary difference that shall be accounted for in accordance with SSAP No. 101.

Other

16. Under federal income tax regulations, employer securities (such as convertible preferred stock) that are held by participants in an ESOP and are not readily tradable on an established market must include a put option. Securities subject to such repurchase obligations shall be reported as outstanding and as a component of capital stock and/or gross paid-in and contributed surplus in accordance with *SSAP No. 72—Surplus and Quasi-Reorganizations*.

Disclosures

17. An employer sponsoring an ESOP shall disclose the following information about the plan, if applicable:

- a. A description of the plan, the basis for determining contributions, including the employee groups covered, and the nature and effect of significant matters affecting comparability of information for all periods presented. For leveraged ESOPs and pension reversion ESOPs, the description shall include the basis for releasing shares and how dividends on allocated and unallocated shares are used;
- b. A description of the accounting policies followed for ESOP transactions, including the method of measuring compensation and the classification of dividends on ESOP shares;
- c. The amount of compensation cost recognized during the period;
- d. The number of allocated shares, committed-to-be-released shares, and suspense shares held by the ESOP at the balance sheet date;

- e. The fair value of unearned ESOP shares at the balance sheet date; and
- f. The existence and nature of any repurchase obligation, including disclosure of the fair value of the shares allocated as of the balance sheet date, which are subject to a repurchase obligation.

18. Refer to the Preamble for further discussions regarding disclosure requirements. The disclosures in paragraph 17 shall be included in the annual audited statutory financial reports only.

Relevant Literature

19. This statement adopts SOP 93-6 with a modification to reject paragraphs 13 and 25 to the extent they require reporting all debt obligations of an ESOP as liabilities, paragraphs 28-34, 44 and 53.b. as they relate to earnings per share, and paragraph 37 as it relates to reporting gains and losses on extinguishment of debt.

20. This statement rejects *FASB Emerging Issues Task Force No. 89-11, Sponsor's Balance Sheet Classification of Capital Stock with a Put Option Held by an Employee Stock Ownership Plan*.

Effective Date and Transition

21. 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. 78—Employee Stock Ownership Plans*

Statement of Statutory Accounting Principles No. 15

Debt and Holding Company Obligations

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Nullifies and incorporates INT 00-08, INT 00-10, INT 04-07, INT 04-15 and INT 08-08
Affected by.....	No other pronouncements
Interpreted by	INT 20-01
Relevant Appendix A Guidance	None

STATUS.....	1
SUMMARY CONCLUSION	1
Debt.....	1
Convertible Debt Securities with Beneficial Conversion Features	2
Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements.....	3
Holding Company Obligations	3
Accounting for the Settlement of the Equity-Settled Portion of a Convertible Debt Instrument That Permits or Requires the Conversion Spread to Be Settled in Stock	3
Accounting for Federal Home Loan Banks	4
Disclosures.....	4
Relevant Literature.....	4
Effective Date and Transition	6
REFERENCES.....	6
Relevant Issue Papers	6

SCOPE OF STATEMENT

1. The purpose of this statement is to establish statutory accounting principles for recording debt and related disclosure requirements, including holding company obligations and any related guarantees in the financial statements of an insurance company subsidiary, and debt obligations of Employee Stock Ownership Plans (ESOPs).

SUMMARY CONCLUSION

Debt

2. Debt shall be reported as a liability unless (a) it is debt on real estate in accordance with *SSAP No. 40R—Real Estate Investments* (i.e., reported as a reduction in the carrying value of real estate), (b) it is offset against another asset in accordance with *SSAP No. 64—Offsetting and Netting of Assets and Liabilities*, or (c) other treatment is specified elsewhere within the *Accounting Practices and Procedures Manual*. Instruments that meet the requirements to be recorded as surplus as specified in *SSAP No. 72—*

Surplus and Quasi-Reorganizations are not considered debt. *SSAP No. 25—Affiliates and Other Related Parties* also provides specific guidance for debt obligations owed to related parties.

3. Debt discount or premium, if any, shall be reported in the balance sheet as a direct deduction from or addition to the face amount of the note. Discount or premium shall be amortized over the life of the note using the interest method.
4. Interest on debt shall be accrued and charged to operations over the life of the debt, except when capitalized in accordance with *SSAP No. 44—Capitalization of Interest*. Interest payable shall include interest payable on all debt reported as a liability, approved interest on surplus notes, and interest payable on debt reported as a reduction in the carrying value of real estate.
5. Debt issuance costs (e.g., loan fees and legal fees) do not meet the definition of an asset as defined in *SSAP No. 4—Assets and Nonadmitted Assets*. Accordingly, these costs shall be charged to operations in the period incurred.
6. Debt obligations of ESOPs shall be reported as debt by company sponsors, except when the ESOP has both the ability and intent to satisfy the debt from sources other than dividends on the company stock, contributions from the company, or the sale or exchange of the company's securities. ESOPs are addressed in *SSAP No. 12—Employee Stock Ownership Plans*.
7. Debt which is subject to a troubled debt restructuring shall be accounted for in accordance with *SSAP No. 36—Troubled Debt Restructuring*.
8. Convertible debt securities that are convertible into common stock of the issuer or an affiliated company at a specified price at the option of the holder and which are sold at a price not significantly in excess of the face amount shall be accounted for solely as debt at the time of issuance. An expense shall be recognized, equal to the fair value of additional securities granted or other consideration issued to induce conversion subsequent to the issuance of convertible debt securities. This guidance applies regardless of who initiates the offer, the debt holder or the debtor, and whether the offer applies to all debt holders.
9. Proceeds from debt issued with detachable stock purchase warrants shall be allocated based on the relative fair value of the two securities at the time of issuance. The value attributable to the warrants shall be accounted for as paid-in capital.
10. Other types of debt securities, e.g., capital notes, shall be accounted for in accordance with the substance of the transaction.
11. A reporting entity shall derecognize a liability if, and only if, it has been extinguished. A liability has been extinguished if either of the following conditions is met:
 - a. The reporting entity pays the creditor and is relieved of its obligation for the liability. Paying the creditor includes delivery of cash, other financial assets, goods or services, or reacquisition by the debtor of its outstanding debt securities; or
 - b. The reporting entity is legally released from being the primary obligor under the liability, either judicially or by the creditor.

Convertible Debt Securities with Beneficial Conversion Features

12. Entities may issue convertible debt securities and convertible preferred stock with a nondetachable conversion feature that is in-the-money at the commitment date (a "beneficial conversion feature"). Those securities may be convertible into common stock at the lower of a conversion rate fixed at the commitment date or a fixed discount to the market price of the common stock at the date of

conversion. Certain convertible securities may have a conversion price that is variable based on future events such as a subsequent round of financing at a price lower than the convertible securities' original conversion price, a liquidation or a change in control of the company, or an initial public offering at a share price lower than an agreed-upon amount.

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*.

Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements

14. A line-of-credit or revolving-debt arrangement is an agreement that provides the borrower with the option to make multiple borrowings up to a specified maximum amount to repay portions of previous borrowings, and to then reborrow under the same contract. Line-of-credit and revolving-debt arrangements may include both amounts drawn by the debtor (a debt instrument) and a commitment by the creditor to make additional amounts available to the debtor under predefined terms (a loan commitment). In most situations, a debtor incurs costs to establish line-of-credit or revolving-debt arrangements, and some or all of the costs are deferred and amortized over the term of the arrangement.

15. Modifications to or exchanges of line-of-credit or revolving-debt arrangements, including the accounting for unamortized costs at the time of the change, fees paid to or received from the creditor and third-party costs incurred shall be expensed when incurred.

Holding Company Obligations

16. In situations where the reporting entity does not guarantee the obligation of the holding company, there is no legal obligation on the part of the reporting entity. Therefore, the reporting entity shall not record the obligation of its parent holding company unless the obligation relates to services or benefits incurred by a non-insurance parent company or holding company on its behalf. In these situations, the reporting entity shall recognize an expense for its share of the services or benefits provided to it during the period by the parent company or holding company based on an allocation from the parent or holding company. A liability shall be established for any such amounts due, but not yet paid. The amount of expense incurred and the allocation methodology utilized by the provider of such benefits shall also be disclosed. *SSAP No. 11—Postemployment Benefits and Compensated Absences*, *SSAP No. 92—Postretirement Benefits Other Than Pensions* and *SSAP No. 102—Pensions* address specific examples where the obligation relates to benefits provided to the subsidiary by a non-insurance parent company or holding company.

17. If the reporting entity guarantees an obligation of the holding company, the guidance in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* shall be followed for determining the recording and disclosure of the guarantee. SSAP Nos. 11, 92 and 102 provide specific accounting and disclosure guidelines for employee benefit plans when the reporting entity is directly liable for obligations under the plan.

Accounting for the Settlement of the Equity-Settled Portion of a Convertible Debt Instrument That Permits or Requires the Conversion Spread to Be Settled in Stock

18. Upon settlement of a security with the characteristics of Instrument C in *FASB Emerging Issues Task Force 90-19, Convertible Bonds with Issuer Option to Settle for Cash upon Conversion*, by payment of the accreted value of the obligation (recognized liability) in cash and settlement of the conversion spread (unrecognized equity instrument) with stock, only the cash payment should be considered in the computation of gain or loss on extinguishment of the recognized liability. That is, any shares transferred to settle the embedded equity instrument (referred to as the excess conversion spread in EITF 90-19) would not be considered in the settlement of the debt component.

Accounting for Federal Home Loan Banks

19. Funding agreements issued to a federal home loan bank (FHLB) shall be evaluated on an individual basis, and shall be accounted for according to the substance of the individual arrangement and entity licensing. If the arrangement is in substance a funding agreement, including that the funds are used in an investment spread capacity, it shall be accounted for consistent with other funding agreements in accordance with *SSAP No. 52—Deposit-Type Contracts*. If the arrangement is in substance a borrowing agreement, it shall be accounted for in accordance with this statement, consistent with other borrowed money.

Disclosures

20. The financial statements shall disclose the following items related to debt, including FHLB borrowings accounted for under this SSAP:

- a. Date issued;
- b. Pertinent information concerning the kind of borrowing (e.g., debentures, commercial paper outstanding, bank loans, and lines of credit);
- c. Face amount of the debt;
- d. Carrying value of debt;
- e. The rate at which interest accrues;
- f. The effective interest rate;
- g. Collateral requirements;
- h. Interest paid in the current year;
- i. A summary of significant debt terms and covenants and any violations;
- j. The combined aggregate amount of maturities and sinking fund requirements for each of the five years following the latest balance sheet presented;
- k. If debt was considered to be extinguished by in-substance defeasance prior to the effective date of this statement and any of the debt remains outstanding, a general description of the transaction and the amount of debt that is considered extinguished at the end of the period; and
- l. If assets are set aside after the effective date of this statement solely for satisfying scheduled payments of a specific obligation, a description of the nature of restrictions placed on those assets.

21. FHLB borrowings accounted for under SSAP No. 15 should follow the disclosure requirements required in paragraph 20 as well as the disclosure requirements included in *SSAP No. 30R—Unaffiliated Common Stock*, paragraph ~~18~~¹⁹.

22. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

23. This statement adopts *Accounting Principles Board Opinion No. 14, Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants* and *FASB Statement No. 84, Induced Conversions of Convertible Debt*.

24. This statement adopts *Accounting Principles Board Opinion No. 21, Interest on Receivables and Payables*, with a modification to require that debt issuance costs be charged to operations.
25. This statement adopts *Accounting Principles Board Opinion No. 26, Early Extinguishment of Debt* with modification to require that gains and losses from extinguishment of debt be reported as capital gains or losses and charged to operations unless the extinguishment reflects the forgiveness of a reporting entity's obligation to its parent or other stockholders. Forgiveness of a reporting entity's obligation to its parent or other stockholder shall be accounted for as contributed surplus under SSAP No. 72.
26. This statement adopts paragraphs 13 and 25 of AICPA *Statement of Position 93-6, Employers' Accounting for Employee Stock Ownership Plans* (SOP 93-6) with a modification to exclude debt obligations when the ESOP has both the ability and intent to satisfy the debt from sources other than dividends on the company's stock, contributions from the company, or the sale or exchange of the company's securities. This statement rejects paragraph 37 of SOP 93-6 as it relates to reporting gains and losses on extinguishment of debt which shall be accounted for consistent with SSAP No. 24—*Discontinued Operations and Unusual or Infrequent Items*.
27. This statement adopts *FASB Emerging Issues Task Force No. 90-19, Convertible Bonds with Issuer Option to Settle for Cash upon Conversion* with a modification to reject guidance related to earnings per share.
28. This statement adopts *FASB Technical Bulletin No. 80-1, Early Extinguishment of Debt through Exchange for Common or Preferred Stock*, with a modification to reject guidance related to classification of the loss as an extraordinary item.
29. This statement rejects *ASU 2015-0, Simplifying the Presentation of Debt Issuance Cost* and *ASU 2015-15, Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements* for statutory accounting.
30. This statement adopts the following pronouncements:
- a. *Accounting Principles Board Opinion No. 12, paragraphs 16 and 17, Omnibus Opinion—1967*;
 - b. *AICPA Accounting Interpretations of APB 21, Interest on Receivables and Payables*;
 - c. *AICPA Accounting Interpretations of APB 26, Early Extinguishment of Debt*;
 - d. *FASB Emerging Issues Task Force No. 85-9, Revenue Recognition on Options to Purchase Stock of Another Entity*;
 - e. *FASB Emerging Issues Task Force No. 85-17, Accrued Interest upon Conversion of Convertible Debt*;
 - f. *FASB Emerging Issues Task Force No. 85-29, Convertible Bonds with a "Premium Put"*;
 - g. *FASB Emerging Issues Task Force No. 86-8, Sale of Bad-Debt Recovery Rights*;
 - h. *FASB Emerging Issues Task Force No. 86-15, Increasing-Rate Debt*;
 - i. *FASB Emerging Issues Task Force No. 86-18, Debtor's Accounting for a Modification of Debt Terms*;
 - j. *FASB Emerging Issues Task Force No. 86-28, Accounting Implications of Indexed Debt Instruments*;

- k. *FASB Emerging Issues Task Force No. 86-36, Invasion of a Defeasance Trust;*
- l. *FASB Emerging Issues Task Force No. 95-15, Recognition of Gain or Loss When a Binding Contract Requires a Debt Extinguishment to Occur at a Future Date for a Specified Amount;*
- m. *FASB Emerging Issues Task Force No. 02-15: Determining Whether Certain Conversions of Convertible Debt to Equity Securities Are Within the Scope of FASB Statement No. 84.*

31. This statement rejects *FASB Statement No. 4, Reporting Gains and Losses from Extinguishment of Debt* and *FASB Statement No. 64, Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements—an Amendment of FASB Statement No. 4*. This statement also rejects *FASB Emerging Issues Task Force No. 84-40, Long-Term Debt Repayable by a Capital Stock*, *FASB Emerging Issues Task Force No. 98-5, Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios*, and *FASB Emerging Issues Task Force No. 98-14, Debtor's Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements*.

Effective Date and Transition

32. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The guidance in paragraph 8 related to who initiates an offer was previously included in *INT 04-07: EITF No. 02-15: Determining Whether Certain Conversions of Convertible Debt to Equity Securities Are Within the Scope of FASB Statement No. 84* and was effective September 12, 2004. The guidance in paragraphs 12 and 13 was originally contained within *INT 00-08: EITF 98-5: Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios* and was effective September 11, 2000. The guidance in paragraphs 14 and 15 was originally contained within *INT 00-10: EITF 98-14: Debtor's Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements* and was effective June 12, 2000. The guidance in paragraph 18 was originally contained within *INT 04-15: EITF 03-7: Accounting for the Settlement of the Equity-Settled Portion of a Convertible Debt Instrument That Permits or Requires the Conversion Spread to be Settled in Stock (Instrument C of Issue No. 90-19)* and was effective December 5, 2004. Guidance in paragraph 19 was previously included within *INT 08-08: Balance Sheet Presentation of Funding Agreements Issued to a Federal Home Loan Bank* and was effective for periods beginning March 15, 2009. Guidance in paragraphs 20-21 related to FHLB agreements and borrowings was initially effective January 1, 2014.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 80—Debt*
- *Issue Paper No. 95—Holding Company Obligations*

Statement of Statutory Accounting Principles No. 16 – Revised

Electronic Data Processing Equipment and Software

STATUS

Type of Issue.....	Common Area
Issued	Initial draft; Substantively revised October 18, 2010
Effective Date	January 1, 2001, January 1, 2002, and January 1, 2004
Affects.....	Supersedes SSAP No. 79, SSAP No. 81 and SSAP No. 82; Nullifies and incorporates INT 04-13
Affected by.....	No other pronouncements
Interpreted by	INT 01-18
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
EDP Equipment and Operating / Nonoperating System Software.....	1
Research and Development Costs Incurred to Obtain or Develop Computer Software	2
Accounting for the Costs of Computer Software to be Sold.....	2
Software Revenue Recognition.....	3
Costs of Computer Software Developed or Obtained for Internal Use and Web Site Development Costs..	3
Non-Software Deliverables in Arrangements Containing More-Than-Incidental Software.....	5
Disclosures.....	5
Relevant Literature.....	6
Effective Date and Transition	7
REFERENCES.....	7
Relevant Issue Papers	7

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for electronic data processing (EDP) equipment and provisions for the accounting of other software.

SUMMARY CONCLUSION

EDP Equipment and Operating / Nonoperating System Software

2. EDP equipment and software generally meet the definition of assets established in *SSAP No. 4—Assets and Nonadmitted Assets*. EDP equipment and operating system software are admitted assets to the extent they conform to the requirements of this statement. Nonoperating system software are nonadmitted assets.
3. EDP equipment and operating system software shall be depreciated over the lesser of its useful life or three years. Nonoperating system software shall be depreciated over the lesser of its useful life or

five years. In either case, the methods detailed in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* shall be used.

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)

5. In accordance with the reporting entity's written capitalization policy, amounts less than a predefined threshold shall be expensed when purchased, otherwise the EDP Equipment, operating and nonoperating system software assets shall be capitalized and depreciated in accordance with paragraph 3. 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.

Research and Development Costs Incurred to Obtain or Develop Computer Software

6. Guidance on the accounting for research and development costs is provided in *SSAP No. 17—Preoperating and Research and Development Costs* and requires all research and development costs to be expensed when incurred. Pursuant to the guidance adopted within that SSAP:

- a. To the extent that the acquisition, development, or improvement of a process by an enterprise for use in its selling or administrative activities includes costs for computer software, those costs are not research and development costs.
- b. Costs incurred to purchase or lease computer software developed by others are not research and development costs unless the software is for use in research and development activities.
- c. Costs incurred by an enterprise in developing computer software internally for use in its research and development activities are research and development costs. This includes costs incurred during all phases of software development because all of those costs are incurred in research and development activities.

7. Costs for computer software determined to be research and development costs shall be accounted for and disclosed in accordance with SSAP No. 17. Software costs not considered to be research and development costs shall be accounted for in accordance with this SSAP.

Accounting for the Costs of Computer Software to be Sold

8. This statement adopts with modification *FASB Codification 985-20, Software - Costs of Software to be Sold, Leased or Marketed* (ASC 985-20) to preclude the capitalization of software development costs and to reject guidance regarding the treatment of capitalized costs. Additionally, this statement rejects *FASB Codification 985-330, Software - Inventory* (ASC 985-330). Statutory modifications to ASC 985-20 and rejection of ASC 985-330 precludes capitalization of costs, and requires such costs to be expensed, for:

- a. Costs of producing product masters incurred subsequent to establishing technological feasibility. Those costs include coding and testing performed subsequent to establishing technological feasibility.
- b. Software production costs for computer software that is to be used as an integral part of a product or process.

- c. All indirect costs, including overhead related to programmers and the facilities they occupy.
- d. Costs incurred for duplicating computer software, documentation and training materials from product masters and for physically packaging the product for distribution.

Software Revenue Recognition

9. This statement adopts with modification *FASB Codification 985-605, Software – Revenue Recognition – Provision for Losses* (ASC 985-605), as revised by *ASU 2009-14, Certain Revenue Arrangements That Include Software Elements* (ASU 2009-14), for statutory accounting terms and concepts:

- a. References to GAAP guidance outside FASB Codification topic 985-605 shall be followed only to the extent in which that specific GAAP guidance has been adopted¹ for statutory accounting. The guidance within the applicable SSAP or statutory interpretation shall be considered the authoritative statutory guidance.
- b. Any references to the accounting for capitalized development costs is rejected as all development costs are required to be expensed when incurred.

Costs of Computer Software Developed or Obtained for Internal Use and Web Site Development Costs

10. This statement adopts with modification *FASB Accounting Standards Codification (ASC) 350-40, Internal Use Software* (ASC 350-40) as described in this statement. (This adoption reflects adjustments to ASC 350-40 from *ASU 2015-05, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*.) This statement also adopts *FASB Accounting Standards Codification 350-50, Website Development Costs* (ASC 350-50) in its entirety.

11. This statement also adopts with modification the guidance reflected in ASC 350-40 for cloud computing arrangements as modified by *ASU 2018-15, Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract* and in this statement. Consistent with U.S. GAAP, the guidance in this statement for cloud computing hosting arrangements varies based on whether the cloud computing arrangement is a service contract:

- a. An arrangement that is not a service contract applies to internal-use software if the 1) reporting entity has the contractual right to take possession of the software at any time during the hosting period without significant penalty; and 2) it is feasible for the reporting entity to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software.
- b. If both conditions in paragraph 11.a. are not met, then the arrangement for internal-use software is considered a service contract.

12. For hosting arrangements that are not service contracts, reporting entities shall account for any internal-use software as follows:

- a. The reporting entity shall recognize an operating or non-operating system software asset for the costs incurred for the software license in accordance with paragraph 3 of this statement. This is a modification from U.S. GAAP in which the asset is recognized as an

¹ If statutory accounting principles do not address the FASB Codification reference, consideration of whether the GAAP guidance is adopted for statutory accounting shall be determined in accordance with the respective pre-codification GAAP guidance.

intangible asset. A liability shall also be recognized if payments for the software license are still required.

- b. If the reporting entity has a hosting arrangement that includes both the acquisition of a software asset (pursuant to paragraph 11.a.) and an ongoing hosting arrangement, the reporting entity shall allocate the costs of the arrangement to the different elements. Costs for the ongoing hosting arrangement shall be accounted for in accordance with *SSAP No. 22R—Leases*.

13. For hosting arrangements that are service contracts, reporting entities shall account for the contract as follows:

- a. The reporting entity shall capitalize implementation costs of the hosting arrangement (the costs incurred to implement the cloud hosting service contract), as nonoperating system software. The capitalized costs shall be consistent with the costs which are permitted to be capitalized for internal use software and shall be reported as a nonadmitted asset. These implementation costs shall be recognized as each module or component of the hosting arrangement is ready for its intended use.
- b. The implementation costs shall be amortized over the lesser of the term of the hosting arrangement, or five years. (This statement adopts the provisions in ASC 350-40-35-13 through ASC 350-40-35-17 for determining the term of the hosting arrangement and for when amortization shall begin.) The amortization cost shall be recognized as depreciation of the nonoperating system software. (This is a modification from U.S. GAAP as the amortization is not recognized in the same expense line as the service contract lease.)
- c. The capitalized implementation costs shall be recognized as impaired, with immediate write-off to income when the hosting arrangement (or separate modules or components of the hosting arrangement) ceases to be used, and when events or changes in circumstances occurs indicating that the carrying amount of the related implementation costs may not be recoverable. Example events include:
 - i. The hosting arrangement is not expected to provide substantive service potential.
 - ii. A significant change occurs in the extent or manner in which the hosting arrangement is used or is expected to be used.
 - iii. A significant change is made or will be made to the hosting arrangement.
- d. The service contract hosting arrangement shall be accounted for in accordance with *SSAP No. 22R—Leases*. (The service contract hosting arrangement excludes implementation, set-up and other upfront costs (e.g., implementation costs) incurred in the hosting arrangement.)

14. The modifications to ASC 350-40 are as follows:

- a. ASC 350-40-15-4 states that the accounting for costs of reengineering activities, which often are associated with new or upgraded software applications, is not included within scope. This guidance is expanded to require that such costs be expensed as incurred.
- b. ASC 350-40-25-17 is amended to require software licenses acquired pursuant to paragraph 11.a. are captured within scope of this standard as software, and not as an intangible asset in scope of *SSAP No. 20—Nonadmitted Assets*.

- c. ASC 350-40-35-4 is amended to require entities to follow the amortization guidelines as established in paragraph 10 of *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements*
- d. ASC 350-40-35-5 is amended to require that capitalized operating system software shall be depreciated for a period not to exceed three years. Capitalized nonoperating system software shall be depreciated for a period not to exceed five years. This is consistent with paragraph 3 of this statement.
- e. ASC 350-40-35-9 is amended to require that if during the development of internal use software, an entity decided to market the software to others, the entity shall immediately expense any amounts previously capitalized.
- f. ASC 350-40-50-1 is amended to require entities to follow the disclosure provisions provided in paragraph 17 of this statement and paragraph 5 of SSAP No. 17.
- g. Any software costs capitalized in accordance with this statement shall be deemed either operating or nonoperating system software costs with amortization not to exceed the timeframes stipulated in paragraph 3. Unless this statement explicitly classifies a cost as nonoperating, entities shall make this determination in accordance with the definitions of operating and nonoperating system software contained in the Glossary. As noted in paragraph 2, nonoperating system software is a nonadmitted asset.

Non-Software Deliverables in Arrangements Containing More-Than-Incidental Software

15. In an arrangement that includes software that is more than incidental to the products or services as a whole, software and software-related elements are included within the scope of this guidance. Software-related elements include software products and services as well as any non-software deliverable(s) for which a software deliverable is essential to its functionality. For example, in an arrangement that includes software, computer hardware that will contain the software, and additional unrelated equipment, if the software is essential to the functionality of the hardware, the hardware would be considered software-related and, therefore, included within the scope of this guidance. However, because the software is not essential to the functionality of the unrelated equipment, the equipment would not be considered software-related and would, therefore, be excluded from the scope.

16. In accordance with the reporting entity's written capitalization policy, amounts less than a predefined threshold of costs incurred within the scope of paragraphs 10 and 14 shall be expensed when incurred. 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.

Disclosures

17. The disclosures in this paragraph are specific to EDP equipment and operating and nonoperating system software, but shall also be followed as directed under paragraph 14.e.

- a. Depreciation and amortization expense for the period;
- b. For EDP equipment and operating system software, balances of major classes of depreciable assets, by nature or function, at the balance sheet date;
- c. For EDP equipment and operating system software, accumulated depreciation and amortization, either by major classes of depreciable assets or in total, at the balance sheet date; and

- d. A general description of the method or methods used in computing depreciation with respect to major classes of depreciable assets.

18. The financial statements shall disclose if the written capitalization policies and the resultant thresholds have changed from the prior period and the reason(s) for such change.

19. Refer to the Preamble for further discussion regarding disclosure requirements. The disclosures in paragraph 17 shall be included in the annual audited statutory financial reports only.

Relevant Literature

20. The revisions to this statement, adopted in October 2010, result from incorporating previously adopted statutory accounting guidance from SSAP No. 17, SSAP No. 79, SSAP No. 81, SSAP No. 82 and SSAP No. 87 into this statement. Revisions to incorporate the previously adopted statutory accounting guidance within this SSAP shall not be considered new statutory accounting guidance. This statement also adopts with modification ASU 2009-14, which revises the previous GAAP guidance adopted under SSAP No. 81. The GAAP revisions adopted within ASU 2009-14 are considered nonsubstantive and are effective immediately.

21. This statement references GAAP guidance in accordance with the current FASB Codification. The references to the FASB Codification are intended to reflect the previously adopted pre-codification GAAP guidance as communicated within SSAP No. 17, SSAP No. 81 and SSAP No. 82:

- a. The pre-codification GAAP guidance reflected within SSAP No. 17 and incorporated within paragraph 8 through reference to the FASB ASC 985-20 includes:
 - i. *FASB Statement No. 86, Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed* was adopted with the exception of paragraphs 5 and 6 and paragraphs 8-11. Those paragraphs were rejected to preclude the capitalization of software development costs.
 - ii. *FASB Emerging Issues Task Force No. 96-14, Accounting for Costs Associated with Modifying Computer Software for the Year 2000* was adopted. This guidance was not included within the FASB Codification as it is considered no longer technologically helpful.
- b. The pre-codification GAAP guidance reflected within SSAP No. 81 and incorporated within paragraph 9 through reference to the FASB ASC 985-605 includes:
 - i. *AICPA Statement of Position 97-2, Software Revenue Recognition* paragraphs 6-91 was adopted with certain modifications.
 - ii. *AICPA Statement of Position 98-9, Modification of SOP 97-2 Software Revenue Recognition, With Respect to Certain Transactions* paragraphs 6-8 was adopted. (Note: The adopted paragraphs reflect all of the changes to SOP 97-2.)
 - iii. *FASB Emerging Issues Task Force No. 00-3, Application of AICPA Statement of Position 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity's Hardware* was adopted in its entirety.
 - iv. *AICPA Statement of Position 98-4, Deferral of the Effective Date of a Provision of SOP 97-2, Software Revenue Recognition* was considered not applicable because the effective date was inconsistent with SSAP No. 81.

- c. The pre-codification GAAP guidance reflected within SSAP No. 82 and incorporated within paragraphs 10 and 11 through reference to the FASB ASC 350-40 includes:
- i. *AICPA Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* paragraphs 11-42 and paragraph 93 were adopted with modification.
 - ii. *FASB Emerging Issues Task Force No. 00-2, Accounting for Web Site Development Costs* was adopted in its entirety.

22. SSAP No. 16, SSAP No. 17 and SSAP No. 79 were effective for years beginning January 1, 2001. SSAP No. 81 and SSAP No. 82 were effective for years beginning January 1, 2002. SSAP No. 87 was effective for years beginning on and after January 1, 2004. Transition guidance from the initial adoption of these SSAPs has expired and is not duplicated within this statement.

Effective Date and Transition

23. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The guidance in paragraph 15 was originally contained within *INT 04-13: EITF No. 03-5: Applicability of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software* and was effective December 5, 2004.

24. EDP equipment and operating system software capitalized prior to January 1, 2001, shall be depreciated over the lesser of its remaining useful life or three years. Nonoperating system software capitalized prior to January 1, 2001, shall be depreciated over the lesser of its remaining useful life or five years.

25. The adoption with modification of *ASU 2018-15, Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*, is effective January 1, 2020, with early adoption permitted. The adoption shall occur either prospectively to all implementation costs incurred after the date of adoption, or as a change in accounting principle under *SSAP No. 3—Accounting Changes and Corrections of Errors*.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 16—Electronic Data Processing Equipment and Software*
- *Issue Paper No. 17—Preoperating and Research and Development Costs*
- *Issue Paper No. 109—Depreciation of Non-Operating System Software – An Amendment to SSAP No. 16*
- *Issue Paper No. 111—Software Revenue Recognition*
- *Issue Paper No. 112—Accounting for the Costs of Computer Software Developed or Obtained for Internal Use and Web Site Development Costs*

Statement of Statutory Accounting Principles No. 17

Preoperating and Research and Development Costs

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Nullifies and incorporates INT 99-18 and INT 08-04
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Disclosures.....	2
Relevant Literature.....	2
Effective Date and Transition	2
REFERENCES.....	2
Relevant Issue Papers	2
Preoperating and Research and Development Costs	

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for organizational costs, research and development costs, and start-up costs for new and existing entities.

SUMMARY CONCLUSION

2. Preoperating, including organization and startup costs, and research and development costs shall be expensed as incurred. Preoperating and research and development costs are incurred for such new projects as: (a) arranging operations for a new entity (e.g., legal, actuarial and accounting costs associated with regulatory approval and licensing and issuance of stock), (b) establishing production, sales or service facilities at a new site, (c) changing operations or production significantly, or (d) developing and producing a new product, adopting a new process or offering a new service. Also included in research and development costs are all nonrefundable advance payments for goods or services that will be used or rendered for research and development activities. These nonrefundable advance payments shall be expensed when the advance payment is made.

3. Costs associated with business process reengineering activities, whether done internally or by third parties, shall be expensed when incurred. The total consulting contract price (or the sum of the linked contracts with the same vendor) in a business process reengineering project shall be allocated to each activity based on the relative fair values when a third party is used to complete such a project.

4. Preoperating, including organization and start-up costs, and research and development costs specifically exclude tangible assets acquired in connection with such activities.

Disclosures

5. Disclosure shall be made in the financial statements of the total research and development costs charged to expense in each period for which an income statement is presented. The disclosure shall be included in the annual audited statutory financial report only.

6. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

7. This statement adopts *FASB Statement No. 2, Accounting for Research and Development Costs* and *FASB Interpretation No. 6, Applicability of FASB Statement No. 2 to Computer Software*. From January 1, 2001 through October 2010, this statement also adopted *FASB Statement No. 86, Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed* (FAS 86), with the exception of paragraphs 5 and 6 and paragraphs 8-11. These paragraphs have been rejected to preclude the capitalization of software development costs. *FASB Emerging Issues Task Force No. 96-14, Accounting for the Costs Associated with Modifying Computer Software for the Year 2000* (EITF 96-14) and *FASB Emerging Accounting Issues Task Force No. 97-13: Accounting for Costs Incurred in Connection with a Consulting Contract or an Internal Project that Combines Business Process Reengineering and Information Technical Transformation* (EITF 97-13) are adopted. Effective October 2010, FAS 86 and EITF 96-14 were rejected as FASB issued new GAAP guidance, which is reviewed in SSAP No. 16R.

8. This statement rejects *FASB Statement No. 7, Accounting and Reporting by Development Stage Enterprises*, *FASB Interpretation No. 7, Applying FASB Statement No. 7 in Financial Statements of Established Operating Enterprises*, an interpretation of *FASB Statement No. 7* and *FASB Emerging Issues Task Force No. 07-3, Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities*.

Effective Date and Transition

9. 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*. Guidance reflected in paragraph 2 was previously included in *INT 08-04: FASB Emerging Issues Task Force No. 07-3, Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities* and was originally effective May 31, 2008. Guidance reflected in paragraph 3 was originally included in *INT 99-18: EITF No. 97-13: Accounting for Costs Incurred in Connection with a Consulting Contract or an Internal Project That Combines Business Process Reengineering and Information Technology Transformation* and was effective October 4, 1999.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 17—Preoperating and Research and Development Costs*

Statement of Statutory Accounting Principles No. 19

Furniture, Fixtures, Equipment and Leasehold Improvements

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Supersedes SSAP No. 87 with guidance incorporated August 2011; Nullifies and incorporates INT 09-05
Affected by.....	No other pronouncements
Interpreted by	INT 01-18
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Furniture, Fixtures and Equipment	1
Leasehold Improvements Paid by the Reporting Entity as Lessee	2
Maintenance Costs Paid by Lessee	2
Depreciation and Amortization	2
Disclosures.....	3
Relevant Literature.....	3
Effective Date and Transition	4
REFERENCES.....	4
Relevant Issue Papers	4

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for furniture, fixtures, and equipment (excluding electronic data processing equipment and software that is addressed in *SSAP No. 16R—Electronic Data Processing Equipment and Software*, leasehold improvements paid by the reporting entity as lessee, and depreciation of property and amortization of leasehold improvements. Concession service arrangements, as defined in *SSAP No. 22R—Leases*, are not leases, nor should they be recognized as property, plant or equipment. Therefore, these arrangements, and improvements to infrastructures within concession service arrangements, are outside of the scope of this standard.

SUMMARY CONCLUSION

Furniture, Fixtures and Equipment

2. Furniture, fixtures and equipment generally meet the definition of assets established in *SSAP No. 4—Assets and Nonadmitted Assets*. Such items also meet the criteria defining nonadmitted assets in *SSAP No. 4*. Accordingly, these assets shall be depreciated against net income as the estimated

economic benefit expires and the undepreciated portion of these assets shall be reported as nonadmitted assets and charged against surplus.^(INT 01-18)

3. In accordance with the reporting entity's written capitalization policy, amounts less than a predefined threshold of such assets shall be expensed when purchased. 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.

Leasehold Improvements Paid by the Reporting Entity as Lessee

4. Leasehold improvements shall be defined as lessee expenditures that are permanently attached to an asset that a reporting entity is leasing under an operating lease.

5. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets established in SSAP No. 4. Within that definition, such items also meet the criteria defining nonadmitted assets. Accordingly, such assets shall be reported as nonadmitted assets and charged against surplus. These nonadmitted assets shall be amortized against net income over the shorter of their estimated useful life or the remaining lease term as defined in SSAP No. 22R. Leasehold improvements that do not meet the definition of assets shall be charged to expense when acquired. The amortization of leasehold improvements (including property improvements and integral equipment) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity lessee. Such improvements related to the functionality of health care delivery assets shall follow the accounting, reporting and impairment guidance in *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities*, and an exception to the application of this guidance to leasehold improvements necessary for the functionality of health care delivery assets is included in SSAP No. 73. If leased real estate is acquired, recognition of the real estate shall follow the provisions in *SSAP No. 40R—Real Estate Investments*.

6. In accordance with the reporting entity's written capitalization policy, amounts less than a predefined threshold of such assets shall be expensed when purchased. 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.

Maintenance Costs Paid by Lessee

7. Maintenance costs incurred by the lessee for maintenance on the leased item that do not increase the value and enhance the usefulness of the leased asset shall be expensed when incurred. Reimbursable deposits shall be reflected as nonadmitted assets. Deposits paid to the lessor, reimbursable when the lessee incurs costs for lease maintenance activities, shall be recorded as nonadmitted assets. When the amount on deposit is less than probable of being returned, the deposit shall be recognized as an additional lease expense.

Depreciation and Amortization

8. Depreciable assets include all tangible capital assets classified as either admitted or nonadmitted in accordance with SSAP No. 4. Land shall not be considered a depreciable asset.

9. The acquisition cost of depreciable assets, net of salvage, shall be depreciated against net income over the estimated useful lives of the assets in a systematic and rational manner. The acquisition cost of a leasehold improvement shall be amortized against net income over the shorter of its estimated useful life or the lease term as defined in SSAP No. 22R. For leasehold improvements capitalized subsequent to inception of the lease, the cost shall be amortized over the shorter of its estimated useful life or the remaining lease term. Amounts capitalized for leasehold improvements in periods subsequent to the

original lease term (i.e., during renewal periods), are amortized utilizing the shorter of the estimated useful life of the asset or the remaining lease term.

10. A variety of systematic depreciation and amortization methods is available such as the straight-line method, sum-of-the-years' digits method, and various declining balance methods. The depreciation or amortization method selected shall be that which most appropriately allocates the cost of the depreciable asset or leasehold improvement over its estimated useful life. The use of the sinking fund or constant yield methods of depreciation does not constitute acceptable statutory accounting practice.

11. Useful lives of depreciable assets and leasehold improvements can be obtained from contractors, appraisers, engineers, and manufacturers, or they may be based on prior experience. Estimates published by the Internal Revenue Service can be helpful in the selection of useful lives for specific assets.

12. Changes in the estimated useful lives of depreciable assets or leasehold improvements from one period to another shall be considered a change in accounting estimate and shall be accounted for in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

13. Changes in depreciation or amortization methods from one period to another shall be considered a change in accounting principle and shall be accounted for in accordance with *SSAP No. 3*.

14. Depreciation and amortization expense shall be recorded in the statement of income in accordance with *SSAP No. 70—Allocation of Expenses*.

Disclosures

15. The following disclosures shall be made in the financial statements:

- a. Depreciation and amortization expense for the period;
- b. A general description of the method or methods used in computing depreciation and amortization with respect to major classes of depreciable assets and leasehold improvements.

16. The financial statements shall disclose if the written capitalization policy and the resultant predefined thresholds changed from the prior period and the reason(s) for such change.

17. Refer to the Preamble for further discussion regarding disclosure requirements. The disclosures in paragraph 15 shall be included in the annual audited statutory financial reports only.

Relevant Literature

18. This statement adopts paragraphs 4 and 5 of *Accounting Principles Board Opinion No. 12, Omnibus Opinion—1967*. This statement also adopts *AICPA Practice Bulletin No. 1, Purpose and Scope of AcSEC Practice Bulletins and Procedures for Their Issuance, Exhibit A*.

19. This statement rejects *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins*, "Chapters 9A and 9C;" however, it is considered appropriate to use the concepts of depreciating assets discussed in the GAAP guidance, which requires that the acquisition cost less salvage value be recorded as an expense over the estimated useful life of the asset, as the basis for the statutory guidance in this statement. *FASB Emerging Issues Task Force No. 08-3: Accounting by Lessees for Maintenance Deposits* is adopted with modification to require reimbursable deposits to be reflected as nonadmitted assets.

Effective Date and Transition

20. 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. Guidance reflected in paragraphs 3, 6 and 16, incorporated from SSAP No. 87, was originally effective for years beginning on and after January 1, 2004. Guidance in paragraph 7 related to maintenance costs paid by lessee was previously included within *INT 09-05: FASB Emerging Issues Task Force No. 08-3: Accounting by Lessees for Maintenance Deposits* and was effective for periods beginning September 21, 2009.

21. The use of the sinking fund or constant yield method does not constitute acceptable statutory accounting practice and these methods shall not be applied to new properties acquired since December 3, 1990 (the date the Emerging Accounting Issues (E) Working Group reached its conclusion regarding this method) nor if the reporting entity changes its existing properties' method of depreciation. This conclusion would not impact those properties currently being depreciated using the constant yield method.

REFERENCES**Relevant Issue Papers**

- *Issue Paper No. 19—Furniture, Fixtures, and Equipment*
- *Issue Paper No. 31—Leasehold Improvements Paid by the Reporting Entity as Lessee*
- *Issue Paper No. 67—Depreciation of Property and Amortization of Leasehold Improvements*
- *Issue Paper No. 119—Capitalization Policy, An Amendment to SSAP Nos. 4, 19, 29, 73, 79 and 82*

Statement of Statutory Accounting Principles No. 20

Nonadmitted Assets

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Nullifies and incorporates INT 09-03
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Relevant Literature.....	3
Effective Date and Transition	3
REFERENCES.....	3
Relevant Issue Papers	3

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for nonadmitted assets which are not specifically addressed in other statements.

SUMMARY CONCLUSION

2. The definition and accounting treatment for nonadmitted assets is outlined in *SSAP No. 4—Assets and Nonadmitted Assets* as follows:

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.

3. This statement shall not be considered an all-inclusive list of nonadmitted assets. Certain admitted assets and nonadmitted assets are addressed in other SSAPs.

4. Consistent with paragraph 2, the following assets shall be nonadmitted:

- a. Deposits in Suspended Depositories—Amounts on deposit with suspended depositories may not be fully recoverable. Any amounts not reasonably expected to be recovered shall be written off in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*. Amounts in excess of that written off shall be nonadmitted as they are not available to satisfy obligations to policyholders;
- b. Bills Receivable Not for Premium and Loans Unsecured or Secured by Assets That Do Not Qualify As [Admitted](#) Investments—In accordance with *SSAP No. 5R*, amounts determined to be uncollectible or otherwise impaired shall be written off. Amounts in excess of that written off are not considered to be properly collateralized as there are no underlying assets which would otherwise be admitted [invested](#) assets. Such amounts shall be nonadmitted as they may be of questionable economic value if needed to fulfill policyholder obligations. Receivables arising from working capital finance programs designated by the Securities Valuation Office are subject to the guidance in *SSAP No. 105R—Working Capital Finance Investments*;
- c. Loans on Personal Security, Cash Advances To, Or In The Hands Of, Officers Or Agents And Travel Advances—In accordance with *SSAP No. 5R*, amounts determined to be uncollectible or otherwise impaired shall be written off. Amounts in excess of that written off typically are unsecured and as such have no underlying assets which would otherwise be admitted assets. Such amounts shall be nonadmitted as they may be of questionable economic value if needed to fulfill policyholder obligations. Some of these items may also be considered prepaid expenses which, per *SSAP No. 29—Prepaid Expenses*, are nonadmitted;
- d. All “Non-Bankable” Checks—Examples of “non-bankable” checks are NSF (non-sufficient funds) checks, post-dated checks, or checks for which payment has been stopped. Although these checks may still maintain probable future benefits (and thus meet the definition of assets), at the date on which they are non-bankable they are not available for policyholder obligations and shall be nonadmitted until the uncertainty related to the probable future benefit is resolved and the checks are converted to available funds;
- e. Trade Names And Other Intangible Assets¹—These assets, by their nature, are not readily marketable and available to satisfy policyholder obligations and shall be nonadmitted;
- f. Automobiles, Airplanes and Other Vehicles—Automobiles, airplanes and other vehicles meet the definition of assets established in *SSAP No. 4*. However, they are not readily

¹ Defensible intangible assets are defined as an intangible asset acquired in a business combination or an asset acquisition that an entity does not intend to actively use but does intend to prevent others from using. These may also be referred to as a “locked-up asset” because while the asset is not being actively used, it is likely contributing to an increase in the value of other assets owned by the entity. These assets are not readily available to satisfy policyholder obligations and shall be nonadmitted.

available to satisfy policyholder obligations and as a result the undepreciated portion shall be nonadmitted. The accounting for these assets shall be consistent with the accounting for equipment provided in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* or for commercial airplane leveraged leases, refer to the guidance in *SSAP No. 22R—Leases*;

- g. Company's Stock as Collateral for Loan—When a reporting entity lends money and accepts its own stock as collateral for the loan, it shall report the amount of the loan receivable and any related accrued interest on the loan as a nonadmitted asset. The asset is nonadmitted as the collateral could not be used to satisfy the obligation in the event of default.

Relevant Literature

5. This statement adopts with modification *FASB Emerging Issues Task Force No. 08-7: Accounting for Defensive Intangible Assets* to nonadmit defensible intangible assets. This statement rejects Chapters 3A and 11 of *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins*.

Effective Date and Transition

6. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The guidance reflected in footnote 1, incorporated from *INT 09-03: EITF 08-7: Accounting for Defensive Intangible Assets*, was effective June 13, 2009. With the adoption of SSAP No. 105R, revisions were incorporated into paragraph 4.b. These revisions from SSAP No. 105R are retained for historical purposes within *Issue Paper No. 147—Working Capital Finance Investments*.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 90—Nonadmitted Assets*
- *Issue Paper No. 147—Working Capital Finance Investments*

Statement of Statutory Accounting Principles No. 21 – Revised

Other Admitted Assets

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft; Substantively revised November 15, 2018
Effective Date	January 1, 2001; December 31, 2018
Affects.....	No other pronouncements
Affected by.....	No other pronouncements
Interpreted by.....	No other pronouncements
Relevant Appendix A Guidance	A-001

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Collateral Loans	2
Structured Settlements – Reporting Entity Owner and Payee of Annuity	2
Structured Settlements – Reporting Entity Acquires Legal Right to Receive Payments.....	3
The Amount That Could Be Realized on Life Insurance Where the Reporting Entity is Owner and Beneficiary or Has Otherwise Obtained Rights to Control the Policy	4
Receivables for Securities.....	4
Other Amounts Receivable Under Reinsurance Contracts	5
Guaranteed Investment Contracts	5
State Guaranty Association Loan Agreements	5
Relevant Literature.....	6
Effective Date and Transition	6
REFERENCES.....	6
Relevant Issue Papers	6

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for admitted assets which are not specifically addressed in other statements.

SUMMARY CONCLUSION

2. The definition and accounting treatment for admitted assets is outlined in paragraphs 2 and 3 of *SSAP No. 4—Assets and Nonadmitted Assets*.

3. Consistent with paragraph 2, the following assets shall be considered admitted and shall be reported in accordance with *SSAP No. 4*. These admitted assets are not addressed in other statements.

Collateral Loans

4. Collateral loans are unconditional obligations¹ for the payment of money secured by the pledge of an [qualifying](#) 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:

- a. **Loan Impairment**—Determination as to the impairment of a collateral loan shall be based on current information and events. When it is considered probable that any portion of amounts due under the contractual terms of the loan will not be collected the loan is considered impaired. The impairment shall be measured based on the fair value of the collateral less estimated costs to obtain and sell the collateral. The difference between the net value of the collateral and the recorded asset shall be written off in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*;
- 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. [To support the admissibility of collateral loans, reporting entities shall maintain documentation sufficient to support the reasonableness of the fair value measurement of the underlying collateral, which shall be made available to the applicable domiciliary regulator and independent audit firm upon request.](#)

Structured Settlements – Reporting Entity Owner and Payee of Annuity

5. The reporting of the present value of structured settlement annuities where the reporting entity is the owner and payee as described in SSAP No. 65, paragraph 17.a. shall account for the annuity an admitted asset at its net present realizable value. The annuity described is reported as an other-than-invested asset. Income from the annuities shall be recorded as miscellaneous income. The present value of the annuity and the related amortization schedule shall be obtained from the issuing life insurance company at the time the annuity is purchased. When the reporting entity is the owner and payee, no reduction shall be made to loss reserves.

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 (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 that are also secured with collateral shall continue to be captured within scope of SSAP No. 26R.

² [A qualifying investment](#) defined as those assets listed in Section 3 of *Appendix A-001—Investments of Reporting Entities*, [which would, if held by the insurer, qualify for admittance. For example, if the collateral would not qualify for admittance under SSAP No. 4 due to encumbrances or other third-party interests, then it does not meet the definition of "qualifying" and the collateral loan, or any portion thereof which is not adequately collateralized, is not permitted to be admitted. In the cases where the collateral is an equity/unit investment in a joint venture, partnership, limited liability company, and/or SCA is pledged as collateral in a collateral loan, audited financial statements on a consistent annual basis are always required in accordance with SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies and/or SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities.](#)

Structured Settlements – Reporting Entity Acquires Legal Right to Receive Payments

6. A reporting entity that acquires (directly or indirectly) structured settlement payment rights³ through a factoring company, excluding securitizations captured in 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.)

7. Structured settlement income streams shall be initially reported at cost, including brokerage and other related fees. The cost generally reflects the net present value of the future payment streams with an embedded fixed-rate yield. Structured settlement income streams shall always be acquired at a discount, meaning the amount to be received shall be greater than the acquisition cost. As the structured settlement payments are earned, reporting entities shall reduce the book adjusted carrying value (BACV) to reflect the accrual of the income stream (proportionate payment of original cost on Schedule BA, Part 3) as well as corresponding investment income for the fixed rate spread. (For example, if a reporting entity acquires a structured settlement that equates to three payments, as each payment is received, the BACV would be decreased proportionately, with the pay-down recognized as a disposal.)

- a. Impairment – Determination as to the impairment of a structured settlement income stream shall be based on current information and events. When a reporting entity does not expect to receive a structured settlement payment, the structured settlement shall be considered impaired. Once a structured settlement income stream is impaired, the entire amount of the reported structured settlement investment (including subsequent rights to cash flows related to the impaired structured settlement) shall be written off in accordance with SSAP No. 5R—*Liabilities, Contingencies and Impairments of Assets*. If the structured settlement payment is not expected to be received due to the credit quality of the issuer (e.g., the insurer/obligor making structured settlement payments), all structured settlement income streams expected from that obligor shall also be deemed impaired and written off in accordance with SSAP No. 5R. (For example, if a reporting entity acquired the rights to receive three structured settlement payments in a single brokerage transaction, when the first payment is not expected to be received, then all three structured settlement payments related to this acquisition shall be written off. If the reason for the impairment is due to the obligor, and the reporting entity had acquired other structured settlement income streams that are due from that obligor, all structured settlement income streams due from that obligor shall also be written off as impaired.)

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.).

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).

- b. Investment Income – The discount on acquired structured settlements shall be recognized as an adjustment of yield over the period of time until the cash payments under the structured settlements are received to produce a constant effective yield each year.

The Amount That Could Be Realized on Life Insurance Where the Reporting Entity is Owner and Beneficiary or Has Otherwise Obtained Rights to Control the Policy

8. The provisions in this paragraph are for life insurance policies, which are in compliance with Internal Revenue Code (IRC) §7702⁵, in which the reporting entity is the owner and beneficiary⁶. For these owned products, the amount that could be realized on life insurance policies where the reporting entity is the owner and beneficiary, or has otherwise obtained the rights to control the policy, is similar to a cash deposit that is realizable on demand. As such, the amount that could be realized on a life insurance policy as of the date to which premiums have been paid shall be reported as an admitted asset. In determining the amount that could be realized, reporting entities shall consider the cash surrender value as well as other contractual terms which limit or provide for additional realizable amounts. If any of these contractual terms which limit or provide for additional realizable amounts allow the owner to pay variable premium (reducing or increasing the premium based on the increase or decrease of a variable investment vehicle of the policy), the life insurance policies must always remain compliant with IRC §7702 to be an admitted asset under this paragraph. Amounts recoverable by the reporting entity at the discretion of the issuing company shall not be included. Amounts realizable beyond one year from the surrender date shall be discounted. For group policies or a group of individual life policies, reporting entities shall assume surrender on a policy by policy or certificate by certificate basis, unless contractual terms only allow for surrender of all policies or certificates as a group, in which case the amount that could be realized shall be determined on a group basis. Disclosure is required of the amount of the cash surrender value that is within an investment vehicle by investment category (e.g., bonds, common stock, joint ventures, derivatives, etc.).

Receivables for Securities

9. Sales of securities are recorded as of the trade date. A receivable due from the broker is established in instances when a security has been sold, but the proceeds from the sale have not yet been received. Unless the receivable for securities meets the criteria set forth in paragraph 11, the receivable for securities is an admitted asset to the extent it conforms to the requirements of this statement. For receivables arising from the sale of a security which was acquired on a “To Be Announced” (“TBA”) basis, or from the sale of securities that are received as stock distributions that may be restricted (unregistered) or in physical form, and which has yet to be actually received, admissibility shall be in accordance with paragraph 12.

10. An evaluation shall be made in accordance with SSAP No. 5R, to determine if there is impairment. If, in accordance with SSAP No. 5R, it is probable the balance or any portion thereof is uncollectible, any such deemed uncollectible receivable shall be written off and charged against income

⁵ In order to be in compliance with IRC §7702:

1. The contract must be considered “life insurance” under applicable state insurance law. This is a contractual definition that includes:
 - The contract must be filed and approved as life insurance.
 - It must be regulated as life insurance under applicable laws and regulations (such as variable life insurance regulation and non-forfeiture laws).
 - There must be an insurable interest in the continued life of the insured (federal and state law also require the consent of the insured to the coverage).
 - There must be a significant transfer of mortality risk between the policyholder and the insurance company.
2. The contract must meet one of two actuarial tests of the policy’s cash value relation to its death benefit to assure that, prior to death/maturity, the policy cash value does not exceed the net single premium required to fund the death benefit.

⁶ These life insurance products shall be acquired with the primary consideration of the costs related to employee benefit obligations or the loss of a key person.

in the period the determination is made. If it is reasonably possible, but not probable, the balance or any portion thereof is uncollectible and is therefore not written off, the disclosure requirements outlined in SSAP No. 5R shall be followed.

11. Receivables for securities not received within 15 days from the settlement date shall be nonadmitted and shall be classified as “other-than-invested assets.”

12. Receivables arising from the secondary sale of securities acquired on a TBA basis, or from stock distributions that may be restricted (unregistered) or in physical form, which have not yet been received by the seller in the secondary sale transaction, may be admitted until the security is exchanged for payment. TBA securities are originally purchased well in advance of the actual date of security issuance (frequently 90 days or more). Accordingly, secondary sales of securities so acquired may occur before the date of issuance. Sales of securities so acquired always include a provision that requires simultaneous delivery of the security and receipt of consideration. Upon the secondary sale, and prior to the actual receipt, of a security acquired on a TBA basis, the seller in the secondary sale transaction records a liability for the book value of the security thus sold and a receivable for the consideration reflected in the secondary sale transaction. Profits or losses emanating from the secondary sale transaction are recorded in the same manner as profits and losses emanating from any other sale transaction involving an investment.

Other Amounts Receivable Under Reinsurance Contracts

13. Amounts receivable from Servicemen’s Group Life Insurance (SGLI) or Federal Employees’ Group Life Insurance (FEGLI) pools and Federal Crop Insurance programs shall be reported as admitted assets.

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.

15. Purchases for which all contractual rights and ownership of the GIC result in an investment similar to a corporate bond shall be accounted for in accordance with the guidance in *SSAP No. 26R—Bonds*.

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.

State Guaranty Association Loan Agreements

18. State guaranty associations have the statutory authority to reinsure any or all of the policies of an impaired or insolvent insurer and borrow funds. When this is done in the case of reinsurance, the assuming carrier receives assets supporting the liabilities from the insolvent company’s estate and/or the responsible state guaranty association. If available, the state guaranty association transfers cash at the closing of the transaction. Loan agreements may be utilized in the event a guaranty association does not have the funds on hand or is unable to raise the funds by the closing date. In the case of adverse cash flow situations, guaranty associations may enter into loan agreements with insurers to provide funds that will

allow the association to perform its duties as required by statute. These loan agreements are essentially credit risk free because the notes are backed by all member insurers of an association.

19. Loan agreements issued by state guaranty associations taken by an insurance company in connection with funding an assumption reinsurance agreement or as interim financing meet the definition of assets as defined in SSAP No. 4, are admitted assets to the extent they conform to the requirements of this statement, and shall be reported as a note receivable—other-than-invested assets.

Relevant Literature

20. This statement is consistent with *FASB Statement No. 114, Accounting by Creditors for the Impairment of a Loan* which was adopted with modification in SSAP No. 37—*Mortgage Loans*. This statement is consistent with *Accounting Principles Board Opinion No. 21, Interest on Receivables and Payables* which was adopted in SSAP No. 15—*Debt and Holding Company Obligations*.

21. This statement adopts *FASB Emerging Issues Task Force No. 88-5, Recognition of Insurance Death Benefits* and *FASB Technical Bulletin 85-4, Accounting for Purchases of Life Insurance* with the modification that the entity must be the owner and the beneficiary. This statement also adopts with modification *FASB Emerging Issues Task Force No. 06-05, Accounting for Purchases of Life Insurance – Determining the Amount That Could be Realized in Accordance with FASB Technical Bulletin No. 85-4*. Guidance has been included within this SSAP to clarify how to determine the amount that could be realized on life insurance in situations where the reporting entity is the owner and beneficiary or has otherwise obtained rights to control the policy.

Effective Date and Transition

22. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—*Accounting Changes and Corrections of Errors*. The guidance for structured settlements when the reporting entity acquires the legal right to receive payments is effective December 31, 2018. [The clarification regarding audits of qualifying collateral pledged for collateral loans in the footnote 2 to paragraph 4 requires applicable audits to be obtained for the 2023 reporting period in the subsequent year. In periods after year-end 2023, the audits of equity collateral pledged for collateral loans are required to be obtained for the reporting year in which it was pledged and annually thereafter. The annual audit lag shall be consistent from period to period.](#)

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 87—Other Admitted Assets*
- *Issue Paper 160—Structured Settlements Acquired as Investments*

Statement of Statutory Accounting Principles No. 22 – Revised

Leases

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft; Substantively revised August 3, 2019
Effective Date	January 1, 2001; Substantive revisions detailed in Issue Paper 161 effective January 1, 2020.
Affects.....	Nullifies and incorporates INT 00-02, INT 00-27, INT 04-20 and INT 09-05; Nullifies INT 02-15 and INT 04-18
Affected by.....	No other pronouncements
Interpreted by	INT 20-01
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	2
Determining Whether an Arrangement Contains a Lease.....	2
Identifying an Asset	2
Right to Control the Use of the Identified Asset.....	3
Separating Components of a Contract	5
Modification.....	6
Accounting and Reporting by Lessees.....	6
Accounting and Reporting by Lessors.....	8
Sale-Leaseback Transactions	8
Deposit Method and Financing Method.....	9
Leveraged Leases for Lessors.....	10
Disclosures.....	11
Relevant Literature.....	13
Effective Date and Transition.....	14
REFERENCES.....	14
Relevant Issue Papers	14

SCOPE OF STATEMENT

1. The purpose of this statement is to establish statutory accounting principles for leases. It addresses:

- a. Accounting and reporting by lessees;
- b. Accounting and reporting by lessors;
- c. Sale-leaseback transactions;

- d. Leveraged leases for lessors;
- e. Related party leases; and
- f. Disclosures.

SUMMARY CONCLUSION

2. A lease is defined as a contract or part of a contract conveying the right to control the use of property, plant or equipment (land and/or depreciable assets) for a stated period of time in exchange for consideration. This definition does not include contracts for services that do not transfer the right to use property, plant or equipment from one contracting party to the other (i.e., employee lease contracts) or service concession arrangements¹. Agreements that do transfer the right to control the use of property, plant or equipment meet the definition of a lease even though substantial services by the contractor (lessor) may be called for in connection with the operation or maintenance of the assets.

3. Property, plant or equipment, (including computer software) as used in this SSAP, includes only land and/or depreciable assets. Therefore, inventory (including equipment parts inventory), other intangible assets, assets under construction, leases to explore for or use minerals, natural gas and similar nonregenerative resources, and leases of biological assets, such as timber cannot be the subject of a lease for accounting purposes. Additionally, non-depreciable assets, including investments and premium receivables do not meet the definition of property, plant or equipment and cannot be the subject of a lease for accounting purposes.

Determining Whether an Arrangement Contains a Lease

4. Determining whether an arrangement contains a lease that is within the scope of this SSAP should be based on the substance of the arrangement. At inception of a contract, an entity shall determine whether that contract is or contains a lease. A contract is or contains a lease if the contract conveys the right to control the use of identified property, plant or equipment (an identified asset) for a period of time in exchange for consideration. A period of time may be described in terms of the amount of use of an identified asset (for example, the number of production units that an item of equipment will be used to produce).

Identifying an Asset

5. An asset can be identified by being explicitly or implicitly specified within the contract. Although specific property, plant or equipment may be explicitly identified in an arrangement, it is not the subject of a lease if fulfillment of the arrangement is not dependent on the use of the specified property, plant or equipment. A warranty obligation that permits or requires the substitution of the same or similar property, plant or equipment when the specified property, plant or equipment is not operating properly does not preclude lease treatment. In addition, a contractual provision (contingent or otherwise) permitting or requiring the owner/seller to substitute other property, plant or equipment for any reason on or after a specified date does not preclude lease treatment prior to the date of substitution. Property, plant or equipment has been implicitly specified if, for example, the seller owns or leases only one asset with

¹ A service concession arrangement is an arrangement between a public sector entity grantor and an operating entity under which the operating entity operates the grantor's infrastructure (for example, airports, roads, bridges, tunnels, prisons and hospitals) for a specified period of time. A public-sector entity includes a governmental body or an entity to which the responsibility to provide public service has been delegated. In a service concession arrangement, both of the following conditions exist:

- a. The grantor controls or has the ability to modify or approve the services that the operating entity must provide with the infrastructure, to whom it must provide them and at what price.
- b. The grantor controls, through ownership, beneficial entitlement, or otherwise, any residual interest in the infrastructure at the end of the term of the arrangement.

which to fulfill the obligation and it is not economically feasible or practicable for the owner/seller to perform its obligation through the use of alternative property, plant or equipment. Property, plant or equipment can also be implicitly specified at the time the asset is made available for use by the lessee.

6. Even if an asset is specified, the asset does not qualify as an identified asset if the lessor has the substantive right to substitute the asset throughout the period of use. A lessor's right to substitute an asset is substantive only if (1) the lessor has the practical ability to substitute alternative assets throughout the period of use (for example, the lessee cannot prevent the lessor from substituting an asset, and alternative assets are readily available to the lessor or could be sourced by the lessor within a reasonable period of time), and (2) the lessor would benefit economically from the exercise of its right to substitute the asset (that is, the economic benefits associated with substituting the asset is expected to exceed the costs associated with substituting the asset).

7. An entity's evaluation of whether a lessor's substitution right is substantive is based on facts and circumstances at inception of the contract and shall exclude consideration of future events that, at inception, are not considered likely to occur. Examples of future events that, at inception of the contract, would not be considered likely to occur and, thus, should be excluded from the evaluation include, but are not limited to, the following:

- a. An agreement by a future lessee to pay an above-market rate for use of the asset;
- b. The introduction of new technology that is not substantially developed at inception of the contract;
- c. A substantial difference between the lessee's use of the asset, or the performance of the asset and the use or performance considered likely at inception of the contract;
- d. A substantial difference between the market price of the asset during the period of use and the market price considered likely at inception of the contract.

8. If the asset is located at the lessee's premises or elsewhere, the costs associated with substitution are generally higher than when located at the lessor's premises and, therefore, are more likely to exceed the benefits associated with substituting the asset. If the lessor has a right or an obligation to substitute the asset only on or after either a particular date or the occurrence of a specified event, the lessor does not have the practical ability to substitute alternative assets throughout the period of use. The lessor's right or obligation to substitute an asset for repairs or maintenance, if the asset is not operating properly, or if a technical upgrade becomes available, does not preclude the lessee from having the right to use an identified asset. If the lessee cannot readily determine whether the lessor has a substantive substitution right, the lessee shall presume that any substitution right is not substantive.

9. A capacity portion of an asset is an identified asset if it is physically distinct (for example, a floor of a building or a segment of a pipeline that connects a single lessee to the larger pipeline). A capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fiber optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the lessee with the right to obtain substantially all of the economic benefits from use of the asset.

Right to Control the Use of the Identified Asset

10. To determine whether a contract conveys the right to control the use of an identified asset for a period of time, an entity shall assess whether, throughout the period of use, the lessee has both:

- a. The right to obtain substantially all of the economic benefits from use of the identified asset.

- i. To control the use of an identified asset, a lessee is required to have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period). A lessee can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, holding, or subleasing the asset. The economic benefits from use of an asset include its primary output and byproducts (including potential cash flows derived from these items) and other economic benefits from using the asset that could be realized from a commercial transaction with a third party.
 - ii. When assessing the right to obtain substantially all of the economic benefits from use of an asset, an entity shall consider the economic benefits that result from use of the asset within the defined scope of a lessee's right to use the asset in the contract.
 - iii. If a contract requires a lessee to pay the lessor or another party a portion of the cash flows derived from use of an asset as consideration, those cash flows paid as consideration shall be considered to be part of the economic benefits that the lessee obtains from use of the asset. For example, if a lessee is required to pay the lessor a percentage of sales from use of retail space as consideration for that use, that requirement does not prevent the lessee from having the right to obtain substantially all of the economic benefits from use of the retail space. That is because the cash flows arising from those sales are considered to be economic benefits that the lessee obtains from use of the retail space, a portion of which it then pays to the lessor as consideration for the right to use that space.
- b. The right to direct the use of the identified asset.
- i. A lessee has the right to direct the use of an identified asset throughout the period of use in either of the following situations. Additionally, if the lessee in the contract is a joint operation or a joint arrangement, an entity shall consider whether the joint operation or joint arrangement has the right to control the use of an identified asset throughout the period of use.
 - (a) The lessee has the right to direct how and for what purpose the asset is used throughout the period of use. If the lessee has the right to control the use of an identified asset for only a portion of the term of the contract, the contract contains a lease for that portion of the term.
 - (b) The relevant decisions about how and for what purpose the asset is used are predetermined and at least one of the following conditions exists:
 - (1) The lessee has the right to operate the asset (or to direct others to operate the asset in a manner that it determines) throughout the period of use without the lessor having the right to change those operating instructions.
 - (2) The lessee designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use.
 - ii. The relevant decisions about how and for what purpose an asset is used can be predetermined in a number of ways. For example, the relevant decisions can be

predetermined by the design of the asset or by contractual restrictions on the use of the asset.

- iii. In assessing whether a lessee has the right to direct the use of an asset, an entity shall consider only rights to make decisions about the use of the asset during the period of use unless the lessee designed the asset (or specific aspects of the asset) in accordance with paragraph 10.b.i.(b). Consequently, unless that condition exists, an entity shall not consider decisions that are predetermined before the period of use. For example, if a lessee is able only to specify the output of an asset before the period of use, the lessee does not have the right to direct the use of that asset. The ability to specify the output in a contract before the period of use, without any other decision-making rights relating to the use of the asset, gives a lessee the same rights as any lessee that purchases goods or services.
- iv. A contract may include terms and conditions designed to protect the lessor's interest in the asset or other assets, to protect its personnel, or to ensure the lessor's compliance with laws or regulations. These are examples of protective rights. For example, a contract may specify the maximum amount of use of an asset or limit where or when the lessee can use the asset, may require a lessee to follow particular operating practices, or may require a lessee to inform the lessor of changes in how an asset will be used. Protective rights typically define the scope of the lessee's right of use but do not, in isolation, prevent the lessee from having the right to direct the use of an asset.
- v. A lessee has the right to direct how and for what purpose an asset is used throughout the period of use if, within the scope of its right of use defined in the contract, it can change how and for what purpose the asset is used throughout that period. In making this assessment, an entity considers the decision-making rights that are most relevant to changing how and for what purpose an asset is used throughout the period of use. Decision-making rights are relevant when they affect the economic benefits to be derived from use. The decision-making rights that are most relevant are likely to be different for different contracts, depending on the nature of the asset and the terms and conditions of the contract.

11. An entity shall reassess whether a contract is or contains a lease only if the terms and conditions of the contract are changed.

Separating Components of a Contract

12. An entity shall identify the separate lease components within the contract. An entity shall consider the right to use an underlying asset to be a separate lease component (that is, separate from any other lease components of the contract) if both of the following criteria are met:

- a. The lessee can benefit from the right of use either on its own or together with other resources that are readily available to the lessee. Readily available resources are goods or services that are sold or leased separately (by the lessor or other lessors) or resources that the lessee already has obtained (from the lessor or from other transactions or events).
- b. The right of use is neither highly dependent on nor highly interrelated with the other right(s) to use underlying assets in the contract. A lessee's right to use an underlying asset is highly dependent on or highly interrelated with another right to use an underlying asset if each right of use significantly affects the other.

13. The consideration in the contract shall be allocated to each separate lease component and nonlease component of the contract. Components of a contract include only those items or activities that transfer a good or service to the lessee.

14. An entity shall account for each separate lease component separately from the nonlease components of the contract. Nonlease components are not within the scope of this statement and shall be accounted for in accordance with the statutory accounting guidance applicable to the nonlease component.

15. An entity shall combine two or more contracts, at least one of which is or contains a lease, entered into at or near the same time with the same counterparty (or related parties) and consider the contracts as a single transaction if any of the following criteria are met:

- a. The contracts are negotiated as a package with the same commercial objective(s).
- b. The amount of consideration to be paid in one contract depends on the price or performance of the other contract.
- c. The rights to use underlying assets conveyed in the contracts are a single lease component.

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

Modification

17. An entity shall account for a modification to a contract as a separate contract (that is, separate from the original contract) when both of the following conditions are present:

- a. The modification grants the lessee an additional right of use not included in the original lease (for example, the right to use an additional asset).
- b. The lease payments increase commensurate with the standalone price for the additional right of use, adjusted for the circumstances of the particular contract. For example, the standalone price for the lease of one floor of an office building in which the lessee already leases other floors in that building may be different from the standalone price of a similar floor in a different office building, because it was not necessary for a lessor to incur costs that it would have incurred for a new lessee.

18. An entity shall account for initial direct costs, lease incentives and any other payments made to or by the entity in connection with a modification to a lease in the same manner as those items would be accounted for in connection with a new lease.

Accounting and Reporting by Lessees

19. All leases shall be considered operating leases, which means that rental expense is recognized over the lease term, without recognition of a right-to-use asset or lease liability. Rent on operating leases, reflecting all lease considerations in paragraph 20, shall be charged to expense on a straight-line basis over the lease term. Statutory accounting rejects the recognition of a right-to-use lease asset and the associated lease liabilities.

20. The consideration in the contract for a lessee includes all of the following payments that will be made during the lease term:

- a. Any fixed payments (for example, monthly service charges) or in substance fixed payments, less any incentives paid or payable to the lessee.
- b. Any other variable payments that depend on an index or a rate, initially measured using the index or rate at the commencement date.

21. A lessee should recognize contingent rental expense (in annual periods as well as in interim periods) prior to the achievement of the specified target that triggers the contingent rental expense, provided that achievement of that target is considered probable. Previously recorded rental expense should be reversed into income at such time that it is probable that the specified target will not be met.

22. For the early termination or non-use of leased property, plant or equipment benefits, the lessee shall recognize liabilities, initially measured at fair value. Liabilities for costs to terminate a contract before the end of its term shall be recognized when the entity terminates the contract in accordance with the contract terms (i.e., gives written notice of termination or negotiated termination with the lessor).

23. Liabilities for costs that will continue to be incurred under a contract for its remaining term without economic benefit shall be recognized as the cease-date (the date the entity ceases using the right conveyed by the contract – i.e., the right to use a leased property). The fair value of the liability at the cease-use date shall be determined based on the remaining lease rentals, adjusted for the effects of any prepaid or deferred items recognized under the lease, and reduced by estimated sublease rentals that could be reasonably obtained for the property, even if the entity does not intend to enter into a sublease. Remaining lease rentals shall not be reduced to an amount less than zero.

24. An entity shall determine the lease term as the noncancellable period of the lease, together with all of the following:

- a. Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option.
- b. Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.
- c. Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is controlled by the lessor.

25. A lessee shall reassess the lease term or a lessee option to purchase the underlying asset only if and at the point in time that any of the following occurs:

- a. There is a significant event or a significant change in circumstances that is within the control of the lessee that directly affects whether the lessee is reasonably certain to exercise or not to exercise an option to extend or terminate the lease or to purchase the underlying asset.
- b. There is an event that is written into the contract that obliges the lessee to exercise (or not to exercise) an option to extend or terminate the lease.
- c. The lessee elects to exercise an option even though the entity had previously determined that the lessee was not reasonably certain to do so.
- d. The lessee elects not to exercise an option even though the entity had previously determined that the lessee was reasonably certain to do so.

26. At the commencement date, an entity shall include the periods described in paragraph 24 in the lease term having considered all relevant factors that create an economic incentive for the lessee (that is, contract-based, asset-based, entity-based and market-based factors). Those factors shall be considered together, and the existence of any one factor does not necessarily signify that a lessee is reasonably certain to exercise or not to exercise an option.

27. Maintenance costs incurred by the lessee for maintenance on the leased item that do not increase the value and enhance the usefulness of the leased asset shall be expensed when incurred pursuant to *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements*. Reimbursable deposits shall be reflected as nonadmitted assets. Deposits paid to the lessor, reimbursable when the lessee incurs costs for lease maintenance activities, shall be recorded as nonadmitted assets. When the amount on deposit is less than probable of being returned, the deposit shall be recognized as an additional lease expense.

Accounting and Reporting by Lessors

28. The definition of property, plant and equipment for lessors is defined in paragraph 3 and is the same as for lessees. All leases, except leveraged leases as defined in paragraph 42, shall be considered operating leases and accounted for by the lessor as follows:

- a. The leased property, plant or equipment shall be included in the same balance sheet category it would be had the property, plant or equipment not been leased. The property, plant or equipment shall be depreciated following the lessor's normal depreciation policies for such assets;
- b. Rental income shall be reported as investment income as it becomes receivable according to the provisions of the lease. Rentals may be recognized before they become due, if rentals vary from the straight-line basis. The guidance in *SSAP No. 34—Investment Income Due and Accrued* shall be applied to the receivable balance; and
- c. Initial direct costs shall be charged to expense when incurred and shall not be deferred and allocated over the lease term. Initial direct costs are those incremental costs that the lessor has incurred in directly evaluating, negotiating, administering and closing a lease transaction.

29. If the terms of a variable payment amount other than those in paragraph 20.b. relate to a lease component, even partially, the lessor shall not recognize those payments before the changes in facts and circumstances on which the variable payment is based occur (for example, when the lessee's sales on which the amount of the variable payment depends occur). When the changes in facts and circumstances on which the variable payment is based occur, the lessor shall allocate those payments to the lease and nonlease components of the contract.

30. Contingent rental income shall be recognized as revenue when the changes in the factor(s) on which the contingent lease payments is (are) based actually occur.

Sale-Leaseback Transactions

31. Sale-leaseback transactions involve the sale of property, plant or equipment by the owner and a lease of the property, plant or equipment back to the seller. Sale-leaseback accounting is a method of accounting in which the seller-lessee records the sale and removes all property, plant or equipment and related liabilities from its balance sheet. The definition of property, plant and equipment eligible for sale-leaseback treatment is in paragraph 3. As noted in paragraph 3, non-depreciable assets, including investments and premium receivables, do not meet the definition of property, plant or equipment, are not allowed to be included in lease transactions, and therefore, are not allowed to be included in sale-leaseback transactions. Assets that do not meet the definition of property, plant and equipment in

paragraph 3 may only be used in sale-leaseback transactions as permitted practices with regulatory approval.

32. A sale of property, plant or equipment that is accompanied by a leaseback of all or any part of the property, plant or equipment for all or part of its remaining economic life shall be accounted for by the buyer-lessor and seller-lessee as a purchase and operating lease and a sale and an operating lease, respectively, unless the sale-leaseback includes sale of nonadmitted assets to a related party. If the transaction involves a sale of nonadmitted assets to a related party, the transaction shall be accounted for by the deposit method detailed in paragraph 37.

33. Sale-leaseback accounting shall be used by a seller-lessee only if a sale-leaseback transaction includes all of the following:

- a. A normal leaseback is a lessee-lessor relationship that involves active use of the property by the seller-lessee in consideration for payment of rent, including contingent rentals that are based on future operations of the seller-lessee. The phrase active use of the property by the seller-lessee refers to use of the property during the lease term in the seller-lessee's trade or business, provided that subleasing of the leased property is minor.
- b. Admitted assets, if the buyer-lessor is a related party, or either admitted or nonadmitted assets if the buyer-lessor is not a related party. For purposes of this paragraph, related parties include those identified in SSAP No. 25 and entities created for the purpose of buying and leasing nonadmitted assets for the reporting entity and/or its affiliates.

34. Under sale-leaseback accounting, any profit on the sale shall be deferred and amortized in proportion to the related gross rental charged to expense over the lease term, with the exception of a sale of real estate settled entirely in cash.

35. A sale of real estate, settled entirely in cash, that is accompanied by a leaseback of all or any part of the property, plant or equipment for all or part of its remaining economic life shall be accounted for by the buyer-lessor and seller-lessee as a purchase and operating lease and a sale and an operating lease, respectively. The sale and gain shall be recognized directly to special surplus funds and subsequently amortized to unassigned funds (surplus) over the lease term.

Deposit Method and Financing Method

36. The deposit method is used when the transaction involves a sale-leaseback of nonadmitted assets to a related party. To the extent that leases between related parties are, in substance, arms-length transactions the guidance in this statement shall be applied. The determination of whether related party leases qualify as arms-length transactions is addressed in SSAP No. 25.

37. If a sale-leaseback transaction is accounted for by the deposit method, lease payments decrease and collections on the buyer-lessor's note, if any, increase the seller-lessee's deposit account. The sale-leaseback assets identified in paragraph 31 and any related debt continue to be included in the seller-lessee's balance sheet, and the seller-lessee continues to depreciate the sale-leaseback assets. A seller-lessee that is accounting for any transaction by the deposit method shall recognize a loss if at any time the net carrying amount of the sale-leaseback assets exceeds the sum of the balance in the deposit account, the fair value of the unrecorded note receivable and any debt assumed by the buyer.

38. If a sale-leaseback transaction is accounted for by the deposit method and then subsequently qualifies for sales recognition under paragraph 33, the transaction is accounted for using sale-leaseback accounting, and the gain or loss is recognized in accordance with the provisions of paragraph 34 of this statement. In addition, the leaseback is classified and accounted for in accordance with this statement as if the sale had been recognized at the inception of the lease. The change in the related lease accounts that would have been recorded from the inception of the lease had the transaction initially qualified for sale-

leaseback accounting is included in computing the gain or loss recognized in accordance with paragraph 34 of this statement.

39. A sale-leaseback transaction that does not qualify for sale-leaseback accounting nor the deposit method shall be accounted for by the financing method. Under this method the seller-lessee shall not derecognize the transferred asset and shall account for any amounts received as a financial liability and the buyer-lessor shall not recognize the transferred asset and shall account for the amounts paid as a receivable.

40. If a sale-leaseback transaction is reported as under the financing method, lease payments, exclusive of an interest portion, decrease and collections on the buyer-lessor's note increase the seller-lessee's liability account with a portion of the lease payments being recognized under the interest method. The seller-lessee reports the sales proceeds as a liability, continues to report the sale-leaseback assets identified in paragraph 31 as an asset and continues to depreciate the sale-leaseback assets.

41. If a sale-leaseback transaction accounted for under the financing method subsequently qualifies under paragraph 33, the transaction is then recorded using sale-leaseback accounting, and the cumulative change in the related balance sheet accounts is included in the computation of the gain recognized in accordance with the provisions of paragraph 34 of this statement. In addition, the leaseback is classified and accounted for as an operating lease as if the sale had been recognized at the inception of the lease. The change in the related lease accounts from the inception of the lease to the date the sale is recognized is included in the gain recognized in accordance with paragraph 34 of this statement.

Leveraged Leases for Lessors

42. A lessor shall record its investment in a leveraged lease. Generally, leveraged leases are those in which the lessor acquires, through the incurrence of debt (such that the lessor is substantially "leveraged" in the transaction), property, plant or equipment with the intentions to lease the asset(s) to the lessee. The net of the balances of the following accounts as measured in accordance with this guidance shall represent the lessor's initial and continuing investment in leveraged leases:

- a. Rentals receivable
- b. Investment-tax-credit receivable
- c. Estimated residual value of the leased asset
- d. Unearned and deferred income.

43. A lessor shall initially measure its investment in a leveraged lease net of the nonrecourse debt. The net of the balances of the following accounts shall represent the initial and continuing investment in leveraged leases:

- a. Rentals receivable, net of that portion of the rental applicable to principal and interest on the nonrecourse debt.
- b. A receivable for the amount of the investment tax credit to be realized on the transaction.
- c. The estimated residual value of the leased asset. The estimated residual value shall not exceed the amount estimated at lease inception except if the lease agreement includes a provision to escalate minimum lease payments either for increases in construction or acquisition cost of the leased property, plant or equipment or for increases in some other measure of cost or value (such as general price levels) during the construction or preacquisition period. In that case, the effect of any increases that have occurred shall be

considered in the determination of the estimated residual value of the underlying asset at lease inception.

- d. Unearned and deferred income consisting of both of the following:
 - i. The estimated pretax lease income (or loss), after deducting initial direct costs, remaining to be allocated to income over the lease term.
 - ii. The investment tax credit remaining to be allocated to income over the lease term.

44. The investment in leveraged leases minus deferred taxes arising from differences between pretax accounting income and taxable income shall represent the lessor's net investment in leveraged leases for purposes of computing periodic net income from the leveraged lease. Given the original investment and using the projected cash receipts and disbursements over the term of the lease, the rate of return on the net investment in the years in which it is positive shall be computed. The rate is that rate that, when applied to the net investment in the years in which the net investment is positive, will distribute the net income to those years and is distinct from the interest rate implicit in the lease. In each year, whether positive or not, the difference between the net cash flow and the amount of income recognized, if any, shall serve to increase or reduce the net investment balance. The use of the term years is not intended to preclude application of the accounting prescribed in this paragraph to shorter accounting periods.

45. The pretax lease income (or loss) and investment tax credit elements shall be allocated in proportionate amounts from the unearned and deferred income included in the lessor's net investment. The tax effect of the pretax lease income (or loss) recognized shall be reflected in tax expense for the year. The tax effect of the difference between pretax accounting income (or loss) and taxable income (or loss) for the year shall be charged or credited to deferred taxes.

46. If, at any time during the lease term the application of the method prescribed in this section would result in a loss being allocated to future years, that loss shall be recognized immediately. This situation might arise in circumstances in which one of the important assumptions affecting net income is revised.

47. The projected timing of income tax cash flows generated by the leveraged lease is an important assumption and shall be reviewed annually, or more frequently, if events or changes in circumstances indicate that a change in timing has occurred or is projected to occur. The income effect of a change in the income tax rate shall be recognized in the first accounting period ending on or after the date on which the legislation effecting a rate change becomes law.

48. The lessor shall record its investment net of the nonrecourse debt. In cases where the asset being leased is a nonadmitted asset, any net leveraged lease asset shall be nonadmitted. However, leveraged leases involving commercial airplanes are admitted assets.

Disclosures

49. The following disclosures shall be made in the financial statements of lessees:
- a. A general description of the lessee's leasing arrangements including, but not limited to, the following:
 - i. Rental expense for each period for which an income statement is presented, with separate amounts for minimum rentals, contingent rentals, and sublease rentals. Rental payments under leases with terms of a month or less that were not renewed need not be included;

- ii. The basis on which contingent rental payments are determined;
 - iii. The existence and terms of renewal or purchase options and escalation clauses; and
 - iv. Restrictions imposed by lease agreements, such as those concerning dividends, additional debt and further leasing;
 - v. Identification of lease agreements that have been terminated early or for which the lessee is no longer using the leased property, plant or equipment benefits, and the liability recognized in the financial statements under these agreements.
- b. For leases having initial or remaining lease terms in excess of one year:
- i. Future minimum rental payments required as of the date of the latest balance sheet presented, in the aggregate and for each of the five succeeding years; and
 - ii. The total of minimum rentals to be received in the future under noncancelable subleases as of the date of the latest balance sheet presented.
- c. For sale-leaseback transactions:
- i. A description of the terms of the sale-leaseback transaction, including future commitments or obligations; and
 - ii. For those accounted for as deposits, (a) the obligation for future minimum lease payments as of the date of the latest balance sheet presented in the aggregate and for each of the five succeeding years and (b) the total of minimum sublease rentals, if any, to be received in the future under noncancelable subleases in the aggregate and for each of the five succeeding years.
 - iii. For those accounted for using the financing method, it is required to disclose the information in i. as well as the financing obligation and lease liabilities.

50. When leasing is a significant part of the lessor's business activities in terms of revenue, net income, or assets, the following information with respect to leases shall be disclosed in the financial statements:

- a. For operating leases:
- i. The cost and carrying amount, if different, of property, plant or equipment on lease or held for leasing by major classes of property, plant or equipment according to nature or function, and the amount of accumulated depreciation in total as of the date of the latest balance sheet presented;
 - ii. Minimum future rentals on noncancelable leases as of the date of the latest balance sheet presented, in the aggregate and for each of the five succeeding years;
 - iii. Total contingent rentals included in income for each period for which an income statement is presented; and
 - iv. A general description of the lessor's leasing arrangements.

- b. For leveraged leases:
 - i. A description of the terms including the pretax income from the leveraged leases. For purposes of presenting the investment in a leveraged lease in the lessor's balance sheet, the amount of related deferred taxes shall be presented separately (from the remainder of the net investment);
 - ii. Separate presentation (from each other) shall be made of pretax income from the leveraged lease, the tax effect of pretax income, and the amount of investment tax credit recognized as income during the period; and
 - iii. When leveraged leasing is a significant part of the lessor's business activities in terms of revenue, net income, or assets, the components of the net investment balance in leveraged leases shall be disclosed.

51. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

52. This statement rejects *ASU 2016-02, Leases*. For statutory accounting, leases are treated as operating leases for lessees and rejects the treatment as financing leases specified in 842-10-25 and rejects the recognition of the right to use assets and related liabilities. For statutory accounting, specific guidance is adopted on sale leaseback transactions, specific guidance from lessors, leveraged leases from sections 842-40 and 842-50, respectively. The financing method is rejected for statutory accounting but adopted for instances where a sale-leaseback transaction fails sale accounting. The guidance within *INT 02-15: EITF 00-11: Lessors' Evaluation of Whether Leases of Certain Integral Equipment Meet the Ownership Transfer Requirements of FASB Statement 13* applied to leases with inception between January 1, 2003 and January 1, 2020. With adoption of substantive revisions to SSAP No. 22R this guidance is nullified.

- a. Accounting Standards Codification (ASC) 420-10-25 paragraphs 11-13 and ASC 420-10-30 paragraph 8 regarding the recognition of costs to terminate an operating lease before the end of the term and costs that will continue to be incurred under the contract for its remaining term without economic benefit are adopted. Other provisions of ASC 420 are rejected in *SSAP No. 24—Discontinued Operations and Unusual or Infrequent Items*.
- b. *ASU 2014-05, Service Concession Arrangements* (Adopted with modification to only exclude service concession arrangements from the lease definition.)
- c. *ASU 2017-10, Determining the Customer of the Operation Services* (Adopted with modification to clarify the customer in the previously adopted service concession arrangement definition.)
- d. *ASU 2018-01, Land Easement Practical Expedient for Transition to Topic 842* (Rejected in its entirety.)
- e. *ASU 2018-10, Codification Improvements to Topic 842, Leases* (Rejected in its entirety.)
- f. *ASU 2018-11, Leases (Topic 842), Targeted Improvements* (Rejected in its entirety.)
- g. *ASU 2018-20, Leases (Topic 842), Narrow-Scope Improvements for Lessors* (Rejected for statutory accounting, except for paragraph 842-10-15-(40-42) as it was modified by ASU 2018-20.)
- h. *ASU 2019-01, Leases (Topic 842), Codification Improvements* (Rejected in its entirety.)

- i. *ASU 2021-05, Leases (Topic 842), Lessors—Certain Leases with Variable Lease Payments* (Rejected in its entirety.)
- j. *ASU 2021-09, Leases (Topic 842), Discount Rate for Lessees That Are Not Public Business Entities* (Rejected in its entirety.)

53. Effective December 31, 2023, this statement rejects *ASU 2016-13 Financial Instruments—Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB’s issuance of ASU 2016-13 and other related ASUs.*

Effective Date and Transition

~~53.~~54. This statement is effective for years beginning January 1, 2001. The substantive revisions documented in *Issue Paper No. 161—Leases* are effective for all new leases entered into, and for existing leases reassessed due to a change in terms and conditions under paragraph 11, on or after January 1, 2020. Earlier adoption is permitted. The guidance in paragraph 34 regarding commercial airplanes was originally contained within *INT 00-02: Accounting for Leveraged Leases Involving Commercial Airplanes Under SSAP No. 22—Leases* and was effective March 13, 2000. The guidance in paragraph 5 was originally contained within *INT 04-20: EITF 01-8: Determining Whether an Arrangement Contains a Lease* and was effective March 13, 2005. Guidance in paragraph 27 related to maintenance costs incurred by lessee was previously included within *INT 09-05: EITF 08-3: Accounting by Lessees for Maintenance Deposits* and was effective for periods beginning September 21, 2009. The guidance in paragraphs 17 and 18 was originally contained within *INT 00-27: EITF 98-9: Accounting for Contingent Rent* and was effective September 11, 2000.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 22—Leases*
- *Issue Paper No. 161—Leases*

Statement of Statutory Accounting Principles No. 23

Foreign Currency Transactions and Translations

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 No other pronouncements
Relevant Appendix A Guidance None

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

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for accounting for foreign currency transactions and translations.

SUMMARY CONCLUSION

2. A foreign currency transaction is a transaction denominated in a currency other than the reporting entity's functional currency. The reporting entity's functional currency is defined as the currency of the primary economic environment in which the reporting entity operates. Foreign currency translation is the translation of financial statements, denominated in the reporting entity's functional currency, into U.S. dollars prior to their incorporation into financial statements through consolidation or the equity method of accounting.

3. For the purposes of this statement, a U.S. domiciled reporting entity's reporting currency shall be defined as the U.S. dollar, regardless of the primary economic environment in which the reporting entity operates. In order to ensure consistency, all elements of statutory financial statements shall be reported in U.S. dollars.

4. Each foreign currency transaction shall be examined and a determination made if the foreign currency transaction was made in support of insurance operations denominated in the same foreign currency. For example, some reporting entities engage in insurance operations in foreign countries with the premiums collected and claims paid in local currency. As in any insurance operation there will at times be uncollected premiums, policy reserves, unpaid claims, and other incomplete transactions that

must be recorded in the reporting entity's balance sheet. Premiums, reserves, and claims normally are recorded in U.S. dollars at the rate of exchange that is in effect at the time the policy is written, or when the claim is incurred. Changes in exchange rates, while not affecting the foreign policyholder, do affect the value of the foreign business as it is recorded in U.S. dollars.

5. Foreign currency transactions made in support of insurance operations denominated in the same foreign currency, such as foreign branches, shall be accounted for as follows:

- a. Canadian Insurance Operations—Canadian insurance operations, resulting in less than 10% of the reporting entity's admitted assets, less than 10% of the reporting entity's liabilities and less than 10% of the reporting entity's net premium, can be translated to U.S. dollars by making an adjustment to the net assets of the foreign operation. The adjustment is calculated by summarizing the assets and liabilities in the foreign currency and in U.S. dollars. The net value is converted to U.S. dollars at the current rate of exchange and compared with the net value in U.S. dollars recorded by the reporting entity. Any difference in the net value to current exchange rates is recorded as a separate asset or liability and the change in the foreign exchange adjustment is recorded as an unrealized capital gain or loss. If a reporting entity does not meet the requirements of this paragraph or elects to translate each financial statement line item, the reporting entity shall follow the accounting in paragraph 5.b. of this statement;
- b. All Other Foreign Insurance Operations—All other foreign insurance operations must be translated to U.S. dollars as follows: each financial statement line shall be translated to U.S. dollars by applying the following exchange rates: (i) for assets and liabilities, the exchange rate at the balance sheet date shall be used and (ii) for revenues, expenses, gains, losses and surplus adjustments, the exchange rate at the dates on which those elements are recognized shall be used. Because translation at the exchange rates at the dates the numerous revenues, expenses, gains, losses and surplus adjustments are recognized is generally impractical, an appropriately weighted average exchange rate for the period may be used to translate those elements. Gains or losses due to translating foreign operations to U.S. dollars shall be recorded as unrealized capital gains or losses.

6. All other foreign currency transactions shall be accounted for as follows:

- a. Assets and liabilities denominated in foreign currencies shall be accounted for at their U.S. dollar equivalent values using exchange rates at the balance sheet date. Income and expenses recognized during an accounting period shall be recorded at an appropriately weighted average exchange rate;
- b. Changes in balance sheet asset and liability values due to fluctuations in foreign currency exchange rates shall be recorded as unrealized capital gains and losses until the asset is sold or exchanged or the liability is settled. Additionally, in situations in which the reporting entity has an investment in a foreign entity (such as an investment in a joint venture under *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* or an investment in subsidiary under *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*), the parent reporting entity shall realize foreign currency translation changes when the parent loses control of the foreign entity, the parent entity derecognizes the entire equity method investment, or the parent entity acquires control in a foreign entity when the parent previously only held a noncontrolling interest (step acquisition). Upon partial sale or acquisition of control of a foreign entity, the parent reporting entity shall realize a pro-rata share of foreign currency translation changes. Upon settlement, or the situations previously described, all previously recorded unrealized capital gains and losses shall be reversed and the foreign exchange profit or loss for the entire holding period shall be recorded as a realized capital gain or loss.

When a foreign entity investee is substantially liquidated, the entire unrealized foreign currency translation balance is to be realized;

- c. Transactions involving settlement in cash, such as purchases, payment of expenses, sales, and receipt of income, shall be recorded at their U.S. dollar equivalent value based on the foreign currency exchange rate as of the transaction date. Any foreign currency exchange gains or losses on purchases, payment of expenses, sales, maturities or changes in income or expense accruals shall be recorded as a capital gain or loss realized on the purchase, sale or maturity.

7. Nominal information such as par value of investments may be expressed in the foreign currency or U.S. dollar equivalent (description of issue), but where the information is displayed comparatively (column of par values), U.S. dollar equivalent amount shall be used. The U.S. dollar equivalent amount is translated utilizing the exchange rate at the balance sheet date. Ratios and factors shall be based on data that is entirely consistent with respect to currency.

8. A currency in a highly inflationary environment (one that has cumulative inflation of approximately 100% or more over a three year period) is not considered stable enough to serve as a functional currency and the more stable currency of the reporting parent is to be used instead. If a reporting entity's books of record are not maintained in its functional currency, remeasurement into the functional currency is required. That remeasurement is required before translation into the reporting currency. The remeasurement process is intended to produce the same result as if the reporting entity's books of record had been maintained in the functional currency. The remeasurement of and subsequent accounting for transactions denominated in a currency other than the functional currency shall be recognized as a realized gain or loss in the statement of operations.

Relevant Literature

9. This statement adopts, with modification, *ASU 2013-05, Parents Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity*. Modifications within this statement reflect the statutory accounting definition of controlling interest, as specified in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* and *SSAP No. 25—Affiliates and Other Related Parties*, as well as the reporting specified in this statement.

10. This statement rejects *FASB Statement No. 52, Foreign Currency Translation*, *FASB Emerging Issues Task Force No. 87-12, Foreign Debt-for-Equity Swaps*, *FASB Emerging Issues Task Force No. 87-26, Hedging of Foreign Currency Exposure with a Tandem Currency*, *FASB Emerging Issues Task Force No. 92-4, Accounting for a Change in Functional Currency When an Economy Ceases to Be Considered Highly Inflationary*, *FASB Emerging Issues Task Force No. 95-2, Determination of What Constitutes a Firm Commitment for Foreign Currency Transactions Not Involving a Third Party*, *FASB Emerging Issues Task Force No. 96-15, Accounting for the Effects of Changes in Foreign Currency Exchange Rates on Foreign-Currency-Denominated Available-for-Sale Debt Securities* and *FASB Interpretation No. 37, Accounting for Translation Adjustments upon Sale of Part of an Investment in a Foreign Entity*, an interpretation of *FASB Statement No. 52*, and *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins*, Chapter 12.

Effective Date and Transition

11. 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. 81—Foreign Currency Transactions and Translations*

Not for Distribution

Statement of Statutory Accounting Principles No. 24

Discontinued Operations and Unusual or Infrequent Items

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Nullifies and incorporates INT 02-17
Affected by.....	No other pronouncements
Interpreted by	INT 08-05
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Identification of Discontinued Operations	1
Measurement and Reporting of Discontinued Operations	3
Unusual or Infrequently Occurring Items	3
Business Interruption Insurance Recoveries	4
Disclosures.....	4
Relevant Literature.....	5
Effective Date and Transition	7
REFERENCES.....	7
Relevant Issue Papers	7

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles related to the accounting and reporting for discontinued operations and unusual or infrequently occurring items.

SUMMARY CONCLUSION

Identification of Discontinued Operations

2. A disposal of a component¹ shall be considered a discontinued operation if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results when any situation detailed in paragraphs 2.a. through 2.c. occurs. Examples of a strategic shift include a disposal of a major geographical area, major line of business, a major equity method investment or other major parts of the entity.

¹ A component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. A component of an entity may be a reportable segment or an operating segment, a reporting unit, a subsidiary or an asset group. For purposes of this statement, reference to a component also includes "groups of components."

- a. The entity to be sold² meets all of the following criteria to be classified as held for sale:
 - i. Management, having the authority to approve the transaction, commits to a plan to sell;
 - ii. The entity to be sold is available for immediate sale in its present condition subject only to terms that are usual and customary;
 - iii. An active program to locate a buyer and other actions to complete the sale have been initiated;
 - iv. The sale and transfer is expected to qualify as a completed sale within one year unless the qualifying exceptions in paragraph 4 are noted;
 - v. The entity to be sold is being actively marketed for sale at a price that is reasonable in relation to its current fair value; and
 - vi. Actions required to complete the plan to sell indicate that it is unlikely that significant changes will be made to the plan or that the plan will be withdrawn.
 - b. The component is disposed of by sale.
 - c. The component is disposed of other than by sale (for example, by abandonment, in an exchange measured based on the recorded amount of the nonmonetary asset relinquished, or in a distribution to owners in a spinoff^(INT 08-05)).
3. A business or nonprofit activity that, on acquisition, meets the criteria of paragraph 2.a. is a discontinued operation.
4. Events or circumstances beyond an entity's control may extend the period required to complete the sale of an entity to be sold beyond one year. An exception to the one-year requirement in paragraph 2.a.iv. shall apply in the following situations in which those events or circumstances arise:
- a. If at the date that an entity commits to a plan to sell an entity to be sold, the entity reasonably expects that others (not a buyer) will impose conditions on the transfer of the entity to be sold that will extend the period required to complete the sale and both of the following conditions are met:
 - i. Actions necessary to respond to those conditions cannot be initiated until after a firm purchase commitment is obtained; and
 - ii. A firm purchase commitment is probable within one year.
 - b. If an entity obtains a firm purchase commitment and, as a result, a buyer or others unexpectedly impose conditions on the transfer of an entity to be sold previously classified as held for sale that will extend the period required to complete the sale and both of the following conditions are met:
 - i. Actions necessary to respond to the conditions have been or will be timely initiated; and
 - ii. A favorable resolution of the delaying factors is expected.

² A component, group of components or a business or nonprofit activity subject to this statement are collectively referred to as "the entity to be sold."

- c. If during the initial one-year period circumstances arise that previously were considered unlikely and, as a result, an entity to be sold previously classified as held for sale is not sold by the end of that period and all of the following conditions are met:
 - i. During the initial one-year period the entity initiated actions necessary to respond to the change in circumstances;
 - ii. The entity to be sold is being actively marketed at a price that is reasonable given the change in circumstances; and
 - iii. The criteria in paragraph 2.a. are met.

Measurement and Reporting of Discontinued Operations

5. Upon classification as held for sale³ (paragraph 2.a.), the entity to be sold shall be measured and reported at the lower of its carrying value or fair value less costs to sell. Costs to sell are incremental direct costs to transact a sale. These costs include broker commissions, legal and title transfer fees and closing costs that must be incurred before legal title can be transferred. These costs exclude expected future losses associated with the operations of the entity to be sold while it is classified as held for sale. The calculation of fair value less costs to sell shall be updated each period until the disposal transaction occurs, but only additional losses shall be recognized. Entities are not permitted to recognize recoveries as a result of improvements in fair value or costs to sell. Depreciation or amortization shall no longer be recognized once an asset is classified as held for sale.

6. A realized loss shall be recognized for any initial or subsequent write-down to fair value less costs to sell. If a component is disposed of without being classified as held for sale, a realized loss shall be recognized in the period of the disposal. Regardless if an entity is classified as held for sale, a gain shall not be recognized until the disposal transaction is complete.

7. The results of a reporting entity's discontinued operations shall be reported consistently with the entity's reporting of continuing operations (i.e., no separate line item presentation in the balance sheet or statement of operations aggregating current and future losses from the measurement date).

8. If the entity decides not to sell the discontinued operation, the assets shall be reported at the lower of the carrying amount before the asset was classified as held for sale, adjusted for depreciation that would have been recognized if the asset had not been classified as held for sale, or fair value at the date of the decision not to sell.

Unusual or Infrequently Occurring Items

9. A material event or transaction that an entity considers to be of an unusual nature or of a type that indicates infrequency of occurrence or both shall be reported consistently with the reporting entity's reporting of continuing operations (i.e., no separate line item presentation in the balance sheet or statement of operations). Such items shall not be charged directly to surplus unless specifically addressed elsewhere within the *Accounting Practices and Procedures Manual*.

- a. "Unusual Nature" shall be defined as the underlying event or transaction that should possess a high degree of abnormality and be of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity, taking into account the environment in which the entity operates.

³ Pursuant to SSAP No. 90—*Impairment or Disposal of Real Estate Investments*, paragraph 21, real estate investments are classified as held for sale under the same criteria identified in paragraph 2.a. These real estate investments are not considered discontinued operations and shall follow the guidelines in SSAP No. 90.

- b. “Infrequency of Occurrence” is defined as the underlying event or transaction that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the entity operates.

Business Interruption Insurance Recoveries

10. Business interruption (BI) insurance is designed to protect the prospective earnings or profits of the insured entity. That is, BI insurance provides coverage if business operations are suspended due to the loss of use of property and equipment resulting from a covered cause of loss. BI insurance coverage generally provides for reimbursement of certain costs and losses incurred during the reasonable period required to rebuild, repair, or replace the damaged property. The types of costs and losses covered typically include:

- a. Gross margin that was "lost" or not earned due to the suspension of normal operations
- b. A portion of fixed charges and expenses in relation to that lost gross margin
- c. Other expenses incurred to reduce the loss from business interruption (for example, rent of temporary facilities and equipment, use of subcontractors, and so forth)

An entity may choose how to classify BI insurance recoveries in the statement of operations, as long as that classification is not contrary to existing statutory accounting principles.

Disclosures

Discontinued Operations

11. The following shall be disclosed in the notes to the financial statements that cover the period in which a discontinued operation either has been disposed of or is classified as held for sale under paragraph 2.a.:

- a. Description of the facts and circumstances leading to the disposal or expected disposal and a description of the expected manner and timing of that disposal.
- b. The loss recognized on the discontinued operation. The recognized loss shall be reported for the reporting period, and as a cumulative total since classified as held for sale.
- c. The carrying amount immediately prior to the classification as held for sale, and the current fair value less costs to sell, including the balance sheet lines where the item is reported. Also report income received from the discontinued operation prior to the disposal transaction.

12. If the entity decides to change its plan of sale for the discontinued operation, disclose a description of the facts and circumstances leading to the decision to change the plan and the effect on the assets reported in the financial statements.

13. Adjustments to amounts reported related to discontinued operations as a result of:

- a. The resolution of contingencies that arise pursuant to the terms of the disposal transaction, such as the resolution of purchase price contingencies and indemnification issues with the purchaser.
- b. The resolution of contingencies that arise from and are directly related to the disposal of a discontinued operation of the component in a period prior to its disposal, such as environmental and product warranty obligations retained by the seller.

- c. The settlement of employee benefit plan obligations (pension, postemployment benefits other than pensions, and other postemployment benefits), provided the settlement is directly related to the disposal transaction. (A settlement is directly related to the disposal transaction if there is a demonstrated direct cause-and-effect relationship and the settlement occurs no later than one year following the disposal transaction, unless it is delayed by events or circumstances beyond an entity's control.)

14. If the entity will retain significant continuing involvement with a discontinued operation after the disposal transaction, the entity shall complete the disclosures in paragraphs 14.a. through 14.c. Examples of significant continuing involvement include a supply and distribution arrangement, a financial guarantee, an option to repurchase and an equity method investment in the discontinued operation.

- a. Description of the activities that give rise to the continuing involvement.
- b. The period of time the involvement is expected to continue.
- c. The expected cash inflows/outflows as a result of continuing involvement.

15. If the entity will retain an equity interest in the discontinued operations after the disposal date, disclose the ownership interest before and after the disposal transaction and the entity's share of the income or loss of the investee as of the year-end reporting date after the disposal transaction.

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.

Business Interruption Insurance Recoveries

17. The following information should be disclosed in the notes to the financial statements in the period(s) in which BI insurance recoveries are recognized:

- a. The nature of the event resulting in business interruption losses
- b. The aggregate amount of BI insurance recoveries recognized during the period and the line item(s) in the statement of operations in which those recoveries are classified (including amounts defined as an extraordinary item pursuant to this SSAP).

18. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

19. This statement adopts with modification *ASU 2014-08, Presentation of Financial Statements and Property, Plant and Equipment— Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*. Modifications from ASU 2014-08 include:

- a. This statement rejects guidance in ASU 2014-08 for separate reporting of discontinued operations. An entity's discontinued operations shall be reported consistently with the entity's reporting of continuing operations.
- b. A gain from discontinued operations shall not be recognized until the disposal transaction is complete. Losses shall be recognized when discontinued operations are classified as held for sale, and are required in subsequent periods when the fair value less costs to sell is below the carrying value. Losses are not permitted to be adjusted for subsequent recoveries in fair value changes or improvements in the expected costs to sell.
- c. This statement only adopts the ASU 2014-08 disclosures applicable for all types of discontinued operations, and only to the extent reflected in this statement. The detailed disclosures for discontinued operations for components or group of components and discontinued operations comprising an equity method investment are rejected and not required.

20. This statement adopts with modification *ASU 2015-01, Income Statement—Extraordinary and Unusual Items*. The statutory accounting modification to ASU 2015-01 requires reporting entities to report unusual or infrequent items consistently with other operations and prevents recognizing unusual or infrequent events or transactions as a separate component of operations. Additionally, disclosures of these transactions are required in the statutory financial statements. As ASU 2015-01 eliminated the concept of an “extraordinary item,” the adoption of ASU 2015-01 nullifies the previous consideration of GAAP guidance related to this term.

21. This statement adopts with modification *Emerging Issues Task Force No. 01-13: Income Statement Display of Business Interruption Insurance Recoveries*, with changes of GAAP references to statutory terminology.

22. The following U.S. GAAP accounting principles were previously noted as adopted in this statement. However, upon the adoption with modification of ASU 2014-08 and ASU 2015-01, the following guidance is considered rejected for statutory accounting purposes:

- a. *Accounting Principles Board Opinion No. 30, Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, (APB No. 30), paragraphs 13-18.
- b. *AICPA Accounting Interpretations, Reporting the Results of Operations: Accounting Interpretations of APB Opinion No. 30*, relating to the definition of extraordinary items and terminology relevant to the disposal of a segment and the criteria for recording a related loss.
- c. *FASB Emerging Issues Task Force No. 85-36, Discontinued Operations with Expected Gain and Interim Operating Losses*.
- d. *FASB Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets* (FAS 144), paragraphs 44.a. – 44.c.

23. The following standards were rejected prior to the adoption with modification of ASU 2014-08 and ASU 2015-01 and are still noted as rejected for statutory accounting:

- a. *FASB Statement No. 146, Accounting for Costs Associated with Exit or Disposal Activities*;

- b. *FASB Emerging Issues Task Force No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring); and*
- c. *FASB Emerging Issues Task Force No. 95-18, Accounting and Reporting for a Discontinued Business Segment When the Measurement Date Occurs after the Balance Sheet Date but before the Issuance of Financial Statements.*

24. This statement ~~adopts~~rejects ASU 2021-10, *Government Assistance: Disclosure by Business Entities about Government Assistance*, ~~with modification to require disclosure by all entity types. However, it does incorporate general disclosures about government assistance for all reporting entity types.~~

Effective Date and Transition

25. This statement was originally 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. The guidance in paragraphs 10 and 17 was originally contained in *INT 02-17: EITF 01-13: Income Statement Display of Business Interruption Insurance Recoveries* and was effective September 10, 2002.

26. Changes from the adoption with modification of ASU 2014-08 and ASU 2015-01 are not expected to change the measurement or reporting process for discontinued operations or unusual or infrequent items. As such, these changes are considered nonsubstantive and were effective immediately upon adoption on June 17, 2015.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 24—Discontinued Operations and Extraordinary Items*

Statement of Statutory Accounting Principles No. 25

Affiliates and Other Related Parties

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Supersedes SSAP No. 96 with guidance incorporated August 2011; Nullifies and incorporates INT 03-16
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	A-440

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	2
Related Party Loans	4
Transactions Involving the Exchange of Assets or Liabilities.....	5
Transactions Involving Services	6
Disclosures.....	7
Relevant Literature.....	8
Effective Date and Transition	9
REFERENCES.....	9
Other	9
Relevant Issue Papers	9

SCOPE OF STATEMENT

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

2. This statement shall be followed for all related party transactions, including transactions with parties that own 10% or more of the reporting entity, even if the transaction is also governed by other statutory accounting principles. Furthermore, this statement shall be followed in all transactions which involve unrelated parties as intermediaries between related parties. In determining whether a transaction is a related party transaction, consideration shall be given to the substance of the agreement and the parties whose actions or performance materially impact the insurance reporting entity under the transaction. For example, an investment acquired from a non-related intermediary in which the investment return is predominantly contingent on the performance of a related party shall be considered a related party investment. As a general principle, it is erroneous to conclude that the mere inclusion of a non-related intermediary eliminates the requirement to assess and properly identify the related party transaction in

accordance with the provisions of this statement. It is also erroneous to conclude that the presence of non-related assets in a structure predominantly comprised of related party investments eliminates the requirement to assess and identify the investment transaction as a related party arrangement.

3. If a company receives the stock of an affiliated company as a capital contribution rather than through a purchase, the transaction shall be accounted for according to *SSAP No. 25—Affiliates and Other Related Parties*, *SSAP No. 95—Nonmonetary Transactions*, or *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, based on the details of each transaction. The statutory purchase method within *SSAP No. 68—Business Combinations* is not applicable for stock received as a capital contribution.

SUMMARY CONCLUSION

4. Related parties are defined as entities that have common interests as a result of ownership, control, affiliation or by contract. Related parties shall include but are not limited to the following:

- a. Affiliates of the reporting entity, as defined in paragraph 5;
- b. Trusts for the benefit of employees, such as pension and profit-sharing trusts and Employee Stock Ownership Plans that are managed by or under the trusteeship of management of the reporting entity, its parent or affiliates;
- c. The principal owners, directors, and officers of the reporting entity;
- d. Any immediate family member of a principal owner, director or executive officer of the reporting entity, which means any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, or individual related by blood or marriage whose close association is equivalent to a family relationship of such director, executive officer or nominee for director, or any person (other than a tenant or employee) sharing the household of such director, executive officer or nominee for director;
- e. Companies and entities which share common control, such as principal owners, directors, or officers, including situations where principal owners, directors, or officers have a controlling stake in another reporting entity;
- f. Any direct or indirect ownership greater than 10% of the reporting entity results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation;
- g. The management of the reporting entity, its parent or affiliates (including directors);
- h. Members of the immediate families of principal owners and management of the reporting entity, its parent or affiliates and their management;
- i. Parties with which the reporting entity may deal if either party directly or indirectly controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interest;
- j. A party which can, directly or indirectly, significantly influence the management or operating policies of the reporting entity, which may include a provider who is contracting with the reporting entity. This is not intended to suggest that all provider contracts create related party relationships;

- k. A party which has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests;
- l. Attorney-in-fact of a reciprocal reporting entity or any affiliate of the attorney-in-fact; and
- m. A U.S. manager of a U.S. Branch or any affiliate of the U.S. manager of a U.S. Branch.

5. An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies as defined in *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*. Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity method for all such investments. An affiliate is any person that is directly or indirectly, owned or controlled by the same person or by the same group of persons, that, directly or indirectly, own or control the reporting entity. Any invested asset held by a reporting entity which is issued by an affiliated entity, or which includes the obligations of an affiliated entity, is an affiliated investment.

6. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by contract for goods or nonmanagement services where the volume of activity results in a reliance relationship (d) by common management, or (e) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity.

7. Control as defined in paragraph 6 shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13%, and therefore, each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. Examples of situations where the presumption of control may be in doubt include the following:

- a. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.
- b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.
- c. An entity where the insurer has given up participation rights¹ as a shareholder to the investee.

¹ The term "participating rights" refers to the type of rights that allows an investor to effectively participate in significant decisions related to an investee's ordinary course of business and is distinguished from the more limited type of rights referred to as "protective rights". Refer to the sections entitled: "Protective Rights" and "Substantive Participating Rights" in EITF 96-16, *Investor's Accounting for an Investee When the Investor Owns a Majority of the Voting Stock but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights*. The term "participating rights" shall be used consistent with the discussion of substantive participating rights in this EITF.

- d. Agreements where direct or indirect non-controlling ownership interest is less than 10% where the parties have structured the arrangement in this structure to avoid the 10% threshold in paragraph 4.f. and paragraph 8.

8. Any direct or indirect ownership interest of the reporting entity greater than 10% results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation. The *Insurance Holding Company System Regulatory Act* (#440) and the *Insurance Holding Company System Model Regulation With Reporting Forms and Instructions* (#450) include a provision that allows for the disclaimer of affiliation and/or the disclaimer of control for members of an insurance holding company system. The disclaimer must be filed with the state insurance commissioner. Entities whose relationship is subject to a disclaimer of affiliation or a disclaimer of control are related parties and are subject to the related party disclosures within this statement. Such a disclaimer does not eliminate a “related party” distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

9. For entities not controlled by voting interests, such as limited partnerships, trusts and other special purpose entities, control may be held by a general partner, servicer, or by other arrangements. The ability of the reporting entity or its affiliates to direct the management and policies of an entity through such arrangements shall constitute control as defined in paragraph 6. Additionally, a reporting entity or its affiliates may have indirect control of other entities through such arrangements. For example, if a limited partnership were to be controlled by an affiliated general partner, and that limited partnership held greater than 10% of the voting interests of another company², indirect control shall be presumed to exist unless the presumption of control can be overcome as detailed in paragraph 7. If direct or indirect control exists, whether through voting securities, contracts, common management or otherwise, the arrangement is considered affiliated under paragraph 5. Consistent with paragraph 8, a disclaimer of affiliation does not eliminate a “related party” distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

10. Transactions between related parties must be in the form of a written agreement. The written agreement must provide for timely settlement of amounts owed, with a specified due date. Amounts owed to the reporting entity over ninety days from the written agreement due date shall be nonadmitted, except to the extent this is specifically addressed by other statements of statutory accounting principles (SSAPs). If the due date is not addressed by the written agreement, any uncollected receivable is nonadmitted.

Related Party Loans

11. Loans or advances (including debt, public or private) made by a reporting entity to its parent or principal owner shall be admitted if approval for the transaction has been obtained from the domiciliary commissioner and the loan or advance is determined to be collectible based on the parent or principal owner’s independent payment ability. An affiliate’s ability to pay shall be determined after consideration of the liquid assets or revenues available from external sources (i.e., determination shall not include dividend paying ability of the subsidiary making the loan or advance) which are available to repay the balance and/or maintain its account on a current basis. Evaluation of the collectibility of loans or advances shall be made periodically. If, in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. Pursuant to *SSAP No. 72—Surplus and Quasi-Reorganization*, forgiveness by a reporting entity of any debt, surplus note or other obligation of its parent or other stockholder shall be accounted for as a dividend.

² Consistent with SSAP No. 97, footnote 1, investments in an exchange traded fund (ETF), a mutual fund (as defined by the SEC) or a foreign open-end investment fund governed and authorized in accordance with regulations established by the applicable foreign jurisdiction does not reflect ownership in an underlying entity, regardless of the ownership percentage the reporting entity (or the holding company group) has of the ETF, mutual fund or foreign open-end investment fund unless ownership of the fund actually results in “control” with the power to direct or cause the direction of management of an underlying company. ETFs, mutual funds and foreign open-end investment funds are comprised of portfolios of securities subject to the regulatory requirements of the federal securities laws or the applicable foreign jurisdictions laws.

12. Loans or advances by a reporting entity to all other related parties shall be evaluated by management and nonadmitted if they do not constitute arm's-length transactions as defined in paragraph 15. Loans or advances made by a reporting entity to related parties (other than its parent or principal owner) that are economic transactions as defined in paragraph 15 shall be admitted. This includes financing arrangements with providers of health care services with whom the reporting entity contracts with from time to time. Such arrangements can include both loans and advances to these providers. Evaluation of the collectibility of loans or advances shall be made periodically. If, in accordance with SSAP No. 5R, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made.

13. Any advances under capitation arrangements made directly to providers, or to intermediaries that represent providers, that exceed one month's payment shall be nonadmitted assets.

14. Indirect loans are loans or extensions of credit to any person who is not an affiliate, where the reporting entity makes loans or extensions of credit with the agreement or understanding that the proceeds of the transactions, in whole or in substantial part, are to be used to make loans or extensions of credit to, to purchase assets of, or to make investments in, any affiliate of the reporting entity making the loans or extensions of credit. The admissibility of indirect loans made by a reporting entity for the benefit of its parent or principal owner shall be determined in accordance with the guidelines in paragraph 11. Indirect loans or advances made for the benefit of all other related parties shall be evaluated and accounted for consistent with loans or advances to related parties as described in paragraph 12 and paragraph 13.

Transactions Involving the Exchange of Assets or Liabilities

15. An arm's-length transaction is defined as a transaction in which willing parties, each being reasonably aware of all relevant facts and neither under compulsion to buy, sell, or loan, would be willing to participate. A transaction between related parties involving the exchange of assets or liabilities shall be designated as either an economic transaction or non-economic transaction. An economic transaction is defined as an arm's-length transaction which results in the transfer of the risks and rewards of ownership and represents a consummated act thereof, i.e., "permanence." The appearance of permanence is also an important criterion in assessing the economic substance of a transaction. In order for a transaction to have economic substance and thus warrant revenue (loss) recognition, it must appear unlikely to be reversed. If subsequent events or transactions reverse the effect of an earlier transaction prior to the issuance of the financial statements, the reversal shall be considered in determining whether economic substance existed in the case of the original transaction. Subsequent events are addressed in *SSAP No. 9—Subsequent Events*. An economic transaction must represent a bonafide business purpose demonstrable in measurable terms. A transaction which results in the mere inflation of surplus without any other demonstrable and measurable betterment is not an economic transaction. The statutory accounting shall follow the substance, not the form of the transaction.

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

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

- d. Whether limitations or restrictions exist on the buyer's use of the financial interest transferred or on the profits arising from it;
- e. Whether there is retention of effective control of the financial interest by the seller.

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

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

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

- a. Economic transactions between related parties shall be recorded at fair value at the date of the transaction. To the extent that the related parties are affiliates under common control, the controlling reporting entity shall defer the effects of such transactions that result in gains or increases in surplus (see paragraph 17);
- b. Non-economic transactions between reporting entities, which meet the definition of related parties above, shall be recorded at the lower of existing book values or fair values at the date of the transaction;
- c. Non-economic transactions between a reporting entity and an entity that has no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates, shall be recorded at the fair value at the date of the transaction; however, to the extent that the transaction results in a gain, that gain shall be deferred until such time as permanence can be verified;
- d. Transactions which are designed to avoid statutory accounting practices shall be reported as if the reporting entity continued to own the assets or to be obligated for a liability directly instead of through a subsidiary.

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

Transactions Involving Services

20. Transactions involving services between related parties can take a variety of different forms. One of the significant factors as to whether these transactions will be deemed to be arm's length is the amount charged for such services. In general, amounts charged for services are based either on current market

rates or on allocations of costs. Determining market rates for services is difficult because the circumstances surrounding each transaction are unique. Unlike transactions involving the exchange of assets and liabilities between related parties, transactions for services create income on one party's books and expense on the second party's books, and therefore, do not lend themselves to the mere inflation of surplus. These arrangements are generally subject to regulatory approval.

21. Transactions involving services provided between related parties shall be recorded at the amount charged³. Regulatory scrutiny of related party transactions where amounts charged for services do not meet the fair and reasonable standard established by Appendix A-440, may result in (a) amounts charged being recharacterized as dividends or capital contributions, (b) transactions being reversed, (c) receivable balances being nonadmitted, or (d) other regulatory action. Expenses that result from cost allocations shall be allocated subject to the same fair and reasonable standards, and the books and records of each party shall disclose clearly and accurately the precise nature and details of the transaction. See *SSAP No 70—Allocation of Expenses* for additional discussion regarding the allocation of expenses.

Disclosures

22. The financial statements shall include disclosures of all material related party transactions, including transactions with the ownership interests identified in paragraph 23. In some cases, aggregation of similar transactions, that on a stand-alone basis are not material, may be appropriate. Sometimes, the effect of the relationship between the parties may be so pervasive that disclosure of the relationship alone will be sufficient. If necessary to the understanding of the relationship, the name of the related party should be disclosed. Transactions shall not be purported to be arm's-length transactions unless there is demonstrable evidence to support such statement. The disclosures shall include:

- a. The nature of the relationships involved;
- b. A description of the transactions for each of the periods for which financial statements are presented, and such other information considered necessary to obtain an understanding of the effects of the transactions on the financial statements. Exclude reinsurance transactions, any non-insurance transactions which involve less than ½ of 1% of the total admitted assets of the reporting entity, and cost allocation transactions. The following information shall be provided if applicable:
 - i. Date of transaction;
 - ii. Explanation of transaction;
 - iii. Name of reporting entity;
 - iv. Name of affiliate;
 - v. Description of assets received by reporting entity;
 - vi. Statement value of assets received by reporting entity;
 - vii. Description of assets transferred by reporting entity; and

³ The amount charged shall be reviewed when there are any modifications or waivers subsequent to the establishment of the contract terms. If waivers or modifications to amounts charged occur, the related party transaction shall be reassessed to determine whether the contract continues to reflect fair and reasonable standards. If the transaction was with a parent or other stockholder and the charge for services has been fully waived, then the guidance in SSAP No. 72 for recognition as contributed capital (forgiveness of reporting entity obligation) or as a dividend (forgiveness of amount owed to the reporting entity) shall apply.

- viii. Statement value of assets transferred by reporting entity.
- c. The dollar amounts of transactions for each of the periods for which financial statements are presented and the effects of any change in the method of establishing the terms from that used in the preceding period;
 - d. Amounts due from or to related parties as of the date of each balance sheet presented and, if not otherwise apparent, the terms and manner of settlement;
 - e. Any guarantees or undertakings, written or otherwise, shall be disclosed in accordance with the requirements of SSAP No. 5R. In addition, the nature of the relationship to the beneficiary of the guarantee or undertaking (affiliated or unaffiliated) shall also be disclosed;
 - f. A description of material management or service contracts and cost-sharing arrangements involving the reporting entity and any related party. This shall include, but is not limited to, sale lease-back arrangements, computer or fixed asset leasing arrangements, and agency contracts, which remove assets otherwise recordable (and potentially nonadmitted) on the reporting entity's financial statements;
 - g. The nature of the control relationship whereby the reporting entity and one or more other enterprises are under common ownership or control and the existence of that control could result in operating results or financial position of the reporting entity significantly different from those that would have been obtained if the enterprises were autonomous. The relationship shall be disclosed even though there are no transactions between the enterprises; and
 - 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](#), ~~the Purposes and Procedure Manual of the NAIC Investment Analysis Office, "Procedures for Valuing Common Stocks and Stock Warrants."~~
23. The disclosures of ownership interests in the reporting entity shall be provided outside of the financial statements (Schedule Y). The intent of this disclosure is to capture information related to active ownership and is not intended for passive fund owners to be reported.
- a. Disclosure is required for all owners with greater than 10% ownership of the reporting entity.
 - b. Reporting entity must disclose each owner's ultimate controlling party and must provide a listing of other U.S. insurance groups or entities under that ultimate controlling party's control.
24. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

25. This statement adopts *FASB Statement No. 57, Related Party Disclosures* with a modification to paragraph 4 to require disclosure of compensation arrangements, expense allowances, and other similar items in the ordinary course of business.
26. This statement rejects *ASU 2009-17, Consolidations (Topic 810)—Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities*, *ASU 2010-02, Consolidation (Topic 810)—Accounting and Reporting for Decreases in Ownership of a Subsidiary—a Scope Clarification*,

ASU 2010-10, Consolidations (Topic 810)—Amendments for Certain Investment Funds, ASU 2013-06, Not-For-Profit Entities, Services Received from Personnel of an Affiliate, ASU 2014-07, Consolidation (Topic 810)—Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements, ASU 2015-02, Consolidation (Topic 810)—Amendments to the Consolidation Analysis, ASU 2016-17, Consolidation (Topic 810)—Interests Held through Related Parties That Are under Common Control, ASU 2018-17, Consolidation (Topic 810)—Targeted Improvements to Related Party Guidance for Variable Interest Entities and AICPA Accounting Interpretations, Business Combinations: Accounting Interpretations of APB Opinion No. 16, No. 39, “Transfers and Exchanges between Companies under Common Control.”

27. Guidance in paragraph 10 was incorporated from SSAP No. 96 as discussed in *Issue Paper No. 128—Settlement Requirements for Intercompany Transactions, An Amendment to SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties*. SSAP No. 96 was nullified in 2011 with the guidance from that SSAP retained within this SSAP.

Effective Date and Transition

28. 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*.

29. Guidance reflected in paragraph 10, incorporated from SSAP No. 96, is effective for reporting periods ending December 31, 2007. Early adoption is permitted. A change resulting from the application of this paragraph shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. Guidance reflected in paragraph 3, incorporated from *INT 03-16: Contribution of Stock*, was originally effective December 7, 2003.

REFERENCES

Other

- *Purposes and Procedures Manual of the NAIC Investment Analysis Office*

Relevant Issue Papers

- *Issue Paper No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties*
- *Issue Paper No. 128—Settlement Requirements for Intercompany Transactions, An Amendment to SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties*

Statement of Statutory Accounting Principles No. 26 – Revised

Bonds

STATUS

Type of Issue.....	Common Area
Issued	Initial draft; Substantively revised April 2017
Effective Date	January 1, 2001; Substantive revisions detailed in Issue Paper No. 156 effective December 31, 2017
Affects.....	Supersedes SSAP No. 99 with guidance incorporated November 2010; Nullifies and incorporates INT 02-05
Affected by.....	No other pronouncements
Interpreted by	INT 01-25; INT 06-02; INT 06-07; INT 07-01
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	2
SUMMARY CONCLUSION	3
Acquisitions, Disposals and Changes in Unrealized Gains and Losses	4
Amortized Cost	4
Application of Yield-to-Worst.....	4
Balance Sheet Amount.....	5
Impairment.....	6
Income	6
Origination Fees.....	7
Origination, Acquisition and Commitment Costs.....	7
Commitment Fees	7
Exchanges and Conversions	8
SVO-Identified Investments	8
Disclosures.....	10
Relevant Literature.....	13
Effective Date and Transition	13
REFERENCES.....	15
Other	15
Relevant Issue Papers	15
EXHIBIT A – GLOSSARY.....	16
EXHIBIT B – SYSTEMATIC VALUE CALCULATION.....	18
EXHIBIT C – AMORTIZATION TREATMENT FOR CALLABLE BONDS	19

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for bonds, specific fixed-income investments, and particular funds identified by the Securities Valuation Office (SVO) as qualifying for bond treatment as identified in this statement.
2. This statement excludes:
 - a. Loan-backed and structured securities addressed in *SSAP No. 43R—Loan-Backed and Structured Securities*.
 - b. Securities that meet the definition in paragraph 3 with a maturity date of one year or less from date of acquisition, which qualify as cash equivalents or short-term investments. These investments are addressed in *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments*.
 - c. Securities that meet the definition in paragraph 3, but for which the contractual 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. These investments, although in the form of a debt instrument, incorporate 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*, unless the investment is a mortgage-referenced security addressed in *SSAP No. 43R—Loan-Backed and Structured Securities*. This exclusion 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 principal amount due/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 (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 this exclusion if the “principal protection” involves only a portion of the principal/original investment amount and/or if the 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 in this exclusion. Securities within the scope of *SSAP No. 43R*, foreign denominated bonds (if only by virtue of their denomination in a foreign currency) and securities comprising elements of risk consistent with replication (synthetic assets) transactions (RSATs) as defined in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*, are also not captured in this exclusion. This exclusion does not impact RSATs as defined in *SSAP No. 86*.
 - d. 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*.

SUMMARY CONCLUSION

3. Bonds shall be defined as any securities¹ representing a creditor relationship, whereby there is a fixed schedule for one or more future payments. This definition includes:

- a. U.S. Treasury securities;^(INT 01-25)
- b. U.S. government agency securities;
- c. Municipal securities;
- d. Corporate bonds, including Yankee bonds and zero-coupon bonds;
- e. Convertible bonds, including mandatory convertible bonds as defined in paragraph 11.b;
- f. Fixed-income instruments specifically identified:
 - i. Certifications of deposit that have a fixed schedule of payments and a maturity date in excess of one year from the date of acquisition;
 - ii. Bank loans issued directly by a reporting entity or acquired through a participation, syndication or assignment;
 - iii. Hybrid securities, excluding: surplus notes, subordinated debt issues which have no coupon deferral features, and traditional preferred stocks.
 - iv. Debt instruments in a certified capital company (CAPCO)^(INT 06-02)

4. The definition of a bond, per paragraph 3, does not include equity/fund investments, such as mutual funds or exchange-traded funds. However, the following types of SVO-identified investments 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 bonds, unless different treatment is specifically identified in paragraphs 23-29.

- 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/securities-valuation-office>~~. (SVO-identified ETFs are reported on Schedule D – Part 1.)

5. Investments within the scope of this statement issued by a related party, or acquired through a related party transaction, are also subject to the provisions and disclosure requirements of *SSAP No. 25—Affiliates and Other Related Parties*. Investments within the scope of this statement meet the definition of

¹ This statement adopts the GAAP definition of a security as it is used in FASB Codification Topic 320 and 860.

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

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.

Acquisitions, Disposals and Changes in Unrealized Gains and Losses

6. 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.

7. 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 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.

8. 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

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.² (INT 07-01) Bonds containing call provisions (where the issue 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

10. For callable bonds³, 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" for reporting in Schedule D, Part 1. Depending on the characteristics of the callable bonds, the yield-to-worst concept in paragraph 9 shall be applied as follows:

² For perpetual bonds with an effective call option, any applicable premium shall be amortized utilizing the yield-to-worst method.

³ Callable bonds within the scope of paragraph 10 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.

- a. For callable bonds with a lockout period, premium in excess of the next call price⁴ (subsequent to acquisition⁵ 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.

Balance Sheet Amount

11. Bonds, as defined in paragraph 3, 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*.)

12. 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.

⁴ 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.

⁵ 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.

Impairment

13. 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.⁶ 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. 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

15. 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.

16. 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.

17. The amount of prepayment penalty and/or acceleration fees 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

⁶ 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.

- 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 par⁷:
 - i. To the extent an entity has in place a process to identify explicit prepayment penalty or acceleration fees, 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 fees, the reporting entity shall calculate the resulting realized gain as the difference between 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

18. 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 9 of this statement. Other origination fees shall be recorded as income upon receipt.

Origination, Acquisition and Commitment Costs

19. 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 6 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

20. 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.

21. 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 9 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.

⁷ 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.

Exchanges and Conversions

22. If a bond is exchanged or converted into other securities (including conversions of mandatory convertible securities addressed in paragraph 11.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 Investments

23. SVO-identified investments, as discussed in paragraph 4, are captured within the scope of this statement for accounting and reporting⁸ purposes only. The inclusion of these investments within this statement is not intended to contradict state law regarding the classification 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).

24. SVO-identified investments shall be initially reported at cost, including brokerage and other related fees. Subsequently, SVO-identified investments shall be reported at fair value,⁹ with changes in fair value recorded as unrealized gains or losses, unless the reporting entity has elected use¹⁰ 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 investments within the scope of this statement.

25. Use of the systematic value for SVO-identified 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 acquired¹¹. 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

⁸ With the inclusion of these SVO-identified investments in Schedule D, Part 1 or Schedule DA, specific guidelines are detailed in the annual statement instructions for reporting purposes.

⁹ For these investments, net asset value (NAV) is allowed as a practical expedient to fair value.

¹⁰ 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*.

¹¹ This guidance requires investments purchased in lots to follow the measurement method established at the time the investment was first acquired.

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 25.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 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 established¹² approach, which is consistently applied for all equity/fund SVO-identified 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.
26. Income distributions received from SVO-identified investments (cash or shares) shall be reported as interest income in the period in which it is earned. For those SVO-identified 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.
27. For reporting entities required to hold an IMR and AVR reserve, realized and unrealized gains and losses for the SVO-identified 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.
28. SVO-identified 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 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 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

¹² Exhibit B details the established systematic value approach.

investment have materially¹³ 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 acquisition¹⁴. 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.

- 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 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.

29. Impairment guidance for SVO-identified 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

30. 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 investments identified in paragraph 4, are stated;

¹³ 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.

¹⁴ Transition guidance in paragraph 35 shall be followed for initial application and for investments that are designated as SVO-identified investments eligible for systematic value.

- 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 24. 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 investments¹⁵ (e.g., fair value or systematic value). If different measurement methods are used¹⁶, 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 receiving bond treatment, category reported in Annual Statement Schedule D – Bonds issued by:
- i. U.S. Governments;
 - ii. All Other Governments;
 - iii. States, Territories and Possessions (Direct and Guaranteed);
 - iv. U.S. Political Subdivisions of States, Territories and Possessions (Direct and Guaranteed);
 - v. U.S. Special Revenue & Special Assessment Obligations and all Non-Guaranteed Obligations of Agencies and Authorities of Governments and Their Political Subdivisions;
 - vi. Industrial & Miscellaneous (Unaffiliated);
 - vii. Hybrid Securities;

¹⁵ As identified in paragraph 25.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.

¹⁶ 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.

- viii. Parent, Subsidiaries and Affiliates;
- f. For the most recent balance sheet, the book/adjusted carrying values and the fair values of bonds and assets receiving bond treatment, 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 receiving bond treatment, reported in Annual Statement Schedule D – Bonds and gross realized gains and gross realized losses on such sales.
- h. For each balance sheet presented, all bonds 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.
- i. The disclosures in paragraphs 30.h.i. and 30.h.ii. should be segregated by those bonds 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.

31. Refer to the Preamble for further discussion regarding disclosure requirements. The disclosures in paragraphs 30.b., 30.e., 30.f., 30.g., 30.h., 30.i., 30.j. and 30.k. shall be included in the annual audited statutory financial reports only.

Relevant Literature

32. 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.

33. 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*. [Effective December 31, 2023, this statement rejects ASU 2016-13 Financial Instruments—Credit Losses \(Topic 326\), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses \(Topic 326\), Derivatives and Hedging \(Topic 815\), and Leases \(Topic 842\), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments.](#) Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB’s issuance of ASU 2016-13 and other related ASUs.

Effective Date and Transition

34. 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. The guidance in paragraphs 13 and 14 was previously included within SSAP No. 99—*Accounting for Securities Subsequent to an Other-Than-Temporary Impairment* and was effective for reporting periods beginning on January 1, 2009, and thereafter, with early adoption permitted. In 2010, the guidance from SSAP No. 99 was incorporated within the impacted standards, with SSAP No. 99 superseded. 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. Guidance reflected in paragraph 12, incorporated from *INT 02-05: Accounting for Zero Coupon Convertible Bonds*, was originally effective December 8, 2002. Guidance adopted in December 2013 clarifying the ‘yield-to-worst’ concept for bonds with make-whole call provisions is a nonsubstantive change initially effective January 1, 2014, unless the company has previously been following the guidance. (Companies that have previously been following the original intent, as clarified in the revisions, should not be impacted by these changes.) The guidance in paragraph 17 with respect to the calculation of investment income for prepayment penalty and/or acceleration fees is effective January 1, 2017, on a prospective basis and is required for interim and annual reporting periods thereafter. Early application is permitted.

35. In April 2017, substantive revisions, as detailed in Issue Paper No. 156, were adopted. These revisions, effective December 31, 2017, clarify the definition of a bond and what is in scope of the bond definition, as well as incorporate new guidance for SVO-identified investments identified as in scope of SSAP No. 26R, but that are not considered bonds. As of the effective date, reporting entities shall modify the measurement method for SVO-identified investments to reflect the guidance in the substantive revisions as follows:

- a. For SVO-identified investments captured within SSAP No. 26R and held by the reporting entity at the time of transition that will be reported at fair value (or NAV), the reporting entity shall reflect an unrealized gain or unrealized loss for the difference between the prior book/adjusted carrying value and fair value (NAV). Subsequently the investment shall continue to be reported at fair value (or NAV) with fair value fluctuations recorded as unrealized gains or losses, until the time of sale or recognition of an other-than-temporary impairment.
- b. For SVO-identified investments captured within SSAP No. 26R and held by the reporting entity at the time of transition for which the reporting entity elects use of the systematic value measurement method, as of December 31, 2017, the reporting entity shall identify the SVO-identified investment with a code in the Annual Statement Schedule D - Part 1 and continue reporting the investment using the measurement method utilized throughout 2017. As the revisions move the prior measurement method (fair value/original cost) to systematic value, which is a new measurement concept, the reporting entity shall begin calculating systematic value using the SVO-identified investments portfolio's aggregated cash flows (ACF) on January 1, 2018, and use the December 31, 2017, book/adjusted carrying value to calculate the initial book yield. This new measurement approach is a change in accounting principle pursuant to SSAP No. 3, and shall be disclosed under SSAP No. 3. However, a cumulative effect adjustment to capital and surplus is not anticipated as reporting entities will be applying the book/adjusted carrying value as of December 31, 2017, to the aggregated cash flows on January 1, 2018, to calculate initial book yield.
 - i. 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.
 - ii. 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 ACF.
- c. 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. For December 31, 2017, reporting, in addition to identifying the SVO-identified investments designated for systematic value, reporting entities shall disclose the CPY for each SVO-identified investment for NPV-CPY impairment recognition going forward.
- d. For SSAP No. 26R Scope Revisions: If the revisions reflected in SSAP No. 26R (e.g., definitions) result with an investment no longer qualifying (or qualifying) within the scope of SSAP No. 26R, this change shall be reflected prospectively from the effective date. As such, investments previously included within SSAP No. 26, that will move within the scope of another SSAP and reporting schedule shall be shown as dispositions on Schedule D – Part 4, and shown as an acquisition on the schedule for which it will be subsequently reported. (If the revisions move the investment into the scope of SSAP No. 26R, the investment shall be reported as a disposition on the prior investment schedule and as an acquisition on the Schedule D – Part 3.)

36. Revisions adopted April 2019, 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, are effective December 31, 2019.

37. On July 30, 2020, nonsubstantive revisions were adopted to clarify existing guidance that all prepayment penalty 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. Reporting entities that have historically applied this guidance shall not change historical practices, but an effective date of January 1, 2021, with early application permitted, is 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*

EXHIBIT A – GLOSSARY

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.

Bond – Securities representing a creditor relationship, whereby there is a fixed schedule for one or more future payments.

Convertible Bond – A bond that can be converted into a different security, typically shares of common stock.

Hybrids – Securities whose proceeds are accorded some degree of equity treatment by one or more of the nationally recognized statistical rating organizations (NRSRO) and/or which are recognized as regulatory capital by the issuer's primary regulatory authority. Hybrid securities are designed with characteristics of debt and equity and are intended to provide protection to the issuer's senior note holders. Hybrid securities are sometimes referred to as capital securities. An example of a hybrid is a trust-preferred security. Excluded from bond classification are surplus notes, which are reported on BA; subordinated debt issues, which have no coupon deferral features; and "Traditional" preferred stocks, which should be captured under SSAP No. 32R. Traditional preferred stocks include, but are not limited to a) U.S. issuers that do not allow tax deductibility for dividends; and b) those issued as preferred stock of the entity of an operating subsidiary, not through a trust or a special purpose trust.

Trust Preferred Securities – Security possessing characteristics of both equity and debt. A company creates trust-preferred securities by creating a trust, issuing debt to it, and then having it issue preferred securities to investors. Trust-preferred securities are generally issued by bank holding companies. The

preferred securities issued by the trust are what are referred to as trust-preferred securities. The security is a hybrid security with characteristics of both subordinated debt and preferred stock in that it is generally very long term (30 years or more), allows early redemption by the issuer, makes periodic fixed or variable interest payments, and matures at face value. In addition, trust preferred securities issued by bank holding companies will usually allow the deferral of interest payments for up to 5 years.

Mandatory Convertible Bonds - A type of convertible bond that has a required conversion or redemption feature. Either on or before a contractual conversion date, the holder must convert the mandatory convertible bond into the underlying common stock.

Security – Adopts the GAAP definition of a security as it is used in FASB Codification Topic 320 and 860: 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 either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

Yankee Bonds – A bond denominated in U.S. dollars that is publicly issued in the U.S. by foreign banks and corporations. According to the Securities Act of 1933, these bonds must first be registered with the Securities and Exchange Commission (SEC) before they can be sold. Yankee bonds are often issued in tranches. Yankee bonds, or bonds issued by foreign entities denominated in U.S. dollars are not considered hybrid securities unless they have equity-like features.

Zero Coupon Bond – A bond that does not pay interest during the life of the bond. Instead, investors buy zero coupon bonds at a deep discount from their face value, which is the amount a bond will be worth when it "matures" or comes due. When a zero coupon bond matures, the investor will receive one lump sum equal to the initial investment plus the imputed interest, which is discussed below. The maturity dates on zero coupon bonds are usually long-term. Because zero coupon bonds pay no interest until maturity, their prices fluctuate more than other types of bonds in the secondary market. In addition, although no payments are made on zero coupon bonds until they mature, investors may still have to pay federal, state, and local income tax on the imputed or "phantom" interest that accrues each year.

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 Schedule D Part I 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

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 15, the entity would recognize a \$(2) loss (BACV less par), and investment income of \$2 (consideration less par).

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 15, the entity would recognize a \$(1.50) loss (BACV less par), and investment income of \$2 (consideration less par).

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 15, the entity would recognize a \$(1) loss (BACV less par), and investment income of \$1 (consideration less par).

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.

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 prepayment penalty or acceleration fees.

**Entity 2 has in place a process to identify explicit prepayment penalty or acceleration fees.

Not for Distribution

Statement of Statutory Accounting Principles No. 27

Off-Balance-Sheet and Credit Risk Disclosures

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 No other pronouncements
Relevant Appendix A Guidance None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Disclosure of Extent, Nature, and Terms of Financial Instruments with Off-Balance-Sheet Risk.....	2
Disclosure of Credit Risk of Financial Instruments with Off-Balance-Sheet Credit Risk.....	2
Disclosure of Concentrations of Credit Risk of All Financial Instruments	2
Annual and Quarterly Disclosure Requirements.....	3
Relevant Literature.....	3
Effective Date and Transition	3
REFERENCES.....	3
Relevant Issue Papers	3

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for disclosure of information about financial instruments with off-balance-sheet risk and financial instruments with concentration of credit risk.

SUMMARY CONCLUSION

2. A financial instrument shall be defined as cash, evidence of an ownership interest in an entity, or a contract that both:

- a. Imposes on one entity a contractual obligation (i) to deliver cash or another financial instrument to a second entity or (ii) to exchange other financial instruments on potentially unfavorable terms with the second entity; and
- b. Conveys to that second entity a contractual right (i) to receive cash or another financial instrument from the first entity or (ii) to exchange other financial instruments on potentially favorable terms with the first entity.

3. Examples of the financial instruments, which encompass both assets and liabilities recognized and not recognized in the financial statement, to which this statement applies include, but are not limited

to, short-term investments, bonds, common stocks, preferred stocks, mortgage loans, derivatives¹, financial guarantees written, standby letters of credit, notes payable and deposit-type contracts.

Disclosure of Extent, Nature, and Terms of Financial Instruments with Off-Balance-Sheet Risk

4. For financial instruments¹ with off-balance-sheet risk, except as noted in paragraphs 14 and 15 of *FASB Statement No. 105, Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk* (FAS 105), a reporting entity shall disclose in the financial statements the following information by class of financial instrument:

- a. The face or contract amount (or notional principal amount if there is no face or contract amount); and
- b. The nature and terms including, at a minimum, a discussion of (i) the credit and market risk of those instruments, (ii) the cash requirements of those instruments, and (iii) the related accounting policy pursuant to the requirements of *APB Opinion No. 22, Disclosure of Accounting Policies*.

5. Additional disclosures related to derivatives and embedded credit derivatives are addressed in *SSAP No. 86—Derivatives*.

Disclosure of Credit Risk of Financial Instruments with Off-Balance-Sheet Credit Risk

6. For financial instruments¹ with off-balance-sheet credit risk, except as noted in paragraphs 14 and 15 of FAS 105, an entity shall disclose in the financial statements the following information by class of financial instrument:

- a. The amount of accounting loss the entity would incur if any party to the financial instrument failed completely to perform according to the terms of the contract and the collateral or other security, if any, for the amount due proved to be of no value to the entity; and
- b. The entity's policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the entity's access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments.

Disclosure of Concentrations of Credit Risk of All Financial Instruments

7. Except as noted in paragraph 14 of FAS 105, a reporting entity shall disclose all significant concentrations of credit risk arising from all financial instruments¹ whether from an individual or group. Group concentrations of credit risk exist if a number of individuals or groups are engaged in similar activities and have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. The following shall be disclosed in the financial statements about each significant concentration:

- a. Information about the (shared) activity, region, or economic characteristic that identifies the concentration;
- b. The amount of the accounting loss due to credit risk the entity would incur if parties to the financial instruments that make up the concentration failed completely to perform

¹ The financial instruments captured within this statement shall include financial instruments that contain embedded derivatives that are not separately recognized as financial instruments with derivatives under SSAP No. 86, and that expose the holder to the possibility (however remote) of making future payments.

according to the terms of the contracts and the collateral or other security, if any, for the amount due proved to be of no value to the entity; and

- c. The entity's policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the entity's access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments.

Annual and Quarterly Disclosure Requirements

8. Refer to the Preamble for further information regarding disclosure requirements. The disclosures in paragraph 7 shall be included in the annual audited statutory financial reports only.

Relevant Literature

9. This statement adopts the provisions of FAS 105 with the following modifications:
 - a. The disclosures required in paragraph 17 of FAS 105 shall distinguish between derivatives entered into for hedging purposes and for other-than-hedging purposes.
 - b. Paragraph 19 of FAS 105 is rejected. It addresses voluntary disclosures not required by this statement.

Effective Date and Transition

10. This statement is effective for years beginning January 1, 2001.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 27—Disclosure of Information about Financial Instruments with Concentration of Credit Risk*
- *Issue Paper No. 33—Disclosures about Fair Value of Financial Instruments*
- *Issue Paper No. 85—Derivative Instruments (as it relates to disclosure about financial instruments with off-balance-sheet risk)*

Statement of Statutory Accounting Principles No. 29

Prepaid Expenses

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Supersedes SSAP No. 87 with guidance incorporated August 2011; Nullifies and incorporates INT 08-04
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Disclosures.....	2
Relevant Literature.....	2
Effective Date and Transition	2
REFERENCES.....	2
Relevant Issue Papers	2

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for the accounting for prepaid expenses. This statement does not address accounting for deferred policy acquisition costs and other underwriting expenses, income taxes, and guaranty fund assessments. This statement does not address nonrefundable advance payments for goods or services received for use in future research and development activities, which are addressed in *SSAP No. 17—Preoperating and Research and Development Costs*.

SUMMARY CONCLUSION

2. A prepaid expense is an amount which has been paid in advance of receiving future economic benefits anticipated by the payment. Prepaid expenses generally meet the definition of assets in *SSAP No. 4—Assets and Nonadmitted Assets*. Such expenditures also meet the criteria defining nonadmitted assets as specified in SSAP No. 4, (i.e., the assets are not readily available to satisfy policyholder obligations). Prepaid expenses shall be reported as nonadmitted assets and charged against unassigned funds (surplus). They shall be amortized against net income as the estimated economic benefit expires.

3. In accordance with the reporting entity's written capitalization policy, prepaid expenses less than a predefined threshold shall be expensed when purchased. 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.

Disclosures

4. The financial statements shall disclose if the written capitalization policy and the resultant predefined thresholds changed from the prior period and the reason(s) for such change.

Relevant Literature

5. This statement rejects *AICPA Practice Bulletin No. 13, Direct-Response Advertising and Probable Future Benefits*, *AICPA Statement of Position 93-7, Reporting on Advertising Costs* and *FASB Emerging Issues Task Force No. 88-23, Lump-Sum Payments under Union Contracts*.

Effective Date and Transition

6. 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*. Guidance reflected in paragraphs 3 and 4, incorporated from SSAP No. 87, was originally effective for years beginning on and after January 1, 2004.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 29—Prepaid Expenses (excluding deferred policy acquisition costs and other underwriting expenses, income taxes and guaranty fund assessments)*
- *Issue Paper No. 119—Capitalization Policy, An Amendment to SSAP Nos. 4, 19, 29, 73, 79 and 82*

Statement of Statutory Accounting Principles No. 30 – Revised

Unaffiliated Common Stock

STATUS

Type of Issue	Common Area
Issued.....	Initial Draft; Substantively revised November 15, 2018
Effective Date.....	January 1, 2001; Substantive revisions detailed in Issue Paper No. 158 effective January 1, 2019
Affects	Nullifies INT 02-07
Affected by	No other pronouncements
Interpreted by	INT 06-02; INT 06-07
Relevant Appendix A Guidance	None

STATUS	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	2
Acquisitions and Sales	3
Balance Sheet Amount.....	3
Impairment.....	3
Income	3
Stock Splits, Stock Dividends, Payment in Kind Dividends, and Stock Exchanges	4
FHLB Capital Stock.....	4
Disclosures.....	5
FHLB Disclosures.....	5
Relevant Literature.....	6
Effective Date and Transition	6
REFERENCES.....	6
Other	6
Relevant Issue Papers	6

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for common stocks.
2. Investments in common stock of subsidiaries, controlled or affiliated entities (investments in affiliates) are not within the scope of this statement. They are addressed in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.
3. Investments in the form of common stock that are in substance residual interests or a residual security tranche, as defined in *SSAP No. 43R—Loan-Backed and Structured Securities* or *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, shall be reported on Schedule BA: Other Long-Term Assets in the dedicated reporting lines for residuals.

SUMMARY CONCLUSION

~~3.4.~~ Common stocks (excluding investments in affiliates) are securities which represent a residual/subordinate ownership in a corporation. This definition includes:

- a. Publicly traded common stocks;
- b. Common stocks that are not publicly traded; and
- c. Common stocks restricted as to transfer of ownership¹

~~4.5.~~ In addition, the following equity² investments are captured within scope of this statement:

- a. Master limited partnerships trading as common stock and American deposit receipts only if the security is traded on the New York or NASDAQ exchange;
- b. Publicly traded common stock warrants;
- 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 stocks⁴), 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;
- 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/securities-valuation-office>~~;
- e. Foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction. Other foreign funds are excluded from the scope of this statement; and
- f. Equity interests in certified capital companies in accordance with *INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)*.

~~5.6.~~ Investments within 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.

¹ Restricted stock shall be defined as a security for which sale is restricted by governmental or contractual requirement (other than in connection with being pledged as collateral), except where that requirement terminates within one year or if the holder has the power by contract or otherwise to cause the requirement to be met within one year. Any portion of the security that can be reasonably expected to qualify for sale within one year is not considered restricted. Regardless of redemption timeframe, FHLB capital stock is considered restricted stock until actual redemption by the FHLB.

² Unless as specifically noted, the equity investments identified within scope are subject to the provisions of this standard as if they were common stock investments.

³ Non-SEC registered investment companies (e.g., private investment companies or hedge funds) are excluded from the scope of this statement.

⁴ Money market mutual funds are considered cash equivalents under SSAP No. 2R.

Acquisitions and Sales

~~6.7.~~ At acquisition, common stocks shall be reported at their cost, including brokerage and other related fees. Common stock acquisitions and dispositions shall be recorded on the trade date. Private placement stock transactions shall be recorded on the funding date. A reporting entity may become qualified for use of equity method accounting by an increase in the level of ownership. In this situation, the reporting entity shall add the cost of acquiring additional interest in the investee to the current basis of the previously held interest and shall apply the equity method, as prescribed in SSAP No. 97, prospectively, as of the date the investment becomes qualified for equity method accounting.

~~7.8.~~ A reporting entity can subscribe for the purchase of stock, but not be required to make payment until a later time. Transactions of this nature are common in the formation of corporations. Common stock acquired under a subscription represents a conditional transaction in a security authorized for issuance but not yet actually issued. Such transactions are settled if and when the actual security is issued and the exchange or National Association of Securities Dealers (NASD) rules that the transactions are to be settled. Common stock acquired under a subscription shall be recorded as an admitted asset when the reporting entity or its designated custodian or transfer agent takes delivery of the security and the security is recorded in the name of the reporting entity or its nominee (i.e., the accounting for such common stock acquisitions shall be on the settlement date).

Balance Sheet Amount

~~8.9.~~ Investments in scope of this standard shall be reported at fair value. For FHLB capital stock, which is only redeemable at par, the fair value shall be presumed to be par, unless considered other-than-temporarily impaired. Mutual funds, unit-invested funds, and exchange traded funds without a readily determinable fair value are permitted to be reported at net asset value if permitted as a practical expedient pursuant to the guidance in SSAP No. 100R. Closed-end funds are not permitted to be reported at net asset value and shall be reported at fair value. Changes in fair value (or net asset value, as permitted) shall be recorded as unrealized gains or losses.

~~9.10.~~ For reporting entities required to maintain an Asset Valuation Reserve (AVR), the accounting for unrealized capital gains and losses shall be in accordance with SSAP No. 7—*Asset Valuation Reserve and Interest Maintenance Reserve*. For reporting entities not required to maintain an AVR, unrealized capital gains and losses shall be recorded as a direct credit or charge to surplus.

Impairment

~~10.11.~~ For any decline in the fair value of a common stock which is determined to be other than temporary (INT 06-07) the common stock shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. For those reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with SSAP No. 7. 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 decline in fair value which is other than temporary includes situations where a reporting entity has made a decision to sell a security at an amount below its carrying value.

Income

~~11.12.~~ Dividends on common stock shall be recorded as investment income on the ex-dividend date with a corresponding receivable to be extinguished upon receipt of cash (i.e., dividend income shall be recorded on stocks declared to be ex-dividends on or prior to the statement date).

~~12.13.~~ For reporting entities required to maintain an AVR, the accounting for realized capital gains and losses on sales of common stock shall be in accordance with SSAP No. 7. For reporting entities not required

to maintain an AVR, realized gains and losses on sales of common stock shall be reported as realized gains/losses in the statement of operations.

Stock Splits, Stock Dividends, Payment in Kind Dividends, and Stock Exchanges

~~13.~~14. Stock splits, stock dividends, payment in kind dividends, and stock exchanges shall be accounted for in accordance with *SSAP No. 95—Nonmonetary Transactions*.

FHLB Capital Stock

~~14.~~15. FHLB capital stock is held by reporting entities that are members of an FHLB. Each reporting entity must acquire FHLB capital stock for membership and maintain capital stock holding sufficient to support its business activity (borrowings⁵) in accordance with the respective FHLB's capital plan. The price of FHLB capital stock cannot fluctuate, and all FHLB capital stock must be purchased, repurchased or transferred at its par value. FHLB capital stock is restricted for redemption in accordance with the FHLB capital plan and shall be coded as restricted within the financial statements (e.g., investment schedules and general interrogatories).

~~15.~~16. Acquisition of FHLB capital stock allows members to conduct business activity (borrowings) from an FHLB. The amount of capital stock acquired determines the reporting entity's eligible borrowing amount. At a minimum, all borrowings from an FHLB (regardless of structure) must also be fully collateralized in accordance with the FHLB capital plan, which determines the amount of collateral required by type of pledged instrument. Collateral pledged to an FHLB shall be coded as restricted within the financial statements (e.g., investments schedules and general interrogatories). Collateral pledged to an FHLB by a reporting entity FHLB member is considered an admitted asset if all of the conditions in paragraphs ~~15~~16.a. through ~~15~~16.d. are met:

- a. The asset would have been admitted under SSAP No. 4⁶;
- b. The pledging insurer continues to receive the income on the pledged collateral;
- c. The pledging insurer can remove and substitute other securities with little or advance notice to the FHLB as long as the insurer complies with related investment quality and market value provisions; and
- d. There has been no uncured default or event to indicate an impairment or loss contingency for the pledged assets.

~~16.~~17. The guidance in paragraph ~~14~~15 and paragraph ~~15~~16 is specific for reporting entities that are FHLB members. A reporting entity that engages with an FHLB through an "affiliate arrangement" (meaning an affiliate of the reporting entity is the FHLB member), is not considered an FHLB member. In those situations, any FHLB capital stock held by the non-FHLB member reporting entity or collateral pledged to an FHLB on behalf of an affiliate shall be nonadmitted. Detail of the affiliate FHLB arrangement, including any collateral pledged or funds received, shall be captured as a related party transaction (as if the activity occurred directly with the affiliate) under the provisions of *SSAP No. 25—Affiliates and Other Related Parties*.

⁵ Membership in an FHLB allows reporting entities to take advances / borrow from the FHLB. These borrowings can be structured in a variety of ways, for example: debt, funding agreements, repurchase agreements, securities lending, etc. Borrowings from an FHLB shall be reflected in the financial statements in accordance with the SSAP that addresses the substance of the agreement.

⁶ As detailed in SSAP No. 4, if assets are pledged or otherwise restricted by the action of a related party, the assets are not permitted to be admitted in the statutory financial statements. As such, a reporting entity pledging assets to an FHLB on behalf of an affiliate shall nonadmit the pledged assets.

Disclosures

~~17~~18. The following disclosures regarding common stocks shall be made in the financial statements:

- a. Basis at which the common stocks are stated; and
- b. A description, as well as the amount, of common stock that is restricted outside of FHLB agreements and the nature of the restriction. (Disclosures of FHLB capital stock are captured in paragraph ~~18~~19.)
- c. For each balance sheet presented, all common stocks 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 common stocks with unrealized losses.
- d. The disclosures in (i) and (ii) above should be segregated by those common stocks 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—Fair Value*.
- e. As of the most recent balance sheet 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.
- f. When it is not practicable to estimate fair value, 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.

FHLB Disclosures

~~18~~19. For reporting entity FHLB members, the following information shall be disclosed in the financial statements for current and prior year and between general account and separate account activity. The information in the disclosures shall be presented gross even if a right to offset exists per *SSAP No. 64—Offsetting and Netting of Assets and Liabilities*.

- a. General description of FHLB agreements, with information on the nature of the agreement, type of borrowing (advances, lines of credit, borrowed money, etc.) and use of the funding.
- b. Amount of FHLB capital stock held, in aggregate, and classified as follows: i) membership stock (separated by Class A and Class B); ii) Activity Stock; and iii) Excess Stock. For membership stock, report the amount of FHLB capital stock eligible for redemption⁷ and the anticipated timeframe for redemption: i) less than 6 months, ii) 6 months to 1 year, iii) 1 year to 3 years, and iv) 3 to 5 years.

⁷ For FHLB membership stock to be eligible for redemption, written notification must have been provided to the FHLB prior to the reporting date.

- c. Amount (fair value and carrying value) of collateral pledged to the FHLB as of the reporting date. In addition, report the maximum amount of collateral pledged to the FHLB at any time during the current reporting period. (Maximum shall be determined on the basis of carrying value, but with fair value also reported.)
- d. Aggregate amount of borrowings at the reporting date from the FHLB, reflecting compilation of all advances, loans, funding agreements, repurchase agreements, securities lending, etc., outstanding with the FHLB, and classify whether the borrowing is in substance: i) debt (*SSAP No. 15—Debt and Holding Company Obligations*), ii) a funding agreement (*SSAP No. 52—Deposit-Type Contracts*), or iii) Other. For funding agreements, report the total reserves established. Report the maximum amount of aggregate borrowings from an FHLB at any time during the current reporting period, the actual or estimated maximum borrowing capacity as determined by the insurer, with a description of how the borrowing capacity was determined, and whether current borrowings are subject to prepayment penalties.

~~19~~~~20~~. The disclosures in paragraphs ~~17~~~~18~~.c. through ~~17~~~~18~~.f. shall be included in the annual audited statutory financial reports only. The FHLB disclosures in paragraph ~~18~~~~19~~ are required in all interim and annual financial statements regardless if the activity is materially different from the activity reported during the prior reporting period. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

~~20~~~~21~~. This statement adopts *ASU 2016-07, Investments - Equity Method and Joint Ventures*, modified to reflect statutory terms including the definition of control and statutory reporting concepts. This statement rejects *ASU 2018-03, Recognition and Measurement of Financial Assets and Financial Liabilities*, and *ASU 2016-01, Financial Instruments – Overall and FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities*.

Effective Date and Transition

~~21~~~~22~~. 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*. Revisions adopted to this statement in October 2013 amending SSAP No. 15 and SSAP No. 52 to incorporate FHLB disclosure information are initially effective for interim and annual reporting periods after January 1, 2014. Revisions adopted to this statement in November 2018, incorporating closed-end funds and unit-investment trusts within scope, are initially effective January 1, 2019. Revisions adopted in April 2019 to explicitly include foreign registered open-end investment funds in scope are effective January 1, 2019.

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. 30—Investments in Common Stock (excluding investments in common stock of subsidiary, controlled, or affiliated entities)*
- *Issue Paper No. 158—Unaffiliated Common Stock*

Statement of Statutory Accounting Principles No. 32 – Revised

Preferred Stock

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft; Substantively revised July 30, 2020
Effective Date	January 1, 2001; Substantive revisions detailed in Issue Paper No. 164 effective January 1, 2021
Affects.....	Supersedes SSAP No. 99 with guidance incorporated November 2010; Nullifies and incorporates INT 99-29
Affected by	No other pronouncements
Interpreted by	INT 06-02; INT 06-07
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	2
Acquisitions and Sales	3
Amortization	3
Balance Sheet Amount.....	4
Impairment of Redeemable Preferred Stock.....	4
Impairment of Perpetual Preferred Stock.....	5
Income	5
Redemption of Preferred Stock.....	5
Exchanges and Conversions	5
Disclosures.....	6
Relevant Literature.....	6
Effective Date and Transition	7
REFERENCES.....	7
Other	7
Relevant Issue Papers	7
EXHIBIT A – GLOSSARY.....	8

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for preferred stock.
2. Investments in preferred stock of entities captured in *SSAP No. 97—Investments in Subsidiaries, Controlled or Affiliated Entities* or *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability*

*Companies*¹ as well as preferred stock interests of certified capital companies per INT 06-02: *Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)* are included within the scope of this statement. The requirement to file investments in preferred stock of certain subsidiaries, controlled or affiliated entities with the NAIC pursuant to SSAP No. 97 does not affect the application of the accounting, valuation or admissibility under this statement. In addition to the provisions of this statement, preferred stock investments in SCAs are also subject to the provisions of SSAP No. 25—*Affiliates and Other Related Parties* and SSAP No. 97—*Investments in Subsidiary, Controlled and Affiliated Entities*.

3. Investments in the form of preferred stock that are in substance residual interests or a residual security tranche, as defined in SSAP No. 43R—*Loan-Backed and Structured Securities* or SSAP No. 48—*Joint Ventures, Partnerships and Limited Liability Companies*, shall be reported on Schedule BA: Other Long-Term Assets in the dedicated reporting lines for residuals.

SUMMARY CONCLUSION

~~3.4.~~ Preferred stock which may or may not be publicly traded is a security that represents ownership of a corporation and gives the holder a claim prior to the claim of common stockholders on earnings and also generally on assets in the event of liquidation. Most preferred stock pays a fixed dividend that is paid prior to the common stock dividend, stated in a dollar amount or as a percentage of par value. Preferred stock does not usually carry voting rights. Preferred stock has characteristics of both common stock and debt. Preferred stock shall include:

- a. Redeemable preferred stock, which is preferred stock subject to mandatory redemption requirements or whose redemption is at the option of the holders. Redeemable preferred stock is any stock which 1) the issuer undertakes to redeem at a fixed or determinable price on the fixed or determinable date or dates, whether by operation of a sinking fund or otherwise; or 2) is redeemable at the option of the holders. Preferred stock which meet one or more of these criteria would be classified as redeemable preferred stock,² regardless of other attributes such as voting rights or dividend rights.
- b. Perpetual preferred stock, which is preferred stocks which are not redeemable or for which redemption is not at the option of the holder (non-redeemable preferred stock). Perpetual preferred stock is any preferred stock which does not meet the criteria to be classified as redeemable preferred stock pursuant to paragraph ~~3.4.~~a.
- c. Publicly traded preferred stock warrants.

~~4.5.~~ The definition of preferred stock, as defined in paragraph ~~3.4.~~, does not include fund investments. However, the following types of SVO-identified investments are captured within scope of this statement.

- 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/securities-valuation-office>~~. SVO-identified preferred stock ETFs shall follow the accounting provisions for perpetual preferred stock.

¹ Certain legal entities captured in SSAP No. 48, such as LLCs that are corporate-like, do not issue preferred stock in legal form, but instead issue identical instruments labeled preferred units, interests, or shares. These instruments shall be captured in this statement provided they meet the structural characteristics as defined in paragraph ~~3.4.~~ Additionally, these instruments shall not be in-substance common stock in which the holder has risk and reward characteristics that are substantially similar to common stock.

² Preferred stock shall be classified by its characteristics. For example, a preferred stock that is named “redeemable perpetual preferred stock” shall be reported as either “redeemable” or “perpetual” preferred stock based on whether the characteristics of paragraph ~~3.4.~~a. are met.

~~5.6.~~ Restricted preferred stock is defined³ as either redeemable or perpetual preferred stock that must be traded in compliance with special Securities Exchange Commission (SEC) regulations concerning its purchase and resale. These restrictions generally result from affiliate ownership, merger and acquisition (M&A) activity and underwriting activity. Pursuant to the SEC, restricted securities are securities acquired in an unregistered, private sale from the issuing company or from an affiliate of the issuer. They typically bear a “restrictive” legend clearly stating that the holding may not resell the stock in the public marketplace unless the sale is exempt from the SEC’s registration requirements. Restricted preferred stock is generally considered an admitted asset; however, admittance may be limited based on the degree of restriction in accordance with *SSAP No. 4—Assets and Nonadmitted Assets*. Restricted preferred stock shall be coded as restricted in the investment schedule and disclosed pursuant to *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures*.

~~6.7.~~ Preferred stocks meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement, *SSAP No. 25* and *SSAP No. 97*.

Acquisitions and Sales

~~7.8.~~ At acquisition, preferred stock shall be reported at cost, including brokerage and other related fees. Preferred stock received as dividends shall be recorded at fair value. Acquisitions and dispositions shall be recorded on the trade date. Private placement stock transactions shall be recorded on the funding date.

~~8.9.~~ A reporting entity can subscribe for the purchase of stock, but not be required to make payment until a later time. Transactions of this nature are common in the formation of corporations. Preferred stock acquired under a subscription represents a conditional transaction in which preferred stock is authorized for issuance but not yet actually issued. Such transactions are settled if and when the actual preferred stock is issued and the exchange or National Association of Securities Dealers (NASD) rules that the transactions are to be settled. Preferred stock acquired under a subscription shall be recorded as an admitted asset when the reporting entity or its designated custodian or transfer agent takes delivery of the preferred stock and the preferred stock is recorded in the name of the reporting entity or its nominee, (i.e., the accounting for such preferred stock acquisitions shall be on the settlement date).

Amortization

~~9.10.~~ Redeemable preferred stock purchased at a premium shall be amortized to reduce the carrying value to the call or redemption value over the period to the call or earliest redemption date, whichever produces the lowest asset value (yield to worst). Redeemable preferred stock purchased at a discount shall be accreted to increase the carrying value to the redemption price over the period to maturity or the latest redemption date.

~~10.11.~~ Amortization (and accretion) of the premium and discount arising at acquisition shall be calculated using the interest method and shall be reported through investment income.

³ This definition of restricted stock does not preclude a “restricted asset” classification for any preferred stock that is restricted (e.g., not under the exclusive control of the entity) by actions of the reporting entity or others. For example, if a reporting entity has pledged preferred stock, or used preferred stock in securities lending / repo transactions, the preferred stock shall be coded and disclosed as restricted stock pursuant to *SSAP No. 1—Accounting Policies, Risks & Uncertainties and Other Disclosures*.

Balance Sheet Amount

~~11~~.12. Preferred stock shall be valued based on (a) the underlying characteristics (redeemable, perpetual or mandatory convertible), (b) the quality rating expressed as an NAIC designation, and (c) whether an asset valuation reserve (AVR) is maintained by the reporting entity⁴:

- a. For reporting entities that do not maintain an AVR:
 - i. Highest-quality or high-quality redeemable preferred stocks (NAIC designations 1 and 2) shall be valued at amortized cost. All other redeemable preferred stocks (NAIC designations 3 to 6) shall be reported at the lower of amortized cost or fair value.
 - ii. Perpetual preferred stock and publicly traded preferred stock warrants shall be reported at fair value, not to exceed any currently effective call price.
 - iii. Mandatory convertible preferred stocks (regardless if the preferred stock is redeemable or perpetual) shall be reported at fair value, not to exceed any currently effective call price, in the periods prior to conversion. Upon conversion to common stock, these securities shall be in scope of SSAP No. 30R.
 - iv. For preferred stocks reported at fair value, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus).
- b. For reporting entities that maintain an AVR:
 - i. Highest-quality, high-quality or medium quality redeemable preferred stocks (NAIC designations 1 to 3) shall be valued at amortized cost. All other redeemable preferred stocks (NAIC designations 4 to 6) shall be reported at the lower of amortized cost or fair value.
 - ii. Perpetual preferred stock and publicly preferred stock warrants shall be valued at fair value, not to exceed any currently effective call price.
 - iii. Mandatory convertible preferred stocks (regardless if the preferred stock is redeemable or perpetual) shall be reported at fair value, not to exceed any currently effective call price, in the periods prior to conversion. Upon conversion to common stock, these securities shall be in scope of SSAP No. 30R.
 - iv. For preferred stocks reported at fair value, the accounting for unrealized gains and losses shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*.

Impairment of Redeemable Preferred Stock

~~12~~.13. 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 the preferred stock in effect at the date of acquisition. An assessment of other-than-temporary impairment shall occur whenever mandatory redemption rights or sinking fund requirements do not occur. A decline in fair value which is other-than-temporary includes situations where the reporting entity has made a decision to sell the preferred stock prior to its maturity at an amount below its carrying value (i.e., amortized cost). If

⁴ In all situations noted in this statement in which the fair value is limited to the currently effective call price, this limitation only applies when the call is 1) currently exercisable by the issuer, or 2) the issuer has announced that the instruments will be redeemed/called.

it is determined that a decline in the fair value of a redeemable preferred stock is other-than-temporary, an impairment loss shall be recognized as a realized loss equal to the entire difference between the redeemable preferred stock's carrying value and its fair value, not to exceed any currently effective call price, 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, realized losses shall be accounted for in accordance with SSAP No. 7.

~~13.~~14. In periods subsequent to the recognition of other-than-temporary impairment loss for a redeemable preferred stock, the reporting entity shall account for the other-than-temporarily impaired preferred stock as if the preferred stock had been purchased on the measurement date of the other-than-temporary impairment. The fair value of the redeemable preferred stock on the other-than-temporary impairment measurement date shall become the new cost basis of the redeemable preferred stock and the new cost basis shall not be adjusted for subsequent recoveries in fair value. The discount or reduced premium recorded for the preferred stock, based on the new cost basis, shall be amortized over the remaining life of the preferred stock in the prospective manner based on the amount and timing of future estimated cash flows. The preferred stock 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.

Impairment of Perpetual Preferred Stock

~~14.~~15. For any decline in the fair value of perpetual preferred stock or publicly traded preferred stock warrants, which is determined to be other-than-temporary ^(INT 06-07), the perpetual preferred stock or warrant shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. For reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with SSAP No. 7. Subsequent fluctuations in fair value shall be recorded as unrealized gains or losses. Future declines, which are determined to be other-than-temporary, shall be recognized as realized losses. A decline in fair value which is other-than-temporary includes situations where the reporting entity has made a decision to sell a preferred stock at an amount below its carrying value.

Income

~~15.~~16. Dividends on preferred stock shall be recorded as investment income for dividend-eligible preferred stock on the ex-dividend date with a corresponding receivable to be extinguished upon dividend settlement. Dividends received shall be recognized in the form received (e.g., cash, preferred stock, common stock) at fair value with differences between fair value and the dividend receivable recognized as gains or losses. Subsequent treatment shall follow the statement that addresses the type of asset received. For example, dividends received in the form of common stock shall be accounted for and reported in accordance with SSAP No. 30R.

Redemption of Preferred Stock

~~16.~~17. A reporting entity that sells or redeems preferred stock back to the issuer shall recognize consideration received in excess of the book/adjusted carrying value as a realized gain or loss. This recognition shall occur regardless of whether the issuer repurchases the preferred shares at market value, or if the shares are redeemed by the issuer at a predetermined set call price.

Exchanges and Conversions

~~17.~~18. If preferred stock is exchanged or converted into other securities, the fair value of the preferred stock 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 preferred stock surrendered, then it shall become the cost basis for the new securities.

Disclosures

~~18~~19. The following disclosures regarding preferred stocks shall be made 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*;
- c. Basis at which the preferred stocks are stated, and
- d. A description as well as the amount of preferred stock that is restricted and the nature of the restriction.
- e. For each balance sheet presented, all preferred stocks 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 preferred stocks with unrealized losses.
- f. The disclosures in (i) and (ii) above should be segregated by those preferred stocks 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*.
- g. As of the date of the most recent balance sheet 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.
- h. When it is not practicable to estimate fair value, 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.

~~19~~20. Refer to the Preamble for further discussion regarding disclosure requirements. The disclosure requirements of paragraphs ~~18~~19.b., ~~18~~19.e., ~~18~~19.f., ~~18~~19.g. and ~~18~~19.h. shall be included in the annual audited statutory financial reports only.

Relevant Literature

~~20~~21. This statement rejects *ASU 2018-03, Recognition and Measurement of Financial Assets and Financial Liabilities*, *ASU 2016-01, Financial Instruments – Overall*, *FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities* and *FASB Emerging Issues Task Force No. 86-32, Early Extinguishment of a Subsidiary's Mandatorily Redeemable Preferred Stock*. This statement 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. [Effective December 31, 2023, this statement rejects ASU 2016-13 Financial Instruments—Credit Losses \(Topic 326\), Measurement of Credit Losses on Financial](#)

Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB’s issuance of ASU 2016-13 and other related ASUs.

Effective Date and Transition

~~21~~22. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—*Accounting Changes and Corrections of Errors*. The guidance in paragraphs ~~23~~24–~~26~~27 was previously included within SSAP No. 99—*Accounting for Securities Subsequent to an Other-Than-Temporary Impairment* and was effective for reporting periods beginning on January 1, 2009, and thereafter, with early adoption permitted. In 2010, the guidance from SSAP No. 99 was incorporated within the impacted standards, with SSAP No. 99 superseded. The original impairment guidance included in this standard, and the substantive revisions reflected in SSAP No. 99 are retained for historical purposes within Issue Paper No. 131. The guidance in paragraphs 2 and ~~34~~ to SSAP No. 32 was originally superseded January 1, 2005, by guidance included in SSAP No. 88—*Investments in Subsidiaries, Controlled and Affiliated Entities*, A replacement of SSAP No. 46, and then subsequently reflected in SSAP No. 97. In 2011, the guidance related to preferred stock of SCAs from SSAP No. 97 was incorporated into this statement and revised to reflect a definition of preferred stock. The original guidance included in this statement, and the substantive revisions reflected in SSAP No. 88 and SSAP No. 97 (including the title change already reflected in SSAP No. 32) are retained for historical purposes within Issue Paper Nos. 32 and 118. Guidance in paragraph ~~17~~18 was originally contained in INT 99-29: *Classification of Step-Up Preferred Stock* and was effective December 6, 1999.

~~22~~23. On July 30, 2020, substantive revisions, as detailed in *Issue Paper No. 164—Preferred Stock* were adopted. These revisions update definitions of preferred stock and reporting values based on characteristics of the preferred stock and are effective January 1, 2021, with early adoption permitted.

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. 32—Investments in Preferred Stock (excluding investments in preferred stock of subsidiary, controlled, or affiliated companies)*
- *Issue Paper No. 131—Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment*
- *Issue Paper No. 164—Preferred Stock*

EXHIBIT A – GLOSSARY

Callable Preferred Stock – A preferred stock in which the issuer has the right to call or redeem the stock at a preset price after a defined date. Callable preferred stock can be either redeemable preferred stock or perpetual preferred stock depending on other characteristics of the preferred stock. For example, callable preferred stock with a maturity or a specific buyback date would be redeemable preferred stock, whereas callable preferred stock electable at the discretion of the issuer is perpetual preferred stock.

Convertible Preferred Stock – A preferred stock that is convertible into another security based on a conversion rate. For example, convertible preferred stock that is convertible into common stock on a two-for-one basis (two shares of common for each share of preferred).

Cumulative Preferred Stock – A preferred stock with a provision that missed dividend payments must be paid to cumulative preferred shareholders before other classes of preferred stock shareholders and common shareholders can receive dividend payments. Cumulative preferred stock may have different levels, with a “first” or “senior” cumulative preferred, “regular” cumulative preferred and “subordinate” cumulative preferred that determines the priority in which accumulated unpaid dividends or asset liquidation occurs. (Under SSAP No. 32R, holders of cumulative preferred stock are not permitted to recognize a receivable for unpaid cumulative dividends until declared and the reporting entity is entitled to the dividend.)

Dividend Declaration Date – The date a corporation declares a dividend payment to its shareholders.

Dividend Record Date – The date that identifies the shareholders that are entitled to a declared dividend.

Dividend Payment Date – The date the declared dividend will be paid.

Ex-Dividend Date – The cut-off date of holding stock to be captured as a shareholder on record entitled to the dividend. (A shareholder that sells their stock on the ex-dividend date would continue to be identified as a shareholder on record entitled to a declared dividend. Anyone who acquires a stock on the ex-dividend date would not be a shareholder on record entitled to a declared dividend.)

Mandatory Redeemable Preferred Stock – A preferred stock that embodies an unconditional obligation requiring the issuer to redeem the instrument by transferring its assets at a specified or determinable date (or dates) or upon an event that is certain to occur. (The existence of a mandatory redemption right does not convert the holder of a preferred stock into a creditor, and an issuer may be prohibited from redeeming shares when redemption would cause an impairment of capital.)

Noncumulative Preferred Stock – A preferred stock that does not entitle the stockholder to accumulated unpaid dividends. After missing dividend payments, a corporation only has to make current dividend payments to preferred stock holders before providing dividends to common stock holders.

Participating Preferred Stock – A preferred stock that gives the holder participation in the additional earnings of a business or liquidation rights in addition to the normal preferred stock dividend. Pursuant to the terms of the preferred stock, the participation rights may only be activated when income or operations of the issuer exceeds a certain threshold level.

Payment-in-kind (PIK) – A term of the preferred stock prospectus that identifies that dividends may take the form of securities (e.g., common stock) rather than cash.

Perpetual Preferred Stock - Preferred stocks which are not redeemable or are redeemable solely at the option of the issuer. Perpetual preferred stock is any preferred stock which does not meet the criteria to be classified as redeemable preferred stock.

Preferred stock - A security, which may or may not be publicly traded, that shows ownership of a corporation and gives the holder a claim, prior to the claim of common stockholders on earnings and also generally on assets in the event of liquidation.

Redeemable Preferred Stock - Preferred stock subject to mandatory redemption requirements or whose redemption is outside the control of the issuer. Redeemable preferred stock is any stock which 1) the issuer undertakes to redeem at a fixed or determinable price on the fixed or determinable date or dates, whether by operation of a sinking fund or otherwise; 2) is redeemable at the option of the holders; or 3) has conditions for redemption which are not solely within the control of the issuer, such as stock which must be redeemed out of future earnings. Preferred stock which meet one or more of these three criteria is redeemable preferred stock regardless of other attributes such as voting rights or dividend rights.

Restricted Preferred Stock - Redeemable or perpetual preferred stock that must be traded in compliance with special SEC regulations concerning its purchase and resale. These restrictions generally result from affiliate ownership, M&A activity and underwriting activity. Pursuant to the SEC, restricted securities are securities acquired in an unregistered, private sale from the issuing company or from an affiliate of the issuer. They typically bear a “restrictive” legend clearly stating that the holding may not resell the stock in the public marketplace unless the sale is exempt from the SEC’s registration requirements.

Sinking Fund – A potential component of a preferred stock charter that requires the issuer to regularly set funds aside in a separate custodial account for the exclusive purpose of redeeming preferred stock shares. Failure of an issuer to provide to the sinking fund does not create an act of default. Rather, the stock charter may implement provisions for failing to provide to the sinking fund, which could include penalties, restrictions of providing common stock dividends or the repurchase of the preferred stock.

Step-Up Preferred Stock – A potential component of a preferred stock charter that identifies whether specific terms will increase over time or with stated provisions. For example, a “step-up dividend” is a feature that increases the dividend rate. A “step-up call” is a feature that increases the call price. A “step-up conversion” increases the conversion price.

Term Preferred Stock – Preferred stock with a mandatory redemption requirement (maturity date) captured in the definition of redeemable preferred stock.

Statement of Statutory Accounting Principles No. 34

Investment Income Due and Accrued

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Supersedes SSAP No. 99 with guidance incorporated November 2010
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS	1
SCOPE OF STATEMENT	1
SUMMARY CONCLUSION	1
Disclosures.....	2
Effective Date and Transition	2
REFERENCES	3
Relevant Issue Papers	3

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for investment income due and accrued.

SUMMARY CONCLUSION

2. Investment income due shall be defined as investment income earned and legally due to be paid to the reporting entity (i.e., receivable) as of the reporting date. Investment income accrued shall be defined as investment income earned as of the reporting date but not legally due to be paid to the reporting entity until subsequent to the reporting date.
3. In general, gross investment income shall be recorded as earned and shall include investment income collected during the period, the change in investment income due and accrued, the change in unearned investment income plus any amortization (e.g., discounts or premiums on bonds, origination fees on mortgage loans, etc.) Immediate amortization of premium which occurs upon recognition of an other-than-temporary impairment loss for a debt security with a recorded premium shall be reported as a realized loss and shall not be included in investment income.
4. Investment income due and accrued shall be recorded as an asset in accordance with *SSAP No. 4—Assets and Nonadmitted Assets*. An evaluation shall be made of such assets in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*, to determine whether an impairment exists. Amounts determined to be uncollectible shall be written off through the statement of operations. Then an evaluation shall be made to determine nonadmitted amounts.

5. This two-step process is set forth below.
- a. Investment income due and accrued shall be assessed for collectibility. If, in accordance with SSAP No. 5R, it is probable the investment income due and accrued balance is uncollectible, the amount shall be written off and shall be charged against investment income in the period such determination is made;
 - b. Any remaining investment income due and accrued (i.e., amounts considered probable of collection) representing either (1) amounts that are over 90 days past due (generated by any invested asset except mortgage loans in default), or (2) amounts designated elsewhere in the *Accounting Practices and Procedures Manual* as nonadmitted shall be considered nonadmitted assets and recognized through a direct charge to surplus in accordance with SSAP No. 4. These nonadmitted amounts shall be subject to continuing assessments of collectibility and, if determined to be uncollectible, a write-off shall be recorded in the period such determination is made in accordance with paragraph 5.a.
6. Accrued interest on mortgage loans that are in default (as defined in *SSAP No. 37—Mortgage Loans*) shall be recorded as Investment Income Due and Accrued when such interest is deemed collectible. Interest can be accrued on mortgage loans in default if deemed collectible; if interest is deemed uncollectible, it shall not be accrued and any previously accrued amounts are to be written off in accordance with the guidelines in paragraph 5.a. If a mortgage loan in default has interest 180 days past due which has been assessed as collectible, all interest shall be considered a nonadmitted asset and recognized through a direct charge to surplus as outlined in paragraph 5.b.

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;¹
 - 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.¹
8. Refer to the Preamble for further discussion regarding disclosure requirements.

Effective Date and Transition

9. This statement 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. Effective December 31, 2023,

¹ 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.

this statement rejects ASU 2016-13 Financial Instruments—Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB’s issuance of ASU 2016-13 and other related ASUs.

10. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—*Accounting Changes and Corrections of Errors*. The guidance in paragraph 3 was previously included within SSAP No. 99—*Accounting for Securities Subsequent to an Other-Than-Temporary Impairment* and was effective for reporting periods beginning on January 1, 2009, and thereafter, with early adoption permitted. In 2010, the guidance from SSAP No. 99 was incorporated within the impacted standards, with SSAP No. 99 superseded. The original paragraph 3 guidance from this standard, and the substantive revisions reflected in SSAP No. 99 are retained for historical purposes within Issue Paper No. 131.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 34—Investment Income Due and Accrued*
- *Issue Paper No. 131—Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment*

Statement of Statutory Accounting Principles No. 35 – Revised

Guaranty Fund and Other Assessments

STATUS

Type of Issue.....	Common Area
Issued	Finalized March 13, 2000; Substantively revised October 18, 2010, December 15, 2013, June 12, 2014, and December 10, 2016
Effective Date	January 1, 2001; Substantive revisions detailed in Issue Paper No. 143R effective January 1, 2011, with additional revisions effective January 1, 2017
Affects.....	Nullifies INT 03-01; Nullifies and incorporates INT 07-03
Affected by.....	No other pronouncements
Interpreted by	INT 02-22
Relevant Appendix A Guidance	A-010; A-820

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	2
Reporting Assets for Premium Tax Offsets and Policy Surcharges.....	3
Discounting of Liabilities and Assets Related to Long-Term Care Assessments.....	4
Acting as an Agent for Collection and Remittance of Fees and Assessments.....	5
Applying the Recognition Criteria.....	6
Disclosures.....	7
Relevant Literature.....	8
Effective Date and Transition.....	9
REFERENCES.....	9
Relevant Issue Papers	9
EXHIBIT A – PRIMARY METHODS OF GUARANTY FUND ASSESSMENTS.....	10

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for guaranty fund and other assessments.
2. Guaranty fund assessments represent a funding mechanism employed by states to provide funds to cover policyholder obligations of insolvent reporting entities. Most states have enacted legislation establishing guaranty funds for both life and health insurance and for property and casualty insurance to provide for covered claims or to meet other insurance obligations of insolvent reporting entities in the state.
3. This statement addresses other assessments including but not limited to workers' compensation second injury funds and for funds that pay operating costs of an insurance department, a state guaranty

fund, and/or the workers' compensation board. This statement also addresses health related assessments including but not limited to state health insurance high-risk pools, health insurance small group and individual reinsurance pools, state health demographic and risk adjustment assessments. Guidance regarding the Affordable Care Act Section 9010 assessment is provided in *SSAP No. 106—Affordable Care Act Section 9010 Assessment*.

SUMMARY CONCLUSION

4. This statement adopts with modification guidance from *Accounting Standard Codification 405-30, Insurance-Related Assessments* (ASC 405-30) as reflected within this SSAP. Consistent with ASC 405-30-25-1, entities subject to assessments shall recognize liabilities for insurance-related assessments when all of the following conditions are met (paragraph 17 provides guidance on applying the recognition criteria):

- a. An assessment has been imposed or information available prior to issuance of the statutory financial statements indicates that it is probable that an assessment will be imposed.
- b. The event obligating an entity to pay an imposed or probable assessment has occurred on or before the date of the financial statements.
- c. The amount of the assessment can be reasonably estimated.

Guaranty fund and other assessments shall be charged to expense (Taxes, Licenses and Fees) and a liability shall be accrued when the above criteria are met except for certain health related assessments which shall be reported as a part of claims. Health related assessments that are reported as a part of claims instead of taxes, licenses and fees are those assessments that are designed for the purpose of spreading the risk of severe claims or adverse enrollment selection among all participating entities, and where the funds collected via the assessment are re-distributed back to the participating entities based upon the cost of specific claims, enrollment demographics, or other criteria affecting health care expenses. This standard does not permit liabilities for guaranty funds or other assessments to be discounted, except for liabilities for guaranty funds and the related assets recognized from accrued and paid liability assessments from insolvencies of entities that wrote long-term care contracts (see paragraphs 12-14).

5. For refunded guaranty or other fund assessments and assessments used to fund state operating expenses, reporting entities shall credit the refund or charge the assessment to expense when notification of the refund or assessment is made.

6. For premium-based guaranty fund assessments, except those that are prefunded, paragraph 4.a. is met when the insolvency has occurred. For purposes of applying this guidance, the insolvency shall be considered to have occurred when a reporting entity meets a state's (ordinarily the state of domicile of the insolvent reporting entity) statutory definition of an insolvent reporting entity. In most states, the reporting entity must be declared to be financially insolvent by a court of competent jurisdiction. In some states, there must also be a final order of liquidation. Prefunded guaranty-fund assessments and premium-based administrative type assessment are presumed probable when the premiums on which the assessments are expected to be based are written. Loss-based administrative-type and second injury fund assessments are presumed probable when the losses on which the assessments are expected to be based are incurred.

7. Paragraph 4.b. requires that the event obligating an entity to pay an imposed or probable assessment has occurred on or before the date of the financial statements. Based on the fundamental differences in how assessment mechanisms operate, the event that makes an assessment probable (for example, an insolvency) may not be the event that obligates an entity. The following defines the event that obligates an entity to pay an assessment:

- a. For premium-based assessments, the event that obligates the entity is generally writing the premiums or becoming obligated to write or renew (such as multiple-year, noncancelable policies) the premiums on which the assessments are expected to be based. Some states, through law or regulatory practice, provide that an insurance entity cannot avoid paying a particular assessment even if that insurance entity reduces its premium writing in the future. In such circumstances, the event that obligates the entity is a formal determination of insolvency or similar triggering event. For example, in certain states, an insurance entity may remain liable for assessments even though the insurance entity discontinues the writing of premiums. In this circumstance, the underlying cause of the liability is not the writing of the premium, but the insolvency. Regulatory practice would be determined based on the stated intentions or prior history of the insurance regulators.
- b. For loss-based assessments, the event that obligates an entity is an entity's incurring the losses on which the assessments are expected to be based.

8. Paragraph 4.c. requires that the amounts can be reasonably estimated. For retrospective-premium-based guaranty fund assessments, a reporting entity's estimate of the liability shall reflect an estimate of its share of the ultimate loss expected from the insolvency. The reporting entity shall also estimate any applicable premium tax credits and policy surcharges. An entity need not be able to compute the exact amounts of the assessments or be formally notified of such assessments by a guaranty fund to make a reasonable estimate of its liability. Entities subject to assessments may have to make assumptions about future events, such as when the fund making the assessment will incur costs and pay claims to determine the amounts and the timing of assessments. The best available information about market share or premiums by state and premiums by line of business generally should be used to estimate the amount of future assessments. Estimates of loss-based assessments should be consistent with estimates of the underlying incurred losses and should be developed based upon enacted laws or regulations and expected assessment rates. Premium tax credits or policy surcharges may only be considered in the estimate if it is probable they will be realized. Because of the uncertainties surrounding some insurance-related assessments, the range of assessment liability may have to be re-evaluated regularly during the assessment process. Changes in the amount of the liability (or asset) as information becomes available over time and revisions to estimates in the amount or timing of the payments shall be recorded in taxes, licenses and fees.

9. In accordance with SSAP No. 5R, when the reasonable estimate of the loss is a range, the amount in the range that is considered the best estimate shall be accrued. When, in management's opinion, no amount within management's estimate of the range is a better estimate than any other amount, however, the midpoint (mean) of management's estimate in the range shall be accrued. For purposes of this statement, it is assumed that management can quantify the high end of the range. If management determines that the high end of the range cannot be quantified, then a range does not exist, and management's best estimate shall be accrued.

Reporting Assets for Premium Tax Offsets and Policy Surcharges

10. The liability for accrued assessments shall be established gross of any probable and estimable recoveries from premium tax credits and premium surcharges. When it is probable that a paid or accrued assessment will result in an amount that is recoverable from premium tax offsets or policy surcharges, an asset shall be recognized for that recovery in an amount that is determined based on current laws, projections of future premium collections or policy surcharges from in-force policies, and as permitted in accordance with paragraphs 10.a., 10.b. and 10.c. Assets recognized from paid and accrued guaranty fund (or other) liability assessments from insolvencies of entities that primarily wrote long-term care are also subject to the discounting requirements in paragraphs 12-14. Any recognized asset from premium tax credits or policy surcharges shall be re-evaluated regularly to ensure recoverability. Upon expiration, tax credits no longer meet the definition of an asset and shall be written off.

- a. For assessments paid before premium tax credits are realized or policy surcharges are collected, an asset results, which represents a receivable for premium tax credits that will be taken and policy surcharges which will be collected in the future. These receivables, to the extent it is probable they will be realized, meet the definition of assets, as specified in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement. The asset shall be established and reported independent from the liability (not reported net).
- b. Assets recognized from accrued liability assessments shall be determined in accordance with the type of guaranty fund assessment as detailed in the following subparagraphs. Assets recognized from accrued liability assessments meet the definition of an asset under SSAP No. 4, and are admitted assets to the extent they conform to the requirements of this statement.
 - i. For retrospective-premium-based and loss-based assessments, to the extent that it is probable that accrued liability assessments will result in a recoverable amount in a future period from business currently in-force considering appropriate persistency rates for long-duration contracts, an asset shall be recognized at the time the liability is recorded. In-force policies do not include expected renewals of short-term contracts except in cases when retrospective-premium-based assessments are imposed on short-term health contracts for the insolvencies of insurers that wrote long-term care contracts. In which case, to the extent that it is probable that premium tax credits from accrued liability assessments will result in a recoverable amount in a future period from business currently in force, appropriate renewal rates of short-term health contracts shall be taken into consideration when recognizing the asset.
 - ii. For prospective-premium-based assessments, the recognition of assets from accrued liability assessments is limited to the amount of premium an entity has written or is obligated to write and to the amounts recoverable over the life of the in-force policies. This SSAP requires reporting entities to recognize prospective-based-premium assessments as the premium is written or obligated to be written by the reporting entity. Accordingly, the expected premium tax offset or policy surcharge asset related to the accrual of prospective-premium-based assessments shall be based on and limited to the amount recoverable as a result of premiums the insurer has written or is obligated to write.
- c. An asset shall not be established for paid or accrued assessments that are recoverable through future premium rate structures.

11. An evaluation of assets recognized under paragraph 10 shall be made in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* to determine if there is any impairment. If, in accordance with SSAP No. 5R, it is probable that the asset is no longer realizable, the asset shall be written off to the extent it is not realizable and charged to income in the period the determination is made. Considering expected future premiums other than on in-force policies for long duration contracts in evaluating recoverability of premium tax offsets or policy surcharges is not permitted. For short-term health contracts subject to long-term care assessments, appropriate renewal rates may be considered in evaluating recoverability of premium tax offsets or policy surcharges.

Discounting of Liabilities and Assets Related to Long-Term Care Assessments

12. Liabilities – Liabilities from guaranty funds or other assessments from the insolvencies of entities that wrote long-term care contracts that extend in excess of one year to payment shall be discounted as

prescribed in paragraph 14. If the liability amount is prefunded in full in the year of the insolvency, it is not to be discounted. Because requirements for payments vary by jurisdiction, the discount period, based on the expected dates for payment, shall be determined on the basis of jurisdiction.

13. Assets – Discounting of premium tax credit assets recognized from accrued and paid long-term care assessments is required for assets as prescribed in paragraph 14 when the time to forecasted recoverability is in excess of one year. Discounting premium tax credit assets is required if recoverability exceeds one year, even in instances when the related liability is not discounted. Because of variations in the recoverability of tax credits, determination of the time to recoverability for application of the discount period shall be on the basis of jurisdiction.

14. Discount Rate – The following discount rate shall be applied to the assets and liabilities that are to be discounted pursuant to paragraphs 12 and 13:

- a. The discount rate to be applied is the maximum valuation interest rate for whole life policies that is detailed in Appendix A-820, paragraphs 7.a., 8.a. and 9.a. This discount rate is the rate referenced by Appendix A-010, Exhibit I, paragraph 3, as the maximum allowed interest rate for contract reserves.
- b. Appendix A-820 applies a rate that is determined at the date of policy issuance. For purposes of discounting the long-term care guaranty fund assessments and related assets, the discount rate applied to balances expected to be settled in excess of one year (paid or recovered), shall be the maximum valuation interest rate for whole life policies (specified in Appendix A-820) in effect for the reporting date. With this guidance, the discount rate is updated annually as the specified whole-life discount rate is updated and the same rate is applied to all discounted insolvencies.

Acting as an Agent for Collection and Remittance of Fees and Assessments

15. In certain circumstances, a reporting entity acts as an agent for certain state or federal agencies in the collection and remittance of fees or assessments. In these circumstances, the liability for the fees and assessments rests with the policyholder rather than with the reporting entity. The reporting entity's obligation is to collect and subsequently remit the fee or assessment.^(INT 02-22) When both the following conditions are met, an assessment shall not be reported in the statement of operations of a reporting entity:

- a. The assessment is reflected as a separately identifiable item on the billing to the policyholder; and
- b. Remittance of the assessment by the reporting entity to the state or federal agency is contingent upon collection from the insured.

16. The impact to the statement of operations depends on the nature of the charge:

- a. For charges which are the ultimate responsibility of the policyholder, follow existing guidance in paragraph 15, and pass these charges and recoveries through the balance sheet with no impact to the statement of operations.
- b. For charges which are the ultimate responsibility of the reporting entity and may be recovered all or in part, apply gross or net reporting in the statement of operations as appropriate based on the nature of the charge and recovery. For example, charges which are considered in rate development or for which the recovery is classified as premium should be reported gross, charges for which recovery is considered a reduction of the expense should be reported net.

- c. For collection or administrative fees, report such fees as revenue in the statement of operations as “Finance and Service Charges Not Included in Premiums” or “Aggregate Write-Ins for Miscellaneous Income”.

Applying the Recognition Criteria

17. Application of the recognition criteria in paragraph 4:

- a. *Retrospective-premium-based guaranty-fund assessments* - An assessment is probable of being imposed when a formal determination of insolvency occurs¹. At that time, the premium that obligates the entity for the assessment liability has already been written. Accordingly, an entity that has the ability to reasonably estimate the amount of the assessment shall recognize a liability for the entire amount of future assessments related to a particular insolvency when a formal determination of insolvency is rendered.
- b. *Prospective-premium-based guaranty-fund assessments* - The event that obligates the entity for the assessment liability generally is the writing of, or becoming obligated to write or renew, the premiums on which the expected future assessments are to be based (for example, multiple-year contracts under which an insurance entity has no discretion to avoid writing future premiums). Therefore, the event that obligates the entity generally will not have occurred at the time of the insolvency. Law or regulatory practice affects the event that obligates the entity in either of the following ways:
 - i. In states that, through law or regulatory practice, provide that an entity cannot avoid paying a particular assessment in the future (even if the entity reduces premium writings in the future), the event that obligates the entity is a formal determination of insolvency or a similar event. An entity that has the ability to reasonably estimate the amount of the assessment shall recognize a liability for the entire amount of future assessments that cannot be avoided related to a particular insolvency when a formal determination of insolvency occurs.
 - ii. In states without such a law or regulatory practice, the event that obligates the entity is the writing of, or becoming obligated to write, the premiums on which the expected future assessments are to be based. An entity that has the ability to reasonably estimate the amount of the assessments shall recognize a liability when the related premiums are written or when the entity becomes obligated to write the premiums.
- c. *Prefunded-premium-based guaranty-fund assessments* - A liability for an assessment arises when premiums are written. Accordingly, an entity that has the ability to reasonably estimate the amount of the assessment shall recognize a liability as the related premiums are written.
- d. *Other premium-based assessments* - Other premium-based assessments shall be accounted for in the same manner as prefunded premium-based guaranty-fund assessments.

¹ As detailed within paragraph 6 for premium-based guaranty-fund assessments, an insolvency shall be considered to have occurred when a reporting entity meets a state's (ordinarily the state of domicile of the insolvent reporting entity) statutory definition of an insolvent reporting entity. In most states, the reporting entity must be declared to be financially insolvent by a court of competent jurisdiction. In some states, there must also be a final order of liquidation.

- e. *Loss-based assessments* - An assessment is probable of being asserted when the loss occurs. The obligating event of the assessment also has occurred when the loss occurs. Accordingly, an entity that has the ability to reasonably estimate the amount of the assessment shall recognize a liability as the related loss is incurred.
- f. *Administrative-type assessments* – As this assessment is typically an annual amount per entity assessed to fund operations of the guaranty association, regardless of the existence of an insolvency, such assessments are generally expensed in the period assessed.

Disclosures

18. A reporting entity shall disclose the following:

- a. Describe the nature of any assessments that could have a material financial effect, by type of assessment, and state the estimate of the liability, identifying whether the corresponding liability has been recognized under paragraph 4, a liability has not been recognized as the obligating event has not yet occurred, or that an estimate cannot be made.
- b. For assessments with liabilities recognized under paragraph 4, disclose the amount of the recognized liabilities, any related asset for premium tax credits or policy surcharges, the periods over which the assessments are expected to be paid, and the period over which the recorded premium tax offsets or policy surcharges are expected to be realized.
- c. Disclose assets recognized from paid and accrued premium tax offsets or policy surcharges, and include a reconciliation of assets recognized within the previous year's annual statement to the assets recognized in the current year's annual statement. The reconciliation shall reflect, in aggregate, each component of the increase and decrease in paid and accrued premium tax offsets and policy surcharges, including the amount charged off.
- d. Disclosures shall be made in accordance with paragraph 31 of SSAP No. 5R when there is at least a reasonable possibility that the impairment of an asset from premium tax offsets or policy surcharges may have been incurred.
- e. The financial statements shall disclose the following related to guaranty fund liabilities and assets related to assessments from insolvencies of entities that wrote long-term care contracts. The disclosures shall be by insolvency except for paragraph 18.e.ii., which is the same rate for all discounted insolvencies:
 - i. The undiscounted and discounted amount of the guaranty fund assessments and related assets;
 - ii. The discount rate applied as of the current reporting date (determined in accordance with paragraphs 12-14);
 - iii. The number of jurisdictions for which the long-term care guaranty fund assessments payables were discounted and the number of jurisdictions for which asset recoverables were discounted;
 - iv. Identify the ranges of years used to discount the assets and the range of years used to discount the liabilities;

- v. The weighted average numbers of years of the discounting time period for long-term care guaranty fund assessment liabilities; and
- vi. The weighted average number of years of the discounting time period for the asset recoverables.

Illustration of paragraph 18.e.iii. through paragraph 18.e.vi. disclosures:

Name of the Insolvency	Payables			Recoverables		
	Number of Jurisdictions	Range of Years	Weighted Average Number of Years	Number of Jurisdictions	Range of Years	Weighted Average Number of Years
ABC Estate	10	2-10	8	8	5-20	10

19. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

20. This statement adopts GAAP guidance for recording guaranty fund and other assessments, which is contained in *Accounting Standards Codification 405-30, Insurance Related Assessments* (ASC 405-30) to the extent reflected in this SSAP. Statutory accounting modifications from ASC 405-30 are as follows:

- a. The option to discount accrued liabilities (and reflect the time value of money in anticipated recoverables) is rejected for statutory accounting. Liabilities and assets related to assessments from insolvencies of entities that wrote long-term care contracts are required to be discounted as described in paragraphs 12-14; however, other liabilities for guaranty funds or other assessments shall not be discounted.
- b. The use of a valuation allowance for premium tax offsets and policy surcharges no longer probable for realization has been rejected for statutory accounting. Evaluation of assets shall be made in accordance with SSAP No. 5R, and if it is probable that the asset is no longer realizable, the asset shall be written off and charged to income in the period the determination is made.
- c. Guidance within ASC 405-30 pertaining to noninsurance entities has been rejected as not applicable for statutory accounting.
- d. Guidance within ASC 405-30 pertaining to accrual of an asset based on future renewals of premium is modified to allow accrual of the asset based on in-force short-term health contract renewals in instances when retrospective-premium-based assessments are imposed on short-term health contracts for the insolvencies of insurers that wrote long-term care contracts.

21. This statement also adopts with modification *Emerging Issues Task Force No. 06-3: How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross versus Net Presentation)* (EITF 06-3), now included in *Accounting Standards Codification 605-45, Revenue Recognition, Principal Agent Considerations* to the extent reflected in paragraph 16 of this statement.

Effective Date and Transition

22. 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*. Substantive revisions to paragraphs 4, 6, 7, 8, 10, 11, 17 and 18 as documented in *Issue Paper No. 143R—Guaranty Fund Assessments* are initially effective for the reporting period beginning January 1, 2011. The result of applying this revised statement shall be considered a change in accounting principle in accordance with SSAP No. 3. Pursuant to SSAP No. 3, the cumulative effect of changes in accounting principles shall be reported as an adjustment to unassigned funds (surplus) in the period of the change in accounting principle. The cumulative effect recognized through surplus from initial application of this statement shall reflect the removal of liabilities established under SSAP No. 35, and the re-establishment of liabilities required under SSAP No. 35R. If there is no change in the liabilities recognized (for example, retrospective-premium based assessments), no cumulative effect adjustment shall occur. With regards to assets, the entity shall complete an assessment of the SSAP No. 35 asset reported as of the transition date. If it is determined that the reported asset exceeds what is allowed under SSAP No. 35R, then the excess asset shall be written-off, through unassigned funds, so the ultimate asset reflected corresponds with what is permitted under SSAP No. 35R. Although it is possible that the excess asset will be reinstated once the liability assessment is recognized (prospective-premium based assessments), it is inappropriate to continue to reflect an asset for assessments that are not reflected within the financial statements. The guidance in paragraph 16 adopted with modification *Emerging Issues Task Force No. 06-3: How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross versus Net Presentation)* and was incorporated from INT 07-03 and effective September 29, 2007. The Section 9010 ACA fee has specific guidance (adopted December 2013) that was effective for annual reporting periods beginning January 1, 2014, and was moved to SSAP No. 106 in June 2014. Consistent with the federal repeal of the Section 9010 ACA fee, SSAP No. 106 was superseded effective January 1, 2021. As documented in *Issue Paper No. 143R*, modification of the adoption of ASC 405-30 to allow accrual of the asset based on in-force short-term health contract renewals in instances when retrospective-premium-based assessments are imposed on short-term health contracts for the insolvencies of insurers that wrote long-term care contracts as described in paragraph 10.b.i., paragraph 11 and paragraph 20.d. is initially effective January 1, 2017. Although the ASC 405-30 option to discount liabilities is still rejected, effective for reporting periods after January 1, 2017, reporting entities are required to discount guaranty fund assessments, and related assets, resulting from the insolvencies of insurers that wrote long-term care contracts, in accordance with the provisions of paragraphs 12-14 of this statement, as documented in *Issue Paper No. 143R*.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 35—Accounting for Guaranty Fund and Other Assessments*
- *Issue Paper No. 143R—Guaranty Fund Assessments*
- *Issue Paper No. 148—Affordable Care Act Section 9010 Assessment*

EXHIBIT A – PRIMARY METHODS OF GUARANTY FUND ASSESSMENTS

- a. *Retrospective-premium-based assessments* - Guaranty funds covering benefit payments of insolvent life, annuity, and health insurance entities typically assess entities based on premiums written or received in one or more years before the year of insolvency. Assessments in any year are generally limited to an established percentage of an entity's average premiums for the three years preceding the insolvency. Assessments for a given insolvency may take place over several years.
- b. *Prospective-premium-based assessments* - Guaranty funds covering claims of insolvent property and casualty insurance entities typically assess entities based on premiums written in one or more years after the insolvency. Assessments in any year are generally limited to an established percentage of an entity's premiums written or received for the year preceding the assessment. Assessments for a given insolvency may take place over several years.
- c. *Prefunded-premium-based assessments* - This kind of assessment is intended to prefund the costs of future insolvencies. Assessments are imposed before any particular insolvency and are based on the current level of written premiums. Rates to be applied to future premiums are adjusted as necessary.
- d. *Administrative-type assessments* - These assessments are typically a flat (annual) amount per entity to fund operations of the guaranty association, regardless of the existence of an insolvency.
- e. *Other premium-based assessments* - Entities are subject to a variety of other insurance-related assessments. Many states and a number of local governmental units have established other funds supported by assessments. The most prevalent uses for such assessments are (a) to fund operating expenses of state insurance regulatory bodies (for example, the state insurance department or workers' compensation board) and (b) to fund second-injury funds.
 - i. *Premium-based* - The assessing organization imposes the assessment based on the entity's written premiums. The base year of premiums is generally either the current year or the year preceding the assessment.
 - ii. *Loss-based* - The assessing organization imposes the assessment based on the entity's incurred losses or paid losses in relation to that amount for all entities subject to that assessment in the particular jurisdiction.

Statement of Statutory Accounting Principles No. 36

Troubled Debt Restructuring

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Nullifies and incorporates INT 03-12
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Determining Whether a Creditor Has Granted a Concession	2
Determining Whether a Debtor Is Experiencing Financial Difficulties.....	3
Evaluating Whether a Restructuring Results in a Delay in Payment That is Insignificant.....	3
Accounting by Debtors	4
Accounting by Creditors	5
Disclosure by Debtors.....	5
Disclosure by Creditors.....	5
Relevant Literature.....	6
Effective Date and Transition	7
REFERENCES.....	8
Other	8
Relevant Issue Papers	8

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for troubled debt restructuring.

SUMMARY CONCLUSION

2. A troubled debt restructuring is defined as a debt restructuring whereby the creditor, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise grant. That concession either stems from an agreement between the creditor and the debtor or is imposed by law or a court. Many troubled debt restructurings involve modifying terms to reduce or defer cash payments required of the debtor in the near future to help the debtor attempt to improve its financial condition and eventually be able to pay the creditor. The creditor, for example, may accept cash, other assets, or an equity interest in the debtor in satisfaction of the debt though the value received is less than the amount of the debt, because the creditor concludes the concession will maximize recovery of its investment. A debtor in a troubled debt restructuring can obtain funds from sources other than the existing creditor, if at all, only at effective interest rates (based on market prices) so high that it cannot afford to

pay them. A troubled debt restructuring shall include debt that is fully satisfied by foreclosure, repossession, or other transfer of assets or by grant of equity securities by the debtor that is, in a technical sense, not restructured.

3. The determination of whether a debt restructuring is considered a troubled debt restructuring, as defined above, shall be made independently for the debtor and the creditor.

4. A debt restructuring shall not necessarily be considered a troubled debt restructuring for purposes of this statement even if the debtor is experiencing some financial difficulties. In general, a debtor that can obtain funds from sources other than the existing creditor at market interest rates at or near those for nontroubled debt is not involved in a troubled debt restructuring. For example, a troubled debt restructuring is not involved if:

- a. The fair value of cash, other assets, or an equity interest accepted by a creditor from a debtor in full satisfaction of its receivable at least equals the creditor's recorded investment in the receivable;
- b. The fair value of cash, other assets, or an equity interest transferred by a debtor to a creditor in full settlement of its payable at least equals the debtor's carrying amount of the payable;
- c. The creditor reduces the effective interest rate on the debt primarily to reflect a decrease in market interest rates in general or a decrease in the risk so as to maintain a relationship with a debtor that can readily obtain funds from other sources at the current market interest rate;
- d. The debtor issues, in exchange for its debt, new marketable debt having an effective interest rate based on its market price that is at or near the current market interest rates of debt with similar maturity dates and stated interest rates issued by nontroubled debtors; or
- e. The debtor, in connection with bankruptcy proceedings, enters into debt restructuring that results in a general restatement of most of the debtor's liabilities.

Determining Whether a Creditor Has Granted a Concession

5. A creditor has granted a concession when, as a result of the restructuring, it does not expect to collect all amounts due, including interest accrued at the original contract rate. In that situation, and if the payment of principal at original maturity is primarily dependent on the value of collateral, an entity shall consider the current value of that collateral in determining whether the principal will be paid.

6. A creditor may restructure a debt in exchange for additional collateral or guarantees from the debtor. In that situation, a creditor has granted a concession when the nature and amount of that additional collateral or guarantees received as part of a restructuring do not serve as adequate compensation for other terms of the restructuring. When additional guarantees are received in a restructuring, an entity shall evaluate both a guarantor's ability and its willingness to pay the balance owed.

7. If a debtor does not otherwise have access to funds at a market rate for debt with similar risk characteristics as the restructured debt, the restructuring would be considered to be at a below-market rate, which may indicate that the creditor has granted a concession. In that situation, a creditor shall consider all aspects of the restructuring in determining whether it has granted a concession.

8. A temporary or permanent increase in the contractual interest rate as a result of a restructuring does not preclude the restructuring from being considered a concession because the new contractual interest rate on the restructured debt could still be below market interest rates for new debt with similar

risk characteristics. In that situation, a creditor shall consider all aspects of the restructuring in determining whether it has granted a concession.

Determining Whether a Debtor Is Experiencing Financial Difficulties

9. In evaluating whether a receivable is a troubled debt restructuring, a creditor must determine whether the debtor is experiencing financial difficulties. In making this determination, a creditor shall consider the following indicators:

- a. The debtor is currently in payment default on any of its debt. In addition, a creditor shall evaluate whether it is probable that the debtor would be in payment default on any of its debt in the foreseeable future without the modification. That is, a creditor may conclude that a debtor is experiencing financial difficulties, even though the debtor is not currently in payment default.
- b. The debtor has declared or is in the process of declaring bankruptcy.
- c. There is substantial doubt as to whether the debtor will continue to be a going concern.
- d. The debtor has securities that have been delisted, are in the process of being delisted, or are under threat of being delisted from an exchange.
- e. On the basis of estimates and projections that only encompass the debtor's current capabilities, the creditor forecasts that the debtor's entity-specific cash flows will be insufficient to service any of its debt (both interest and principal) in accordance with the contractual terms of the existing agreement for the foreseeable future.
- f. Without the current modification, the debtor cannot obtain funds from sources other than the existing creditors at an effective interest rate equal to the current market interest rate for similar debt for a nontroubled debtor.

The above list of indicators is not intended to include all indicators of a debtor's financial difficulties.

Evaluating Whether a Restructuring Results in a Delay in Payment That is Insignificant

10. A restructuring that results in only a delay in payment that is insignificant is not a concession. The following factors, when considered together, may indicate that a restructuring results in a delay in payment that is insignificant:

- a. The amount of the restructured payments subject to the delay is insignificant relative to the unpaid principal or collateral value of the debt and will result in an insignificant shortfall in the contractual amount due.
- b. The delay in timing of the restructured payment period is insignificant relative to any one of the following:
 - i. The frequency of payments due under the debt
 - ii. The debt's original contractual maturity
 - iii. The debt's original expected duration

11. If the debt has been previously restructured, an entity shall consider the cumulative effect of the past restructurings when determining whether a delay in payment resulting from the most recent restructuring is insignificant.

Accounting by Debtors

12. A debtor shall account for a troubled debt restructuring according to the type of the restructuring (transfer of assets in full settlement, grant of equity interest in full settlement, modification of terms or combination of types). Generally, troubled debt restructuring involving the transfer of assets or the grant of an equity interest shall be accounted for at the fair value of the assets transferred or the equity interest granted.

13. A debtor in a troubled debt restructuring involving only modification of terms of a payable—that is, not involving a transfer of assets or grant of an equity interest—shall account for the effects of the restructuring prospectively from the time of restructuring, and shall not change the carrying amount of the payable at the time of the restructuring unless the carrying amount exceeds the total future cash payments specified by the new terms. That is, the effects of changes in the amounts or timing (or both) of future cash payments designated as either interest or face amount shall be reflected in future periods. Interest expense shall be computed in a way that a constant effective interest rate is applied to the carrying amount of the payable at the beginning of each period between restructuring and maturity. The new effective interest rate shall be the discount rate that equates the present value of the future cash payments specified by the new terms (excluding amounts contingently payable) with the carrying amount of the payable.

14. If the total future cash payments specified by the new terms of a payable, including both payments designated as interest and those designated as face amount, are less than the carrying amount of the payable, the debtor shall reduce the carrying amount to an amount equal to the total future cash payments specified by the new terms and shall recognize a gain on restructuring of payables equal to the amount of the reduction. Thereafter, all cash payments under the terms of the payable shall be accounted for as reductions of the carrying amount of the payable, and no interest expense shall be recognized on the payable for any period between the restructuring and maturity of the payable.

15. A debtor shall not recognize a gain on a restructured payable involving indeterminate future cash payments as long as the maximum total future cash payments may exceed the carrying amount of the payable. Amounts designated either as interest or as face amount by the new terms may be payable contingent on a specified event or circumstance (e.g., the debtor may be required to pay specified amounts if its financial condition improves to a specified degree within a specified period). To determine whether the debtor shall recognize a gain according to the provisions of paragraphs 13 and 14, those contingent amounts shall be included in the “total future cash payments specified by the new terms” to the extent necessary to prevent recognizing a gain at the time of restructuring that may be offset by future interest expense. Thus, the debtor shall apply *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* in which probability of occurrence of a gain contingency is not a factor and shall assume that contingent future payments will have to be paid. The same principle applies to amounts of future cash payments that must sometimes be estimated to apply the provisions of paragraphs 13 and 14. For example, if the number of future interest payments is flexible because the face amount and accrued interest is payable on demand or becomes payable on demand, estimates of total future cash payments shall be based on the maximum number of periods possible under the restructured terms.

16. If a troubled debt restructuring involves amounts contingently payable, those contingent amounts shall be recognized as a payable and as interest expense in future periods in accordance SSAP No. 5R. Thus, in general, interest expense for contingent payments shall be recognized in each period in which (a) it is probable that a liability has been incurred and (b) the amount of that liability can be reasonably estimated. Before recognizing a payable and interest expense for amounts contingently payable, however, accrual or payment of those amounts shall be deducted from the carrying amount of the restructured payable to the extent that contingent payments included in “total future cash payments specified by the new terms” prevented recognition of a gain at the time of restructuring (paragraph 15).

Accounting by Creditors

17. A creditor shall account for a troubled debt restructuring according to the type of the restructuring (receipt of assets in full satisfaction, modification of terms, combination of types). Generally, troubled debt restructuring involving the transfer of assets shall be accounted for at the fair value of the assets received. Troubled debt restructuring involving modification of terms shall be accounted for at fair value (as determined by acceptable appraisal methodologies) in accordance with *SSAP No. 100R—Fair Value*. If the restructured loan is collateral dependent, fair value shall be the fair value of the collateral. If the restructured loan is not collateral dependent, fair value shall be determined in accordance with SSAP No. 100R. If the determined fair value of the loan is less than the recorded investment in the loan (including accrued interest, net deferred loan fees or costs, and unamortized premium or discount), a new cost basis shall be established at the fair value with the difference being recorded as a realized loss in the statement of operations. After the troubled debt restructuring, a creditor shall account for the assets consistent with the statutory guidance for such assets.

18. A creditor shall account for assets, including foreclosed property and equity interests in corporations, joint ventures, or partnerships, received in satisfaction of the loan at their fair value (as determined by acceptable appraisal methodologies) at the time of restructuring or at the book value of the loan if lower. If the fair value is less than the book value, the required writedown shall be recognized as a realized capital loss. The creditor shall reclassify the asset from loans to the appropriate asset account, such as real estate or other invested assets, at the time that the creditor obtains clear title to the asset except for mortgage loans which shall follow the guidance in paragraph 18 of SSAP No. 37. After the troubled debt restructuring, a creditor shall account for the assets received in satisfaction of the loan consistent with the statutory guidance for similar assets.

19. Any fees received in connection with a modification of terms of a troubled debt restructuring shall be applied as a reduction of the recorded investment in the loan. All costs associated with the restructuring, including direct loan origination costs, shall be charged to expense as incurred.

Disclosure by Debtors

20. A debtor in a troubled debt restructuring shall disclose in the financial statements the following information about troubled debt restructurings that have occurred during a period for which financial statements are presented:

- a. For each restructuring or separate restructuring within a fiscal period for the same category of payables, (e.g., accounts payable or subordinated debentures), a description of the principal changes in terms, the major features of settlement, or both;
- b. Aggregate gain on restructuring of payables and the related income tax effect; and
- c. Aggregate net gain or loss on transfers of assets recognized during the period.

21. A debtor shall disclose in financial statements for periods after a troubled debt restructuring the extent to which amounts contingently payable are included in the carrying amount of restructured payables. A debtor shall also disclose total amounts that are contingently payable on restructured payables and the conditions under which those amounts would become payable or would be forgiven.

22. Refer to the Preamble for further discussion regarding disclosure requirements.

Disclosure by Creditors

23. A creditor shall disclose in the financial statements the information captured in paragraphs 23.a., 23.b. and 23.c. about troubled debt restructuring as of the date of each balance sheet presented.

Disclosures captured from paragraphs 23.d. and 23.e. are required in the statutory audited financial statements only:

- a. As of the date of each statement of financial position presented, the recorded investment in the loans for which impairment has been recognized in accordance with this statement and the related realized capital loss. (For mortgage loans, the disclosures in SSAP No. 37 shall also be completed.)
 - b. The amount of commitments, if any, to lend additional funds to debtors owing receivables whose terms have been modified in troubled debt restructuring
 - c. The creditor's income recognition policy for interest income on an impaired loan
 - d. For troubled debt restructurings that occurred during the annual reporting period, aggregated by type of instrument, qualitative and quantitative information on (1) how the items were modified and (2) the financial effects of the modifications
 - e. If restructured within the previous 12 months and there has been a payment default during that period, disclose qualitative and quantitative information about the defaulted instruments, aggregated by type of instrument, including: (1) type of instruments that defaulted and (2) the amount of recorded investments for which default occurred
24. Refer to the Preamble for further discussion regarding disclosure requirements.
25. This statement is not intended to modify the requirement for life and health insurers to complete the annual statement exhibit disclosing long-term mortgage loans in good standing with restructured terms.

Relevant Literature

26. This statement rejects *ASU 2022-02, Troubled Debt Restructurings and Vintage Disclosures* and the U.S. GAAP guidance within the Accounting Standards Codification for troubled debt restructurings for creditors. This ASU is rejected as the U.S. GAAP guidance for troubled debt restructuring by creditors has been significantly modified to eliminate the separate recognition of losses from restructurings as losses are captured within the allowance for credit losses valuation account established pursuant to *ASU 2016-13, Financial Instruments – Credit Losses*. As statutory accounting has not adopted ASU 2016-13, the prior troubled debt restructuring adopted from U.S. GAAP in effect prior to ASU 2016-13 and ASU 2022-02 has been retained. With the rejection of ASU 2022-02, reporting entities shall continue to apply the prior concepts within SSAP No. 36 when assessing and classifying modifications as troubled debt restructurings. These retained concepts do not permit entities to consider troubled debt restructurings as new loans and therefore do not permit immediate recognition of unamortized fees, costs, or prepayment penalties as interest income at the time of restructuring. Additionally, fees received by a reporting entity from a restructuring shall continue to reduce the recorded investment and all costs incurred by a reporting entity with the restructuring shall continue to be charged to expense as incurred.

27. Although the statutory accounting guidance for troubled debt restructurings for creditors no longer reflects authoritative guidance from U.S. GAAP, the guidance in SSAP No. 36 reflects the following superseded U.S. GAAP guidance as follows:

- a. Adopted with modification *FASB Statement No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings* (FAS 15) to specify that creditors shall reclassify assets obtained in a troubled debt restructuring from loans to the appropriate asset account at the time the creditor obtains clear title to the asset, except for mortgage loans which shall be reclassified at the beginning of the redemption period unless it is probable that the mortgage loan will be redeemed and with modification to require that

gains and losses from extinguishment of debt be reported as capital gains or losses, and charged to operations.

- b. Adopted paragraphs 310-40-15-13 through 310-40-15-18 and 310-40-15-20 of the FASB Codification incorporated through *FASB ASU 2011-02, A Creditors Determination of Whether a Restructuring Is a Troubled Debt Restructuring*.
 - c. Adopted with modification the disclosure requirements included in paragraphs 310-10-50-33 through 310-10-50-34 of the FASB Codification originally incorporated from *ASU 2010-20, Receivables (Topic 310), Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, deferred by *ASU 2011-01, Receivables (Topic 310), Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20* and reinstated through *ASU 2011-02*. These disclosure requirements were modified to be applicable for all troubled debt restructurings within the scope of SSAP No. 36, rather than limited to troubled debt restructurings of “financing receivables.”
 - d. Adopted paragraphs 9, 22, and 25 of *FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan* (FAS 114). Adopted *FASB Statement No. 118, Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures* as it relates to troubled debt restructuring.
 - e. Adopts *FASB Technical Bulletin 81-6, Applicability of Statement 15 to Debtors in Bankruptcy Situations* and *FASB Technical Bulletin 80-2, Classification of Debt Restructuring by Debtors and Creditors*, *FASB Emerging Issue Task Force No. 87-18, Use of Zero Coupon Bonds in a Troubled Debt Restructuring*, *FASB Emerging Issue Task Force No. 87-19, Substituted Debtors in a Troubled Debt Restructuring*, *FASB Emerging Issue Task Force No. 89-15, Accounting for a Modification of Debt Terms When the Debtor is Experiencing Financial Difficulties* consistent with the modifications to FAS 15, *FASB Emerging Issues Task Force No. 96-22, Applicability of the Disclosures Required by FASB Statement No. 114 When a Loan Is Restructured in a Troubled Debt Restructuring into Two (or More) Loans* and *FASB EITF 02-4: Determining Whether a Debtor’s Modification or Exchange of Debt Instruments is Within the Scope of FASB Statement No. 15*.
 - f. This statement is consistent with paragraph 14 of *FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases* (FAS 91), but FAS 91 was rejected in SSAP No. 26R—*Bonds*.
28. For historical reference purposes, the following superseded U.S. GAAP guidance was previously rejected within this statement:
- a. Paragraphs 6.d., 13 and 21 of FAS 114.
 - b. FASB Emerging Issues Task Force No. 94-8, *Accounting for Conversion of a Loan into a Security in a Troubled Debt Restructuring* and FASB Technical Bulletin 94-1, *Application of Statement 115 to Debt Securities Restructured in a Troubled Debt Restructuring*.

Effective Date and Transition

29. This statement is effective for years beginning January 1, 2001. The provisions of this statement shall be applied to all troubled debt restructurings entered into on or after January 1, 2001. The adoption of *FASB EITF 02-4: Determining Whether a Debtor’s Modification or Exchange of Debt Instruments is*

within the Scope of FASB Statement No. 15 was incorporated from INT 03-12 and effective December 7, 2003. The revisions adopted in August 2012 from ASU 2011-02 and ASU 2010-20 are effective January 1, 2013, with early application permitted.

REFERENCES

Other

- *Purposes and Procedures Manual of the NAIC Investment Analysis Office*

Relevant Issue Papers

- *Issue Paper No. 36—Troubled Debt Restructurings*

Not for Distribution

Statement of Statutory Accounting Principles No. 37

Mortgage Loans

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Nullifies and incorporates INT 99-04
Affected by.....	No other pronouncements
Interpreted by	INT 06-07
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	2
Commitment Fees	3
Loan Origination Fees.....	3
Loan Origination, Acquisition, and Commitment Costs.....	3
Initial Investment	3
Amortization	3
Prepayments.....	4
Interest Income.....	4
Accrued Interest.....	4
Impairments	4
Escrow Payments	6
Construction Loans	6
Disclosures.....	6
Relevant Literature.....	8
Effective Date and Transition	9
REFERENCES.....	9
Relevant Issue Papers	9

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for the accounting and reporting of mortgage loans and related fees.

SUMMARY CONCLUSION

2. A mortgage loan is defined as a debt obligation that is not a security, which is secured by a mortgage on real estate. In addition to mortgage loans directly originated, a mortgage loan also includes mortgage loans acquired or obtained through assignment, syndication or participation¹. Investments that reflect “participating mortgages,” “mortgage loan fund,” “bundled mortgage loans²” or the “securitization of assets” are not considered mortgage loans within scope of this SSAP.

- a. A security is a share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:
 - i. It is either represented by an instrument issued in bearer or registered form, or if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.
 - ii. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.
 - iii. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

3. Mortgage loans meet the definition of assets as specified in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement.

¹ Examples of agreements intended to be captured within this statement:

- a. Reporting entity is a “co-lender” in a single mortgage loan agreement that identifies more than one lender (which includes the reporting entity) with the real estate collateral securing all lenders identified in the agreement. For these single-mortgage loan agreements, each lender is incorporated directly into the loan documents. The key differentiating characteristic of a mortgage loan provided under a group “mortgage loan co-lending agreement” rather than a solely owned mortgage loan is that no one lender of the lending group may unilaterally foreclose on the mortgage. With these agreements, the lenders must foreclose on the mortgage loan as a group.
- b. Reporting entity has a “participation agreement” to invest in a single-mortgage loan. The reporting entity is not the lender of record named as a payee on the mortgage loan, but the lender of record sells a portion of the mortgage loan to the reporting entity through an assignment or participation interest under the participation agreement. Under a participation agreement, the reporting entity acquires an undivided interest in the single mortgage loan proceeds to be received by the lender of record. Under a participation agreement, single mortgage loan proceeds include the periodic mortgage loan principal and interest payments received by the lender of record, and all rights and proceeds received in the foreclosure of a mortgage, deed of trust, deed in lieu of foreclosure, or other similar proceeding by the lender of record. The amount of the proceeds to be received by the reporting entity is based on the ratio of its participation interest to the then-outstanding single mortgage loan balance. To qualify as a mortgage loan under the scope of this statement, the reporting entity must have a signed participation agreement with the lender of record named in the mortgage loan, the financial rights and obligations of the reporting entity under the participation agreement are the same as the lender of record, the reporting entity’s participation interest in the single mortgage loan proceeds must be pari-passu with the lender of record named on the mortgage loan agreement, and the participation agreement must be properly and promptly recorded on the lender or record’s books and records. For the purposes of this footnote, “financial rights” may include the right to take legal action against the borrower, or participate with the other lenders in determining whether legal action should be taken, but typically does not include the right to solely initiate legal action, foreclosure, or under normal circumstances, communicate directly with the borrower.

² The scope of this SSAP is limited to single mortgage loan agreements. Although single mortgage loan agreements can potentially have more than one lender (e.g., co-lenders/participations) and more than one borrower (such as in a tenancy-in-common arrangement), the concept of a “single mortgage loan” does not include arrangements in which a reporting entity acquires more than one mortgage loan in a sole transaction. (For example, if a reporting entity was to acquire an interest in a “bundle” of mortgage loans with various unrelated borrowers and collateral, this agreement would be outside of the scope of this SSAP. However, a bundle of mortgage loans does not include a “bulk purchase” where the reporting entity’s interest in each mortgage loan is legally separate and divisible and the purchase just facilitates the acquisitions of multiple single mortgage loan agreements.)

Commitment Fees

4. Commitment (or commitment standby) fees are fees paid to the reporting entity that obligate the reporting entity to make or acquire a loan or to satisfy an obligation of another party 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 loan is granted. If the loan is not granted, then the fees shall be recorded as investment income by the reporting entity when the commitment is no longer available.

5. 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 9 over the life of the loan as an adjustment to the investment income on the loan. If the commitment expires unexercised, the commitment fee shall be recognized in income on the commitment expiration date.

Loan Origination Fees

6. Loan origination fees are defined as fees charged to the borrower in connection with the process of originating, refinancing, or restructuring a loan. The term includes, but is not limited to, points, management, arrangement, placement, application, underwriting, and other fees pursuant to a lending transaction. Nonrefundable loan origination fees shall not be recorded until received in cash. Nonrefundable fees representing points shall be deferred as part of the loan balance and amortized over the life of the loan in accordance with paragraph 9. Nonrefundable fees other than points shall be recorded in income upon receipt.

Loan Origination, Acquisition, and Commitment Costs

7. All costs incurred in connection with originating a loan, acquiring purchased loans or committing to purchase loans shall be charged to expense as incurred.

Initial Investment

8. For mortgage loans originated by the reporting entity, the initial investment in mortgage loans shall be recorded at the principal amount of the loan net of any amounts deferred under the provisions of paragraphs 5 and 6. For mortgage loans purchased by a reporting entity, the initial investment shall be recorded as the amount paid to the seller. Accordingly, there may be a premium or discount on such loans resulting from a difference between the amount paid and the principal amount.

Amortization

9. Premiums and discounts on acquired loans, and mortgage interest points and commitment fees (if such qualify for amortization as described in paragraphs 5 and 6) shall be recognized as an adjustment of yield over the life of the loan (i.e., the period of time until total principal proceeds of the loan are received in cash) to produce a constant effective yield each year to maturity. If the reporting entity holds a large number of similar loans for which the prepayments of principal are probable, (probable is used in the same context as in paragraph 6 in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*, which defines probable as the future event or events are likely to occur), and the timing and amount can be reasonably estimated, the reporting entity shall include estimates of future principal prepayments in the calculation of the constant effective yield necessary to apply the interest method. The amount recognized as an adjustment of yield shall be credited or charged to interest income in the calculation of net investment income.

Prepayments

10. Payments received in advance of due dates may produce prepaid interest which shall be recorded as a liability, Unearned Investment Income, on the reporting entity's balance sheet. The portion of the payments received in advance of due dates that represents prepayments of principal shall be recorded as a reduction in the mortgage loan balance.

11. A mortgage loan may provide for a prepayment penalty or acceleration fee in the event the loan is liquidated prior to its scheduled termination date. Such fees shall be reported as investment income when received.

Interest Income

12. Interest income shall be recorded as earned and shall be included in investment income in the Summary of Operations. Interest income shall include interest collected, the change in interest income due and accrued, and the change in unearned interest income as well as amortization of premiums, discounts, and deferred fees as specified in paragraph 9.

Accrued Interest

13. Reporting entities that use servicing agents for their mortgage loans shall report the Interest Due and Accrued asset on the balance sheet consistently with the income statement treatment of the charge for servicing costs. If interest income is reported net of servicing costs, which is usual when the servicing agent fee is based on a percentage retention of each interest payment, then the interest receivable in the balance sheet shall be net of the related servicing costs. If interest is reported gross, with the servicing costs reported as an expense item, then interest due and accrued shall be reflected as an asset at the gross amount, with an appropriate liability to reflect the related servicing cost accrual.

14. When a loan is determined to be in default (per the contractual terms of the loan), the accrued interest on the loan shall be recorded as investment income due and accrued if deemed collectible. If a loan in default has any investment income due and accrued which is 180 days past due and collectible, the investment income shall continue to accrue, but all interest related to the loan is to be reported as a nonadmitted asset. If accrued interest on a mortgage loan in default is not collectible, the accrued interest shall be written off immediately and no further interest accrued.

15. Contingent interest represents income generated through the occurrence of specific economic events in relation to the borrower. For example, contingent interest may become payable upon the attainment of a given level of cash flow or income. Contingent interest may be reported as income when received or accrued. The proper accrual of such income does, however, require an analysis of the applicable provisions in the underlying agreement and the verification that the prerequisite conditions have been met.

Impairments

16. A mortgage loan shall be considered to be impaired when, based on current information and events, it is probable that a reporting entity will be unable to collect all amounts due according to the contractual terms of the mortgage agreement. According to the contractual terms means that both the contractual principal payments and contractual interest payments of the mortgage loan will be collected as scheduled in the mortgage agreement. A reporting entity shall measure impairment based on the fair value (as determined by acceptable appraisal methodologies) of the collateral less estimated costs to obtain and sell. The difference between the net value of the collateral³ and the recorded investment in the mortgage

³ If the mortgage loan is subject to a mortgage loan participation or co-lending agreement, collateral valuations conducted for impairment assessment, and the reporting of the appraisal value of land and buildings, shall only reflect the reporting entity's pro-rata share of the collateral/appraised value as it relates to the reporting entity's interest in the mortgage loan.

loan shall be recognized as an impairment by creating a valuation allowance with a corresponding charge to unrealized loss or by adjusting an existing valuation allowance for the impaired loan with a corresponding charge or credit to unrealized gain or loss. Subsequent to the initial measurement of impairment, if there is a significant change (increase or decrease) in the net value of the collateral, the reporting entity shall adjust the valuation allowance; however, the net carrying amount of the loan shall at no time exceed the recorded investment in the loan. For reporting entities required to maintain an asset valuation reserve (AVR), the unrealized gain or loss on impairments shall be included in the calculation of the AVR. If the impairment is other than temporary^(INT 06-07), a direct write down shall be recognized as a realized loss, and a new cost basis is established. This new cost basis shall not be changed for subsequent recoveries in value. Mortgage loans for which foreclosure is probable shall be considered permanently impaired.

17. For loans that are in default, being voluntarily conveyed, or being foreclosed, additional expenses, such as insurance, taxes, and legal fees that have been incurred to protect the investment or to obtain clear title to the property shall not be added to the carrying value, but shall be expensed when incurred.

18. Reporting entities shall derecognize mortgage loans and recognize real estate (subject to SSAP No. 40R) when receiving physical possession (resulting in a in substance repossession or foreclosure) of real estate property collateralizing a mortgage loan only when the following occurs:

- a. The reporting entity obtains legal title to the real estate property upon completion of a foreclosure. This includes situations in which the reporting entity receives legal title to the real estate property even if the borrower has redemption rights that provide the borrower with the legal right for a period of time after a foreclosure to reclaim the real estate property by paying certain amounts specified by law.
- b. The borrower conveys all interest in the real estate property to the reporting entity to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. The deed in lieu of foreclosure or similar legal agreement is completed when agreed-upon terms and conditions have been satisfied by both the borrower and the reporting entity.

19. Real estate recognized pursuant to paragraph 18 shall be initially recognized at the lower of the recorded investment in the mortgage loan or fair value less costs to sell. If the real estate is recognized at fair value less costs to sell, then a realized loss shall be recognized for the difference between that amount and the recorded investment in the mortgage loan. (A gain shall not be recognized as a result of foreclosure.)

20. Reporting entities that hold mortgage loans that are government-guaranteed shall derecognize the mortgage loans and recognize a separate other receivable (as an aggregate write-in for an other-than-invested asset) upon foreclosure (that is the reporting entity receives physical possession of the assets regardless of whether formal foreclosure proceedings take place, or in which the reporting entity otherwise obtains one or more of the debtor's assets in place of all or part of the receivable) if the following conditions are met:

- a. The loan has a government guarantee that is not separable from the loan before foreclosure.
- b. At the time of foreclosure, the reporting entity has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the reporting entity has the ability to recover under that claim. A reporting entity would be considered to have the ability to recover under the guarantee at the time of foreclosure if the reporting entity

determines that it has maintained compliance with the conditions and procedures required by the guarantee program.

- c. At the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed.

21. The separate other receivable recognized under paragraph 20 shall reflect the amount of the mortgage loan balance (principal and interest) expected to be recovered from the guarantor. A realized loss shall be recognized for any amount of the recorded investment in the mortgage loan that is not expected to be recovered. If the conditions in paragraph 20 are not met, upon foreclosure, the real estate collateralizing the mortgage loan (if any) shall be recognized pursuant to paragraph 19.

22. The separate other receivable recognized under paragraph 20, even if over ninety days past due, is an admitted asset similar to other receivables guaranteed by the government. If, in accordance with SSAP No. 5R, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made.

Escrow Payments

23. Amounts paid to the reporting entity by the mortgagor to cover future tax payments, insurance premiums, and other costs related to the property requires the creation of escrow accounts in the general ledger to record these liabilities. If these amounts are held by the servicing agents, they shall be reported on the reporting entity's balance sheet both as an asset and as a liability when they produce income for the reporting entity. This may occur if the servicing agent invests the escrow funds and is required to remit the income (or portion thereof) to the reporting entity.

Construction Loans

24. A construction loan is defined as a mortgage loan of less than three years in term, made for financing the cost of construction of a building or other improvement to real estate, which is secured by the real estate. The principal amount of a construction loan shall be the amount of funds disbursed to the borrower. If, in accordance with the terms of the contract, interest is deferred until the maturity of the loan, the accrued interest shall be included in the balance of the loan outstanding. The impairment test in paragraph 16 shall be applied to all construction loans, regardless of whether there are any defaults. Accordingly, construction loans shall not be reported at an amount greater than the fair value of the property. The percentage of completion of the property shall be considered in determining fair values of property securing construction loans.

Disclosures

25. The following disclosures shall be made 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 as well as 1) information as to how and to what extent management monitors the credit quality of its mortgage loans in an ongoing manner, and 2) to assess the quantitative and qualitative risks arising from the credit quality of its mortgage loans. To meet these objectives reporting entities shall provide information, aggregated by type, about the credit quality of mortgage loans including the following:
 - i. A description of the credit quality indicator
 - ii. The recorded investment in mortgage loans by credit quality indicator

- iii. For each credit quality indicator, the date or range of dates in which the information was updated for that credit quality indicator
 - c. Description of the valuation basis of the mortgage loans;
 - d. Information on the minimum and maximum rates of interest received for new loans made by category;
 - e. Maximum percentage of any one loan to the value of security at the time of the loan;
 - f. An age analysis of mortgage loans, aggregated by type, with identification of mortgage loans in which the insurer is a participant or co-lender in a mortgage loan agreement, capturing: 1) recorded investment of current mortgage loans, 2) recorded investment of mortgage loans past due classified as 30-59 days past due, 60-89 days past due, 90-179 days past due, and greater than 180 days past due; 3) recorded investment of mortgage loans 90 days and 180 days past due still accruing interest; 4) interest accrued for mortgage loans 90 days and 180 days past due; and 5) recorded investment and number of mortgage loans where interest has been reduced, by percent reduced; and
 - g. Taxes, assessments, and amounts advanced not included in the mortgage loan total.
26. The following additional disclosures shall be made for impaired loans:
- a. The total recorded investment in impaired loans, aggregated by type, at the end of each period with (i) the amount for which there is a related allowance for credit losses determined in accordance with this statement and the amount of that allowance, (ii) the amount for which there is no related allowance for credit losses determined in accordance with this statement, and (iii) the total recorded investment in impaired loans subject to a participant or co-lending mortgage loan agreement for which the reporting entity is restricted from unilaterally foreclosing on the mortgage loan;
 - b. The policy for recognizing interest income on impaired loans, including how cash receipts are recorded;
 - c. For each period for which results of operations are presented, the average recorded investment, aggregated by type, in the impaired loans during each period, the related amount of interest income recognized during the time within that period that the loans were impaired, the recorded investments on nonaccrual status pursuant to SSAP No. 34, paragraph 6 and, unless not practicable, the amount of interest income recognized using a cash-basis method of accounting during the time within that period that the loans were impaired; and
 - d. For each period for which results of operations are presented, the activity in the allowance for credit losses account, including the balance in the allowance for credit losses account at the beginning and end of each period, additions charged to operations, direct write-downs charged against the allowance, and recoveries of amounts previously charged off.
 - e. The aggregate amount of mortgage loans derecognized as a result of foreclosure and the corresponding amounts of:
 - i. Real estate collateral recognized.
 - ii. Other collateral recognized.

- iii. Receivables recognized from a government guarantee of the foreclosed mortgage loan.

27. Refer to the Preamble for further discussion regarding disclosure requirements. The disclosure requirements of paragraph 25.b. shall be included in the annual audited statutory financial reports only.

Relevant Literature

28. This statement adopts *FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan* (FAS 114), and *FASB Statement No. 118, Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures, an amendment of FASB Statement No. 114*, for collateral dependent loans with the following modifications:

- a. Impairment shall be measured based on the fair value of the collateral less costs to obtain and sell, whereas that is just one option under FAS 114; and
- b. The reporting entity is required to record any other than temporary impairment as a realized loss and shall not record subsequent recoveries in fair value.

29. This statement adopts disclosure requirements in paragraphs 310-10-50-7, 310-10-50-7A, 310-10-50-15, and 310-10-50-29(b) of *ASU 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance For Credit Losses* (ASU 2010-20) for mortgage loans only. Other disclosure requirements of ASU 2010-20, and the application of the adopted disclosures to other investments or receivables are rejected as not applicable for statutory accounting. This statement also adopts *ASU 2014-14, Receivable – Troubled Debt Restructuring by Creditors, Classification of Certain Government-Guaranteed Mortgage Loans Upon Foreclosure* and *FASB Emerging Issues Task Force Issue No. 84-19, Mortgage Loan Payment Modifications*.

30. This statement adopts with modification *ASU 2014-04, Troubled Debt Restructuring by Creditors – Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*. The ASU 2014-04 guidance has been modified to remove the restrictions limiting it to residential real estate with a consumer mortgage loan. The guidance reflected in this statement shall encompass all foreclosed mortgage loans collateralized by real estate. Additionally, ASU 2014-04 guidance has been modified to require a “lower-of” valuation method for the real estate collateral recognized from a foreclosure. This guidance will result in a deferral of any gain as a result of a mortgage loan foreclosure. Recognition of any gain shall be deferred until the real estate property is sold and the excess proceeds over the mortgage loan balance are attributable to the reporting entity and not required to be remitted back to the mortgage loan debtor.

31. This statement rejects *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. 88-17, Accounting for Fees and Costs Associated with Loan Syndications and Loan Participations*, and *AICPA Practice Bulletin 6, Amortization of Discounts on Certain Acquired Loans*. Effective December 31, 2023, this statement rejects *ASU 2016-13 Financial Instruments—Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB’s issuance of ASU 2016-13 and other related ASUs.

Effective Date and Transition

32. This statement is effective for years beginning January 1, 2001. Initial recognition of the impairment losses resulting from the application of this statement shall apply to mortgage loans held at January 1, 2001, and be based on management's best estimates as of that date. Insurers shall release all unamortized amounts included in IMR related to prepayment penalties upon adoption of Codification and recognize such change in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. 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. The guidance in this paragraph related to unamortized amounts included in IMR was originally contained within *INT 99-04: Recognition of Prepayment Penalties Upon Adoption of Codification* and was effective March 8, 1999.

33. The adoption of ASU 2014-14 and the adoption with modification of ASU 2014-04 (detailed in paragraphs 18-22 and 26.e.) shall be applied prospectively from the date of adoption (March 28, 2015). With this prospective application, guidance adopted from ASU 2014-14 applies to all foreclosures that occur after the date of adoption, and guidance from ASU 2014-04 applies to all instances of the reporting entity receiving physical possession of real estate property collateralized by mortgage loans that occur after the date of adoption.

REFERENCES**Relevant Issue Papers**

- *Issue Paper No. 37—Mortgage Loans*

Statement of Statutory Accounting Principles No. 38

Acquisition, Development and Construction Arrangements

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	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Relevant Literature.....	2
Effective Date and Transition	2
REFERENCES.....	2
Relevant Issue Papers	2

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for real estate acquisition, development and construction (ADC) arrangements and provides guidance on when to account for ADC arrangements as mortgage loans and when to account for ADC arrangements as investments in real estate or real estate joint ventures.

SUMMARY CONCLUSION

2. ADC arrangements shall be defined as lending agreements that are made to the owner of property to finance the acquisition, development and construction of real estate projects on the property in which the lender participates in the expected residual profits. Expected residual profit is the amount of profit, whether called interest or another name (e.g., equity kicker) above a reasonable amount of interest and fees expected to be earned by the lender. ADC arrangements shall include participations in loans and purchased loans that meet that definition of ADC arrangements.

3. If the lender is expected to receive over 50% of the expected residual profits of the project, the ADC arrangement shall be classified and accounted for as an investment in real estate in accordance with *SSAP No. 40R—Real Estate Investments*. If the lender is expected to receive 50% or less of the expected residual profits, the ADC arrangement shall be classified and accounted for as a loan or as a real estate joint venture, depending on the circumstances.

4. If any of the characteristics in paragraph 9.b. through 9.e. of *AcSEC Practice Bulletin 1*, “Exhibit I, ADC Arrangements” (PB1), or if a qualifying personal guarantee (as defined in PB1) is

present, the ADC arrangement shall be classified and accounted for as a construction loan in accordance with *SSAP No. 37—Mortgage Loans*. Otherwise, the ADC arrangement shall be classified and accounted for as a real estate joint venture in accordance with *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*.

5. The factors that are evaluated in determining the accounting treatment at inception may subsequently change for some ADC arrangements, for example, as a result of a renegotiation of the terms. Consequently, the accounting treatment for an ADC arrangement shall be periodically reassessed, as described in paragraph 20 of PB1. Any changes in classification shall result in a reclassification of the asset at the amount the asset should be reported at under its new classification with the net effect, if any, charged to income in the period that the change in classification is made.

6. Regardless of whether an ADC arrangement is accounted for as an investment in real estate, a joint venture, or a mortgage loan, the ADC arrangement meets the definition of an asset as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and is an admitted asset to the extent it conforms to the requirements of this statement.

7. ADC arrangements may involve related parties, in which case, *SSAP No. 25—Affiliates and Other Related Parties* shall also be followed.

Relevant Literature

8. This statement adopts PB1, “Exhibit I, ADC Arrangements” and *FASB Emerging Issues Task Force No. 86-21, Application of the AICPA Notice to Practitioners regarding Acquisition, Development, and Construction Arrangements to Acquisition of an Operating Property*.

Effective Date and Transition

9. 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. 38—Acquisition, Development and Construction Arrangements*

Statement of Statutory Accounting Principles No. 39

Reverse Mortgages

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 06-07
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Valuation and Impairment	2
Disclosures.....	3
Relevant Literature.....	4
Effective Date and Transition	4
REFERENCES.....	4
Relevant Issue Papers	4

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for reverse mortgages.

SUMMARY CONCLUSION

2. A reverse mortgage loan is defined as a non-recourse loan with the following characteristics:
 - a. It is secured by a mortgage against the primary residence of the borrower;
 - b. It guarantees a stream of cash disbursements to the borrower, either for the life of the borrower with no limit or up to a set percentage of the value of the residence or as a line of credit which the borrower can draw upon as needed; and
 - c. It has no maturity date and requires no repayment until one of the following events occur:
 - i. The borrower dies;
 - ii. The borrower sells the residence;
 - iii. The residence ceases to be the borrower's primary residence; or
 - iv. The borrower terminates the loan by paying back the outstanding balance.

3. A reverse mortgage meets the definition of an asset as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and is an admitted asset to the extent it conforms to the requirements of this statement. Reverse mortgages shall be recorded as an other invested asset on the reporting entity's statement of financial position and Schedule BA, Other Long-Term Invested Assets, of the annual statement.
4. To be considered admitted assets, investments in reverse mortgages are limited to first lien mortgages only.
5. All expenses associated with acquiring reverse mortgages shall be recognized immediately as investment expense.
6. Revenue associated with originating or otherwise acquiring reverse mortgages, including non-refundable fees, shall be amortized to investment income on a straight line basis over the period from inception to the expected maturity date.
7. Generally, fees are not paid by the borrower at the time of closing but become payable when the outstanding balance of the reverse mortgage becomes due. In these situations, no accounting entries are recorded at the time of closing. Investment income shall be recognized and the outstanding balance of the loan shall increase as the fees are amortized.
8. If fees are paid by the borrower at the time of closing, a liability shall be established. Investment income shall be recognized and the liability shall decrease as the fees are amortized.
9. Interest is payable by the borrower when the outstanding balance of the reverse mortgage becomes due. Accrued interest shall be calculated on the outstanding balance of the loan on a monthly basis. As it is earned, accrued interest shall be recorded to investment income and added to the outstanding balance of the loan.
10. The outstanding balance of the reverse mortgage shall include the accumulation of amounts disbursed, accrued interest, and amortized origination fees (i.e., origination fees not paid by the borrower at the time of closing). Neither the fair value of the underlying collateral nor the obligation for future cash payments guaranteed by the lender are recorded.
11. The lender's equity in the appreciation of the property, if any, is not recorded until realized upon the sale of the home.

Valuation and Impairment

12. The major categories of risk affecting reverse mortgages are:
 - a. Mortality risk—risk of loan payments extending beyond the borrower's original projected life expectancy. Since most reverse mortgages guarantee a continuing monthly payment to the borrower, there is the possibility that the borrower will collect cash payments and accrue interest exceeding the ultimate disposal value of the collateral. In situations where loan payments extend beyond the borrower's original projected life expectancy, the reporting entity will experience a diminished yield, and may experience a loss. Reverse mortgage contracts shall be combined into groups which are of sufficient size to provide an actuarially and statistically credible basis for estimating life expectancy to project future cash flows;
 - b. Collateral risk—risk of deterioration in the value of the collateral such that it is insufficient to cover the loan balance. This risk shall be evaluated loan-by-loan and is based on information obtained from periodic real estate appraisals and other pertinent information;

- c. Interest rate risk—risk of interest rates rising on adjustable rate reverse mortgages to the extent that accrued interest creates a collateral risk.

13. Reverse mortgages subject to the risks addressed in paragraph 12 shall be reported net of an appropriate actuarially calculated valuation reserve. Assumptions shall be applied consistently to similar loans. The assumptions, cash flow projections, and evaluation of risk shall be reviewed and updated at least annually. The fair value of the underlying collateral and the obligation for future cash payments guaranteed by the lender shall be considered in cash flow projections. Future appreciation in property value beyond the valuation date shall not be included in the projection of cash receipts.

14. If the impairment is temporary, any resulting adjustment shall be made to the valuation reserve (contra-asset) and unrealized gains and losses. Subsequent to the initial measurement of impairment, if there is a significant change (increase or decrease) in the risk factors affecting the value of the mortgage, the reporting entity shall adjust the valuation allowance in accordance with paragraph 13; however, the net carrying amount of the loan shall at no time exceed the recorded investment in the loan. The term recorded investment in the loan is distinguished from net carrying amount of the loan because the latter term is net of the valuation allowance, while the former term is not. The recorded investment (including accrued interest, net deferred loan fees, and unamortized premium or discount) in the loan does, however, reflect any direct write down of the investment. If the impairment is other than temporary ^(INT 06-07), the investment shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. The new basis shall not be changed for subsequent recoveries in fair value. A reverse mortgage shall be considered to be impaired when, based on current information and events, it is probable that the reporting entity will be unable to collect all amounts due according to the contractual terms of the reverse mortgage. “According to the contractual terms” means that both the contractual principal payments and contractual interest payments of the loan will be collected as specified in the reverse mortgage agreement.

Disclosures

15. The following disclosures shall be made for reverse mortgages in the financial statements:
- a. A description of the reporting entity’s accounting policies and methods, including the statistical methods and assumptions used in calculating the reserve;
 - b. General information regarding the reporting entity’s commitment under the agreement;
 - c. The reserve amount which is netted against the asset value;
 - d. Investment income or loss recognized in the period as a result of the re-estimated cash flows.

16. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

17. Effective December 31, 2023, this statement rejects *ASU 2016-13 Financial Instruments—Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB’s issuance of ASU 2016-13 and other related ASUs.

Effective Date and Transition

~~17.~~18. 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. 39—Reverse Mortgages*

Statement of Statutory Accounting Principles No. 40 – Revised

Real Estate Investments

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft; Substantively revised December 12, 2014
Effective Date	January 1, 2001; Substantive revisions detailed in Issue Paper No. 149 effective January 1, 2015
Affects.....	Supersedes SSAP No. 77 with guidance incorporated August 2012; Nullifies INT 04-18; Nullifies and incorporates INT 99-16, INT 99-22, INT 99-25, INT 08-02 and INT 08-07
Affected by.....	Paragraphs 11, 12 and 25 superseded by SSAP No. 90
Interpreted by	INT 06-13
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Income, Expenses, and Capital Improvements	5
Sale of Real Estate	5
Real Estate Projects Under Development	6
Participating Mortgage Loans	6
Disclosures.....	6
Relevant Literature.....	7
Effective Date and Transition	8
REFERENCES.....	9
Relevant Issue Papers	9

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for real estate investments.

SUMMARY CONCLUSION

2. Real estate investments are defined as directly-owned real estate properties and single real estate property investments that are directly and wholly-owned through a limited liability company (LLC) that meet all of the criteria in paragraph 4. Real estate investments may be acquired in exchange for consideration (including but not limited to cash, a contract for deed or mortgage, or other non-cash consideration) obtained through foreclosure or voluntary conveyance in satisfaction of a mortgage loan, or received as contributed surplus. Real estate investments 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.

3. Real estate investments include certain acquisition, development and construction arrangements (ADC) as defined in *SSAP No. 38—Acquisition, Development and Construction Arrangements*.

4. A single real estate property investment that is wholly-owned by an LLC that is directly¹ and wholly-owned by the reporting entity shall be captured within this statement and reported on Schedule A – Real Estate if all of the following criteria are met. Real estate owned through an LLC that meets the stated criteria shall follow all statutory requirements within this statement². Real estate owned through an LLC that does not meet the criteria shall be reported on Schedule BA – Other Long-Term Invested Assets. Regardless if reported on Schedule A or Schedule BA, all LLC's owned by the reporting entity shall be detailed in Schedule Y.

- a. The real estate LLC has no transactions of its own other than transactions associated with an ownership structure utilized only for the ownership and management of a single real estate investment exclusively for the reporting entity (e.g., real estate taxes). A reporting entity may have more than one LLC that wholly-owns a single real estate property investment, but each LLC must separately comply with the paragraph 4 conditions, and be separately reported on Schedule A. All transactions of the LLC shall be reported as transactions of the reporting entity pursuant to the guidance in paragraphs 15-17.
- b. The LLC only owns a single real estate property supported by an appraisal pursuant to paragraphs 13-14. A single real estate property can include multiple parcels of land and more than one structure; however, to be considered a single real estate property, the multiple of parcels of land and structure(s) must be contiguously located and managed together as a single asset (with reasonable allowances for public access routes). Criteria that may assist with determining a single real estate property would include the legal definition of the property, real estate tax assessments, postal address, the appraisal and the management and use of the property.
- c. The reporting entity solely controls the real estate property in a manner similar to directly-owned real estate. As such, the reporting entity controls others' access to the real estate, and the real estate must be able to be sold exactly as, and as promptly as, directly-owned real estate.
- d. The reporting entity solely and distinctly possesses all risks (other than the limitation of potential liability afforded by the LLC structure itself) and rewards of ownership of the real estate investment, without any constraints imposed by the LLC. A standard mortgage or encumbrance by an unrelated party is not considered a sharing of risks or rewards and is permitted within this guidance. However, a participating mortgage loan (paragraph 22) with related or unrelated parties, or loans or other encumbrances from related parties, would result with the reporting entity not solely and distinctly possessing all risks and rewards of the real estate investment.
- e. The reporting entity is the only member of the LLC. The LLC is not comprised of any other members, including: groups, competing interests, mutual beneficial interests, or co-venturers. The single-member ownership is required even if other members in the LLC are affiliates. An LLC comprised of affiliated parties is not within scope of this statement.

¹ For example, qualifying LLCs that are owned by a downstream holding company are not within scope of this statement regardless if the downstream holding company is wholly-owned by the reporting entity.

² The inclusion in this statement of real estate owned by a single member LLC is not an election by the reporting entity. All real estate owned in an LLC meeting the criteria in paragraph 4 are required to be captured within this statement, and are subject to this statement's requirements for valuation and admittance. Departures from the requirements within this SSAP, or continuing to follow SSAP No. 48 for these investments would be considered a departure from NAIC statutory accounting principles subject to permitted or prescribed practice disclosure requirements.

- f. There shall be no apportionment by the LLC or the reporting entity of the appraised value, expenses or income from the single real estate property to any other entity or between the general or separate account.
5. Real estate investments shall be reported in accordance with the following balance sheet categories, with parenthetical disclosure of the amount of related encumbrances:
- a. Properties occupied by the company – depreciated cost, less encumbrances;
 - b. Properties held for the production of income – depreciated cost, less encumbrances; and
 - c. Properties held for sale – lower of depreciated cost or fair value, less encumbrances and estimated costs to sell the property. (Paragraph 21 of *SSAP No. 90—Impairment or Disposal of Real Estate Investments* provides criteria that must be met for this real estate classification.)
6. Any real estate which is owned by and is more than 50% occupied by the reporting entity and its affiliates shall be considered property occupied by the company. “More than 50% occupied” shall mean that the square footage occupied by the reporting entity and its affiliates totals more than 50% of the rentable square footage of the property, including common areas. This shall include property occupied by the company which is not necessarily home office (e.g., claims processing, data processing and branch centers). Property which does not meet this 50% requirement shall be classified as property held for the production of income or property held for sale, consistent with SSAP No. 90.
7. Encumbrances represent outstanding mortgages or other debt related to the real estate investment and any unpaid accrued acquisition or construction costs. Participating mortgage loan liabilities are addressed in paragraphs 22-24. Interest expense shall be included in investment expenses.
8. The cost of real estate represents the fair value of the consideration exchanged plus any costs incurred to place the real estate asset in usable condition, including but not limited to, brokerage fees, legal fees, demolition, clearing and grading, fees of architects and engineers, any additional expenditures made for equipment and fixtures that are made a permanent part of the structure and certain interest costs as provided for in *SSAP No. 44—Capitalization of Interest*. Where cost includes both land and building, the cost shall be allocated among the assets purchased based on the relative values determined using appraisals, as described in paragraph 13. The cost shall be reduced by any amounts received for sales of rights or privileges in connection with the property or by any cash recoveries received after acquiring title to the property. The cost of real estate which has been foreclosed upon shall be initially established in accordance with *SSAP No. 36—Troubled Debt Restructuring* and *SSAP No. 37—Mortgage Loans*. The cost of contributed real estate shall be initially established in accordance with *SSAP No. 95—Nonmonetary Transactions* as a nonreciprocal transfer.
9. Internal preacquisition costs classified as nonoperating at the date of a property acquisition (that otherwise meet the requirements of paragraph 4 of FAS 67) shall be capitalized. If the entity subsequently determines that the property should have been classified as operating at the date of acquisition, such costs should be charged to expense and any additional costs shall be expensed as incurred. If internal preacquisition costs classified as operating at the date of acquisition were expensed as incurred, and the entity subsequently determines that the property should have been classified as nonoperating, the expensed costs shall remain as originally reported and shall not be reclassified to capitalized costs.
10. The cost of property included in real estate investments, other than land, shall be depreciated over the estimated useful life, not to exceed fifty years. Depreciation expense shall be included in investment expenses.
11. Properties occupied by the company and properties held for the production of income shall be carried at depreciated cost less encumbrances unless events or circumstances indicate the carrying amount

of the asset (amount prior to reduction for encumbrances) may not be recoverable. Paragraph 5 of *FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* (FAS 121), provides examples of events or changes in circumstances which indicate that the recoverability of the carrying amount of properties occupied by the company or properties held for the production of income should be assessed. If the events or changes in circumstances set forth in paragraph 5 of FAS 121 are present or if other events or changes in circumstances indicate that the carrying amount of properties occupied by the company or properties held for the production of income may not be recoverable, the entity shall determine whether an impairment loss must be recognized in accordance with paragraph 6 of FAS 121. Property occupied by the company shall be evaluated using the asset grouping approach of paragraph 8 of FAS 121. An impairment loss is measured as the amount by which the individual carrying amounts exceed the fair value of properties occupied by the company or properties held for the production of income. Fair value is determined in accordance with paragraph 13 of this statement. If the fair value of the asset is less than the carrying value, the asset shall be written down to the fair value thereby establishing a new cost basis. The new cost basis shall not be changed for subsequent recoveries in fair value. The adjustment shall be recorded in the statement of operations as a realized loss.

12. Properties that the reporting entity has the intent to sell or is required to sell shall be classified as properties held for sale and carried at the lower of depreciated cost or fair value less encumbrances and estimated costs to sell the property consistent with paragraph 16 of FAS 121. The intent to sell a property exists when management, having the authority to approve the action, has committed to a plan to dispose of the asset, either by sale or abandonment. Fair value of the asset shall be determined in accordance with paragraph 13 of this statement. Subsequent revisions to the fair value of the asset shall be accounted for in accordance with paragraph 17 of FAS 121.

13. The current fair value of real estate shall be determined on a property by property basis (i.e., increases in the fair value of one property shall not be used to offset declines in fair value of another). If market quotes are unavailable, estimates of fair value shall be determined by an appraisal (internal or third party), which is based upon an evaluation of all relevant data about the market, considering the following:

- a. A physical inspection of the premises;
- b. The present value of future cash flows generated by the property (Discounted Cash Flows), or capitalization of stabilized net operating income (Direct Capitalization);
- c. Current sales prices of similar properties with adjustments for differences in the properties (Sales Comparison Approach);
- d. Costs to sell the property if the reporting entity does not have the intent or ability to hold the real estate as an investment; and
- e. Replacement costs of the improvements, less depreciation, plus the value of the land (Cost Approach).

14. For all properties held for the production of income, the reporting entity must maintain an appraisal that is no more than five years old as of the reporting date. For all properties held for sale, an appraisal shall be obtained at the time such property is classified as held for sale, and subsequently an appraisal shall be maintained that is no more than five years old as of the reporting date. However, if conditions indicate there has been a significant decrease in the fair value of a property, a current appraisal shall be obtained. Additionally, appraisals shall be obtained for real estate investments at the time of foreclosure or contribution. Contributed real estate shall be supported by an independent third party appraisal at the date of contribution. If any of the previous conditions exist but an appraisal has not been

obtained, the related property shall be considered a nonadmitted asset until the required appraisals are obtained.

Income, Expenses, and Capital Improvements

15. Rental income on real estate leased is addressed in *SSAP No. 22R—Leases*, which requires that rental income be included in investment income. Expenses incurred in operating the real estate investment, including but not limited to, real estate taxes, utilities, and ordinary repair and maintenance, shall be charged to expense as incurred and included in investment expenses.

16. Expenditures that are necessary to put the asset back into good operating condition or to keep it in good operating condition, shall be charged to expense as incurred. Expenditures that add to or prolong the life of the property shall be added to the cost of the real estate (capitalized) and depreciated over the remaining estimated useful life of the property. If the property was fully depreciated at the time capital improvements are incurred, the capital improvements shall be capitalized and depreciated over the remaining extended useful life of the asset.

17. A reporting entity shall include in both its income and expenses an amount for rent relating to its occupancy of its own buildings. The amount recorded shall be at a rate comparable to rent received from others and/or rental rates of like property in the same area. If this is unavailable, it shall be derived from consideration of the repairs, expenses, taxes, and depreciation incurred, plus interest added at an average fair rate on the carrying value of the reporting entity's investment in its home office building.

Sale of Real Estate

18. Recognition of profit on sales of real estate investments shall be accounted for in accordance with *FASB Statement No. 66, Accounting for Sales of Real Estate* (FAS 66), except as modified in paragraph 20 of this statement, *FASB Emerging Issues Task Force No. 87-9, Profit Recognition on Sales of Real Estate with Insured Mortgages or Surety Bonds*, *FASB Emerging Issues Task Force No. 87-29, Exchange of Real Estate Involving Boot*, *FASB Interpretation No. 43, Real Estate Sales an interpretation of FASB Statement No. 66* (FIN 43) and *FASB Emerging Issues Task Force No. 00-13, Determining Whether Equipment is "Integral Equipment" Subject to FASB Statements No. 66 and No. 98*^(INT 06-13). This statement applies to all sales of real estate including real estate with property improvements or integral equipment. The terms "property improvements" and "integral equipment" refer to any physical structure or equipment attached to the real estate that cannot be removed and used separately without incurring significant costs, such as an office building. Additionally, this guidance applies to all transfers of financial assets that are in substance real estate.

19. Profit shall be recognized in full when real estate is sold, provided (a) the profit is determinable, that is, the collectibility of the sales price is reasonably assured or the amount that will not be collectible can be estimated, and (b) the earnings process is virtually complete, that is, the seller is not obliged to perform significant activities after the sale to earn the profit. Unless both conditions exist, recognition of all or part of the profit shall be postponed. Profit shall not be recognized by the full accrual method until all of the following criteria are met:

- a. A sale is consummated;
- b. The buyer's initial and continuing investments are adequate to demonstrate a commitment to pay for the property;
- c. The seller's receivable is not subject to future subordination; and
- d. The seller has transferred to the buyer the usual risks and rewards of ownership in a transaction that is in substance a sale and does not have a substantial continuing involvement with the property after the sale.

20. The calculation of the buyer's initial investment specified in paragraph 9 of FAS 66 shall be modified to reflect that buyer's notes must be supported by letters of credit from institutions that are listed by the Securities Valuation Office of the National Association of Insurance Commissioners as meeting credit standards to be included in determining the buyer's initial investment. Any profit or loss is considered a realized gain or loss in the year of the sale in accordance with FAS 66.

Real Estate Projects Under Development

21. Costs and initial rental operations of real estate projects under development, which include ADC arrangements accounted for as real estate under the provisions of SSAP No. 38, shall be accounted for in accordance with *FASB Statement No. 67, Accounting for Costs and Initial Rental Operations of Real Estate Projects* (FAS 67). Costs incurred in connection with real estate projects shall be expensed as incurred unless the criteria established in FAS 67 are met. The statement value of a real estate project, or parts thereof, held for sale or development and sale shall not exceed the estimated selling price in the ordinary course of business less estimated costs of completion (to stage of completion assumed in determining the selling price), holding, and disposal (net realizable value). If costs exceed net realizable value, capitalization of eligible costs shall continue, however, an allowance shall be provided to reduce the admitted value to estimated net realizable value.

Participating Mortgage Loans

22. A participating mortgage loan is established when the lender is entitled to participate in appreciation of the fair value of mortgaged real estate, the results of operations of the mortgaged real estate project, or in both. Mortgage loan participation features should be recorded at fair value at inception of the loan. The borrower should recognize a participation liability for the determined fair valued amount, with a corresponding debit to a debt discount account. The debt discount should be amortized by the interest method, using the effective interest rate. After inception, adjustment of the participation liability should occur at each reporting date to current fair value. The corresponding debit or credit should be to the related debt discount account. The revised debt discount should be amortized prospectively, using the effective interest rate method.

23. The real estate investment with the participating mortgage loan should be reported in accordance with paragraph 5, with no adjustment for appreciation of fair value.

24. Extinguishment of participating mortgage loans prior to the due date should be determined in accordance with *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. Gains or losses from early extinguishment should be determined in considering the difference between the recorded amount of debt (including unamortized debt discount and the participation liability) and the amount exchanged to extinguish the debt.

Disclosures

25. An entity that recognizes an impairment loss shall disclose all of the following in financial statements that include the period of the impairment write-down:

- a. A description of the impaired assets and the facts and circumstances leading to the impairment;
- b. The amount of the impairment loss and how fair value was determined; and
- c. The caption in the statement of operations in which the impairment loss is aggregated.

26. An entity that engages in retail land sales operations shall disclose:
- a. Maturities of accounts receivable for each of the five years following the date of the financial statements;
 - b. Delinquent accounts receivable and the method(s) for determining delinquency;
 - c. The weighted average and range of stated interest rates of receivables;
 - d. Estimated total costs and estimated dates of expenditures for improvements for major areas from which sales are being made over each of the five years following the date of the financial statements; and
 - e. Recorded obligations for improvements.
27. An entity that holds real estate investments through an LLC, which qualifies for inclusion in this statement because all the criteria in paragraph 4 are met, shall separately report each investment on Schedule A, and code the real estate as wholly-owned through an LLC.
28. An entity that holds real estate investments with participating mortgage loan features should disclose:
- a. Aggregate amount of participating mortgage obligations at the balance-sheet date, with separate disclosure of the aggregate participation liabilities and related debt discounts.
 - b. Terms of participations by the lender in either the appreciation in the fair value of the mortgaged real estate project or the results of operations of the mortgaged real estate project, or both.
29. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

30. This statement adopts FAS 66, with modification to paragraph 10 to indicate that only letters of credit from institutions listed by the Securities Valuation Office of the National Association of Insurance Commissioners shall be included in determining the buyer's initial investment. Additionally, as they relate to FAS 66, the following are adopted: *FASB Emerging Issues Task Force Issue No. 86-6, Antispeculation Clauses in Real Estate Sales Contracts*, *FASB Emerging Issues Task Force No. 87-9, Profit Recognition on Sales of Real Estate with Insured Mortgages or Surety Bonds*, *FASB Emerging Issues Task Force No. 87-29, Exchange of Real Estate Involving Boot*, *FASB Emerging Issues Task Force No. 88-12, Transfer of Ownership Interest as Part of Down Payment under FASB Statement No. 66*, *FASB Emerging Issues Task Force No. 88-24, Effect of Various Forms of Financing under FASB Statement No. 66*, *FASB Emerging Issues Task Force No. 06-8: Applicability of the Assessment of a Buyer's Continuing Investment under FASB Statement No. 66 for Sales of Condominiums*, with modification consistent to paragraph 9 of FAS 66, in which continuing investment payments made in the form of buyer's notes must be supported by letters of credit from institutions that are listed by the Securities Valuation Office of the National Association of Insurance Commissioners as meeting credit standards to be included in determining the buyer's initial investment, and *FASB Emerging Issues Task Force No. 07-6: Accounting for the Sale of Real Estate Subject to the Requirements of FASB Statement No. 66, When the Arrangements Includes a Buy Sale Clause*.

31. This statement adopts *FASB Interpretation No. 43, Real Estate Sales, an Interpretation of FASB Statement No. 66* (FIN 43), which clarifies that the phrase "all real estate sales" includes sales of real estate with property improvements or integral equipment that cannot be removed and used separately from the real estate without incurring significant costs. This statement adopts *FASB Emerging Issues Task*

Force No. 84-17, Profit Recognition on Sales of Real Estate with Graduated Payment Mortgages or Insured Mortgages, FASB Emerging Issues Task Force No. 89-13, Accounting for the Cost of Asbestos Removal, FASB Emerging Issues Task Force No. 89-14, Valuation of Repossessed Real Estate, FASB Emerging Issues Task Force No. 90-8, Capitalization of Costs to Treat Environmental Contamination, FASB Emerging Issues Task Force No. 95-23, The Treatment of Certain Site Restoration/Environmental Exit Costs When Testing a Long-Lived Asset for Impairment, FASB Emerging Issues Task Force 97-11: Accounting for Internal Costs Relating to Real Estate Property Acquisitions, FASB Emerging Issues Task Force No. 98-8: Accounting for Transfers of Investments That Are in Substance Real Estate and FASB Emerging Issues Task Force No. 00-13, Determining Whether Equipment is “Integral Equipment” Subject to FASB Statements No. 66 and No. 98, which clarifies the term “integral equipment” as used in this statement.

32. This statement adopts FAS 121 for real estate investments except for paragraphs 13, 14.c. and 14.d. which are rejected in SSAP No. 68—*Business Combinations and Goodwill*. This statement adopts FAS 67, AICPA *Statement of Position 92-1, Accounting for Real Estate Syndication Income*, and AICPA *Statement of Position 92-3, Accounting for Foreclosed Assets*. This statement also adopts FAS 152: *Accounting for Real Estate Time-Sharing Transactions, an amendment to FASB Statements No. 66 and 67*. FAS 152 is adopted as it modifies previously adopted GAAP guidance in FAS 66 and FAS 67 to identify the guidance that should/should not be applied to real estate time-sharing transactions. This guidance is adopted as it impacts the scope of previous adopted GAAP guidance to prevent an unnecessary GAAP to SAP difference. However, real estate time-sharing transactions are considered not applicable for statutory accounting, and the GAAP guidance in SOP 04-2 is rejected in Issue Paper No. 99.

33. This statement adopts AICPA *Statement of Position 97-1: Accounting by Participating Mortgage Loan Borrowers* (SOP 97-1) regarding the borrower’s accounting for a participating mortgage loan.

34. This statement rejects paragraph 52 of *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises* and *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins*, “Chapter 10, Taxes, Section A—Real Estate and Personal Property Taxes.”

Effective Date and Transition

35. 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 Correction of Errors*. Guidance in paragraph 8 was originally contained in INT 99-16: EITF No. 97-11: *Accounting for Internal Costs Relating to Real Estate Property Acquisitions* and was effective October 4, 1999. Guidance in paragraph 15 was originally contained in INT 99-25: *Accounting for Capital Improvements* and was effective December 6, 1999. Guidance in paragraphs 18-20 was previously included within SSAP No. 77—*Real Estate Sales* and was effective for years beginning January 1, 2002. The original guidance included in this standard from SSAP No. 77 is retained for historical purposes in Issue Paper No. 106. Guidance related to EITF 06-8 referenced in paragraph 30 was incorporated from INT 08-02: EITF 06-8: *Applicability of the Assessment of a Buyer’s Continuing Investment under FASB Statement No. 66 for Sales of Condominiums* and was effective for periods beginning May 31, 2008. The guidance reflected in paragraph 30 adopting EITF 07-6: *Accounting for the Sale of Real Estate Subject to the Requirements of FASB Statement No. 66, When the Agreement Includes a Buy-Sell Clause* was incorporated from INT 08-07: EITF 07-6, *Accounting for the Sale of Real Estate Subject to the Requirements of FASB Statement No. 66 When the Agreement Includes a Buy-Sell Clause*, and was effective September 22, 2008.

36. The substantive revisions to incorporate real estate property investments that are wholly-owned by an LLC that is directly and wholly-owned by the reporting entity in accordance with the criteria detailed in paragraph 4 are effective as of January 1, 2015. For these investments previously reported within SSAP No. 48 and owned as of the effective date, the reporting entity shall recognize a cumulative

effect of a change in accounting principle as if the entity had followed this statement since acquisition of the property. The change from applying these substantive revisions shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

37. To determine statement value for real estate owned through an LLC as of the paragraph 36 effective date, the reporting entity shall:

- a. Allocate the original cost of the real estate investment to land and property other-than-land pursuant to paragraph 8.
- b. To arrive at the current depreciated cost for property (excluding land), the entity shall apply the depreciation that would have occurred if this statement had been applied since acquisition, in accordance with the original expected useful life, adjusted for subsequent capital improvements pursuant to paragraph 16.
- c. The depreciated cost calculated under paragraph 37.b. shall be compared to a current appraisal to determine if an impairment assessment is required under SSAP No. 90. Recognition of impairment shall result in a new cost basis for the property, with recalculation of the depreciation based on the property's remaining useful life, as limited by the terms of this statement.
- d. The depreciated cost, reflecting any impairment from paragraph 37.c., less encumbrances, shall be recognized as the real estate investment as of the effective date.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 23—Property Occupied by the Company*
- *Issue Paper No. 40—Real Estate Investments*
- *Issue Paper No. 106—Real Estate Sales – An Amendment to SSAP No. 40—Real Estate Investments*
- *Issue Paper No. 149—Wholly-Owned Single Real Estate Property in an LLC*

Statement of Statutory Accounting Principles No. 41 – Revised

Surplus Notes

STATUS

Type of Issue.....	Common Area
Issued	Initial draft; Substantively revised April 3, 2016
Effective Date	January 1, 2001; Substantive revisions detailed in Issue Paper No. 151 effective January 1, 2017
Affects.....	Nullifies and incorporates INT 04-02
Affected by.....	No other pronouncements
Interpreted by	INT 06-07
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Issuers of Surplus Notes.....	1
Holders of Capital or Surplus Notes	2
Income	3
Impairment.....	3
Disclosures.....	4
Relevant Literature.....	5
Effective Date and Transition	6
REFERENCES.....	6
Other	6
Relevant Issue Papers	6

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for issuers and holders of surplus notes, and for holders of capital notes. Statutory accounting principles for issuers of capital notes are provided in *SSAP No. 15—Debt and Holding Company Obligations*.

SUMMARY CONCLUSION

Issuers of Surplus Notes

2. Reporting entities sometimes issue instruments that have the characteristics of both debt and equity. These instruments are commonly referred to as surplus notes, the term used herein, but are also referred to as surplus debentures or contribution certificates. These instruments are used for various reasons, including but not limited to:

- a. Providing regulators with flexibility in dealing with problem situations to attract capital to reporting entities whose surplus levels are deemed inadequate to support their operations;
 - b. Providing a source of capital to mutual and other types of non-stock reporting entities who do not have access to traditional equity markets for capital needs;
 - c. Providing an alternative source of capital to stock reporting entities, although not for the purpose of initially capitalizing the reporting entity.
3. Surplus notes issued by a reporting entity that are subject to strict control by the commissioner of the reporting entity's state of domicile and have been approved as to form and content shall be reported as surplus and not as debt only if the surplus note contains the following provisions:
 - a. Subordination to policyholders;
 - b. Subordination to claimant and beneficiary claims;
 - c. Subordination to all other classes of creditors other than surplus note holders; and
 - d. Interest payments and principal repayments require prior approval of the commissioner of the state of domicile.
4. Proceeds received by the issuer must be in the form of cash or other admitted assets having readily determinable values and liquidity satisfactory to the commissioner of the state of domicile.
5. Interest shall not be recorded as a liability nor an expense until approval for payment of such interest has been granted by the commissioner of the state of domicile. All interest, including interest in arrears, shall be expensed in the statement of operations when approved for payment. Unapproved interest shall not be reported through operations, shall not be represented as an addition to the principal or notional amount of the instrument, and shall not accrue further interest, i.e., interest on interest.
6. As of the date of approval of principal repayment by the commissioner of the state of domicile, the issuer shall reclassify such approved payments from surplus to liabilities.
7. Costs of issuing surplus notes (e.g., loan fees and legal fees) shall be charged to operations when incurred.
8. Discount or premium, if any, shall be reported in the balance sheet as a direct deduction from or addition to the face amount of the note. Such discount or premium shall be charged or credited to the statement of operations concurrent with approved interest payments on the surplus note and in the same proportion or percentage as the approved interest payment is to the total estimated interest to be paid on the surplus note.

Holders of Capital or Surplus Notes

9. Investments in capital or surplus notes 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. Additionally, the amount admitted is specifically limited to the following two provisions:
 - a. The admitted asset value of a capital or surplus note shall not exceed the amount that would be admitted if the instrument was considered an equity instrument and added to any other equity instruments in the issuer held directly or indirectly by the holder of the capital or surplus note.

- b. The surplus note shall be nonadmitted if issued by an entity that is subject to any order of liquidation, conservation, rehabilitation or any company action level event based on its risk-based capital. Subsequent to this nonadmittance, if any of the conditions described ceased to exist, the holder may admit the surplus note at the value determined under paragraph 11. If a surplus note was nonadmitted pursuant to this paragraph, and the surplus note was ultimately determined to be other-than-temporarily impaired, the reporting entity shall recognize a realized loss for the portion of the surplus note determined to be other-than-temporarily impaired, with elimination of a corresponding amount of the previously nonadmitted assets.
10. Capital or surplus notes shall be valued in accordance with paragraph 11. Pursuant to that paragraph, the value is determined by NAIC credit rating provider (CRP) ratings. Part One – Capital and Surplus Debentures of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* provides guidance in determining the NAIC designation for these investments.
11. If the capital or surplus note has been rated by an NAIC CRP and has a designation equivalent of NAIC 1 or NAIC 2, then it shall be reported at amortized cost. If the capital or surplus note is not CRP rated or has an NAIC designation equivalent of NAIC 3 through 6, then the balance sheet amount shall be reported at the lesser of amortized cost or fair value, with fluctuations in value reflected as unrealized valuation changes.
12. For reporting entities required to 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*. 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).
13. For surplus notes issued and held (directly or indirectly) between insurance reporting entities and subsidiary, controlled and affiliated entities, the guidance in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* requires adjustment to prevent double-counting of surplus notes. For example, an insurance reporting entity is not permitted to report the issuance of a surplus note as an increase in surplus and have an asset representing an investment in the SCA that includes the issued surplus note (held by an SCA). Pursuant to *SSAP No. 97*, the “investment in the SCA” shall be adjusted to eliminate the surplus note issued by the direct or indirect parent insurance reporting entity. This treatment shall also apply for instances in which the SCA acquires any portion of outstanding surplus notes issued by the direct or indirect parent through any means (e.g., directly acquired from the parent, acquired through a third-party broker, or via the market).

Income

14. Only interest that has been approved by the issuer’s domiciliary commissioner shall be accrued as income by a holder of surplus notes. Interest income for any period consists of interest collected during the period and the change in the due and accrued interest between the beginning and end of the period approved by the issuer’s domiciliary commissioner.
15. Except for the specific limitations on recognizing interest income in paragraph 14, investment income, and the recognition of uncollectible accrued interest, shall follow the guidance in *SSAP No. 34—Investment Income Due and Accrued*.

Impairment

16. An other-than-temporary impairment^(INT 06-07) 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 the surplus note. Pursuant to the terms of a surplus note, payments of principal and interest may be delayed if the issuer’s domiciliary commissioner does not approve payment. Extended delays of either principal or

interest shall trigger an evaluation for an other-than-temporary impairment. An other-than-temporary impairment shall be recognized in situations when the reporting entity has made a decision to sell a surplus note prior to its maturity at an amount below its carrying value. If it is determined that a decline in fair value is other-than-temporary, an impairment loss shall be recognized as a realized loss equal to the difference between the surplus note's carrying value and the fair value at the balance sheet date of the reporting period for which the assessment is made. The measurement of impairment shall not include partial recoveries of fair value subsequent to the balance sheet date. For reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with SSAP No. 7.

17. In periods subsequent to the recognition of an other-than-temporary impairment loss for a surplus note, the holder of the surplus note shall account for the other-than-temporarily impaired surplus note as if the surplus note had been purchased on the measurement date of the other-than-temporary impairment. The fair value of the surplus note on the measurement date shall become the new cost basis of the surplus note and the new cost basis shall not be adjusted for subsequent recoveries in fair value. The discount or reduced premium recorded for the surplus note, based on the new cost basis, shall be amortized over the remaining life of the surplus note in the prospective manner based on the amount and timing of future estimated cash flows. The surplus note 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.

Disclosures

18. The notes to the financial statements of a reporting entity that issues surplus notes shall disclose the following as long as the surplus notes are outstanding:

- a. Date issued;
- b. Description and fair value of the assets received;
- c. Holder of the note or, if public, the names of the underwriter and trustee, with identification on whether the holder of the surplus note is a related party per *SSAP No. 25—Affiliates and Other Related Parties*;
- d. Original issue amount of note;
- e. Carrying value of note;
- f. The rate at which interest accrues;
- g. Maturity dates or repayment schedules, if stated;
- h. Unapproved interest and/or principal;
- i. Life-to-date and current year approved interest and principal recognized;
 - i. Percentage interest payments offset through 'administrative offsetting' (not inclusive of amounts paid to a third-party liquidity provider). For example, if \$100 in interest was recognized through the year, \$10 of which was remitted to a third-party liquidity provider and the remainder \$90 was offset, the reporting entity shall report 100% as offset.
- j. Disclosure of whether the surplus note was issued as part of a transaction with any of the following attributes:

- i. Do surplus note/associated asset terms negate or reduce cash flow exchanges, and/or are amounts payable under surplus note and amounts receivable under other agreements contractually linked? (For example, the asset provides interest payments only when the surplus note provides interest payments.)
- ii. Are any amounts due under surplus notes and associated assets netted or offset (partially or in full) thus eliminating or reducing the exchange of cash or assets that would normally occur throughout the duration, or at maturity, of the agreement? (This may be referred to as administrative offsetting.)
- iii. Were the proceeds from the issuance of a surplus note used to purchase an asset directly or indirectly from the holder of the surplus note?
- k. Principle amount and fair value of assets received upon surplus note issuance, if applicable;
- l. Subordination terms;
- m. Liquidation preference to the reporting entity's common and preferred shareholders;
- n. The repayment conditions and restrictions;
- o. Information about any guarantees, support agreements or related party transactions associated with the surplus note issuance, and whether payments have been made under such agreements.

19. If a reporting entity has ceded business to a surplus note issuer that is a related party as part of a reinsurance transaction in which the surplus note meets any of the criteria in paragraph 18.j., the ceding entity shall provide a description of the transaction, including whether the criteria in paragraph 18.j. were met with respect to the surplus note issuance, as long as the reinsurance agreement remains in force. The ceding entity should provide a description of the risks reinsured, the related party reinsurer, any guarantees or support agreements, and the amount of notes outstanding.

20. If the proceeds from the issuance of a surplus note used to purchase an asset directly or indirectly from the holder of the surplus note, the following information shall be disclosed regarding the assets received:

- a. Identification of asset, including the investment schedule where the asset is reported and reported NAIC designation.
- b. Book/adjusted carrying value of asset as of the current reporting date.
- c. A description of terms under which liquidity would be provided should a triggering event occur.

21. In addition to the above, a reporting entity shall identify all affiliates that hold any portion of a surplus debenture or similar obligation (including an offering registered under the Securities Act of 1933 or distributed pursuant to rule 144A under the Securities Act of 1933), and any holder of 10% or more of the outstanding amount of any surplus note registered under the Securities Act of 1933 or distributed pursuant to Rule 144A under the Securities Act of 1933.

Relevant Literature

22. This statement rejects *AICPA Practice Bulletin No. 15, Accounting by the Issuer of Surplus Notes*, which requires surplus notes to be accounted for as debt and that interest be accrued over the life of

the surplus note, irrespective of the approval of interest and principal payments by the insurance commissioner. Effective December 31, 2023, this statement rejects ASU 2016-13 Financial Instruments—Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

Effective Date and Transition

23. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—*Accounting Changes and Corrections of Errors*. The provisions of paragraph 3, which are required for an instrument to qualify as a surplus note, apply to all surplus notes issued or amended after December 12, 1991. Surplus notes issued on or before December 12, 1991, shall not be required to meet the provisions of paragraph 3 in order to be accounted for as a surplus note. Guidance reflected in paragraph 9.b., incorporated from INT 04-02: *Surplus Notes Issued by Entities Under Regulatory Action*, was originally effective June 13, 2004.

24. In April 2016 substantive revisions were adopted to change the valuation method for holders of surplus notes. With the adopted substantive revisions, surplus notes with a designation equivalent to NAIC 1 or NAIC 2 shall be reported at amortized cost. All other surplus notes are required to be reported at the lesser of amortized cost or fair value. The substantive revisions also incorporated guidance to clarify when surplus notes shall be nonadmitted, have an unrealized loss and undergo an other-than-temporary impairment assessment. The substantive revisions, detailed for historical purposes in Issue Paper No. 151, are effective January 1, 2017, and shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—*Accounting Changes and Corrections of Errors*.

REFERENCES

Other

- *Purposes and Procedures Manual of the NAIC Investment Analysis Office, "Procedures for Valuing Surplus Debentures"*

Relevant Issue Papers

- *Issue Paper No. 41—Surplus Notes*
- *Issue Paper No. 151—Valuation for Holders of Surplus Notes*

Statement of Statutory Accounting Principles No. 42

Sale of Premium Receivables

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	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Disclosures.....	2
Relevant Literature.....	2
Effective Date and Transition	2
REFERENCES.....	3
Relevant Issue Papers	3

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for the sale or factoring of premium receivables.

SUMMARY CONCLUSION

2. For purposes of this statement, receivables shall only include amounts due to the reporting entity for premium receivables (i.e., uncollected premium, agent's balances, and bills receivable).

3. A transfer of receivables can take the form of a transfer with recourse or a transfer without recourse:

- a. Recourse means that the transferee has the right to receive payment from the transferor of those receivables for (i) failure of the debtors to pay when due, (ii) the effects of prepayments, or (iii) adjustments resulting from defects in the eligibility of the transferred receivables, for example defects in the legal title of the transferred receivables. When the transferor has the right to repurchase (a call) or the transferee has the right to require the transferor to repurchase (a put) the transferred receivables, the transfer shall be considered to have recourse;
- b. Without recourse means that the transferor has surrendered all of the future economic implications of the risks and rewards embodied in the transferred receivables.

4. A transfer of receivables with recourse shall not be recognized as a sale. A transfer of receivables without recourse shall only be recognized if the transferor receives cash for the receivables. The sale shall be recognized when cash is received.

5. If a transfer qualifies to be recognized as a sale, the difference between (a) the sales price and (b) the receivables transferred shall be recognized as a gain or loss. If receivables are sold with servicing retained and the stated servicing fee is less than a current (normal) servicing fee rate (a servicing fee rate that is representative of servicing fee rates most commonly used in comparable servicing agreements covering similar types of receivables) or no servicing fee is specified, the gain or loss recognized by the sale of receivables shall be adjusted to recognize the deviation of the stated servicing fee rate from the commonly used servicing fee rate and a liability shall be established to provide for a normal servicing fee in each subsequent servicing period, which shall not be less than the estimated servicing costs. When the stated servicing fee is greater than a normal servicing fee the gain or loss shall not be adjusted and the excess servicing fee revenues shall not be recorded currently but shall be recorded when realized.

6. If the conditions of paragraph 3.b. are not met, or the transfer is for other than cash, the receivables shall remain on the transferor's financial statements. A liability shall be established in an amount equal to the greater of the carrying amount of the receivables transferred or the amount of the proceeds received. To the extent that the proceeds received are less than the carrying amount of receivables transferred, a loss shall be recorded. The carrying amount of the receivable balance shall be evaluated at each reporting period and adjusted for any uncollectible amounts. The liability shall be derecognized as the transferee receives cash. When the proceeds received are greater than the receivables transferred, the liability shall be derecognized on a pro rata basis as the receivables are collected.

Disclosures

7. For transfers of receivables reported as sales, the transferor's financial statements shall disclose:
- a. The proceeds to the transferor; and
 - b. The gain or loss recorded on the sale.
8. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

9. This statement rejects paragraph 83 of *FASB Statement No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FAS 125) to the extent that it permits sales recognition for sales of receivables with recourse provisions. FAS 125 is addressed in its entirety in *SSAP No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, which was superseded by *SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* adopts with modification *FAS 166, Accounting for Transfers of Financial Assets—An Amendment of FASB Statement No. 104* and supersedes *SSAP No. 91R*.

Effective Date and Transition

10. 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. 42—Sale of Premium Receivables*

Not for Distribution

Statement of Statutory Accounting Principles No. 43 – Revised

Loan-Backed and Structured Securities

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft; Substantively revised September 2009
Effective Date	January 1, 2001; Substantive revisions detailed in Issue Paper No. 140 effective September 30, 2009; December 2009 revisions to paragraph 27 effective December 31, 2009; Revisions to paragraphs 2, 3 and 4 adopted October 2010 effective January 1, 2011
Affects.....	Supersedes SSAP No. 98 and paragraph 13 of SSAP No. 99; Nullifies and incorporates INT 00-11
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.....	2
SUMMARY CONCLUSION	2
Collection of All Contractual Cashflows is Probable.....	4
Collection of All Contractual Cashflows is Not Probable	5
Beneficial Interests.....	6
Reporting Guidance for All Loan-Backed and Structured Securities.....	8
Residual Tranches or Interests	9
Designation Guidance.....	9
Specific Interim Reporting Guidance Financially Modeled Securities.....	10
Unrealized Gains and Losses and Impairment Guidance	11
Origination Fees.....	15
Origination, Acquisition, and Commitment Costs.....	15
Commitment Fees	15
Giantization/Megatization of FHLMC or FNMA Mortgage-Backed Securities	15
Structured Securities Acquired for a Specified Investment Strategy	16
Disclosures.....	16
Relevant Literature.....	17
Effective Date and Transition	18
REFERENCES.....	19
Other	19
Relevant Issue Papers	19
EXHIBIT A – QUESTION AND ANSWER IMPLEMENTATION GUIDE	20

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for investments in loan-backed securities, structured securities and mortgage-referenced securities. In accordance with *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, retained beneficial interests from the sale of loan-backed securities and structured securities are accounted for in accordance with this statement. In addition, mortgage loans in scope of *SSAP No. 37—Mortgage Loans* that qualify under an SVO structural assessment are in scope of this statement as credit tenant loans (CTLs). Items captured in scope of this statement are collectively referred to as loan-backed securities.

SUMMARY CONCLUSION

2. Loan-backed securities are defined as securitized assets not included in structured securities, as defined below, for which the payment of interest and/or principal is directly proportional to the payments received by the issuer from the underlying assets, including but not limited to pass-through securities, lease-backed securities, and equipment trust certificates.

3. Structured securities are defined as loan-backed securities which have been divided into two or more classes for which the payment of interest and/or principal of any class of securities has been allocated in a manner which is not proportional to payments received by the issuer from the underlying assets.

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

5. Mortgage-referenced securities do not meet the definition of a loan-backed or structured security but are explicitly captured in scope of this statement. 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 which 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 for loan-backed securities within this standard apply to mortgage-referenced securities.

6. 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. Loan-backed and structured securities meet the definition of assets as defined in *SSAP No. 4—*

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.

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 a loan-backed or structured 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. A loan-backed or structured 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 loan-backed or structured security or any type of underlying servicing arrangement. For the avoidance of doubt, investments from any arrangement that results in direct or indirect control, which include but are not limited to control through a servicer or other controlling arrangement, shall be reported as affiliated in accordance with SSAP No. 25.

7. The scope of this statement encompasses all types of loan-backed and structured securities, including, but not limited to, the following:

- a. Loan-backed and structured securities acquired at origination,
- b. Loan-backed and structured securities acquired subsequent to origination for which it is probable, at acquisition, that the reporting entity will be able to collect all contractually required payments receivable, and are accounted for at acquisition under SSAP No. 103R,
- c. Loan-backed and structured securities for which it is probable, either known at acquisition or identified during the holding period³, that the reporting entity will be unable to collect all contractually required payments receivable, and
- d. Transferor's beneficial interests in securitization transactions that are accounted for as sales under SSAP No. 103R and purchased beneficial interests in securitized financial assets⁴.

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, 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.

³ Securities classified within the type of paragraph 7.a. or 7.b. may be required to change classification to type 6.c. when it becomes probable that the reporting entity will be unable to collect all contractually required payments receivable.

⁴ The accounting requirements related to these types of securities included in paragraphs 22-25 shall be determined at acquisition or initial transfer.

8. At acquisition, loan-backed and structured securities, except for loan-backed or structured securities that are beneficial interests that are not of high credit quality or can contractually be prepaid or otherwise settled in such a way that the reporting entity would not recover substantially all of its recorded amount⁵ (see paragraphs 22-25), shall be reported at cost, including brokerage and related fees. Acquisitions and dispositions shall be recorded on the trade date, not the settlement date, except for the acquisition of private placement loan-backed and structured 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.

9. 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 loan-backed and structured securities is expected to occur, not the stated maturity period.

10. 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 loan-backed and structured 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.

11. For reporting entities required to maintain an IMR, the accounting for realized capital gains and losses on sales of loan-backed and structured securities shall be in accordance with paragraph 3840 of this statement. For reporting entities not required to maintain an IMR, realized gains and losses on sales of loan-backed and structured securities shall be recorded on the trade date and shall be reported as net realized capital gains or losses in the Statement of Income.

12. A loan-backed or structured 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.

13. 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.

Collection of All Contractual Cashflows is Probable

14. 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 19-21 provide guidance for securities in which collection of all contractual cash flows is not probable and paragraphs 22-25 provide guidance for beneficial interests.) Prepayments are a significant variable element in the cash flow of loan-backed and structured securities because they affect the yield and determine the expected maturity against which the yield is evaluated. Falling interest rates generate faster

⁵ As referenced in the Relevant Literature section, this statement adopts EITF 99-20, including the scope requirements of that guidance.

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.

15. Changes in currently estimated cash flows, including the effect of prepayment assumptions, on loan-backed and structured 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.

16. Loan-backed and structured 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 anytime 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 19-21.

17. 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.

18. 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 decreased to the amount that would have resulted had the revised yield been applied since inception, and investment income is correspondingly decreased or increased.

Collection of All Contractual Cashflows is Not Probable

19. The following guidance applies to loan-backed and structured securities with evidence of deterioration of credit quality since origination for which it is probable, either known at acquisition or identified during the holding period, that the investor will be unable to collect all contractually required payments receivable, except for those beneficial interests that are not of high credit quality or can contractually be prepaid or otherwise settled in such a way that the reporting entity would not recover substantially all of its recorded amount determined at acquisition (see paragraphs 22-25).

20. The reporting entity shall recognize the excess of all cash flows expected at acquisition over the investor's initial investment in the loan-backed or structured security as interest income on an effective-

yield basis over the life of the loan-backed or structured security (accretable yield).⁶ Any excess of contractually required cash flows over the cash flows expected to be collected is the nonaccretable difference. Expected prepayments shall be treated consistently for determining cash flows expected to be collected and projections of contractual cash flows such that the nonaccretable difference is not affected. Similarly, the difference between actual prepayments and expected prepayments shall not affect the nonaccretable difference.

21. An investor shall continue to estimate cash flows expected to be collected over the life of the loan-backed or structured security. If, upon subsequent evaluation:

- a. The fair value of the loan-backed or structured security has declined below its amortized cost basis, an entity shall determine whether the decline is other than temporary^(INT 06-07). For example, if, based on current information and events, there is a decrease in cash flows expected to be collected (that is, the investor is unable to collect all cash flows expected at acquisition plus any additional cash flows expected to be collected arising from changes in estimate after acquisition (in accordance with paragraph 21.b.), an other-than-temporary impairment shall be considered to have occurred. The investor shall consider both the timing and amount of cash flows expected to be collected in making a determination about whether there has been a decrease in cash flows expected to be collected.
- b. Based on current information and events, if there is a significant increase in cash flows previously expected to be collected or if actual cash flows are significantly greater than cash flows previously expected, the investor shall recalculate the amount of accretable yield for the loan-backed or structured security as the excess of the revised cash flows expected to be collected over the sum of (1) the initial investment less (2) cash collected less (3) other-than-temporary impairments plus (4) amount of yield accreted to date. The investor shall adjust the amount of accretable yield by reclassification from nonaccretable difference. The adjustment shall be accounted for as a change in estimate in conformity with *SSAP No. 3—Accounting Changes and Corrections of Errors*, with the amount of periodic accretion adjusted over the remaining life of the loan-backed or structured security (prospective method).

Beneficial Interests

22. The following paragraphs provide statutory accounting guidance for interest income and impairment for a reporting entity that continues to hold an interest in securitized financial assets accounted for as sales under SSAP No. 103R, or that purchases a beneficial interest in securitized financial assets that are not of high credit quality or can contractually be prepaid or otherwise settled in such a way that the reporting entity would not recover substantially all of its recorded amount, determined at acquisition or the date of transfer⁷. Beneficial interests that are of high credit quality and cannot contractually be prepaid or otherwise settled in such a way that the reporting entity would not recover substantially all of its recorded investment, shall be accounted for in accordance with paragraphs 14-18.

⁶ A loan-backed or structured security may be acquired at a discount because of a change in credit quality or rate or both. When a loan-backed or structured 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 loan-backed or structured security.

⁷ The accounting requirements related to these types of securities included in paragraphs 22-25 shall be determined at acquisition or initial transfer. As referenced in the Relevant Literature section, this statement adopts EITF 99-20 (as amended by FAS 166), including the scope requirements of that guidance.

23. The reporting entity shall recognize the excess of all cash flows attributable to the beneficial interest estimated at the acquisition/transaction date (referred to herein as the transaction date) over the initial investment (the accretable yield) as interest income over the life of the beneficial interest using the effective yield method. If the holder of the beneficial interest is the reporting entity that transferred the financial assets for securitization, the initial investment would be the fair value of the beneficial interest as of the date of transfer, as required by SSAP No. 103R. The amount of accretable yield shall not be displayed in the balance sheet.

24. The reporting entity that holds a beneficial interest shall continue to update the estimate of cash flows over the life of the beneficial interest. If upon evaluation:

- a. Based on current information and events it is probable that there is a favorable (or an adverse) change in estimated cash flows from the cash flows previously projected, then the investor shall recalculate the amount of accretable yield for the beneficial interest on the date of evaluation as the excess of estimated cash flows over the beneficial interest's reference amount (the reference amount is equal to (1) the initial investment less (2) cash received to date less (3) other-than-temporary impairments recognized to date [as described in paragraph 24.b.] plus (4) the yield accreted to date. 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 beneficial interest. Based on estimated cash flows, interest income may be recognized on a beneficial interest even if the net investment in the beneficial interest is accreted to an amount greater than the amount at which the beneficial interest could be settled if prepaid immediately in its entirety.
- b. The fair value of the beneficial interest has declined below its reference amount; a reporting entity shall determine whether the decline is other-than-temporary. If, based on current information and events it is probable that there has been an adverse change in estimated cash flows (in accordance with paragraph 24.a.), then (1) an other-than-temporary impairment shall be considered to have occurred and (2) the beneficial interest shall be written down to the current estimate of cash flows at the financial reporting date discounted at a rate equal to the current yield used to accrete the beneficial interest with the resulting change being recognized as a realized loss. Determining whether there has been a favorable (or an adverse) change in estimated cash flows from the cash flows previously projected (taking into consideration both the timing and amount of the estimated cash flows) involves comparing the present value of the remaining cash flows as estimated at the initial transaction date (or at the last date previously revised) against the present value of the cash flows estimated at the current financial reporting date. The cash flows shall be discounted at a rate equal to the current yield used to accrete the beneficial interest. If the present value of the original cash flows estimated at the initial transaction date (or the last date previously revised) is less than the present value of the current estimate of cash flows expected to be collected, the change is considered favorable (that is, an other-than-temporary impairment shall be considered to have not occurred). If the present value of the original cash flows estimated at the initial transaction date (or the last date previously revised) is greater than the present value of the current estimated cash flows, the change is considered adverse (that is, an other-than-temporary impairment shall be considered to have occurred). However, absent any other factors that indicate an other-than-temporary impairment has occurred, changes in the interest rate of a "plain-vanilla," variable-rate beneficial interest generally shall not result

in the recognition of an other-than-temporary impairment⁸ (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).

25. 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 determination for purposes of determining a gain or loss under SSAP No. 103R. Subsequent to the transaction date, estimated cash flows are defined as the holder's estimate of the amount and timing of estimated principal and interest cash flows based on the holder's best estimate of current information and events. A change in estimated cash flows is considered in the context of both timing and amount of the estimated cash flows.

Reporting Guidance for All Loan-Backed and Structured Securities

26. Loan-backed and structured securities shall be valued and reported in accordance with this statement, the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual), and the designation assigned in the *NAIC Valuations of Securities* product prepared by the NAIC Securities Valuation Office or equivalent specified procedure. The carrying value method shall be determined as follows:

- a. For reporting entities that maintain an Asset Valuation Reserve (AVR), loan-backed and structured 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, loan-backed and structured 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 interests⁹ captured in scope of this statement, 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*.

⁸ 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.

⁹ Reference to "residual tranches or interests" intends to capture securitization tranches and beneficial interests as well as other structures captured in scope of this statement 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.

Residual Tranches or Interests

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

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

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

Designation Guidance

27-29. 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 [2729.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 [2729.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

~~28.30.~~ [2729.](#) For securities that will be financially modeled under paragraph [2729](#), 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 [2729](#), 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 [2729.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~~29.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~~30.a. or 28.b., are required to follow the analytical procedures for non-financially modeled securities (paragraph ~~27~~29.b. as appropriate) until the current year financial modeling information becomes available and then follow the procedures for financially modeled securities (paragraph 29.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~~29.b. as appropriate) until the current year financial modeling information becomes available and then follow the procedures for financially modeled securities (paragraph 29.a. as appropriate).

Unrealized Gains and Losses and Impairment Guidance

~~29~~31. For reporting entities required to maintain an AVR, the accounting for unrealized gains and losses shall be in accordance with paragraph ~~38~~40 of this statement. 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).

~~30~~32. The application of this reporting requirement resulting from NAIC designation (i.e., lower of cost or fair value) is not a substitute for other-than-temporary impairment recognition (paragraphs ~~35-39~~37-41). For securities reported at fair value where an other-than-temporary impairment has been determined to have occurred, the realized loss recognized from the other-than-temporary impairment shall first be applied towards the realization of any unrealized losses previously recorded as a result of fluctuations in the security's fair value due to the reporting requirements. After the recognition of the other-than-temporary impairment, the security shall continue to report unrealized gains and losses as a result of fluctuations in fair value.

~~31~~33. If the fair value of a loan-backed or structured security is less than its amortized cost basis at the balance sheet date, an entity shall assess whether the impairment is other than temporary. Amortized cost basis includes adjustments made to the cost of an investment for accretion, amortization, collection of cash, previous other-than-temporary impairments recognized as a realized loss.

~~32~~34. If an entity intends to sell the loan-backed or structured security (that is, it has decided to sell the security), an other-than-temporary impairment shall be considered to have occurred.

~~33~~35. If an entity does not intend to sell the loan-backed or structured security, the entity shall assess whether it has the intent and ability¹⁰ 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

¹⁰ 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).

investment for the time sufficient to recover the amortized cost basis, an other-than-temporary impairment shall be considered to have occurred.

~~34.~~36. 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. Therefore, in those 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 (that is, a non-interest related decline¹¹ exists), and an other-than-temporary impairment shall be considered to have occurred. A decrease in cashflows expected to be collected on a loan-backed or structured security that results from an increase in prepayments on the underlying assets shall be considered in the estimate of the present value of cashflows expected to be collected.

~~35.~~37. In determining whether a non-interest related decline exists, 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 loan-backed or structured security, discounted at the security's effective interest rate.

- a. For securities accounted for under paragraphs 14-18 – the effective interest rate of the loan-backed or structured security 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).
- b. For securities accounted for under paragraphs 19-21 – the effective interest rate is the rate implicit immediately prior to the recognition of the other-than-temporary impairment.
- c. For securities accounted for under paragraphs 22-25 – the reporting entity shall apply the guidance in paragraph 24.b.

~~36.~~38. 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. (This guidance includes loan-backed and structured securities previously held at lower of cost or market. For these securities, upon recognition of an other-than-temporary impairment, unrealized losses would be considered realized.)

~~37.~~39. 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 loan-backed or structured security's effective interest rate in accordance with paragraph ~~35.~~37. (This guidance includes loan-backed and structured securities previously held at lower of cost or market. For these securities, upon recognition of

¹¹ A non-interest related decline is a decline in value due to fundamental credit problems of the issuer. Fundamental credit problems exist with the issuer when there is evidence of financial difficulty that may result in the issuer being unable to pay principal or interest when due. An interest related decline in value may be due to both increases in the risk-free interest rate and general credit spread widening.

an other-than-temporary impairment, unrealized losses would be considered realized for the non-interest related decline. Hence, unrealized losses could continue to be reflected for these securities due to the reporting requirements.)

38.40. For reporting entities required to maintain an AVR or IMR, the accounting for unrealized gains and losses shall be in accordance with paragraph 38.40.a. For realized gains and losses, the AVR and IMR analysis required and provision to allocate gains and losses between AVR and IMR is the same regardless whether the 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 addressed in paragraphs 38.40.b. through 38.40.f.:

- a. Unrealized Gains and Losses – Record all unrealized gains and losses through AVR. At the time an unrealized gain or loss is realized, the accounting shall follow the premise in paragraph 38.40, as detailed in paragraphs 38.40.b. through 38.40.f. for specific transactions. 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. Gains and losses shall only be reflected in IMR when realized and as appropriate based on the analysis of interest and non-interest factors.
- b. Other-Than-Temporary Impairment – Non-interest related other-than-temporary impairment losses shall be recorded through the AVR. If the reporting entity wrote the security down to fair value due to the intent to sell or does not have the intent and ability to retain the investment for a period of time sufficient to recover the amortized cost basis, the non-interest related portion of the other-than-temporary impairment losses shall be recorded through the AVR; the interest related other-than-temporary impairment losses shall be recorded through the 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.
- 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. As such, an entity shall report the loss in separate AVR and IMR components as appropriate.
- 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.

39.41. For situations where an other-than-temporary impairment is recognized pursuant to paragraphs 36.38 and 37.39 of this statement, the previous amortized cost basis less the other-than-temporary

impairment recognized as a realized loss shall become the new amortized cost basis of the investment. That new amortized cost basis shall not be adjusted for subsequent recoveries in fair value. Therefore, the prospective adjustment method shall be used for periods subsequent to loss recognition.

~~40.~~42. In periods subsequent to the recognition of an other than temporary impairment loss for a loan-backed or structured 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 loan-backed or structured security.

- a. For securities accounted for under paragraphs 14-21, if upon subsequent evaluation, there is a significant increase in the cash flows expected to be collected or if actual cash flows are significantly greater than cash flows previously expected, such changes shall be accounted for as a prospective adjustment to the accretable yield in accordance with paragraphs 19-21. The security shall continue to be subject to impairment analysis for each subsequent reporting period. The new amortized cost basis shall not be changed for subsequent recoveries in fair value. Future declines in fair value which are determined to be other-than-temporary shall be recorded as realized losses.
- b. For beneficial interests accounted for under paragraphs 22-25, a reporting entity shall apply the guidance in paragraphs 23-24 to account for changes in cash flows expected to be collected.

~~41.~~43. 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.

~~42.~~44. 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 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”¹²). 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.

Origination Fees

~~43.~~45. Origination fees represent fees charged to the borrower 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 loan-backed or structured security consistent with paragraph 9 of this statement. Other origination fees shall be recorded as income upon receipt.

Origination, Acquisition, and Commitment Costs

~~44.~~46. 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 loan-backed or structured security, consistent with paragraph 8 of this statement. All other costs, including internal costs or costs paid to an affiliated entity related to origination, purchase, or commitment to purchase loan-backed and structured securities, shall be charged to expense when incurred.

Commitment Fees

~~45.~~47. 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 loan-backed or structured security is issued. If the loan-backed or structured security is not issued, then the fees shall be recorded as investment income by the reporting entity when the commitment expires.

~~46.~~48. 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, 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 9 of this statement over the life of the loan-backed or structured security as an adjustment to the investment income on the loan-backed or structured security. If the commitment expires unexercised, the commitment fee shall be recognized in income on the commitment expiration date.

Giantization/Megatization of FHLMC or FNMA Mortgage-Backed Securities

~~47.~~49. 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.

¹² 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.

~~48.~~50. 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.

~~49.~~51. Transaction fees charged by the issuing agencies shall be capitalized and amortized over the life of the repooled security.

Structured Securities Acquired for a Specified Investment Strategy

~~50.~~52. To achieve certain strategic investment results, structured securities may be issued in combination with other structured securities as a unit or a pair. One strategy involves the purchase of two structured securities with opposite interest rate reset provisions. Under that strategy, the fixed coupon rate or maturity date for each structured security would be determined shortly after issuance depending on movements in market interest rates. Following that reset date, the resulting yields on each of the structured securities will move in opposite directions; however, the average yield of the two securities will generally reflect the market yield of the combined instruments in effect on the issuance date. In situations when structured securities are issued in combination with other structured securities as a unit or a pair, each structured security shall be accounted for separately in accordance with the appropriate SSAP. The guidance in paragraph 8 of SSAP No. 103R on the accounting for transfers of entire financial assets or group of entire financial assets that qualify as sales shall be applied to each structured security upon transfer.

Disclosures

~~51.~~53. 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.~~53.f., ~~51.~~53.g. and ~~51.~~53.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 loan-backed and structured 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.
- 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 30.e., 30.f. and 30.g.

~~52.54.~~ Refer to the Preamble for further discussion regarding disclosure requirements. All disclosures within this statement, except disclosures included in paragraphs ~~5153.~~b., ~~5153.~~k. and ~~5153.~~m., shall be included within the interim and annual statutory financial statements. Disclosure requirements in paragraphs ~~5153.~~b., ~~5153.~~k. and ~~5153.~~m. are required in the annual audited statutory financial statements only.

Relevant Literature

~~53.55.~~ This statement adopts *FASB Emerging Issues Task Force No. 99-20, Exchange of Interest-Only and Principal-Only Securities for a Mortgage-Backed Security*, as amended by *FAS 166, Accounting for Transfers of Financial Assets*, *An Amendment of FAS 140*, and *FASB Staff Position EITF 99-20-1, Amendments to the Impairment Guidance of EITF Issue No. 99-20*. This statement adopts paragraphs 5, 7 and 9 of *AICPA Statement of Position 03-03, Accounting for Certain Loans or Debt Securities Acquired*

in a Transfer (SOP 03-03) for loan-backed and structured securities only. With the exception of this specific adoption, consideration of SOP 03-03 is still pending consideration for statutory accounting.

~~54.~~56. This statement rejects *ASU 2018-03, Recognition and Measurement of Financial Assets and Financial Liabilities*, *ASU 2016-01, Financial Instruments – Overall*, *FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities* and *FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*.

~~55.~~57. This statement also rejects *FASB Emerging Issues Task Force No. 89-4, Accounting for a Purchased Investment in a Collateralized Mortgage Obligation Instrument or in a Mortgage-Backed Interest-Only Certificate*, *FASB Emerging Issues Task Force No. 90-2, Exchange of Interest-Only and Principal-Only Securities for a Mortgage-Backed Security*, *FASB Emerging Issues Task Force No. 93-18, Recognition of Impairment for an Investment in a Collateralized Mortgage Obligation Instrument or in a Mortgage-Backed Interest-Only Certificate*, *FASB Emerging Issues Task Force No. 96-12, Recognition of Interest Income and Balance Sheet Classification of Structured Notes*, and *FASB Emerging Issues Task Force No. 98-15, Structured Notes Acquired for a Specified Investment Strategy*.

58. Effective December 31, 2023, this statement rejects *ASU 2016-13 Financial Instruments—Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments*, *ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, *ASU 2019-04 Codification Improvements to Topics 326, 815, 825*, *ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842)*, *ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, and *ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB’s issuance of ASU 2016-13 and other related ASUs.

Effective Date and Transition

~~56.~~59. 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*. Subsequent revisions to this statement include:

- a. Substantive revisions pertaining to valuation and impairment based on expected cash flows, as detailed in *Issue Paper No. 140—Substantive Revisions to SSAP No. 43—Loan-Backed and Structured Securities*, were effective September 30, 2009. (Transition guidance previously included in SSAP No. 43R was removed from the SSAP in the *As of March 2018 Accounting Practices and Procedures Manual* but is retained for historical purposes in the issue paper.)
- b. Substantive revisions to incorporate a new method to determine the final NAIC designation were effective, on a prospective basis, for reporting periods ending on or after December 31, 2009. In 2011, revisions were incorporated to this process to be consistent with the P&P Manual. These revisions expanded the guidance to explicitly detail the process for “financial modeling” and “modified filing exempt” securities.
- c. Nonsubstantive revisions to clarify the accounting for gains and losses between AVR and IMR securities were adopted in June 2010 with a January 1, 2011, effective date with early application allowed. Reporting entities that had previously bifurcated gains and losses between AVR and IMR for sale transactions were restricted from reversing prior bifurcations and were prohibited from reverting to a process that did not bifurcate gains and losses in the period between adoption and the effective date.

- d. Nonsubstantive revisions, reflected in paragraph ~~50~~⁵², to incorporate guidance from *INT 00-11: EITF 98-15: Structured Notes Acquired for a Specified Investment Strategy* were effective September 11, 2000.
- e. Nonsubstantive revisions pertaining to the calculation of investment income for prepayment penalty and/or acceleration fees, reflected in paragraph 13, were effective January 1, 2017, on a prospective basis with early application permitted.
- f. Nonsubstantive revisions to eliminate the modified filing exempt (MFE) method were effective March 31, 2019, with early adoption permitted for year-end 2018. Early adoption was considered an “all or nothing” approach. As such, reporting entities that did not elect to early adopt were required to apply the MFE process to all applicable SSAP No. 43R securities as of year-end 2018, whereas reporting entities that elected to early adopt were not permitted to use the MFE process for any SSAP No. 43R securities for year-end 2018.
- g. Revisions adopted April 2019 to explicitly include mortgage-referenced securities in scope of this statement are effective December 31, 2019.
- h. Nonsubstantive revisions adopted in November 2021 to clarify that residual tranches or interests (as defined in footnote 10) shall be reported at the lower of amortized cost or fair value on Schedule BA: Other Invested Assets are effective December 31, 2022. Reporting entities may elect to reclassify residual tranches or interests to Schedule BA in advance of the effective date. As of the effective date, residual tranches or interests previously reported on Schedule BA shall be reclassified to the appropriate residual tranche Schedule BA reporting line based on the underlying characteristics of the investment structure.

~~57~~⁶⁰. For securities purchased prior to January 1, 1994, where historical cash flows are not readily available for applying the retrospective method, the reporting entity may use January 1, 1994, as the acquisition date and the then book value as the cost for purposes of determining yield adjustments in future periods.

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. 43—Loan-Backed and Structured Securities*
- *Issue Paper No. 140—Loan-Backed and Structured Securities, Revised September, 2009*

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 5153.f. and 5153.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 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?

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 3436, 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 3739, 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 loan-backed or structured 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 3234 or 3335, an other-than-temporary impairment shall be considered to have occurred. As detailed in paragraph 3638, 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.

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 3335 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.”
- 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 loan-backed and structured securities, the assessment of “intent and ability” is intended to be a high standard. Despite the intent of paragraph 3335, 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 3436 of SSAP No. 43R states that "A decrease in cash flows expected to be collected on a loan-backed or structured 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 16 states that "Loan-backed and structured 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."
- 5.2 The language in paragraph 3436 is consistent with GAAP, and the GAAP guidance related to the treatment of prepayments in the consideration of credit losses was intended to provide clarification for determining the "cash flows expected to be collected" on interest-only securities and other similar securities that can be contractually prepaid or otherwise settled in such a way that the holder would not recover substantially all of the investment. These securities are generally accounted for in accordance with paragraphs 19-25 of SSAP No. 43R, which requires that an entity estimate cash flows expected to be collected including both amount and timing. Therefore, for securities under SSAP No. 43R, excluding those accounted for under paragraphs 19-25, decreases in cash flows resulting in contractual prepayments should be considered yield adjustments rather than potential credit losses.

6. Question – Are the disclosure requirements within paragraphs ~~51~~53.f. and ~~51~~53.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 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 on 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 ~~40~~42 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 loan-backed or structured 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 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.

Not for Distribution

Statement of Statutory Accounting Principles No. 44

Capitalization of Interest

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	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Capitalization	2
Disclosures.....	2
Impairment.....	2
Relevant Literature.....	3
Effective Date and Transition	3
REFERENCES.....	3
Relevant Issue Papers	3

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for capitalization of interest.

SUMMARY CONCLUSION

2. The historical cost of acquiring an asset generally includes the necessary costs incurred to bring it to the condition and location necessary for its intended use. If an asset requires a period of time in which to carry out the activities necessary to bring it to that condition and location, the interest cost incurred during that period as a result of expenditures for the asset shall be included as a part of the historical cost of acquiring the asset.
3. Interest cost shall be capitalized for the following types of assets:
 - a. Assets constructed or otherwise produced for an enterprise's own use (including assets constructed or produced for the enterprise by others for which deposits or progress payments have been made);
 - b. Assets intended for sale or lease that are constructed or otherwise produced as discrete projects (e.g., real estate developments);

- c. Investments (equity, loans, and advances) accounted for by the equity method while the investee has activities in progress necessary to commence its planned principal operations provided that the investee's activities include the use of funds to acquire qualifying assets for its operations. The equity method is defined in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.
4. Interest cost shall not be capitalized for the following types of assets:
- a. Assets that are in use or ready for their intended use in the earning activities of the enterprise;
 - b. Assets that are not being used in the earning activities of the enterprise and that are not undergoing the activities necessary to get them ready for use;
 - c. Investments accounted for by the equity method after the planned principal operations of the investee begin;
 - d. Investments in regulated investees that are capitalizing both the cost of debt and equity capital;
 - e. Assets acquired with gifts and grants that are restricted by the donor or grantor to acquisition of those assets to the extent that funds are available from such gifts and grants. Interest earned from temporary investment of those funds that is similarly restricted shall be considered an addition to the gift or grant for this purpose;
 - f. Nonadmitted assets.
5. Capitalized interest meets the definition of an asset as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and is an admitted asset to the extent it conforms to the requirements of this statement.

Capitalization

6. The amount of interest cost to be capitalized for qualifying assets shall be determined in accordance with paragraphs 12-16 of *FASB Statement No. 34, Capitalization of Interest Cost* (FAS 34) and paragraph 6 of *FASB Statement No. 62, Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants* (FAS 62).
7. The capitalization period shall be in accordance with paragraphs 17-19 of FAS 34 and paragraph 7 of FAS 62.

Disclosures

8. Disclosures shall be made in the financial statements in accordance with paragraph 21 of FAS 34.
9. Refer to the Preamble for further discussion regarding disclosure requirements. The disclosure in paragraph 8 shall be included in the annual audited statutory financial reports only.

Impairment

10. Capitalized interest shall be assessed for impairment in conjunction with the assessment of the related asset. Interest capitalization shall not cease when such an assessment requires recognition of a lower value for the asset than acquisition cost; rather the provision required to reduce acquisition cost to such lower value shall be increased appropriately.

Relevant Literature

11. The statutory principles established in this statement adopt the GAAP accounting principles for capitalization of interest cost set forth in FAS 34, *FASB Statement No. 42, Determining Materiality for Capitalization of Interest Cost*, *FASB Statement No. 58, Capitalization of Interest Cost in Financial Statements That Include Investments Accounted for by the Equity Method*, and FAS 62, except that nonadmitted assets are ineligible for capitalization of interest.

Effective Date and Transition

12. 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. 44—Capitalization of Interest*

Not for Distribution

Statement of Statutory Accounting Principles No. 47

Uninsured Plans

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 05-05
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Revenue/Expense Recognition	2
Amounts Receivable	2
Liabilities	3
Disclosures.....	4
Relevant Literature.....	4
Effective Date and Transition	4
REFERENCES.....	5
Relevant Issue Papers	5

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for all uninsured plans. This statement does not encompass policies written under the National Flood Insurance Program created by the Federal Emergency Management Agency (FEMA). Guidance for policies written under the National Flood Insurance Program is included in *SSAP No. 62R—Property and Casualty Reinsurance*.

SUMMARY CONCLUSION

2. For purposes of this statement, uninsured accident and health plans, including HMO administered plans, and uninsured property and casualty plans (collectively referred to as uninsured plans) are defined as plans for which a reporting entity, as an administrator, performs administrative services such as claims processing for a third party that is at risk, and accordingly, the administrator has not issued an insurance policy, regardless of whether an identification card is issued. In the case of uninsured accident and health plans, the administrator may arrange for the provision of medical services through a contracted or employed provider network. The plan (whether insured by another reporting entity or self insured) bears all of the insurance risk, and there is no possibility of loss or liability to the administrator caused by claims incurred related to the plan. The administrator, however, may be subject to credit risk with regard to the risk bearing entity. An uninsured accident and health plan may be either an Administrative Services Only (ASO) plan or an Administrative Services Contract (ASC) plan. Under an ASO plan, claims are

paid from a bank account owned and funded directly by the uninsured plan sponsor; or, claims are paid from a bank account owned by the reporting entity, but only after the reporting entity has received funds from the uninsured plan sponsor that are adequate to fully cover the claim payments. Under an ASC plan, the reporting entity pays claims from its own bank accounts, and only subsequently receives reimbursement from the uninsured plan sponsor. No arrangement where the reporting entity receives a capitated payment for providing medical services to a third party shall qualify as an uninsured plan.

3. Uninsured accident and health plans also include Federal, state or other government department funded programs such as Medicare cost contracts where there is no underwriting risk to the reporting entity. Under Medicare cost contracts, service provided to recipients includes the direct delivery of health care for which the reporting entity is reimbursed based on costs incurred as provided for in regulations governing the administration of such contracts. Other such programs may include some Medicaid contracts for which administration or other non-underwriting services are provided.

4. Partially insured or combination plans exist, under which the reporting entity issues an insurance policy for some of the risks related to the claims (e.g. minimum premium and stop loss coverage), but acts as an administrator for some, or all, of the claims paid by the plan. Such plans shall be treated as two plans: an insured plan (the part for which the reporting entity has issued a policy) and an uninsured plan (the part that meets the definition in paragraph 2 of this statement). The components related to uninsured plans shall be accounted for using the accounting principles established in this statement; the components related to insured plans shall be accounted for as insurance.

Revenue/Expense Recognition

5. The administrator's statement of operations shall exclude all income and expenses related to claims, losses, premiums, and other amounts received or paid on behalf of uninsured ASO or uninsured ASC plans. An administrator acting as a provider of services, that provides such services through a salaried network, where the cost allocation of the service provided to insured vs. uninsured plans cannot be reasonably determined, shall report medical and hospital expenses on a gross basis by type of expense and report revenue from uninsured plans on a gross basis as fee for service income.

6. Commissions, expenses, and taxes paid by the administrator to administer such plans shall be reported on a gross basis by type of expense. Where the only functions provided are administrative, administrative fees and related reimbursements from the plan shall be deducted from general expenses. Reporting entities filing the health blank should deduct administrative fees and related reimbursements from general administrative expenses or claim adjustment expenses if the administrative services provided include services for claim adjustment expenses as defined in *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*. Where the reporting entity provides both administration and health care services directly, income from Medicare or similarly structured cost based reimbursement contracts is not recorded as premium but is recorded as revenue in the appropriate category. Health care services rendered as "medical and hospital" categorized by type and administrative expenses by type of expense shall be reported on an incurred basis.

7. Income from cost based reimbursement contracts is recorded as revenue because the service provided is for the direct delivery of care to recipients. There are risks associated with these plans in that all costs incurred under the contract may not be reimbursable and revenues may be adjusted based on subsequent challenges of costs included in filed cost reports. In addition, revenue may also be adjusted based on the performance under the terms of the contract or other external factors.

Amounts Receivable

8. Amounts receivable from uninsured plans for (a) claims and other costs paid by the administrator on behalf of the third party at risk and (b) fees related to services provided by the administrator to the plan meet the definition of assets as set forth in *SSAP No. 4—Assets and Nonadmitted Assets*. A receivable

shall not be recorded for unpaid claims. A receivable related to Medicare or a similarly structured cost based reimbursement contract shall only be recorded when services have been rendered.

9. Specific funds received as reimbursements (or advance payments) for uninsured claims under a partially uninsured plan, including but not limited to the Medicare Part D program should be accounted for per this statement. These funds include 'Reinsurance Payments' and 'Low-Income Subsidy (cost-sharing portion)'. These funds are paid by the Government for a portion of claims above the out-of-pocket threshold or relate to PDP payments for all or a portion of the deductible, the coinsurance and the co-payment amounts for low-income beneficiaries. Refer to *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage* for additional information and definitions of terms specifically related to Medicare Part D business.

10. An evaluation shall be made of the amounts receivable to determine any nonadmitted amounts. Next, an evaluation shall be made in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*, to determine whether there is an impairment. This two step process is set forth below:

- a. Uncollected uninsured plan receivables (excluding Medicare and similar government plans) over ninety days due shall be accounted for as a nonadmitted asset;
- b. Remaining amounts determined to be uncollectible shall be written off. If in accordance with SSAP No. 5R, it is "probable" the amount receivable is uncollectible, any uncollectible amount receivable shall be written off against operations in the period such determination is made. If it is "reasonably possible" the amount receivable is uncollectible, the disclosure requirements outlined in SSAP No. 5R, paragraph 3+32, shall be made. This evaluation may consider irrevocable letters of credit to which the administrator is beneficiary, amounts on deposit with the administrator or other unrestricted funds available to the administrator.

11. The following shall provide additional guidance in determining the nonadmitted portion of amounts receivable from uninsured plans:

- a. Amounts classified as nonadmitted assets collected subsequent to the date of the statutory financial statements shall not be used to decrease the nonadmitted asset otherwise calculated;
- b. The due date is governed by the contractual billing date of the uninsured plan;
- c. Medicare and similar government funded plans—Amounts due related to Medicare and similar government plans shall not be nonadmitted when they become over ninety days due. Appropriate reserves shall be established to cover costs incurred which may not be reimbursed upon final determination by the governing agencies under the cost contract or for adjustments to revenues based on performance under the terms of the contract or other external factors.

Liabilities

12. A liability shall be established for funds held by an administrator in its general assets for the benefit of an uninsured plan or for funds which may be owed by the administrator in connection with the administration of an uninsured plan. A liability relating to one plan shall not be offset by an asset relating to a different plan. Administrators shall not record aggregate reserves, claim/loss reserves, or liabilities (except for Medicare or similarly structured cost based reimbursement contracts) for any other claim costs paid by the administrator on behalf of uninsured plans.

Disclosures

13. The statutory financial statements shall provide the following:

- a. Information with regard to the profitability to the administrator of all ASO plans and the uninsured portions of partially insured plans for which the reporting entity serves as an ASO administrator;

For the total and each category separately provided: (i) net reimbursement for administrative expenses (including administrative fees) in excess of actual expenses, (ii) total net other income or expense (including interest paid to or received from plans), and (iii) total net gain or loss from operations and (iv) the claim payment volume;

- b. Information with regard to the profitability to the administrator of all ASC plans and the uninsured portions of partially insured plans for which the reporting entity serves as an ASC administrator;

For the total and each category separately provided: (i) gross reimbursement for medical cost incurred, (ii) gross administrative fees accrued, (iii) other income or expense (including interest paid to or received from plans), (iv) gross expenses incurred (claims and administrative), and (v) total net gain or loss from operations.

- c. Information with regards to Medicare or similarly structured cost based reimbursement contracts shall include: (i) major components of revenue by payor, (ii) receivables from payors with account balances the greater of 10% of gross amounts receivable relating to uninsured accident and health plans or \$10,000, (iii) recorded allowances and reserves for adjustment of recorded revenues, (iv) adjustments to revenue resulting from audit of receivables related to revenues recorded in the prior period.

14. Refer to the Preamble for further discussion regarding disclosure requirements.

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*, and *ASU 2021-08, Business Combinations, Accounting for Contract Assets and Contract Liabilities from Contracts with Customers*.

Effective Date and Transition

16. 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. 47—Uninsured Plans*

Not for Distribution

Statement of Statutory Accounting Principles No. 48

Joint Ventures, Partnerships and Limited Liability Companies

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Nullifies and incorporates INT 01-10, 04-10 and INT 08-03; Nullifies INT 01-14
Affected by.....	No other pronouncements
Interpreted by	INT 06-02; INT 06-07
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Residual Interests and Reporting	5
Impairment.....	6
Disclosures.....	6
Relevant Literature.....	7
Effective Date and Transition	8
REFERENCES.....	8
Relevant Issue Papers	8

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for investments in any joint ventures, partnerships, and limited liability companies, including investments in certified capital companies (CAPCO) per *INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)*, whether or not it is considered to be controlled by or affiliated with the reporting entity. Single real estate property investments that are wholly-owned by an LLC that is directly and wholly-owned by the reporting entity, and that meet the criteria established in *SSAP No. 40R—Real Estate Investments*, are excluded from this statement. This statement does not address the accounting for investments in partnerships and limited liability companies that invest in Low-Income Housing Tax Credit Properties as discussed in *SSAP No. 93—Low-Income Housing Tax Credit Property Investments*. However, investments in certain state Low-Income Housing Tax Credit Property Investments that do not fall within the scope of *SSAP No. 93* are covered by the requirements of this statement.

SUMMARY CONCLUSION

2. Investments in joint ventures shall include investments in corporate joint ventures and unincorporated joint ventures (also referred to as undivided interests in ventures). A corporate joint venture is defined as a corporation owned and operated by a small group (the joint venturers) as a separate and specific business or project for the mutual benefit of the members of the group. A corporate joint

venture usually provides an arrangement under which each joint venturer may participate, directly or indirectly, in the overall management of the joint venture. Joint venturers thus have an interest or relationship other than as passive investors. An unincorporated joint venture is similar in its purpose but is not incorporated.

3. Investments in partnerships shall include investments in general partnership interests and limited partnership interests. A general partnership is defined as an association in which each partner has unlimited liability. Each partner assumes joint and several liability for all partnership debts. A limited partnership shall be defined as a partnership having two classes of partners: (a) general partners who manage the partnership, subject to the partnership agreement, and have personal liability for the general obligations of the partnership and (b) limited partners who are passive investors and have no personal liability beyond their investment.

4. A limited liability company is defined as a business organization which is a hybrid of a corporation and partnership whereby the owners have limited liability like a corporation and profits may pass through to the owners for tax purposes like a partnership if certain criteria are met. The owner's personal liability is limited to his own acts and the owners can fully participate in the management of the business with no adverse impact on their limited liability.

5. Investments in the ventures defined in paragraphs 2-4 meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement. Investments in joint ventures, partnerships, and limited liability companies shall be reported in Other Invested Assets in the financial statements.

6. Investments in these ventures, except for joint ventures, partnerships and limited liability companies with a minor ownership interest¹, shall be reported using an equity method as defined in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, paragraphs 8.b.i. through 8.b.iv. (The equity method calculation may result with a negative valuation of the investment; therefore, the SSAP No. 97 equity method calculation shall occur regardless of whether the investment is supported by an audit and the reporting entity will nonadmit the investment.) A reporting entity whose shares of losses in a SSAP No. 48 entity exceeds its investment in the SSAP No. 48 entity shall disclose the information required by SSAP No. 97, paragraph 35.a.

7. Investments reported using an equity method from SSAP No. 97, paragraph 8.b.ii. through 8.b.iv. may have fiscal year ends, not calendar year ends. To recognize a change to the reporting year-end of an equity method investee, including changes in, or the elimination of, previously existing differences (lag period) due to the reporting entity's ability to obtain financial results from a reporting period that is more consistent with, or the same as, that of the reporting entity's, the guidance included in *FASB Emerging Issues Task Force No. 06-9: Reporting a Change in (or the elimination of) a Previously Existing Difference Between the Fiscal Year-End of a Parent Company and That of a Consolidated Entity or Between the Reporting Period of an Investor and That of an Equity Method Investee* that defines such reporting period changes as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors* shall be followed.

¹ With the identification of whether the reporting entity has a minor ownership interest, reporting entities must also identify whether the investment is a related-party transaction. Pursuant to the concepts reflected in *SSAP No. 25—Affiliates and Other Related Parties*, consideration shall be given to the substance of the transaction and the parties whose action or performance materially impacts the insurance reporting entity holding the security. For example, if the underlying assets within a SSAP No. 48 entity represent assets issued by an affiliate, then the SSAP No. 48 entity shall be considered a related party (affiliate) investment, with the transaction subject to the accounting and reporting provisions of SSAP No. 25. As identified in SSAP No. 25, it is erroneous to conclude that the inclusion of a non-related intermediary, or the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to identify and assess the investment transaction as a related party arrangement.

8. Joint ventures, partnerships and limited liability companies in which the entity has a minor ownership interest (i.e., less than 10%) or lacks control as stipulated in paragraphs 15 and 16, shall be recorded based on the underlying audited U.S. GAAP equity of the investee. The investment shall be nonadmitted if the audited financial statements include substantial doubt about the entity's ability to continue as a going concern. Additionally, the investment shall be nonadmitted on the basis/contents of the audit opinion as detailed in paragraph 21 of SSAP No. 97.

9. If audited U.S. GAAP basis financial statements of the investee are not available, joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest (i.e., less than 10%) or lacks control as stipulated in paragraphs 15 and 16 may be recorded based on either of the valuation methodologies allowed under paragraphs 9.a. or 9.b. If either one of the valuation methodologies allowed under paragraphs 9.a. or 9.b. is used to value the investment, documentation must be maintained regarding the reason that audited U.S. GAAP basis financial statements could not be provided.

- a. Non-U.S. joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest of less than 10% and for which audited U.S. GAAP basis financial statements of the investee are not available, may be recorded based on:
 - i. the U.S. GAAP basis equity as set forth in the audited footnote reconciliation of the investee's equity and income to U.S. GAAP within the investee's audited foreign GAAP prepared financial statements or,
 - ii. the IFRS basis equity as set forth in the investee's audited IFRS financial statements prepared in compliance, both annually and quarterly, with IFRS as issued by the International Accounting Standards Board (IASB).
- b. If audited U.S. GAAP basis financial statements of the investee are not available, joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest of less than 10%, measured at the holding company level, may be recorded based on the underlying audited U.S. tax basis equity. The U.S. tax basis equity audit shall occur at the investee level. For investments recorded based on the underlying audited U.S. tax basis equity, the reporting entity shall review investments held by the joint venture, partnership or limited liability company in accordance with the impairment guidance in paragraphs 4821 and 4922. The reporting entity must first attempt to obtain audited U.S. GAAP basis financial statements and, if such financial statements are unavailable, must maintain documentation regarding the reason that audited U.S. GAAP basis financial statements could not be provided.

10. The amount to be recorded shall be defined as the initial investment in an investee at cost (as defined in paragraph 3 of *SSAP No. 68—Business Combinations and Goodwill*) plus subsequent capital contributions to the investee. The carrying amount of the investment shall be adjusted for the amortization of the basis difference (difference between the cost and the underlying GAAP equity), as well as to recognize the reporting entity's share of: (i) the audited U.S. GAAP basis earnings or losses of the investee after the date of acquisition, adjusted for any distributions received, or (ii) if audited U.S. GAAP basis financial statements of the investee are not available, the earnings or losses of the investee after the date of acquisition, adjusted for any distributions received, based on either one of the valuation methodologies allowed under paragraphs 9.a. or 9.b. A reporting entity's share of adjustments, excluding changes in capital contributions to the investee, that are recorded directly to the investee's stockholders' equity shall also be recorded as adjustments to the carrying value of the investment with an offsetting amount recorded to unrealized capital gains and losses on investments.

11. Entities may recognize their investment in joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest based on an unaudited basis for investment

determination (i.e., foreign GAAP, IFRS, or tax basis as allowed under paragraph 9) if annual audited information is not complete as of the annual statement filing deadline. The recorded investment shall be adjusted for annual audit adjustments, if any, as soon as annual audited information is available. If financial statements of an investee are not sufficiently timely for the reporting entity to apply an equity method to the investee's current results of operations, the reporting entity shall record its share of the earnings or losses of an investee from the most recent available financial statements. A lag in reporting shall be consistent from period to period.

12. If an additional investment, in whole or in part, represents, in substance, the funding of prior losses, the entity should recognize previously suspended losses only up to the amount of the additional investment determined to represent the funding of prior losses. Whether the investment represents the funding of prior losses depends on the facts and circumstances.

13. Judgment is required in determining whether prior losses are being funded and that all available information should be considered in performing the related analysis. The following are certain factors to consider in that regard. However, no one factor should be considered presumptive or determinative.

- a. Whether the additional investment is acquired from a third party or directly from the investee. When the additional investment is purchased from a third party and the investee does not obtain additional funds either from the investor or the third party, it is unlikely that, in the absence of other factors, prior losses are being funded.
- b. The fair value of the consideration received in relation to the value of the consideration paid for the additional investment. For example, if the fair value of the consideration received is less than the fair value of the consideration paid, it may indicate that prior losses are being funded to the extent that there is disparity in the value of the exchange.
- c. Whether the additional investment results in an increase in ownership percentage of the investee. In instances in which the investment is made directly with the investee, the investor should consider the form of the investment and whether other investors are making simultaneous investments proportionate to their interests. Investments made without a corresponding increase in ownership or other interests, or a pro rata equity investment made by all existing investors, may indicate that prior losses are being funded.
- d. The seniority of the additional investment relative to existing equity of the investee. An investment in an instrument that is subordinate to other equity of the investee may indicate that prior losses are being funded.

14. Upon making the additional investment, the investor should evaluate whether it has become otherwise committed to provide financial support to the investee.

15. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by common management, or (d) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity.

16. Control as defined in paragraph 15 shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13% and therefore each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment based on the criteria in *FASB Interpretation No.*

35, *Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18*. The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting interests of an investee. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. Examples of situations where the presumption of control may be in doubt include the following:

- a. Any limited partner investment in a Limited Partnership, unless the limited partner is affiliated with the general partner.
- b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.
- c. An entity where the insurer has given up participation rights as a shareholder to the investee.

17. The reporting entity's share of undistributed earnings and losses of the investee shall be included in unrealized gains and losses of the reporting entity. The reporting entity's share of other changes in the investee's surplus (e.g., the change in the investee's nonadmitted assets) shall be recorded by the investor as a component of unrealized capital gains and losses on investments. Distributions received from an investee shall be recognized in investment income when declared to the extent that they are not in excess of the undistributed accumulated earnings attributable to the investee. Distributions declared in excess of the undistributed accumulated earnings attributable to the investee shall reduce the carrying amount of the investment.

Residual Interests and Reporting

18. Investments in scope of this statement are reported on Schedule BA: Other Long-Term Assets. Schedule BA includes dedicated reporting categories for joint ventures, partnerships, and limited liability company investments as well as for residual interests, both with reporting lines in accordance with underlying asset characteristics. Investments within scope of this standard shall be divided within these reporting categories, with investments that reflect residual interests, or that predominantly hold residual interests captured in the residual interest reporting category.

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

20. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive in determination. Classification as a

residual should be based on the substance of the investment and how cash flows to the holder are determined.

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

Impairment

~~18.~~21. For any decline in the fair value of an investment in a joint venture, partnership, or limited liability company which is determined to be other than temporary^(INT 06-07), the investment shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. The write down shall first be considered as an adjustment to any portion of the investment that is nonadmitted (e.g., goodwill). The new cost basis shall not be changed for subsequent recoveries in fair value. Future declines in fair value, which are determined to be other than temporary, shall be recorded as realized losses.

~~19.~~22. An impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to recover the carrying amount of the investment or there is evidence indicating inability of the investee to sustain earnings which would justify the carrying amount of the investment. Even if the fair value of an investment is below the carrying amount it is not necessarily indicative of a loss in value that is other than temporary. Similarly, the existence of investee operating losses may indicate a loss in value; however, it is not necessarily indicative of a loss in value that is other than temporary.

Disclosures

~~20.~~23. The significance of an investment to the reporting entity's financial position and results of operations shall be considered in evaluating the extent of disclosures of the financial position and results of operations of an investee. Disclosures as follows shall be made for all investments in joint ventures, partnerships, or limited liability companies that exceed 10% of the total admitted assets of the reporting entity:

- a. (1) the name of each joint venture, partnership or limited liability company and percentage of ownership, (2) the accounting policies of the reporting entity with respect to investments in joint ventures, partnerships and limited liability companies and (3) the difference, if any, between the amount at which the investment is carried and the amount of underlying equity in net assets (i.e., nonadmitted goodwill or other nonadmitted assets) and the accounting treatment of the difference;

- b. For joint ventures, partnerships, and limited liability companies for which a quoted market price is available, the aggregate value of each joint venture, partnership, or limited liability company investment based on the quoted market price; and
- c. Summarized information as to assets, liabilities, and results of operations for joint ventures, partnerships, and limited liability companies either individually or in groups.

~~21.~~24. Any commitment or contingent commitment (e.g., guarantees or commitments to provide additional capital contributions) to a joint venture, partnership, or limited liability company shall be disclosed.

~~22.~~25. A reporting entity that recognizes an impairment loss shall disclose the following in the financial statements that include the period of the impairment write-down:

- a. A description of the impaired assets and the facts and circumstances leading to the impairment; and
- b. The amount of the impairment and how fair value was determined.

~~23.~~26. Any change due to the requirements of paragraph 7 shall be disclosed per SSAP No. 3.

~~24.~~27. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

~~25.~~28. This statement adopts with modification *FASB Emerging Issues Task Force No. 06-9: Reporting a Change in (or the elimination of) a Previously Existing Difference between the fiscal Year-End of a Parent Company and That of a Consolidated Entity or between the Reporting Period of an Investor and That of an Equity Method Investee*. The modifications include:

- a. Adopt the guidance that defines such reporting period changes as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*, modified to apply only to equity method investments. For instances in which this change in accounting principle occurs, disclosure requirements of SSAP No. 3 shall be followed.
- b. The consolidation guidance in EITF 06-9 is rejected.
- c. Changes affecting companies reporting investments in SCA entities using the equity method: Investments in SSAP No. 97 paragraph 8.b.i. entities are required to be calendar year-end. Investments in SSAP No. 97 paragraphs 8.b.ii. through 8.b.iv. entities may have other fiscal year ends; thus this issue could apply to equity method investments under 8.b.ii. through 8.b.iv. or under equity method valued investments that fall within the scope of SSAP No. 48.

~~26.~~29. This statement adopts *ASU 2016-07, Investments-Equity Method and Joint Ventures*, providing guidance for the prospective application of equity method accounting, modified to reflect statutory terms including the definition of control and statutory reporting concepts.

~~27.~~30. This statement is inconsistent with the guidance in paragraph 17 of *APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock* (APB 18), which addresses when control exists. APB 18 is addressed in its entirety and rejected in SSAP No. 97. This statement also rejects *AICPA Statement of Position 78-9, Accounting for Investments in Real Estate Ventures* and *FASB Emerging Issues Task Force No. 00-01, Investor Balance Sheet and Income Statement Display under the Equity Method for Investments in Certain Partnerships and Other Ventures*.

Effective Date and Transition

~~28.~~31. This statement rejects *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.*

~~29.~~32. This statement is effective for years beginning January 1, 2001. For investments made in joint ventures, partnerships and limited liability companies prior to January 1, 2001, if the joint venture, partnership or limited liability company does not prepare audited GAAP financial statements, and the reporting entity together with all other investors subject to this statement does not have sufficient voting power (pursuant to the joint venture, partnership or limited liability agreement) to force the preparation of audited GAAP financial statements, the reporting entity may then value its investment based on unaudited GAAP or audited tax-basis financial statements. 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*. Guidance in paragraph 1 was previously included within *SSAP No. 93—Low-Income Housing Tax Credit Property Investments* and was effective for reporting periods beginning on January 1, 2006, and thereafter, with early adoption permitted. The original guidance included in this standard, and the substantive revisions reflected in *SSAP No. 93* are retained for historical purposes in *Issue Paper No. 125—Accounting for Low-Income Housing Tax Credit Property Investments*. Guidance in paragraph 7 was previously included within *INT 08-03: EITF 06-9: Reporting a Change in (or the elimination of) a Previously Existing Difference between the fiscal Year-End of a Parent Company and That of a Consolidated Entity or between the Reporting Period of an Investor and That of an Equity Method Investee* and was effective for periods beginning May 31, 2008. Guidance reflected in paragraphs 12, 13 and 14 incorporated from *INT 04-10: Accounting for Subsequent Investments in an Investee after Suspension of Equity Method Loss Recognition*, was originally effective December 5, 2004. Revisions adopted to paragraph 10 in August 2012 to clarify the requirement for the amortization of the basis differences shall be initially effective January 1, 2013, unless the company was previously amortizing the basis difference. (Companies that have previously amortized the basis difference shall not be impacted by these revisions.) For companies initially applying on January 1, 2013, the revisions should be applied prospectively for both new and existing minority-owned investments, with the effective date for this revision being used as the measurement date to determine any basis difference, which is attributable to goodwill, to be amortized on existing minority-owned investments.

~~30.~~33. The substantive revisions to incorporate single real estate property investments wholly-owned by an LLC that is directly and wholly-owned by the reporting entity in accordance with the criteria detailed in *SSAP No. 40R* are effective as of January 1, 2015. For these investments previously reported within the scope of this statement, the reporting entity shall follow the transition guidance in *SSAP No. 40R*.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 48—Investments in Joint Ventures, Partnerships and Limited Liability Companies*
- *Issue Paper No. 125—Accounting for Low-Income Housing Tax Credit Property Investments*
- *Issue Paper No. 149—Wholly-Owned Single Real Estate Property in an LLC*

Statement of Statutory Accounting Principles No. 49

Policy Loans

STATUS

Type of Issue..... Life, Accident and Health
Issued Initial Draft
Effective Date January 1, 2001
Affects..... Nullifies and incorporates INT 01-05
Affected by..... No other pronouncements
Interpreted by No other pronouncements
Relevant Appendix A Guidance None

STATUS	1
SCOPE OF STATEMENT	1
SUMMARY CONCLUSION	1
Policy Loans Related to Separate Account Policies	2
Effective Date and Transition	2
REFERENCES	3
Relevant Issue Papers	3
EXHIBIT A – ILLUSTRATION OF ENTRIES FOR POLICY LOANS RELATED TO THE SEPARATE ACCOUNT	4

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for policy loans.

SUMMARY CONCLUSION

2. A policy (or contract) loan shall be defined as a loan to a policyholder, under the provisions of an insurance contract that is secured by the cash surrender value or collateral assignment of the related policy or contract. Policy loans shall include:
 - a. Cash loans, including loans resulting from early payment benefits or accelerated payment benefits, on contracts when the terms of the contract specify that such payments are policy loans secured by the policy;
 - b. Automatic premium loans, which are loans made in accordance with policy provisions whereby delinquent premium payments are automatically paid from the cash value at the end of the established grace period for premium payments.
3. Policy loans meet the definition of assets, as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets, except as specified in paragraphs 5 and 6 of this statement. Policy loans are readily available to satisfy policyholder obligations as the terms of the policy loan allow the reporting entity to offset an outstanding policy loan balance against the cash surrender value of the policy.

4. Policy loans shall be reported in the general account and carried at the unpaid balance of the loan. (Paragraph 9 and paragraph 10 provide specific accounting and reporting guidance for policy loans related to separate account policies.) The unpaid balance of the loan shall include any unpaid principal plus any accrued interest which is 90 days or more past due.

5. If the unpaid balance of the loan exceeds the cash surrender value or policy reserves established for the policy, the policy generally lapses. Cash surrender value shall be defined as the cash value of the basic policy plus cash value of any policy accumulations such as paid-up additions. The excess of the unpaid balance of the loan over the cash surrender value shall be evaluated for collectibility. If the amount is considered uncollectible, it shall be written off as a reduction of investment income in the statement of operations during the period it is determined to be uncollectible. Except for collateral assignment loans, all other amounts in excess of the cash surrender value shall be considered nonadmitted assets. The change in this nonadmitted asset shall be recorded as a change in nonadmitted assets as applicable.

6. A loan resulting from early payment benefits or accelerated payment benefits and secured by an assignment of the policy to the reporting entity as collateral for the loan shall be an admitted asset, except that the amount of any loan (including accrued interest) in excess of the policy reserve for that policy shall be nonadmitted. Upon death, the entire death benefit is recorded as a death benefit expense. The policy proceeds shall be used to repay the loan. Any proceeds in excess of that needed to repay the loan are payable to the named beneficiary.

7. Interest income on policy loans shall be recorded as earned and included in investment income consistent with *SSAP No. 34—Investment Income Due and Accrued*. For interest received before it is earned, unearned interest income shall be recorded as a liability in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*.

8. Accrued interest income on policy loans that is past due 90 days¹ or more shall be reclassified from Investment Income Due and Accrued and included in the unpaid balance of the policy loan as defined in paragraph 4.

Policy Loans Related to Separate Account Policies

9. Policy loans related to separate account policies are reported in the general account. Pursuant to *SSAP No. 56—Separate Accounts*, policy loans relating to the separate account are recorded as expense transfers to the general account in the Summary of Operations. Exhibit A provides an illustration of the reporting process to record policy loans related to the separate account.

10. Policy loans related to the separate account (for both insulated and non-insulated separate account policies) must be settled with the general account in order for the policy loan to be admitted in the general account. This settlement requires a transfer of assets (generally cash) from the separate account to the general account to fund the policy loan. Policy loans that have not been settled with a transfer of assets from the separate account shall be nonadmitted.

Effective Date and Transition

11. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The guidance in the footnote to paragraph 8 was originally contained within *INT 01-05: Classification of Accrued Interest on Policy Loans* and was effective March 26, 2001.

¹ Interest less than 90 days due is allowed to be reclassified from Investment Income Due and Accrued and included in the unpaid policy loan balance earlier. This is a classification issue and would not result in any amounts being admitted that would otherwise be nonadmitted.

REFERENCES**Relevant Issue Papers**

- *Issue Paper No. 49—Policy Loans*

Not for Distribution

EXHIBIT A – ILLUSTRATION OF ENTRIES FOR POLICY LOANS RELATED TO THE SEPARATE ACCOUNT

The following exhibit illustrates the entries when there is a policy loan related to separate account business. Key concepts within the reporting shall include:

1. All policy loans shall be reported in the general account.
2. All policy loans related to the separate account shall be reflected with an expense transfer between the separate and general account.
3. All policy loans related to the separate account must be “funded” to the general account in order for the policy loan to be admitted.
4. Separate account and general account reserves must be adjusted to reflect the policy loan. For the separate account, reserves shall be reduced, and the general account reserves shall be increased.

Separate Account		General Account	
Dr. Transfers on Account of Policy Loans	100	Dr. Transfers to SA due or accrued (net)	100
Cr. Other Transfers to GA due or accrued (net)	100	Cr. Net Transfers to / from SA	100
<i>Records the expense transfer in the Summary of Operations and the liability owed from the SA.</i>		<i>Records the expense transfer in the Summary of Operations and the asset due from the SA. Since this is a net presentation on the liability page, this asset may be recorded as a contra-liability.</i>	
Dr. Cash	100	Dr. Policy Loan	100
Cr. Separate Account Assets	100	Cr. Cash	100
<i>Records the liquidation of separate account assets to fund the policy loan.</i>		<i>Records the issuance of the policy loan to the policyholder.</i>	
		Dr. Change in Nonadmitted	100
		Cr. Unassigned Funds	100
		<i>The policy loan is nonadmitted until funded from the separate account. If the loan is simultaneously funded, then this entry would not occur.</i>	
Dr. Other Transfers to GA due or accrued (net)	100	Dr. Cash	100
Cr. Cash	100	Cr. Net Transfers to / from SA	100
<i>Settles the amount due to the general account with the issuance of the policy loan.</i>		<i>Settles the amount due from the separate account with the issuance of a policy loan.</i>	

Separate Account		General Account	
		Dr. Unassigned Funds	100
		Cr. Change in Nonadmitted	100
		<i>Removes nonadmittance of the policy loan as the loan has been funded from the separate account.</i>	
Dr. Separate Account Liability	100	Dr. Change in Reserve	100
Cr. Change in Reserve	100	Cr. Reserve Liability	100
<i>Reduces the amount of the separate account liability for the amount of the policy loan.</i>		<i>Establishes a reserve in the general account for the amount of the policy loan.</i>	

Not for Distribution

Statement of Statutory Accounting Principles No. 50

Classifications of Insurance or Managed Care Contracts

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Nullifies and incorporates INT 08-08; Nullifies INT 00-23 and INT 01-23
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Overview	1
Life Contracts.....	2
Life Contracts—Definitions.....	3
Accident and Health Contracts	5
Accident and Health Contracts—Definitions	7
Property and Casualty Contracts.....	7
Property and Casualty Contracts—Definitions.....	8
Deposit-Type Contracts	9
Relevant Literature.....	10
Effective Date and Transition	10
REFERENCES.....	10
Relevant Issue Papers	10

SCOPE OF STATEMENT

1. This statement provides a general framework for classifying insurance or managed care contracts into categories where the recognition of contract and policy reserves and related revenue, benefits, and claims is fundamentally different. Separate statements will establish the accounting principles for premium and income recognition and policy benefit and claim reserves for all contracts defined herein.

SUMMARY CONCLUSION

Overview

2. The primary purpose of insurance, including managed care coverage, is to provide economic protection from identified risks occurring or discovered within a specified period. These risks include death, disability, health benefits, outliving one's financial assets, and damage to property by an insured

peril or damage or injury to the insured or third parties. The accounting for the contract is significantly influenced by the terms of the insurance or managed care contract.

3. In order to provide for a conservative, consistent, and comparable method of accounting for insurance or managed care contracts, premiums and related benefits shall be recognized considering the policy term, premium payment requirements, risks assumed and benefits provided under the contract using conservative assumptions as to interest, mortality, morbidity, and incurred costs for health benefits as applicable. The reserve and income recognition methods reflect the premium payment pattern and the insurance protection and/or benefits provided for in the insurance or managed care contract.

4. This statement establishes an overall framework for existing insurance or managed care contracts by identifying four broad categories of insurance or managed care contracts where the premium payment pattern and the protection and/or benefits provided are fundamentally different and, therefore, require different income recognition and reserving methods.

5. Insurance contracts providing any protection against death, disability, accident or illness in which the reporting entity assumes mortality or morbidity risk shall be classified as life or accident and health contracts, as applicable. Managed care contracts provide defined health care services to subscribers, members or policyholders, collectively referred to hereafter as subscribers, in return for fixed, periodic premiums (usually paid monthly) that are generally due at or before the beginning of the coverage period and shall be classified as health contracts. Contracts which insure against damage to property by an insured peril or damage or injury to the insured or third parties, generally over a fixed/limited period of time, shall be classified as property and casualty contracts. Contracts in which the reporting entity does not assume any mortality, morbidity, health benefit costs incurred, or casualty risk and which act exclusively as investment vehicles shall be classified as deposit-type contracts. Such classification shall be made at the inception of the contract and shall not change.

Life Contracts

6. The primary purpose of life insurance is to provide financial assistance to a beneficiary at the insured's death. The long period of coverage involving the risk of death, a risk which usually increases with age, is the distinguishing characteristic by which life insurance is set apart from other forms of insurance. Life insurance is often sold on a level premium basis under which the annual premium remains constant even though the expected policy benefits and services do not occur evenly over the duration of the contract. Premium revenue generally exceeds expected policy benefits in the early years of the contract and it is necessary to accrue, as premium revenue is recognized, a liability for costs that are expected to be paid in the later years of the contract.

7. The liability for expected costs relating to most types of life contracts is accrued over the current and expected renewal periods of the contracts. The net valuation premium is based upon an assumed interest rate and upon the frequency of death derived from mortality tables. The net premiums collected, after deducting benefits and other costs each year, are accumulated at interest. This accumulation, when combined with future net premiums and future investment income theoretically generates a sum sufficient to pay the claims resulting from the death or disabilities of the insured.

8. The liability which corresponds to this fund is referred to as the policy reserve. These contracts are generally expected to be in force for an extended period of time and require the performance of various functions and services for an undefined period of time and are generally not subject to unilateral changes in their provisions. The policy reserve is generally calculated as the excess of the present value of future benefits to be paid to or on behalf of policyholders less the present value of future net premiums, discounted at valuation interest and mortality.

9. Life insurance contracts shall include contracts with life contingencies, including, but not limited to:
- a. Whole life contracts
 - b. Endowment contracts
 - c. Term life contracts
 - d. Supplementary contracts
 - e. Group life contracts
 - f. Franchise life contracts
 - g. Universal life type contracts
 - h. Variable life contracts
 - i. Limited payment contracts
 - j. Credit life contracts
 - k. Annuity contracts

Life Contracts—Definitions

10. The contract for ordinary life insurance is between the company and the policy owner (often the insured). Many variations of ordinary life coverages are available to a purchaser of insurance, including participating, limited-payment periods, combinations of coverages, and decreasing (or increasing) death benefits. Industrial life insurance, also called “debit” insurance, is insurance under which premiums are paid monthly or more often, the face amount of the policy does not exceed a stated amount, and the words “industrial policy” are printed in prominent type on the face of the policy. Ordinary and industrial life insurance contracts are considered life contracts and include the types of coverage as described in paragraphs 11-20.

11. Whole life contracts provide a fixed amount of insurance coverage over the life of the insured and the related benefits are normally payable only upon the insured’s death. Premiums are paid over various periods as allowed by the terms of the policy contract. Whole life insurance contracts provide for nonforfeiture values, some common types being reduced paid up insurance, extended term insurance, and cash values, and some provide for the payment of policy dividends. A level premium is usually paid for policies of this type, and the premium may be paid in annual or more frequent modes. An ordinary life (straight-life) policy stipulates that premiums are to be paid during the life of the insured.

12. Endowment contracts are principally savings contracts which incorporate an element of life insurance protection. Endowment insurance contracts provide a benefit if the insured survives the endowment period or the amount is paid to a beneficiary if the insured does not survive. A pure endowment contract only provides a benefit to the insured if he/she survives the endowment period. Endowment policies mature at a specified attained age of the insured or at the end of a specified period. Premium payments for endowment contracts are made over a specified period, but may also be made under a single-premium or limited-payment plan. Both whole life and endowment policies contain nonforfeiture or similar clauses which provide for a value in cash or some other form of insurance to be available in the event of failure to continue the required premiums.

13. Term life contracts provide insurance over a specified period of time. If the insured dies during this term, the face amount of the policy will be paid to the beneficiary. Policies for term insurance which are written for relatively short periods of time commonly grant the policyholder the right to renew for an additional period or periods up to a maximum age, such as 60 or 65, without requiring additional evidence of insurability. Rights to convert to whole life or endowment contracts may also be included in the contract. Term contracts may also be made for a period which will end when the insured reaches a certain age (for example, age 60 or 65). Such policies do not usually provide nonforfeiture values.

14. Supplementary contracts with life contingencies are a type of agreement between the insurance company and either the insured or the beneficiary, usually to provide for full or partial settlement of the amount payable upon the termination of an original contract. Generally, the proceeds are paid over the lifetime of one or more beneficiaries. This differs from a supplementary contract without life contingencies under which the proceeds are paid over a definite period without regard to the life of the beneficiary.

15. Group life contracts are insurance on the lives of a group of persons under a single master contract. Insurance of this type is customarily written on a yearly renewable term basis although some permanent group life is sold. Group life insurance is based on a master policy which usually precludes or disallows individual selection and is for the benefit of persons other than the policyholder. The individual insured members may receive certificates of insurance which evidence the contract. The contract is made by the policyholder and the insurer; there is no contract of insurance between the policyholder and the members. State statutes vary as to what constitutes a group and as to who may be a policyholder. Some states permit only employee-employer relationships in a group contract. Others permit union members, credit union members, or similar relationships in group contracts.

16. Franchise life contracts usually consist of individual policies offered to all persons in a general class (usually a work profession) who are related in some way such as belonging to a certain association.

17. Universal life and variable life contracts include those contracts which have terms that are not fixed and guaranteed relative to premium amounts, expense assessments, or benefits accruing to the policyholder. These contracts generally provide for death benefits and nonforfeiture values and may be issued on a fixed premium basis or on a flexible premium basis where the premiums are paid at the insured's discretion.

18. Limited-payment contracts are contracts with terms that are fixed and guaranteed and for which premiums are paid over a specified number of years or to a specified age. The insurance coverage continues for the remainder of the insured's life. A single-premium policy requires a lump-sum payment at the inception of the policy.

19. Credit life contracts are sold in connection with loans or other credit transactions not exceeding a stated duration and provide insurance protection against death. This form of insurance is generally issued in connection with the issuance of credit to an individual by a bank, retailer, finance company, or other similar organizations. This type of insurance most often protects the creditor to the extent of the unpaid balance of the loan in the form of decreasing term insurance; however, some credit life insurance is sold on a level-term basis.

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

members, and collective trusts purchasing contracts for the benefit of participating pension plans and their plan participants. The main types of annuity contracts with life contingencies are discussed below.

- a. A deferred annuity provides for the accumulation of funds to be applied at some future period designated by the policyholder. Premium payments can be made in a lump sum amount (single premium deferred annuity), or periodically (flexible or fixed premium deferred annuity) as allowed by the policy contract. At the end of the accumulation period, the policyholder may elect to receive a lump sum distribution or may elect to receive periodic payments for life, or over a specific period, or some combination thereof;
- b. A variable annuity is an annuity which includes a provision for benefit payments which vary in accordance with the rate of return of the underlying investment portfolio selected by the policyholder. The considerations for a variable annuity are usually invested in a separate account in which the value of the contract share varies according to the performance of the separate account before the commencement of annuity payments as well as after. Premium payments can be made in lump sum amounts or periodically as allowed by the policy contract. A minimum death benefit is often guaranteed during the annuity consideration accumulation period and these contracts are, therefore, classified as life contracts;
- c. A straight-life annuity provides for periodic payments to the annuitant as long as the annuitant lives. Death of the annuitant constitutes completion of the contract and no further payments are made by the insurance company;
- d. A life annuity with a period certain works essentially the same way as the straight-life annuity as the annuitant receives periodic payments for as long as the annuitant lives. However, if the annuitant dies before the end of the specified “certain” period, payments are continued to a beneficiary until the specified number of “certain” payments (i.e., the specified period in the contract) is completed;
- e. A refund annuity is similar to the life annuity with a period certain in which the annuitant receives periodic payments for as long as the annuitant lives. There are two variants of this type of annuity. Under the cash refund annuity, a lump-sum payment is made at the death of the annuitant equal to the excess, if any, of the purchase price of the annuity over the sum of the annuity payments made to date of death. The installment refund annuity provides that annuity payments are to continue to a beneficiary after the death of the annuitant until the sum of all payments made equals the purchase price;
- f. A joint and survivorship annuity provides for the continuation of payments after the death of one of the annuitants during the lifetime of the surviving annuitant.

Accident and Health Contracts

21. Health insurance policies or managed care contracts, offered by a health maintenance or similar organization, many life insurance and some property and casualty companies, may provide hospital, surgical, medical, loss of income, accidental death and dismemberment, or long term care coverage as well as other health related benefits. The insurance protection involving economic loss resulting from a medical condition (e.g., medical care expenses or the risk of disability) is the distinguishing characteristic by which accident and health insurance or managed care contracts are set apart from other forms of insurance. Health coverage is currently furnished under group or individual contracts. Coverage sold to individuals can be subdivided according to the reporting entity’s right to continue the policy, limitations on the reporting entity’s right to increase premiums, as well as other factors.

22. Accident and health contracts also include risk contracts with Medicaid and Medicare whereby the reporting entity assumes insurance risk.

23. Managed care contracts are contracts that provide defined health care services to subscribers in return for fixed, periodic premiums (usually paid monthly) that are generally due at or before the beginning of the coverage period. Managed care means a system or technique(s) generally used by reporting entities to affect access to and control payment for health care services. Managed care techniques most often include one or more of the following: 1) review of the medical necessity and appropriateness of services or site of services; 2) contracts with selected providers; 3) financial incentives for enrollees to use specific providers, services, or service sites; 4) controlled access to and coordination of services by a case manager; and 5) payor efforts to identify treatment alternatives and modify benefit restrictions for high cost patient care. Expenses for medical, hospital, pharmacy and other benefits are recognized based on the way the reporting entity provides for the contracted services. In some instances, this is through the payment of claims to providers as services are rendered which require a claims liability to be recorded as addressed in *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses* or through capitated arrangements based on contracts with providers, where expense is recognized ratably over the contract period in accordance with SSAP No. 55.

24. Similar to life insurance contracts, a significant amount of accident and health contracts is sold to individuals and groups on a level premium basis under which the annual premium remains constant even though the expected policy benefits and services may not occur evenly over the duration of the contract. Premium revenue for level premium contracts generally exceeds expected policy benefits in the early years of the contracts and it is necessary to accrue, as premium revenue is recognized, a liability for costs that are expected to be paid in the later years of the contracts.

25. The liability for expected costs relating to accident and health contracts sold on a level premium basis is accrued over the current and expected renewal periods of the contracts. The net valuation premium is based upon an assumed interest rate, persistency, and the frequency of expected death and disability claims, generally derived from mortality and morbidity tables. The net premiums collected, after deducting benefits and other costs each year, are accumulated with interest. Similar to life insurance, this accumulation or policy reserve, when combined with future net premiums and future investment income theoretically generate a sum sufficient to pay the claims resulting from the death or disabilities of the insured or subscriber. The reserve is generally calculated as the excess of the present value of future benefits to be paid to or on behalf of insureds or subscribers less the present value of future net premiums, discounted at valuation interest, mortality, and morbidity.

26. Accident and health contracts shall include contracts with health benefits or disability contingencies, including, but not limited to:

- a. Managed care contracts
- b. Income replacement contracts
- c. Expense reimbursement contracts
- d. Credit accident and health contracts
- e. Continuing care contracts
- f. Long-term care contracts
- g. Accidental death and dismemberment contracts

Accident and Health Contracts—Definitions

27. Accident and health contracts provide protection against economic losses resulting from accident, sickness or medical condition. This coverage may be provided under individual policies, under group or franchise policies, managed care contracts, Medicaid or Medicare risk contracts or it may be provided under certain special types of policies, such as credit accident and health insurance.

28. The economic losses which accident and health policies cover, or the types of benefits provided, will vary with different policies. The broad categories of economic losses protected against are medical and hospital expense and income replacement. For example, payments for hospital, surgical, or medical expenses may be provided under a hospital expense policy, while under other policies, a more comprehensive form of coverage, known as major medical insurance, may be offered. Similarly, policies may provide monthly benefits for loss of income from disability, either on a short-term or a long-term basis, or only for disabilities due to accident. Loss of life from accident may be covered under accidental death policies, while under certain limited accident policies, only accidental death from air travel may be covered.

29. Accident and health policies may be categorized by the form of policy through which the coverage is provided; it may be categorized according to the benefits provided by the policy; or it may be categorized by the contingencies insured against. These variations in types of policies and the benefits provided must be considered in discussing the reserves for accident and health policies.

30. Credit accident and health insurance contracts are similar to credit life insurance except the insurance protection is in the form of disability insurance.

31. Long-term care contracts represent any contract or policy rider providing coverage for not less than 12 consecutive months for each covered person for one or more necessary diagnostic, preventive, therapeutic, rehabilitative, maintenance or personal care services, provided in a setting other than an acute care unit of a hospital. Under long-term care contracts, the insured event is generally the inability of the contract holder to perform certain activities of daily living as compared to medical contracts which generally provide insurance protection against accident or sickness or disabilities contracts which generally provide income replacement protection.

Property and Casualty Contracts

32. Contracts which insure against damage to property by an insured peril or damage or injury to the insured or third parties shall be classified as property and casualty contracts. Damages shall include both physical and financial damages. Premiums from property and casualty contracts are generally recognized as earned over the exposure period of the contract in proportion to the amount of insurance protection provided.

33. The exposure to insurance risk for most property and casualty insurance contracts does not vary significantly during the duration of the contract. Premiums from property and casualty contracts shall be recognized as earned premium as discussed in *SSAP No. 53—Property and Casualty Contracts—Premiums*.

34. These contracts shall include but shall not be limited to:

- a. Traditional property and casualty insurance contracts
- b. Title insurance contracts
- c. Mortgage and financial guaranty contracts

Property and Casualty Contracts—Definitions

35. Property and casualty contracts include a variety of types of coverage, including, but not limited to, fire, workers' compensation, automobile, multiple peril, professional and miscellaneous liability, and fidelity and surety bonds as further discussed below.

36. Types of insurance represent the perils that are insured by property and liability insurance companies and classified as property and casualty contracts. Some of the more important types of insurance are as follows:

- a. Fire and allied lines, which include coverage for fire, windstorm, hail, and water damage (but not floods);
- b. Ocean marine, which includes coverage for ships and their equipment, cargos, freight or money to be paid for use of the ships, and liability to third parties for damages. This type of insurance includes inland as well as ocean water transportation;
- c. Inland marine, which covers property in transit. (It also includes floaters, which are policies that cover movable property, such as a tourist's personal property);
- d. Workers' compensation, which compensates employees for injuries or illness sustained in the course of their employment;
- e. Automobile, which covers personal injury or automobile damage sustained by the insured and the related liability to third parties for losses caused by the insured;
- f. Multiple peril, which is a package coverage including most property and liability coverage except workers' compensation, automobile insurance, and surety bonds;
- g. Professional liability, which covers physicians, surgeons, dentists, hospitals, engineers, architects, accountants, attorneys, and other professionals from liability arising from error or misconduct in providing or failing to provide professional service;
- h. Miscellaneous liability, which covers most other physical and property damages not included under workers' compensation, automobile liability, and multiple peril policies. (Damages include death, cost of care, and loss of services resulting from bodily injury, as well as loss of use of property);
- i. Fidelity bonds, which cover employers against dishonest acts by employees. Blanket fidelity bonds cover groups of employees;
- j. Surety bonds, which provide for monetary compensation to third parties for failure by the insured to perform specifically covered acts within a stated period. (Most surety bonds are issued for persons doing contract construction, persons connected with court actions, and persons seeking licenses and permits. Surety bonds also include financial guarantees.); and
- k. Prepaid legal expense plans are established through group policies purchased by companies who in turn offer coverage to electing employees. The plans are offered as an employee benefit to help certificate holders more cost effectively solve their legal problems. For a small monthly premium, employees may consult with and/or receive representation from a plan attorney regarding any one of several covered services (such as will preparation, divorce, child adoption, etc.). The group policies are written for a set period, generally one year (and can be up to three-years), with the sponsoring company as the group policyholder. Policies may be canceled by the policyholder with 45 days'

notice. The reporting entity sends monthly premium bills to participating employers based on the previous month's actual employee count. Monthly premium installments are withheld from the participating employee's paycheck and are remitted to the insurance company along with a detailed listing of the number of plan participants that month. Similar to group accident and health policies, premium amounts vary from month to month depending on the number of employees participating in the plan that month.

37. In addition to these types, insurance is provided by excess and surplus lines. Excess liability covers the insured against loss in excess of a stated amount, but only for losses as covered and defined in an underlying policy. The underlying amount is usually insured by another policy but can be retained by the insured. Surplus lines include coverage for risks that do not fit normal underwriting patterns, risks that are not commensurate with standard rates, or risks that will not be written by standard carriers because of general market conditions. These kinds of policies are generally written by carriers not licensed in the jurisdiction where the risk is located and generally are not subject to regulations governing premium rates or policy language.

38. Insurance is generally available to the individual as a means of protection against loss. There are instances, however, in which a person cannot obtain insurance in the voluntary insurance market. States have established involuntary plans to provide insurance to those with high risks whom otherwise would be excluded from obtaining coverage. A common example is the Automobile Insurance Plan (formerly called the Assigned Risk Plan). Under this plan, all companies writing automobile insurance in a state are allocated a share of the involuntary business on an equitable basis. Other states use a reinsurance plan, under which each insurer accepts all applicants but may place high-risk drivers in a reinsurance pool, with premiums paid to and losses absorbed by the pool. Still another approach is a joint underwriting association, in which one or more servicing companies are designated to handle high-risk drivers. All insurers in the state may be required to participate in the underwriting results. Another example of involuntary plans includes Fair Access to Insurance Requirements (FAIR) plans. FAIR plans are federally approved, state-supervised programs established to provide coverage for property in high-risk areas. Companies that operate in the state are assessed for any underwriting losses experienced by the FAIR plan.

39. Medical malpractice pools were established when health-care professionals and institutions were experiencing difficulty in obtaining liability insurance in the voluntary insurance market. The pools were established by law and currently exist in the majority of states. All insurers writing related liability insurance in such states are considered mandatory participants in the pools as a condition for their continuing authority to transact business in such states.

40. Workers' compensation pools are similar to FAIR plans. As with FAIR plans, companies operating in a given state are assessed a proportionate share, based on direct writings, of the underwriting results of the pool.

41. Title insurance insures, guarantees, or indemnifies owners of real property or the holders of liens or encumbrances thereon against loss or damage suffered by unidentified instances of defective titles, liens or encumbrances or the unmarketability of the title.

42. Mortgage guaranty insurance protects a lender against loss of all or a portion of the principal amount of a mortgage loan upon default of the mortgagor. This type of insurance provides no protection other than against loss due to default.

Deposit-Type Contracts

43. Deposit-type contracts do not incorporate insurance risk. Contracts issued by insurers that do not incorporate risk from the death or disability of policyholders (mortality or morbidity risk) are more

comparable to financial or investment instruments issued by other financial institutions than to insurance contracts.

44. Deposit-type contracts shall include contracts without any life or disability contingencies, including, but not limited to, certain types of the following policy categories:

- a. Supplemental contracts
- b. Lottery payouts
- c. Structured settlements
- d. Guaranteed interest contracts
- e. Income settlement options
- f. Dividend and coupon accumulations
- g. Annuities certain
- h. Premium and other deposit funds
- i. Funding Agreements without well-defined class-based (e.g. age, gender) annuity purchase rates defining either specific or maximum purchase rate guarantees (see SSAP No. 15, paragraph 19, paragraph 20 of this statement and *SSAP No. 52—Deposit-Type Contracts*, paragraph 21.)

45. Under deposit-type contracts, the policyholder may assume all, some, or none of the investment risk, depending on the contract terms. Amounts can be deposited in lump sum, or periodically as allowed by the policy contract. Deposit-type contracts would include annuities certain, whose income payments have no reference to life contingencies and benefits are paid over a specified period (i.e., 10 years, 20 years, etc.).

Relevant Literature

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*.

Effective Date and Transition

47. This statement is effective for years beginning January 1, 2001. The guidance in paragraph 36.k. was originally contained within *INT 01-23: Prepaid Legal Insurance Premium Recognition* and was effective June 11, 2001.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 50—Classifications and Definitions of Insurance or Managed Care Contracts In Force*

Statement of Statutory Accounting Principles No. 51 – Revised

Life Contracts

STATUS

Type of Issue.....	Life, Accident and Health
Issued	Initial draft; Substantively revised June 9, 2016
Effective Date	January 1, 2001; Substantive revisions detailed in Issue Paper No. 154 effective January 1, 2017
Affects.....	Supersedes SSAP No. 80 with guidance incorporated November 2011; Nullifies and incorporates INT 00-30 and INT 01-26
Affected by.....	No other pronouncements
Interpreted by	INT 00-03
Relevant Appendix A Guidance	A-200; A-225; A-235; A-585; A-620; A-641; A-695; A-812; A-815; A-817; A-820; A-821; A-822; A-830

ST

ATUS.....	1
SCOPE OF STATEMENT.....	2
SUMMARY CONCLUSION	2
Types of Premiums	2
Premium Income Recognition	2
Premium Adjustments.....	3
Uncollected Premium Balances	3
Other Considerations Received.....	3
Waiver of Monthly Deductions for Flexible Premium Universal Life Insurance Policies	3
Policy Reserves	3
Valuation (Reserve) Method and Deferred Premiums	4
Mean Reserve Method	5
Mid-Terminal Method	5
Advance Premiums	5
Policyholder Dividend Liability.....	6
Coupons	6
Reserve Recognition	6
Change In Valuation Basis.....	6
Supplemental Benefits	8
Unearned Income	8
Accelerated Benefits	8
Additional Reserves Not Included Elsewhere	8
Disclosures.....	8
Relevant Literature.....	12
Effective Date and Transition	12
REFERENCES.....	13
Other	13
Relevant Issue Papers	13

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for income recognition and policy reserves for all contracts classified as life contracts defined in *SSAP No. 50—Classifications of Insurance or Managed Care Contracts*, except for credit insurance contracts which are discussed in *SSAP No. 59—Credit Life and Accident and Health Insurance Contracts* and separate account products which are discussed in *SSAP No. 56—Separate Accounts*.

SUMMARY CONCLUSION

Types of Premiums

2. The gross premium is the amount charged to the policyholder and taken into operations as premium income.

3. The net premium is the amount calculated on the basis of the interest and mortality table used to calculate the reporting entity's statutory policy reserves.

4. The difference between the gross premium and the net premium is referred to as "loading." Loading generally includes allowances for acquisition costs and other expenses but also includes the differences in mortality and interest assumptions utilized for pricing and statutory reserving purposes.

Premium Income Recognition

5. Premiums shall be recognized as income on the gross basis (amount charged to the policyholder) when due from policyholders under the terms of the insurance contract. As a result, premium income shall include first year and renewal premiums, as well as any related premium adjustments (i.e., retrospective premium contracts which are discussed in *SSAP No. 66—Retrospectively Rated Contracts*) provided for by the contract. The contractual due date shall be established through the predetermined billing procedure agreed to by the parties. In addition, premium income shall include single and flexible premium amounts when received from the policyholder. Further, the recognition of premium income and the change in loading shall be consistent with the assumptions made in calculating the related policy reserve.

6. Premium income shall include dividends, coupons, guaranteed annual pure endowments, and similar benefits provided by the insurance contract when such amounts are applied by the terms of the contract to provide additional paid-up insurance, annuities, or to shorten the endowment or premium-paying period. Premiums and considerations waived by the reporting entity under disability provisions contained in its policies and contracts, and reported in operations as a disability benefit, are included in premium income.

7. Premium income shall exclude premiums that have been received by the reporting entity prior to the reporting date but which are due on or after the next policy anniversary date (i.e., advance premiums as discussed in paragraph 29).

8. Premium income shall be reduced for premiums returned and allowances to industrial policyholders for the direct payment of premiums.

9. Premium income shall be increased by reinsurance premiums assumed and reduced by reinsurance premiums ceded. Reinsurance premiums assumed and ceded are defined and addressed in *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*.

10. Death or other benefits used to fund new policies shall be accounted for as a benefit payment and as a new premium, another type of income, or a liability, as appropriate.

Premium Adjustments

11. In the summary of operations, the change in gross deferred and uncollected premiums is recorded as premium income. Deferred premiums are further discussed in paragraphs 25-27. Since only the net premiums are included in the computation of reserves and reported as an asset, it is necessary to adjust the gross premium for an amount representing the change in loading on deferred and uncollected premiums. The change in loading is included as an expense in the summary of operations and is not shown as a reduction to premium income.

Uncollected Premium Balances

12. Gross premiums that are due and unpaid as of the reporting date, net of loading, shall be classified as uncollected premiums. Uncollected premium balances which are less than 90 days past due meet the definition of an asset, 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.

Other Considerations Received

13. Considerations for supplementary contracts, dividends left on deposit to accumulate interest, and amounts deposited and accumulated for guaranteed interest and group annuity contracts shall be recognized as deposit-type funds or considerations for supplemental contracts, as appropriate. These amounts are further discussed in *SSAP No. 52—Deposit-Type Contracts*.^(INT 00-03)

Waiver of Monthly Deductions for Flexible Premium Universal Life Insurance Policies

14. Flexible premium universal life insurance policies do not require specified premiums as traditional policies do. The “waiver” benefit entities offer is a “waiver of monthly deductions” benefit as opposed to a “waiver of premium” benefit. The difference being specific premiums may or may not be required under the policy regardless of whether the insured is disabled or not. Waiver of a deduction is not to be considered revenue nor a benefit paid, therefore a calculation of the amount of the deduction need not be made for flexible premium universal life insurance policies.

Policy Reserves

15. Statutory policy reserves shall be established for all unmatured contractual obligations of the reporting entity arising out of the provisions of the insurance contract. Where separate benefits are included in a contract, a reserve for each benefit shall be established as required in Appendix A-820. These statutory policy reserves have historically been calculated as the excess of the present value of future benefits to be paid to or on behalf of policyholders less the present value of future net premiums. For policies issued on or after the operative date of the *Valuation Manual*, these formulaic calculations will be supplemented for some policies with more advanced deterministic and stochastic reserve methodologies to better reflect company experience, possible economic conditions and inherent policy risks. Statutory policy reserves meet the definition of liabilities as defined in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*. The actuarial methodologies referred to in paragraph 16 meet the criteria required for reasonable estimates in SSAP No. 5R.

16. The reserving methodologies and assumptions used in computation of policy reserves shall meet the provisions of Appendices A-820 and A-822. Policies written prior to the operative of the *Valuation Manual* shall additionally follow the actuarial guidelines found in Appendix C of this Manual. Policies written on or after operative of the *Valuation Manual* shall additionally follow the *Valuation Manual* and be subject to the actuarial guidelines referenced therein. Further, policy reserves shall be in compliance with those Actuarial Standards of Practice promulgated by the Actuarial Standards Board.

17. Paragraphs 15 and 16 of this statement summarize the general reserve requirements for all types of life contracts. Paragraphs 18-21 provide additional detail for specific products for policies that are

issued prior to the operative data of the *Valuation Manual* or otherwise not subject to the *Valuation Manual*.

18. In addition to these general reserve requirements, Appendix A-820 provides additional guidance with respect to certain types of accumulation annuities that have flexible features (e.g., guaranteed nonforfeiture benefits such as interest guarantees, annuitization options, bailout features, partial withdrawals) which can create varying benefit streams if elected by the policyholder. Specific policies with such flexible features include most individual and some group annuity contracts, but exclude any disability and accidental death benefits in these contracts. For benefits under these contracts, reserves shall be established according to the Commissioners' Annuity Reserve Valuation Method (CARVM). Generally under CARVM, the difference between all possible future guaranteed benefits streams, including guaranteed nonforfeiture benefits, over the future considerations is computed as of the end of each contract year. Each of these differences is discounted to the reporting date at the applicable valuation interest rate. A reserve is then recorded based on the greatest present value difference of each of the contract year calculations.

19. Unlike traditional life insurance contracts, flexible premium universal life-type contracts do not have guaranteed premiums and some assumption as to future premiums is required. Appendix A-585 establishes a minimum reserving method for universal life-type contracts by providing guidance on how to estimate future premiums on flexible premium universal life-type contracts so that traditional valuation methodologies can be used. Alternative minimum reserves shall be required, if applicable, for flexible premium universal life-type contracts if the guaranteed maturity premium is less than the valuation net premium. Appendix A-585 shall be used in establishing reserves for flexible premium universal life-type contracts.

20. Policy reserves for fixed premium universal life-type contracts shall also follow guidance in Appendix A-585. Certain fixed premium products offer the policyholder a secondary guarantee. A secondary guarantee provides the policyholder a guaranteed set of cash values, death benefits, and maturity benefits that will be provided regardless of the performance of the policy value. Appendix A-585 requires all guarantees to be considered when establishing policy reserves and shall be followed in establishing reserves for fixed premium universal life-type contracts.

21. Statutory policy reserves for those group annuity contracts or other contracts that, in whole or in part, establish the insurer's obligations by reference to a segregated portfolio of assets not owned by the insurer shall be established in accordance with the guidance in Appendix A-695. Statutory policy reserves for those contracts with nonlevel premiums or benefits, or contracts with secondary guarantees shall be established in accordance with the guidance in Appendix A-830. Statutory policy reserves for those group life contracts utilizing a separate account that meet the requirements outlined in paragraph 1 of Appendix A-200 shall be computed in accordance with the guidance in that appendix.

22. For life and annuity policies issued on or after the operative date of the *Valuation Manual*, reserves shall use the requirements of the *Valuation Manual*. As required by Appendix A-820, reserves are required to be determined using the methodologies and processes described in the *Valuation Manual*. For policies unable to meet the *Valuation Manual* criteria for exemption from deterministic or stochastic reserves, the *Valuation Manual* supplements formulaic life insurance policy reserve methodologies with more advanced deterministic and stochastic reserve methodologies to produce reserves that better reflect company experience, possible economic conditions and inherent policy risks.

Valuation (Reserve) Method and Deferred Premiums

23. Reserves shall be established for all benefits guaranteed under the terms of the policy as of the reporting date using appropriate valuation methods, interest rates, mortality and morbidity rates, as applicable. However, as a practical expedient, reserves have been generally calculated as of the policy anniversary date (i.e., terminal reserves), not the reporting date. As a result, it is necessary to adjust the

terminal reserve back to the reporting date. The components used to compute a terminal reserve shall include an interest rate, lapse rates, a mortality and/or morbidity table, and a valuation method (e.g., net level, full preliminary term, Commissioners' Reserve Valuation Method (CRVM), or CARVM). A terminal reserve is based on the assumption that all net premiums have been received, all interest earned, and all benefits paid to the end of the policy year.

24. Since terminal reserves are computed as of the end of a policy year and not the reporting date, the terminal reserve as of policy anniversaries immediately prior and subsequent to the reporting date are adjusted to reflect that portion of the net premium that is unearned at the reporting date. This is generally accomplished using either the mean reserve method or the mid-terminal method as discussed in paragraphs 25-28. Other appropriate methods, including an exact reserve valuation, may also be used.

Mean Reserve Method

25. Under the mean reserve method, the policy reserve equals the average of the terminal reserve at the end of the policy year and the initial reserve (the initial reserve is equal to the previous year's terminal reserve plus the net annual valuation premium for the current policy year). When reserves are calculated on the mean reserve basis, it is assumed that the net premium for a policy is collected annually at the beginning of the policy year and that policies are issued ratably over the calendar year.

26. However, as premiums are often received in installments more frequently than annually and since the calculation of mean reserves assumes payment of the current policy year's entire net annual premium, the policy reserve is overstated by the amount of net modal premiums not yet received for the current policy year as of the valuation date. As a result, it is necessary to compute and report a special asset to offset the overstatement of the policy reserve.

27. This special asset is termed "deferred premiums." Deferred premiums are computed by taking the gross premium (or premiums) extending from (and including) the modal (monthly, quarterly, semiannual) premium due date or dates following the valuation date to the next policy anniversary date and subtracting any such deferred premiums that have actually been collected. Deferred premium assets shall also be reduced by loading. Since the calculation of mean reserves assumes payment of the current policy year's entire net annual premium, deferred premium assets are considered admitted assets to compensate for the overstatement of the policy reserve. For policies subject to the *Valuation Manual* requirements, the deferred premium asset will continue to be calculated for the net premium reserve component of the total principle-based reserve.

Mid-Terminal Method

28. Under the mid-terminal method, the policy reserves are calculated as the average of the terminal reserves on the previous and the next policy anniversaries. These reserves shall be accompanied by an unearned premium reserve consisting of the portion of valuation premiums paid or due covering the period from the valuation date to the next policy anniversary date. For policies subject to the *Valuation Manual* requirements, the adjustment to the unearned premium reserve will continue to be calculated for the net premium reserve component of the total principle-based reserve.

Advance Premiums

29. Advance premiums are those premiums that have been received by the reporting entity prior to the valuation date but which are due on or after the next policy anniversary date. The policyholder may remit one or more premiums in advance of specific due dates. Where premiums are remitted sufficiently far in advance, the premiums charged to the policyholder may be reduced or discounted to reflect the time value of money. The difference between the gross and discounted premium is ratably charged as interest in the summary of operations from the date of payment to the premium due date. At the premium due date, the amount received from the policyholder plus the accumulated interest equals the gross premium

necessary to fund the policy. The total amount of such advance premiums, less any discount as of the valuation date, is reported as a liability in the statutory financial statement and is not considered premium income until due. The gross premium, not the net valuation premium, is recorded as the advance premium in recognition of the reporting entity's liability to refund such premiums in the event the policy is terminated.

Policyholder Dividend Liability

30. A reporting entity shall accrue, as applicable, the following items relating to participating policies. They are dividends due and unpaid, dividends apportioned (or not yet apportioned) for payment in the following twelve months, and dividends left on deposit to accumulate interest.

31. Dividends due and unpaid represent dividends payable to the policyholder in the current year but which have not been disbursed or otherwise applied at the reporting date.

32. Dividends payable in the following calendar year represent the estimated amount of all dividends declared by a reporting entity's board of directors prior to the end of the statement year which are not yet paid or due at the end of the year (dividends apportioned for payment) as well as all dividends payable in the following calendar year that have not been declared (dividends not yet apportioned for payment). For individual insurance, the amount of this liability shall be equal to the aggregate amount of the dividends estimated to be payable in the following calendar year whether or not declared or apportioned. For group insurance and pensions, the amount of liability is generally equal to the portion of the dividend payable in the following calendar year which has been earned in the current calendar year.

33. Dividends left on deposit with the reporting entity shall be recorded in the amount of the deposit and accrued interest thereon. At the balance sheet date, the interest accrued but not yet credited to the policyholders' accounts shall be established as part of this liability.

Coupons

34. Some entities issue policies that guarantee an annual return, usually evidenced by a coupon that is part of the policy and matures on the policy's anniversary. This return represents an annual pure endowment and is essentially a return of premium previously paid by the policyholder. For matured coupons that have been left to accumulate, the liability is determined in the same way as the liability for dividend accumulations. Interest accrued is calculated for each coupon from the date each matures. The liability for unmatured policyholder coupons shall be the face value of the coupon, discounted at interest and mortality.

Reserve Recognition

35. The difference between the policy reserves for life contracts at the beginning and end of the reporting period shall be reflected as the change in reserves in the summary of operations, except for any difference due to a change in valuation basis.

Change In Valuation Basis

36. A change in valuation basis for reserves determined under paragraphs 17-21, except for reserves defined under *Actuarial Guideline XLIII—CARVM: For Variable Annuities* (AG 43), as detailed in Appendix C of this Manual, shall be defined as a change in the interest rate, mortality assumption, or reserving method (e.g., net level, preliminary term, etc.) or other factors affecting the reserve computation of policies in force and meets the definition of an accounting change as defined in *SSAP No. 3—Accounting Changes and Corrections of Errors*.

37. Changes in reserves developed under paragraph 22 or AG 43 shall be reviewed to determine whether the change represents a change in valuation basis and if it meets the definition of a change in accounting as defined in SSAP No. 3.

- a. Changes in principle-based reserving assumptions are often the result of updating assumptions and other factors required by the existing reserving methodology. Reserve changes resulting from the application of principle-based reserving methodology including, but not limited to, updating assumptions based on reporting entity, industry or other experience, and having the reported reserve transition between net premium reserve, deterministic reserve or stochastic reserve, as required under existing guidance, shall not be considered a change in valuation basis. These types of changes also include, but are not limited to, periodic updates in *Valuation Manual* tables, such as industry valuation basic tables, asset spread tables and default cost tables.
- b. A change in valuation basis for principle-based reserves shall include cases where the required reserve methodology has changed or the insurer makes a voluntary decision to choose one allowable reserving method over another. These types of changes include, but are not limited to, new standardized mortality tables such as Commissioners Standard Ordinary tables and regulatory changes in methodology. Voluntary decisions to choose one allowable reserving methodology over another, which require commissioner approval under the *Valuation Manual*, shall be reported as a change in valuation basis.

38. Consistent with SSAP No. 3, any increase (strengthening) or decrease (destrengthening) in actuarial reserves resulting from such a change in valuation basis shall be recorded directly to surplus (under changes to surplus in the change in valuation basis annual statement line) rather than as a part of the reserve change recognized in the summary of operations.

39. The impact of a change in valuation basis on surplus is based on the difference between the reported reserve under the old and new methods as of the beginning of the year. This difference shall not be phased in over time unless this statement or the *Valuation Manual*, Section VM-21 Requirements for Principle-Based Reserves for Variable Annuities (VM-21), prescribes a new method and a specific transition that allows for grading. Some changes will meet the definition of a change in accounting as defined in SSAP No. 3 and a change in valuation basis as described in paragraphs 36-38 of this statement, but the adjustment to surplus will be zero. This can happen when the change in valuation basis is prospective and only applies to new policies and reserves meaning that policies in force for the prior year-end are not affected, or situations in which the change in reserving methodology did not change the reserves reported in the financial statements. The changes remain subject to the disclosures prescribed in SSAP No. 3. Effective January 1, 2020, if VM-21 (on variable annuities) or this statement prescribes or permits a phase-in period or provides the option of multiple phase-in periods, reporting entities shall also include in the change in accounting disclosures required by SSAP No. 3, disclosure of the following:

- a. The phase-in period being applied, and the remaining time period of the phase-in;
- b. Any adjustments to the phase-in period;
- c. Amount of change in valuation basis phase-in; and
- d. The remaining amount to be phased in.

40. The *Valuation Manual* is effective prospectively for policies written on or after the operative date; however, as the CARVM methodology was already principles-based, some changes to the CARVM methodology in VM-21 (on variable annuities) and to the related AG 43 may result in retroactive application to the reserving for existing contracts. Therefore, upon the initial prospective adoption of principle-based reserving, the change in valuation basis reflected as an adjustment to surplus for most

entities will be zero. After initial adoption of the *Valuation Manual*, changes in valuation basis will need to be evaluated to determine the amount of any surplus adjustments.

Supplemental Benefits

41. In addition to the basic policy benefit, the insurance contract may provide supplemental benefits. Supplemental benefits include, but are not limited to, accidental death benefits and waiver of premium benefits. If the terms of the contract provide for these benefits, appropriate reserves shall be established in accordance with the applicable standards within the *Accounting Practices and Procedures Manual*.

Unearned Income

42. Amounts assessed that represent compensation to the reporting entity for services to be provided in future periods and which are required to be refunded upon policy termination are not earned in the period assessed. Such amounts, if not already considered in the policy reserve, shall be reported as unearned income, a liability, and recognized as income as the related services are provided.

Accelerated Benefits

43. Accelerated benefits are benefits payable under a life insurance contract to a policyholder or certificateholder during the lifetime of the insured, in anticipation of death or upon the occurrence of specified life-threatening or catastrophic conditions as defined by the policy or rider. These benefits reduce the death benefit otherwise payable under the life insurance contract and are payable upon the occurrence of a single qualifying event which results in the payment of a benefit amount fixed at the time of acceleration. When benefits are provided through the acceleration of benefits under group or individual life policies or riders to such policies, policy reserves shall be determined in accordance with Appendices A-820 and A-620. Reserves for such benefits in the aggregate shall be sufficient to cover policies upon which no claim has yet arisen as well as policies upon which an accelerated claim has arisen. Accounting guidance for accelerated benefit payments made in the form of a loan are addressed in *SSAP No. 49—Policy Loans*. In addition, accelerated benefit payments, for those accelerated benefits that reduce the policy, shall not be deferred but shall be charged to the summary of operations as a benefit expense when paid to the policyholder.

Additional Reserves Not Included Elsewhere

44. Additional actuarial liabilities are commonly held for such items as:
- a. Provision for either nondeduction of deferred fractional premiums or return of premiums at death of the insured; and
 - b. Surrender values in excess of reserves otherwise required or carried.

Disclosures

45. For life and annuity reserves the financial statements shall disclose the following:
- a. A description of reserve practices concerning the following:
 - i. Waiver of deduction of deferred fractional premiums upon death of insured;
 - ii. Return of portion of final premium for periods beyond the date of death; and
 - iii. Amount of any surrender value promised in excess of the reserve as legally computed;

- b. The methods employed in the valuation of substandard policies;
- c. The amount of insurance, if any, for which the gross premiums are less than the net premiums according to the valuation standards;
- d. The method used to determine tabular interest, tabular less actual reserves released, and tabular cost (by formula or from the basic data for such items); and
- e. The nature of significant other reserve changes.

46. For the disclosures noted below, disclose the amount of annuity actuarial reserves and deposit liabilities by withdrawal characteristics for the categories of general account, separate account with guarantees, separate account nonguaranteed as well as the total and percentage of the total, include a separate section for individual Annuities, Group Annuities, and Deposit-Type Contracts (with no life contingencies). Supplementary contracts with life contingencies are reported in the appropriate Annuities section (Individual or Group).

- a. Subject to discretionary withdrawal:
 - i. With market value adjustment, where withdrawal of funds is payable at all times, or prior to specified maturity dates where such dates are more than one year after the statement date and;
 - (a) In a lump sum with adjustments to reflect general changes in interest rates, or asset values since receipt of funds by the insurer;
 - (b) In installments over five years or more, with or without a reduction in the interest rate during the installment period;
 - ii. At book value less current surrender charge, where the withdrawal of funds is payable at all times, or at any time within one year from the statement date in a lump sum subject to a current fixed surrender charge of 5% or more and it does not contain a meaningful bail out rate as described in paragraph 46.a.v.(d);
 - iii. At fair value, where the withdrawal of funds is payable at current fair value of the assets supporting the liabilities, the assets are stated at current fair value, and the liabilities are stated at the current fair value or per unit value of the assets supporting the liabilities. These liabilities are for contracts where the customer bears the entire investment risk;
 - iv. Total with adjustment or at fair value;
 - v. At book value without adjustment (minimal or no charge or adjustment), where the withdrawal of funds is either payable at all times, or at any time (including a withdrawal on a scheduled payment date) within one year from the statement date and:
 - (a) In a lump sum without adjustment;
 - (b) In installments over less than five years, with or without a reduction in interest rate during the installment period;
 - (c) In a lump sum subject to a fixed surrender charge of less than 5%;

- (d) In a lump sum subject to surrender charge, but such charge is waived if the credited rate falls below a specified “bail out” rate and the “bail out” rate is more than the maximum statutory valuation rate for life insurance policies for more than 20 years for new issues;
 - b. Not subject to discretionary withdrawal;
 - c. Total gross;
 - d. Reinsurance ceded;
 - e. Total net;
 - f. Amount with current surrender charge of 5% or more included in the current year in paragraph 46.a.ii. that will have less than a 5% surrender charge (and thus be reported with the amounts at book value with minimal or no charge or adjustment noted in paragraph 46.a.v.) for the first time within the year subsequent to the balance sheet year. (Note that percentage of total is not required for this item.)
47. Disclose the amounts of account value, cash value and reserve for the breakouts of life insurance by withdrawal characteristics, separately for General Account products, Separate Account Guaranteed products, and Separate Account Nonguaranteed products as follows:
- a. Subject to discretionary withdrawal, surrender values, or policy loans:
 - i. Term Policies with Cash Value
 - ii. Universal Life
 - iii. Universal Life with Secondary Guarantees
 - iv. Indexed Universal Life
 - v. Indexed Universal Life with Secondary Guarantees
 - vi. Indexed Life
 - vii. Other Permanent Cash Value Life Insurance
 - viii. Variable Life
 - ix. Variable Universal Life
 - x. Miscellaneous Reserves
 - b. Not subject to discretionary withdrawal or no cash value:
 - i. Term Policies without Cash Value
 - ii. Accidental Death Benefits
 - iii. Disability – Active Lives
 - iv. Disability – Disabled Lives
 - v. Miscellaneous Reserves

- c. Total gross (Direct + Assumed)
- d. Reinsurance ceded
- e. Total net (Net: Total gross (paragraph 47.c.) less Reinsurance ceded (paragraph 47.d.))

The difference between the account value and the cash value is the surrender charge, if any. After the surrender period is over, there is no difference. Some contract types have no account value such as traditional whole life, term, etc. So, if there is no account value, leave it blank. UL typically has an account value and a cash surrender value. Just as account values are not reduced for policy loans taken and outstanding, the cash value amount reported in this disclosure should not be reduced for policy loans taken and outstanding. This will ensure the difference between account value and cash value is the actual surrender charge.

48. Reconcile total life insurance reserves amount disclosed to the appropriate sections of the Aggregate Reserves for Life Policies and Contracts Exhibit (Exhibit 5) of the Life, Accident and Health Annual Statement and the corresponding lines in the Separate Accounts Statement. The reconciliation is a single presentation including all amounts from the sections on Individual Life Insurance and Group Life Insurance.

49. Reconcile the total annuity reserves and deposit fund liabilities amount disclosed in the (non-life reserves) annual statement Aggregate Reserve for Life Contracts Exhibit 5 and the deposit-type contract fund liabilities from the Deposit-Type Contracts Exhibit 7, of the Life, Accident & Health Annual Statement and the corresponding lines in the Separate Accounts Statement. The reconciliation is a single presentation including all amounts from the sections on Individual Annuities, Group Annuities and Deposit-Type Contracts.

50. If the reporting entity has reported life insurance premiums and annuity considerations deferred and uncollected on policies in force as of the financial statement date, disclose separately the amounts and the loading excluded for each of the following lines of business:

- a. Industrial business;
- b. Ordinary new business;
- c. Ordinary renewal;
- d. Credit life;
- e. Group life;
- f. Group annuity.

51. Disclose the aggregate amount of direct premiums written through managing general agents or third party administrators. For purposes of this disclosure, a managing general agent means the same as in Appendix A-225. If this amount is equal to or greater than 5% of surplus, provide the following information for each managing general agent and third party administrator:

- a. Name and address of managing general agent or third party administrator;
- b. Federal Employer Identification Number;
- c. Whether such person holds an exclusive contract;
- d. Types of business written;

- e. Type of authority granted (i.e., underwriting, claims payment, etc.);
- f. Total premium written.

52. Reporting entities shall disclose the relative percentage of participating insurance, the method of accounting for policyholder dividends, the amount of dividends, and the amount of any additional income allocated to participating policyholders in the financial statements.

53. Reporting entities shall disclose if the reserve amount calculated on the state prescribed or permitted valuation basis is materially different from the reserve amount calculated on the A-820 valuation basis¹. Although the A-820 standard is viewed as a minimum one, it represents the baseline from which deviations are measured. The determination of whether difference meets the standard of materiality is subjective. Refer to the Preamble regarding further guidance on the criterion of materiality.

54. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

55. This statement incorporates the requirements of Appendices A-225, A-235, A-585, A-620, A-641, A-695, A-812, A-815, A-817, A-820, A-821, A-822, A-830, the Actuarial Standards Board *Actuarial Standards of Practice*, and the actuarial guidelines found in Appendix C of this Manual.

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*.

Effective Date and Transition

57. This statement is effective for years beginning January 1, 2001. Contracts issued prior to January 1, 2001 shall be accounted for based on the laws and regulations of the domiciliary state. State laws and regulations shall be understood to include anything considered authoritative by the domiciliary state under the individual state's statutory authority and due process procedures. 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. The guidance in paragraph 14 was originally contained within *INT 00-30: Application of SSAP No. 51 Paragraph 6 to Waiver of Deduction on Flexible Premium Universal Life Insurance Policies* and was effective December 4, 2000. The guidance in paragraph 51 was originally contained within *INT 01-26: SSAP No. 51 and Reserve Minimum or Required Amount* and was effective January 1, 2001. The revisions adopted in November 2018 to expand liquidity disclosures are effective year-end 2019, concurrent with the inclusion of data-captured financial statement disclosures.

58. Substantive changes that reference the *Valuation Manual* in this statement are effective for January 1, 2017, and thereafter. However, the *Valuation Manual* provides for a 3-year period, starting

¹ This issue applies to contracts issued January 1, 2001, and thereafter.

from the operative date, during which companies are able to continue using the current reserve methodologies, as described in paragraphs 17-21.

REFERENCES

Other

- *NAIC Financial Condition Examiners Handbook*
- *Actuarial Standards Board Actuarial Standards of Practice*

Relevant Issue Papers

- *Issue Paper No. 51—Life Contracts*
- *Issue Paper No. 56—Universal Life-Type Contracts, Policyholder Dividends, and Coupons*
- *Issue Paper No. 110—Life Contracts, Deposit-Type Contracts and Separate Accounts, Amendments to SSAP No. 51—Life Contracts, SSAP No. 52—Deposit-Type Contracts, and SSAP No. 56—Separate Accounts*
- *Issue Paper No. 154—Implementation of Principle-Based Reserving*

Not for Distribution

Statement of Statutory Accounting Principles No. 52

Deposit-Type Contracts

STATUS

Type of Issue.....	Life, Accident and Health
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Supersedes SSAP No. 80 with guidance incorporated November 2011; Nullifies and incorporates INT 08-08; Nullifies INT 00-23
Affected by.....	No other pronouncements
Interpreted by	INT 00-03
Relevant Appendix A Guidance	A-200; A-235; A-695; A-820; A-822; A-830

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Introduction.....	1
Income Recognition	2
Policy Reserves	2
Structured Settlements	3
Cost Recognition.....	3
Change In Valuation Basis.....	3
Unearned Income	3
Additional Reserves Not Included Elsewhere	4
Disclosures.....	4
Relevant Literature.....	6
Effective Date and Transition.....	7
REFERENCES.....	7
Other	7
Relevant Issue Papers	7

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for income recognition and policy reserves for all contracts classified as deposit-type contracts defined in *SSAP No. 50—Classifications of Insurance or Managed Care Contracts*.

SUMMARY CONCLUSION

Introduction

2. As discussed in SSAP No. 50, deposit-type contracts are those contracts that do not subject the reporting entity to any risks arising from policyholder mortality or morbidity. A mortality or morbidity risk is present if, under the terms of the contract, the reporting entity is required to make payments or

forego required premiums contingent upon the death or disability (in the case of life and disability insurance contracts) or the continued survival (in the case of annuity contracts) of a specific individual or group of individuals.

3. Deposit-type contracts frequently grant policyholders significant discretion over the amount and timing of deposits and withdrawals. Reporting entities are frequently granted significant discretion over amounts that accrue to or that are assessed against policyholders.

4. Due to the absence of mortality and/or morbidity risk and the discretionary characteristics noted in paragraph 3, the accounting principles for income recognition and policy reserves for deposit-type contracts differ from the accounting for life contracts set forth in *SSAP No. 51R—Life Contracts*, accident and health contracts established in *SSAP No. 54R—Individual and Group Accident and Health Contracts*, and credit insurance contracts as discussed in *SSAP No. 59—Credit Life and Accident and Health Insurance Contracts*.

5. Categories of contracts that may not subject the reporting entity to risks arising from policyholder mortality or morbidity include, but are not limited to, certain types of the following policy categories:

- a. Supplemental contracts
- b. Lottery payouts
- c. Structured settlements
- d. Guaranteed interest contracts
- e. Income settlement options
- f. Dividend and coupon accumulations
- g. Annuities certain
- h. Premium and other deposit funds

Income Recognition

6. Contracts issued by a reporting entity that do not incorporate mortality or morbidity risk shall not be accounted for as insurance contracts. Amounts received as payments for such contracts shall not be reported as revenues but shall be recorded directly to an appropriate policy reserve account. ^(INT 00-03)

Policy Reserves

7. Statutory policy reserves shall be established for all contractual obligations of the reporting entity arising out of the provisions of the contract. Where separate benefits are included in a contract, a reserve for each benefit shall be established as required in Appendix A-820. Statutory policy reserves meet the definition of liabilities as defined in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*. The actuarial methodologies referred to in paragraph 8 meet the criteria required for reasonable estimates in *SSAP No. 5R*.

8. The reserving methodologies and assumptions used in computation of policy reserves shall meet the provisions of Appendices A-820 and A-822, and the actuarial guidelines found in Appendix C of this Manual. Further, policy reserves shall be in compliance with those Actuarial Standards of Practice promulgated by the Actuarial Standards Board.

9. The policy reserve for contracts without life contingencies where the future benefits are fixed and guaranteed (e.g., certain supplemental contracts, lottery payouts, structured settlements, guaranteed interest contracts, income settlement options, annuities certain, and unmatured coupon accumulations) shall be based on the present value of the future guaranteed benefits discounted at the valuation interest rate. The policy reserve for all other contracts (e.g., certain premium and other deposit funds, and dividend and matured coupon accumulations) shall be based on the accumulated amounts paid plus an income accumulation based on the contract provisions, less any withdrawals and applicable surrender charges.

10. Statutory policy reserves for those group annuity contracts or other contracts that, in whole or in part, establish the insurer's obligations by reference to a segregated portfolio of assets not owned by the insurer shall be established in accordance with the guidance in Appendix A-695. Statutory policy reserves for those contracts with nonlevel premiums or benefits, or contracts with secondary guarantees shall be established in accordance with the guidance in Appendix A-830. Statutory policy reserves for those group life contracts utilizing a separate account that meet the requirements outlined in paragraph 1 of Appendix A-200 shall be computed in accordance with the guidance in that appendix.

11. Policy reserves shall be increased for reinsurance assumed and decreased for reinsurance ceded as further described in *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*.

Structured Settlements

12. Reporting entities that have accepted an assignment of obligations under structured settlements shall record those obligations consistent with the accounting and reporting provided for structured settlements in *SSAP No. 65—Property and Casualty Contracts*.

Cost Recognition

13. Interest credited to deposit-type contracts shall be recorded as an expense in the summary of operations when earned under the terms of the contract. Payments that represent a return of policyholder balances shall not be recorded as expenses. To the extent such payments differ from the recorded reserve, the difference shall be recorded in the summary of operations as a benefit expense.

Change In Valuation Basis

14. A change in valuation basis shall be defined as a change in the interest rate assumption or other factor affecting the reserve computation of policies in force and meets the definition of an accounting change as defined in *SSAP No. 3—Accounting Changes and Corrections of Errors*. Consistent with SSAP No. 3, any increase (strengthening) or decrease (destrengthening) in actuarial reserves resulting from such a change in valuation basis shall be recorded directly to surplus rather than as a part of the reserve change recognized in the summary of operations. The impact on surplus is based on the difference between the reserve under the old and new methods as of the beginning of the year. This difference shall not be graded in over time unless an actuarial guideline adopted by the NAIC prescribes a specific transition that allows for grading. Voluntary decisions to choose one allowable reserving methodology over another, which require commissioner approval under the *Valuation Manual*, shall be reported as a change in valuation basis.

Unearned Income

15. Amounts assessed that represent compensation to the reporting entity for services to be provided in future periods and which are required to be refunded upon policy termination are not earned in the period assessed. Such amounts, if not already considered in the policy reserve, shall be reported as unearned income, a liability, and recognized as income as the related services are provided.

Additional Reserves Not Included Elsewhere

16. Additional actuarial liabilities are commonly held for such items as:
- a. Surrender values in excess of reserves otherwise required or carried; and
 - b. Additional reserves required based on asset adequacy analysis as discussed in Appendix A-822.
17. Funding agreements issued to a Federal Home Loan Bank (FHLB) shall be evaluated on an individual basis, and shall be accounted for according to the substance of the individual arrangement and entity licensing. If the arrangement is in substance a funding agreement, including that the funds are used in an investment spread capacity, it shall be accounted for consistent with other funding agreements in accordance with this statement. If the arrangement is in substance a borrowing agreement, it shall be accounted for in accordance with *SSAP No. 15—Debt and Holding Company Obligations*, consistent with other borrowed money.

Disclosures

18. For life and annuity reserves, the financial statements shall disclose the following:
- a. A description of reserve practices including the amount of any surrender value promised in excess of the reserve as legally computed;
 - b. The method of determination of tabular interest on funds not involving life contingencies; and
 - c. The nature of significant other reserve changes.
19. For the disclosures noted below, disclose the amount of annuity actuarial reserves and deposit liabilities by withdrawal characteristics for the categories of general account, separate account with guarantees, separate account nonguaranteed as well as the total and percentage of the total, include a separate section for Individual Annuities, Group Annuities, and Deposit-Type Contracts (with no life contingencies). Supplementary contracts with life contingencies are reported in the appropriate Annuities section (Individual or Group).
- a. Subject to discretionary withdrawal:
 - i. With market value adjustment, where withdrawal of funds is payable at all times, or prior to specified maturity dates where such dates are more than one year after the statement date and;
 - (a) In a lump sum with adjustments to reflect general changes in interest rates, or asset values since receipt of funds by the reporting entity; and
 - (b) In installments over five years or more, with or without a reduction in the interest rate during the installment period.
 - ii. At book value less current surrender charge, where the withdrawal of funds is payable at all times, or at any time within one year from the statement date in a lump sum subject to a current fixed surrender charge of 5% or more and it does not contain a meaningful bail-out rate as described in paragraph 19.a.v.(d);
 - iii. At fair value, where the withdrawal of funds is payable at current fair value of the assets supporting the liabilities, the assets are stated at current fair value, and the

liabilities are stated at the current fair value or per unit value of the assets supporting the liabilities. These liabilities are for contracts where the customer bears the entire investment risk;

- iv. Total with adjustment or at fair value;
- v. At book value without adjustment (minimal or no charge or adjustment), where the withdrawal of funds is either payable at all times, or at any time (including a withdrawal on a scheduled payment date) within one year from the statement date and:
 - (a) In a lump sum without adjustment;
 - (b) In installments over less than five years, with or without a reduction in interest rate during the installment period;
 - (c) In a lump sum subject to a fixed surrender charge of less than 5%;
 - (d) In a lump sum subject to surrender charge, but such charge is waived if the credited rate falls below a specified “bail out” rate and the “bail out” rate is more than the maximum statutory valuation rate for life insurance policies for more than 20 years for new issues;
- b. Not subject to discretionary withdrawal;
- c. Total gross (Direct + Assumed);
- d. Reinsurance ceded;
- e. Total net (Net: Total gross (paragraph 19.c.) less Reinsurance ceded (paragraph 19.d.));
- f. Amount with current surrender charge of 5% or more included in the current year in paragraph 19.a.ii that will have less than a 5% surrender charge (and thus be reported with the amounts at book value with minimal or no charge or adjustment noted in paragraph 19.a.v.) in the year subsequent to the balance sheet year. (Note that percentage of total is not required for this item.)

20. Reconcile the total annuity reserves and deposit fund liabilities amount disclosed in the (non-life reserves) annual statement Aggregate Reserve for Life Contracts Exhibit 5 and the deposit-type contract fund liabilities from the Deposit-Type Contracts Exhibit 7, of the Life, Accident & Health Annual Statement and the corresponding lines in the Separate Accounts Statement. The reconciliation is a single presentation including all amounts from the sections on Individual Annuities, Group Annuities and Deposit-Type Contracts.

21. For FHLB agreements accounted for under this statement, include information for the FHLB funding agreements with other reporting and disclosure requirements for deposit-type contracts under this statement and complete additional disclosure requirements in *SSAP No. 30R—Unaffiliated Common Stock*, paragraph ~~18~~19.

22. For life insurance claims, disclose the following information regarding the reporting entity’s use of retained asset accounts for beneficiaries. For purposes of this disclosure, retained asset accounts represent settlement of life insurance proceeds, which are retained by the insurance entity within their general account for the benefit of the beneficiaries. Amounts held outside of the insurance entity, for example in a non-insurance subsidiary, affiliated or controlled entity accounted for under *SSAP No. 97—Investments in Subsidiary, Controlled, and Affiliated Entities*, such as an interest bearing account

established in the beneficiary's name with a bank or thrift institution (and subject to applicable Federal Deposit Insurance Corporation coverage) are only required to be described in the context of the structure of the reporting entity's program in accordance with paragraph 22.a., but quantitative information regarding retained asset accounts transferred outside of the reporting entity are not required.

- a. A narrative description of how the accounts are structured and reported within the reporting entity's financial statements (e.g., as drafts written by the reporting entity and reported within cash and supplemental contracts without life contingencies; as accounts transferred into the beneficiary's name to an affiliated or unaffiliated bank or other financial institution in which the reporting entity has disposed of its liabilities and related assets, etc.). This description should include all of the different interest rates paid to retained asset account holders during the reporting year and the number of times changes in rates were made during the reporting year. The description should also include a listing of all applicable fees charged by the reporting entity that are directly or indirectly associated with the retained asset accounts. Also, indicate if the retained asset account is the default method for satisfying life insurance claims.
- b. Number and balance of retained asset accounts in force at the end of the current year and prior year segregated within "aging categories" of "up to 12 months," "13 to 24 months," "25 to 36 months," "37 to 48 months," "49 to 60 months," "over 60 months;"
- c. Number and balance of retained asset accounts in force at the beginning of the year segregated between individual and group contracts;
- d. Number and amount of retained asset accounts issued during the year segregated between individual and group contracts;
- e. Investment earnings credited to retained asset accounts segregated between individual and group contracts;
- f. Fees and other charges assessed to retained asset accounts during the year segregated between individual and group contracts;
- g. Number and amount of retained asset accounts transferred to state unclaimed property funds segregated between individual and group contracts;
- h. Number and amount of retained asset accounts closed/withdrawn during the year segregated between individual and group contracts;
- i. Number and balance of retained asset accounts in force at the end of the year segregated between individual and group contracts.

23. The disclosures in paragraph 22 are not required in the annual audited financial statements. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

24. This statement incorporates the requirements of Appendices A-235, A-695, A-820, A-822, the Actuarial Standards Board *Actuarial Standards of Practice*, and the actuarial guidelines found in Appendix C of this Manual.

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.

Effective Date and Transition

26. This statement is effective for years beginning January 1, 2001. Contracts issued prior to January 1, 2001 shall be accounted for based on the laws and regulations of the domiciliary state. State laws and regulations shall be understood to include anything considered authoritative by the domiciliary state under the individual state's statutory authority and due process procedures. 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. Guidance in paragraph 17 was previously included within *INT 08-08: Balance Sheet Presentation of Funding Agreements Issued to a Federal Home Loan Bank* and was effective for periods beginning March 15, 2009. Guidance in paragraph 21 related to FHLB agreements was initially effective January 1, 2014. The revisions adopted in November 2018 to expand liquidity disclosures are effective year-end 2019, concurrent with the inclusion of data-captured financial statement disclosures.

REFERENCES

Other

- *NAIC Financial Condition Examiners Handbook*
- *Actuarial Standards Board Actuarial Standards of Practice*

Relevant Issue Papers

- *Issue Paper No. 52—Deposit-Type Contracts*
- *Issue Paper No. 110—Life Contracts, Deposit-Type Contracts and Separate Accounts, Amendments to SSAP No. 51—Life Contracts, SSAP No. 52—Deposit-Type Contracts, and SSAP No. 56—Separate Accounts*

Statement of Statutory Accounting Principles No. 53

Property and Casualty Contracts—Premiums

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Nullifies and incorporates INT 99-23, INT 01-23, INT 02-11 and INT 05-06
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	A-225

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Earned but Unbilled Premium.....	3
Earned but Uncollected Premium	3
Advance Premiums	3
Premium Deposits on Perpetual Fire Deposits	4
Premium Deficiency Reserve	4
Disclosures.....	4
Relevant Literature.....	4
Effective Date and Transition	5
REFERENCES.....	5
Relevant Issue Papers	5

SCOPE OF STATEMENT

1. This statement establishes general statutory accounting principles for the recording and recognition of premium revenue for property and casualty contracts as defined in *SSAP No. 50—Classifications of Insurance or Managed Care Contracts*.
2. Specific statutory requirements for certain property and casualty premiums are addressed in the following statements: (a) *SSAP No. 57—Title Insurance*, (b) *SSAP No. 58—Mortgage Guaranty Insurance*, (c) *SSAP No. 60—Financial Guaranty Insurance*, (d) *SSAP No. 62R—Property and Casualty Reinsurance*, (e) *SSAP No. 65—Property and Casualty Contracts*, and (f) *SSAP No. 66—Retrospectively Rated Contracts and Contracts*.

SUMMARY CONCLUSION

3. Except as provided for in paragraph 4, written premium is defined as the contractually determined amount charged by the reporting entity to the policyholder for the effective period of the contract based on the expectation of risk, policy benefits, and expenses associated with the coverage provided by the

terms of the insurance contract. Frequently, insurance contracts are subject to audit by the reporting entity and the amount of premium charged is subject to adjustment based on the actual exposure. Premium adjustments are discussed in paragraphs 10-13 of this statement.

4. For workers' compensation contracts, which have a premium that may periodically vary based upon changes in the activities of the insured, written premiums may be recorded on an installment basis to match the billing to the policyholder. Under this type of arrangement, the premium is determined and billed according to the frequency stated in the contract, and written premium is recorded on the basis of that frequency.

5. Premiums for prepaid legal expense plans shall be recognized as income on the gross basis (amount charged to the policyholder or subscriber exclusive of copayments or other charges) when due from policyholders or subscribers, but no earlier than the effective date of coverage, under the terms of the contract. Due and uncollected premiums shall follow the guidance in *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*, to determine the admissibility of premiums and related receivables.

6. Written premiums for all other contracts shall be recorded as of the effective date of the contract. Upon recording written premium, a liability, the unearned premium reserve, shall be established to reflect the amount of premium for the portion of the insurance coverage that has not yet expired. Flat fee service charges on installment premiums¹ (fees charged to policyholders who pay premiums on an installment basis rather than in full at inception of contract) are reported in the Other Income section of the Underwriting and Investment Exhibit as Finance and Service Charges. Flat fee service charges on installment premiums, which do not meet the requirements outlined in footnote 1 (e.g., policy may be cancelled for non-payment of fee or fee is refundable), shall be recorded as written premium on the effective date of the contract and subject to the unearned premium guidelines included in paragraph 8.

7. The exposure to insurance risk for most property and casualty insurance contracts does not vary significantly during the contract period. Therefore, premiums from those types of contracts shall be recognized in the statement of income, as earned premium, using either the daily pro-rata or monthly pro-rata methods as described in paragraph 8. Certain statements provide for different methods of recognizing premium in the statement of operations for specific types of contracts. For contracts not separately identified in specific statements where the reporting entity can demonstrate the period of risk differs significantly from the contract period, premiums shall be recognized as revenue over the period of risk in proportion to the amount of insurance protection provided.

8. One of the following methods shall be used for computation of the unearned premium reserve:

- a. Daily pro rata method—Calculate the unearned premium on each policy—At the end of each period, the calculation is made on each item of premium to ascertain the unexpired portion and to arrive at the aggregate unearned premium reserve;
- b. Monthly pro rata method—This method assumes that, on average, the same amount of business is written each day of any month so that the mean will be the middle of the

¹ If the policyholder elects to pay an installment rather than the full amount or the full remaining balance, the policyholder is traditionally charged a flat fee service charge on the subsequent billing cycle(s). The amount charged is primarily intended to compensate the insurer for the additional administrative costs associated with processing more frequent billings and has no relationship to the amount of insurance coverage provided, the period of coverage, or the lost investment income associated with receiving the premium over a period of time rather than in a lump sum. As described, there is no underwriting risk associated with this service charge. If a policyholder does not pay the service charge, the policy is not cancelled (unlike non-payment of premium), but instead the policy is converted back to an annual pay plan. If a policyholder cancels coverage, the premium is returned but the service charge is not, as the service charge is not a part of premium. Note that this footnote on flat fee service charges on installment premium is intentionally narrow and specific, and this guidance should not be applied to other fees or service charges. Reporting of installment fees in finance and service charges as other income should not be construed as having any bearing on whether such charges are subject to premium taxation, which remains an issue of state law and regulation.

month. For example, one-year premiums written during the first three months of the year have, at the end of the year, the following unearned fractions: January-1/24; February-3/24; March-5/24.

9. Additional premiums charged to policyholders for endorsements and changes in coverage under the contract shall be recorded on the effective date of the endorsement and accounted for in a manner consistent with the methods discussed in paragraphs 4-8. This is done so that, at any point in time, a liability is accrued for unearned premium related to the unexpired portion of the policy endorsement.

Earned but Unbilled Premium

10. Adjustments to the premium charged for changes in the level of exposure to insurance risk (e.g., audit premiums on workers' compensation policies) are generally determined based upon audits conducted after the policy has expired. Reporting entities shall estimate audit premiums, the amount generally referred to as earned but unbilled (EBUB) premium, and shall record the amounts as an adjustment to premium, either through written premium or as an adjustment to earned premium. The estimate for EBUB may be determined using actuarially or statistically supported aggregate calculations using historical company unearned premium data, or per policy calculations.

11. EBUB shall be adjusted upon completion of the audit and the adjustment shall be recognized as revenue immediately. Upon completion of an audit that results in a return of premiums to the policyholder, earned premiums shall be reduced.

12. Reporting entities shall establish all of the requisite liabilities associated with the asset such as commissions and premium taxes. These liabilities shall be determined based on when premium is earned, not collected².

13. Ten percent of EBUB in excess of collateral specifically held and identifiable on a per policy basis shall be reported as a nonadmitted asset. To the extent that amounts in excess of the 10% are not anticipated to be collected, they shall be written off against operations in the period the determination is made.

Earned but Uncollected Premium

14. Reporting entities may utilize a voluntary procedure whereby policies are not cancelled for non-payment of the premium until after an extended cancellation period (example 30 days), as opposed to the shorter statutory cancellation period. There are other instances when a reporting entity provides coverage for periods when the payment has not been received. Prior to the cancellation of the policy the reporting entity acknowledges it is "at risk" and subject to "actual exposure" for a valid claim despite the fact that the reporting entity may not have received payment of the premium for this exposure. Reporting entities shall record earned but uncollected premium as direct and assumed written premium since the reporting entity is "at risk" and subject to "actual exposure" for the extended period of time when the policy is still in force and effective, whether or not the reporting entity collects a premium for this time period. Earned but uncollected premium would be charged to expenses "net gain or (loss) from agents or premium balances charged off" when it is determined to be uncollectible.

Advance Premiums

15. Advance premiums result when the policies have been processed, and the premium has been paid prior to the effective date. These advance premiums are reported as a liability in the statutory financial

² If an entity feels comfortable enough in their ability to collect the premium that an asset is recorded, they should also book the associated liabilities. Once an estimate of the premium has been made and the entity feels certain that it will be collected, it should also book the liabilities that will be due when they receive the cash. If the premiums were unearned and the policyholder had the ability to cancel, the definition of a liability has not been met.

statement and not considered income until due. Such amounts are not included in written premium or the unearned premium reserve.

Premium Deposits on Perpetual Fire Deposits

16. Premium deposits on perpetual fire insurance risks should be charged as a liability to the extent of at least 90% of the gross amount of such deposit.

Premium Deficiency Reserve

17. When the anticipated losses, loss adjustment expenses, commissions and other acquisition costs, and maintenance costs exceed the recorded unearned premium reserve, and any future installment premiums on existing policies, a premium deficiency reserve shall be recognized by recording an additional liability for the deficiency, with a corresponding charge to operations. Commission and other acquisition costs need not be considered in the premium deficiency analysis to the extent they have previously been expensed. For purposes of determining if a premium deficiency exists, insurance contracts shall be grouped in a manner consistent with how policies are marketed, serviced and measured. A liability shall be recognized for each grouping where a premium deficiency is indicated. Deficiencies shall not be offset by anticipated profits in other policy groupings.

18. If a premium deficiency reserve is established in accordance with paragraph 17, disclose the amount of that reserve. If a reporting entity utilizes anticipated investment income as a factor in the premium deficiency calculation, the reporting entity's disclosures shall include a statement that anticipated investment income was utilized; however, the dollar amount need not be included. Reporting entities need to disclose by statement only that anticipated investment income was utilized in the calculation of premium deficiency reserves whether a reserve is recorded or not (i.e., the use of anticipated investment income mitigated the need for recording a premium deficiency reserve).

Disclosures

19. Disclose the aggregate amount of direct premiums written through managing general agents or third party administrators. For purposes of this disclosure, a managing general agent means the same as in Appendix A-225. If this amount is equal to or greater than 5% of surplus, provide the following information for each managing general agent and third party administrator:

- a. Name and address of managing general agent or third party administrator;
- b. Federal Employer Identification Number;
- c. Whether such person holds an exclusive contract;
- d. Types of business written;
- e. Type of authority granted (i.e., underwriting, claims payment, etc.); and
- f. Total premium written.

20. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

21. This statement rejects *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises*.

Effective Date and Transition

22. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The guidance in paragraph 5 was originally contained within *INT 01-23: Prepaid Legal Insurance Premium Recognition* and was effective June 11, 2001. The guidance reflected in paragraph 12, incorporated from *INT 02-11: Recognition of Amounts Related to Earned but Unbilled Premium*, was effective September 10, 2002. The guidance reflected in paragraph 14, incorporated from *INT 05-06: Earned but Uncollected Premium*, was effective December 3, 2005. The guidance in paragraph 18 incorporated from *INT 99-23: Disclosure of Premium Deficiency Reserves* was effective December 6, 1999.

REFERENCES**Relevant Issue Papers**

- *Issue Paper No. 53—Property Casualty Contracts—Premiums*

Not for Distribution

Statement of Statutory Accounting Principles No. 54 – Revised

Individual and Group Accident and Health Contracts

STATUS

Type of Issue.....	Common Area
Issued	Finalized March 13, 2000; Substantively revised December 10, 2016
Effective Date	January 1, 2001; Substantive revisions detailed in Issue Paper No. 154 effective January 1, 2017
Affects.....	Nullifies and incorporates INT 00-23 and INT 01-23
Affected by.....	No other pronouncements
Interpreted by	INT 05-05
Relevant Appendix A Guidance	A-010; A-225; A-641; A-820; A-822

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	2
Premium Income Recognition	2
Reserve Requirements	2
Policy Reserves.....	3
Additional Reserves (Premium Deficiency Reserves).....	4
Claim Reserves	4
Reserve Recognition	4
Change in Valuation Basis.....	5
Supplemental Benefits	5
Reserve Adequacy	5
Additional Reserves Not Included Elsewhere	5
Contracts Subject to Redetermination.....	6
Disclosures.....	6
Relevant Literature.....	7
Effective Date and Transition	8
REFERENCES.....	8
Other	8
Relevant Issue Papers	8
EXHIBIT A – LONG-TERM CARE ILLUSTRATION ON INTERACTION BETWEEN SSAP NO. 54R AND A-010 AND AG 51	9

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for income recognition and policy reserves for all contracts classified as individual and group accident and health contracts as defined in *SSAP No. 50—Classifications of Insurance or Managed Care Contracts*, except for credit accident and health contracts which are discussed in *SSAP No. 59—Credit Life and Accident and Health Contracts*.

SUMMARY CONCLUSION

Premium Income Recognition

2. Premiums shall be recognized as income on the gross basis (amount charged to the policyholder or subscriber exclusive of copayments or other charges related to the receipt of health care services) when due from policyholders or subscribers, but no earlier than the effective date of coverage, under the terms of the contract. Due and uncollected premiums shall follow the guidance in *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*, to determine the admissibility of premiums and related receivables. Premiums waived by the reporting entity under disability provisions contained in its policies and contracts, and reported in operations as a disability benefit, are included in premium income.
3. Premium income shall exclude premiums that have been received by the reporting entity on or prior to the valuation date but which are due after the valuation date (i.e., advance premiums as discussed below).
4. Premium income shall be reduced for premiums returned and allowances to industrial policyholders for the direct payment of premiums.
5. Premium income shall be increased by reinsurance premiums assumed and reduced by reinsurance premiums ceded. Reinsurance premiums assumed and ceded are defined and addressed in *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*.
6. Advance premiums are those premiums that have been received by the reporting entity prior to or on the valuation date but which are due after the valuation date. The total amount of such advance premiums is reported as a liability in the statutory financial statements and is not considered premium income until due. The gross premium, not the net valuation premium, is recorded as the advance premium in recognition of the reporting entity's liability to refund such premiums in the event the policy is terminated.
7. As discussed in *SSAP No. 47—Uninsured Plans*, amounts received on behalf of uninsured plans or the uninsured portion of partially insured plans shall not be reported as premium income. Administrative fees for servicing the uninsured plans shall be deducted from general expenses. Conversely, income relating to the insured portion of any plan shall be reported as premium income.
8. Specific funds to be received under the Medicare Part D program received as premiums for coverage that is not retrospectively rated should be accounted for under this statement. These funds include 'Beneficiary Premium (supplemental benefit portion)', as these payments are considered to be standard premium payments that do not meet the definitions under *SSAP No. 47* or *SSAP No. 66—Retrospectively Rated Contracts*. Refer to *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage* for additional information and definitions of terms specifically related to Medicare Part D business.

Reserve Requirements

9. The aggregate reserve for individual and group accident and health contracts generally consists of a policy reserve and a claim reserve as well as certain other miscellaneous reserves discussed in paragraph 24. The aggregate reserve reflects the future liabilities arising under accident and health policies. Policy reserves have traditionally been referred to as active life reserves and include unearned premium reserves. Policy reserves reflect that premiums cover future liabilities in addition to current claim costs and expenses. Claim reserves, sometimes referred to as disabled life reserves, are required on claims which involve continuing loss. The reserve in this case is a measure of the present value of future benefits or amounts not yet due as of the statement date (the unaccrued portion) which are expected to arise under claims which have been incurred as of the statement date. The aggregate reserve for individual

and group accident and health contracts does not include claim liabilities which are the amounts payable at the reporting date (the accrued portion) and reflect the reporting entity's liability for benefits due as of the statement date. Claim liabilities are further discussed in *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*.

10. Policy reserves for individual and group accident and health contracts shall include an unearned premium reserve and, as applicable, an additional or contract reserve where constant or level premiums are assumed for certain noncancelable or guaranteed renewable contracts. The claim reserve shall consist of a reserve for the present value of amounts not yet due.

11. Statutory policy reserves shall be established for all unmatured contractual obligations of the reporting entity arising out of the provisions of the contract. Where separate benefits are included in a contract, a reserve for each benefit shall be established as required in Appendix A-820. A prospective gross premium valuation is the ultimate test of reserve adequacy as of a given valuation date. Statutory reserves meet the definition of liabilities as defined in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*. The actuarial methodologies referred to in paragraph 12 meet the criteria required for reasonable estimates in SSAP No. 5R.

12. The reserving methodologies and assumptions used in calculating individual and group accident and health reserves shall meet the provisions of Appendices A-010, A-641, A-820, A-822 (as applicable), the *Valuation Manual* and the actuarial guidelines found in Appendix C of this Manual (as applicable). Further, policy reserves shall be in compliance with those Actuarial Standards of Practice promulgated by the Actuarial Standards Board.

Policy Reserves

13. Unearned premium reserves shall be required for all accident and health contracts for which premiums have been reported for a period beyond the date of valuation other than premiums paid in advance. The minimum unearned premium reserve that applies to the premium period beyond the valuation date shall be based on the valuation net modal premium if contract reserves are required and the gross modal unearned premium reserve if contract reserves are not required. If premiums due and unpaid are carried as an asset, such premiums must be treated as premiums in force, subject to unearned premium reserve determination. The value of unpaid commissions, premium taxes, and the cost of collection associated with due and unpaid premiums must be carried as an offsetting liability. In no event shall the aggregate policy reserve for all contracts be less than the unearned gross premium under such contracts. Additionally, the reserve shall never be less than the expected claims for the period beyond the valuation date represented by the unearned premium reserve, to the extent not provided for elsewhere.

14. Contract or additional reserves on accident and health contracts shall be recorded when premiums and benefits are not earned or incurred at the same incidence over the policy period (e.g., contracts having premiums determined on an issue-age basis where premiums and related morbidity, risk of loss, and the cost of coverage are not evenly matched). This evaluation may be applied on a rating block basis if the total premiums for the block were developed to support the total risk assumed and expected expenses for the block each year, and a qualified actuary certifies the premium development (e.g., community-rated contracts). The additional reserves shall be set aside from the early years' level premiums to pay the claims that experience indicates will be incurred as the policy continues in force. The fact that the reporting entity may have the right to increase premiums or to decline renewal of the policies for certain reasons has no bearing on whether or not a contract or additional reserve should be held. These reserves shall apply regardless of whether or not benefits are currently being received and are in addition to unearned premium reserves discussed in paragraph 13.

15. Contract or additional reserves shall also be recorded where, due to the gross premium structure, the future benefits exceed the future net premiums (e.g., group conversion policies) or where the contract

provides for the extension of benefits after the termination of the coverage (e.g., deferred maternity and other similar benefits).

16. A terminal reserve for accident and health contracts is the policy reserve at the end of a policy year to cover the assumed difference between future benefits and future net premiums. The components used to compute a terminal reserve shall consist of an interest rate, a mortality and/or morbidity table, and a valuation method (e.g., net level, one-year full preliminary term, and two-year full preliminary term) and where allowed, other assumptions. A terminal reserve is based on the assumption that all net premiums have been received, all interest earned, and all benefits paid to the end of the policy year.

17. Since terminal reserves are computed as of the end of a policy year and not the reporting date, the terminal reserve as of policy anniversaries immediately prior to and subsequent to the reporting date are adjusted to reflect that portion of the net premium that is unearned at the reporting date. This is generally accomplished using either the mean reserve method or the mid-terminal method as discussed in paragraphs 25-28 of *SSAP No. 51R—Life Contracts*. Other appropriate methods, including an exact reserve valuation, may also be used.

18. For individual and group accident and health contracts, negative reserves on any benefit shall be offset against positive reserves for other benefits in the same policy but the mean reserve on any policy shall never be taken as less than one-half the valuation net premium. The majority of group accident and health policies are written in conjunction with group life or other policies. If these policies are an experience rated package, positive or favorable margins on one of the contracts can offset the need to establish additional reserves on the other contracts.

Additional Reserves (Premium Deficiency Reserves)

19. When the expected claims payments or incurred costs, claim adjustment expenses and administration costs exceed the premiums to be collected for the remainder of a contract period plus any contract reserve, a premium deficiency reserve shall be recognized by recording an additional liability for the deficiency, with a corresponding charge to operations. For purposes of determining if a premium deficiency exists, contracts shall be grouped in a manner consistent with how policies are marketed, serviced and measured. A liability shall be recognized for each grouping where a premium deficiency is indicated. Deficiencies shall not be offset by anticipated profits in other policy groupings. Such accruals shall be made for any loss contracts, even if the contract period has not yet started.

Claim Reserves

20. Claim reserves shall be accrued for estimated costs of future health care services to be rendered that the reporting entity is currently obligated to provide or reimburse as a result of premiums earned to date and that would be payable after the reporting date under the terms of arrangements, regulatory requirements or other requirements if the insured's or subscriber's illness or disability were to continue. It shall include a reserve for disability benefits covered under premium waiver provisions. For individual and group disability claims with a duration of less than two years, reserves may be based on the reporting entity's experience, if credible, or other methods, as appropriate. Generally, reserves for disability income claims with durations of greater than two years shall be determined based on a tabular method using the age of the insured at the date of disablement, the number of months the insured already has been disabled, and the number of months remaining in the benefit period.

Reserve Recognition

21. The difference between the aggregate reserve for accident and health contracts at the beginning and end of the reporting period shall be reflected as the change in reserves in the summary of operations, except for any difference due to a change in valuation basis.

Change in Valuation Basis

22. A change in valuation basis shall be defined as a change in the interest rate, mortality and morbidity assumptions, or reserving method (e.g., net level, preliminary term, etc.) or other factors affecting the reserve computation of policies in force and meets the definition of an accounting change as defined in *SSAP No. 3—Accounting Changes and Corrections of Errors*. Changing morbidity assumptions regarding the length of claim continuance based on regularly updated credible experience as required for products subject to *Actuarial Guideline XLVII—The Application of Company Experience in the Calculation of Claim Reserves Under the 2012 Group Long-Term Disability Valuation Table* (AG 47) and *Actuarial Guideline L—2013 Individual Disability Income Valuation Table* (AG 50) are not considered a change in valuation basis. Other uses of regularly updated credible experience required to be used for morbidity assumptions by Appendix A-010 regarding continuing claim payments are generally not considered a change in valuation basis. Voluntary decisions to choose one allowable reserving methodology over another, which require commissioner approval under the *Valuation Manual*, shall be reported as a change in valuation basis. Consistent with SSAP No. 3, any increase (strengthening) or decrease (destrengthening) in actuarial reserves resulting from such a change in valuation basis shall be recorded directly to surplus (under changes to surplus in the change in valuation basis annual statement line for life, accident and health, and health reporting entities) rather than as a part of the reserve change recognized in the summary of operations. The impact on surplus is based on the difference between the reserve under the old and new methods as of the beginning of the year. Some changes will meet the definition of a change in accounting as defined in SSAP No. 3 and a change in valuation basis as described in this paragraph, but the adjustment to surplus will be zero. This can happen when the change in valuation basis is prospective and only applies to new policies and reserves meaning that policies in force for the prior year-end are not affected, or situations in which the change in reserving methodology did not change the reserves reported in the financial statements. The changes remain subject to the disclosures prescribed in SSAP No. 3. This difference shall not be graded in over time unless this statement prescribes a new method and a specific transition that allows for grading.

Supplemental Benefits

23. In addition to the basic policy benefit, the contract may provide supplemental benefits. Supplemental benefits include, but are not limited to, accidental death benefits, dental and waiver of premium benefits. If the terms of the contract provide for these benefits, appropriate reserves shall be established in accordance with the applicable standards within the *Accounting Practices and Procedures Manual* and the *Valuation Manual*.

Reserve Adequacy

24. As discussed in Appendix A-010, a prospective gross premium valuation is the ultimate test of the adequacy of a reporting entity's accident and health reserves as of a given valuation date and shall be determined on the basis of unearned premium reserves, contract reserves, additional reserves, claim reserves (including claim liabilities), and miscellaneous reserves combined; however, each component shall be computed separately. Pursuant to Appendix A-010, paragraph 26, an entity's accident and health reserves in total must be adequate under a gross premium valuation. The requirements of Actuarial Guideline LI—The Application of Asset Adequacy Testing to Long-Term Care Insurance Reserves (AG 51) provide a test which indicates whether reserves in addition to the requirements of A-010 are indicated. AG 51 does not change the base requirements of A-010. (See Long-Term Care Illustration in Exhibit A).

Additional Reserves Not Included Elsewhere

25. Reserves for experience-rating refunds or the dividend liability in group policies are discussed in SSAP No. 66.

26. Additional actuarial or other liabilities are commonly held for such items as:
- a. Surrender values in excess of reserves otherwise required or carried;
 - b. Additional reserves required based on asset adequacy analysis as discussed in Appendix A-822; and
 - c. Additional reserves for policies which contain conversion privileges or future contingent benefits.

Contracts Subject to Redetermination

27. This statement also applies to other contracts which are subject to redetermination such as Federal (and State) Groups – subject to rate adjustments through audits by the Office of Personnel Management (OPM). Reporting entities are required to give Federal Groups the lowest rates that are being charged to similar groups.

28. Amounts due from insureds or subscribers and amounts due to insureds or subscribers under contracts subject to redetermination meet the definitions of assets and liabilities as set forth in *SSAP No. 4—Assets and Nonadmitted Assets* and SSAP No. 5R, respectively.

29. Contract redeterminations shall be estimated based on the experience to date. The method used to estimate the liability shall be reasonable based on the reporting entity's procedures, and consistent among reporting periods. An examination of contract requirements in relation to the rates being charged and the current status of applicable audits (e.g., OPM, Centers for Medicare and Medicaid Services (or such other name that this entity shall be known as) and other Federal, state or government department) is a common method used to estimate such contract redeterminations.

30. Premium adjustments for contracts subject to redetermination are estimated for the portion of the policy period that has expired and shall be considered an immediate adjustment to premium. Accrued premium adjustments shall be recorded in premium and considerations receivable with a corresponding entry to written premiums. Accrued return premium adjustments shall be recorded as a liability with a corresponding entry to written premiums, the annual statement liability lines will vary by the type of annual statement the reporting entity files. Managed care/accident and health reporting entities report as aggregate health policy reserves; life and accident and health reporting entities report as aggregate reserves for accident and health contracts; property and casualty reporting entities report as aggregate write-ins for liabilities.

31. If, in accordance with SSAP No. 5R, it is probable that the additional premium adjustment is uncollectible, any uncollectible premium shall be written off against operations in the period the determination is made and the disclosure requirements outlined in SSAP No. 5R shall be made.

32. Premium adjustments for contracts subject to redetermination shall be determined and billed or refunded in accordance with the policy provisions or contract provisions. If such premiums are not billed in accordance with the policy provisions or contract provisions, or the policy provisions or contract provisions do not address the due date of such premiums, the accrual shall be nonadmitted. This is consistent with the guidance for audit premiums established in SSAP No. 6.

Disclosures

33. Disclose the aggregate amount of direct premiums written through managing general agents or third party administrators. For purposes of this disclosure, a managing general agent means the same as in Appendix A-225. If this amount is equal to or greater than 5% of surplus, provide the following information for each managing general agent and third party administrator:

- a. Name and address of managing general agent or third party administrator;
- b. Federal Employer Identification Number;
- c. Whether such person holds an exclusive contract;
- d. Types of business written;
- e. Type of authority granted (i.e., underwriting, claims payment, etc.); and
- f. Total premium written.

34. Reporting entities shall disclose the relative percentage of participating insurance, the method of accounting for policyholder dividends, the amount of dividends, and the amount of any additional income allocated to participating policyholders in the financial statements.

35. If a premium deficiency reserve is established in accordance with paragraph 19, disclose the amount of that reserve. If a reporting entity utilizes anticipated investment income as a factor in the premium deficiency calculation, disclosure of such shall be made in the financial statements.

36. The financial statements shall disclose the method used by the reporting entity to estimate premium adjustments for contracts subject to redetermination. The amount of net premiums that are subject to such adjustments, as well as the corresponding percentage to total net premiums, shall be disclosed.

37. Management's policy for providing charity care,¹ as well as the level of charity care provided, shall be disclosed in the financial statements. Such disclosure shall be measured based on the provider's direct and indirect costs of providing charity care services. If costs cannot be specifically attributed to services provided to charity care patients (for example, based on a cost accounting system), management may estimate the costs of those services using reasonable techniques with the method used to identify or estimate such costs disclosed. Funds received to offset or subsidize charity services provided (for example, from gifts or grants restricted for charity care or from an uncompensated care fund), also shall be disclosed.

38. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

39. This statement adopts the definition of charity care and adopts with modification the disclosure within *ASU 2010-23, Health Care Entities, Measuring Charity Care*, as applicable.

40. This statement incorporates the requirements of Appendices A-010, A-225, A-641, A-820, A-822 (as applicable), the *Valuation Manual*, the Actuarial Standards Board *Actuarial Standards of Practice* and the actuarial guidelines found in Appendix C of this manual (as applicable).

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

¹ Charity care represents health care services that are provided but are never expected to result in cash flows. Charity care is provided to a patient with demonstrated inability to pay. Each entity establishes its own criteria for charity care consistent with its mission statement and financial ability.

Effective Date and Transition

42. This statement is effective for years beginning January 1, 2001. Contracts issued prior to January 1, 2001 shall be accounted for based on the laws and regulations of the domiciliary state. State laws and regulations shall be understood to include anything considered authoritative by the domiciliary state under the individual state's statutory authority and due process procedures. 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. The disclosure related to charity care shall be applied prospectively beginning June 17, 2015. Application of references to the *Valuation Manual* is effective January 1, 2017.

REFERENCES**Other**

- *NAIC Financial Condition Examiners Handbook*
- *Actuarial Standards Board Actuarial Standards of Practice*

Relevant Issue Papers

- *Issue Paper No. 54—Individual and Group Accident and Health Contracts*
- *Issue Paper No. 154—Implementation of Principle-Based Reserving*

Not for Distribution

EXHIBIT A – LONG-TERM CARE ILLUSTRATION ON INTERACTION BETWEEN SSAP NO. 54R, AND A-010 AND AG 51

This illustration is to address the interaction in long-term care reserving requirements noted in this statement, Appendix A-010, Minimum Reserve Standards for Individual and Group Accident and Health Insurance Contracts, and Actuarial Guideline LI—The Application of Asset Adequacy Testing to Long-Term Care Insurance Reserves (AG 51). At a high level, A-010 is from Model #10 of the same name which provides the minimum requirements. AG 51 is an actuarial guideline which provides a test for whether additional reserves are indicated. AG 51 does not change the base requirements of A-010.

Consider the following illustrative, simplified example:

1. Company XYZ has three lines of business: long-term care insurance, Medicare Supplement (Med Sup) insurance, and whole life insurance.
2. Cash flow testing performed for the long-term care block in isolation, in accordance with Actuarial Guideline LI (AG 51), shows deficiencies in all tested scenarios.
3. Cash flow testing performed for the entity as a whole, including both the Life and A&H business combined, shows significant sufficiency at the entity level in all tested scenarios.
4. A gross premium valuation performed on the long-term care reserves, in isolation, indicates that those reserves are deficient by \$250 million.
5. A gross premium valuation performed on the Medicare Supplement reserves, in isolation, indicates that those reserves contain \$150 million of sufficiency.

Given these facts, does Company XYZ- need to strengthen its accident and health reserves in order to comply with the requirements of the NAIC Accounting Practices and Procedures Manual?

Response: Yes. Company XYZ needs to strengthen its accident and health reserves by \$100 million. This number is determined by the following:

	<u>Millions</u>
<u>Long-term care GPV reserves are deficient by</u>	<u>(\$250)</u>
<u>Medicare Supplement GPV reserves sufficiency of</u>	<u>\$150</u>
<u>Accident and Health GPV reserve net deficiency of</u>	<u>\$100</u>

Appendix A-010, paragraph 26, and SSAP No. 54R, paragraph 24, both require gross premium valuation.

AG 51 is a test for additional reserves. That is, passing AG 51 does not relieve the reporting entity of the requirement of SSAP No. 54R and A-010 to have adequate accident and health reserves indicated by gross premium valuation.

Statement of Statutory Accounting Principles No. 55

Unpaid Claims, Losses and Loss Adjustment Expenses

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Supersedes SSAP No. 85 with guidance incorporated August 2011; Nullifies and incorporates INT 00-31, INT 01-28, INT 02-21, INT 03-17 and INT 06-14
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SUMMARY CONCLUSION	2
Property/Casualty.....	2
Life, Accident and Health	4
Managed Care	4
Managed Care and Accident and Health.....	5
General.....	7
Disclosures.....	8
Relevant Literature.....	9
Effective Date and Transition	9
REFERENCES.....	10
Relevant Issue Papers	10

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for recording liabilities for unpaid claims and claim adjustment expenses for life insurance contracts and accident and health contracts and unpaid losses and loss adjustment expenses for property and casualty insurance contracts. This guidance applies equally to those entities with direct and reinsurance-assumed obligations. This statement applies to all insurance contracts as defined in *SSAP No. 50—Classifications of Insurance or Managed Care Contracts*.

2. This statement does not address policy reserves for life and accident and health policies. These reserves are addressed in *SSAP No. 51R—Life Contracts*, *SSAP No. 52—Deposit-Type Contracts*, *SSAP No. 54R—Individual and Group Accident and Health Contracts*, and *SSAP No. 59—Credit Life and Accident and Health Insurance Contracts*.

3. This statement does not address liabilities for punitive damages. These liabilities shall be recorded in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*.

SUMMARY CONCLUSION

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

5. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts for which the liability is established net of capitated payments to providers.

Property/Casualty

6. The following are types of future costs relating to property and casualty contracts, as defined in SSAP No. 50, which shall be considered in determining the liabilities for unpaid losses and loss adjustment expenses:

- a. Reported Losses: Expected payments for losses relating to insured events that have occurred and have been reported to, but not paid by, the reporting entity as of the statement date;
- b. Incurred But Not Reported Losses (IBNR): Expected payments for losses relating to insured events that have occurred but have not been reported to the reporting entity as of the statement date. As a practical matter, IBNR may include losses that have been reported to the reporting entity but have not yet been entered to the claims system or bulk provisions. Bulk provisions are reserves included with other IBNR reserves to reflect deficiencies in known case reserves;
- c. Loss Adjustment Expenses: Expected payments for costs to be incurred in connection with the adjustment and recording of losses defined in paragraphs 6.a. and 6.b. Examples of expenses incurred in these activities are estimating the amounts of losses, disbursing loss payments, maintaining records, general clerical, secretarial, office maintenance, occupancy costs, utilities, computer maintenance, supervisory and executive duties, supplies, and postage. Loss adjustment expenses can be classified into two broad categories: Defense and Cost Containment (DCC) and Adjusting and Other (AO):
 - i. DCC include defense¹, litigation, and medical cost containment expenses, whether internal or external. DCC include, but are not limited to, the following items:
 - (a) Surveillance expenses;

¹ Legal defense costs incurred under the definition of covered damages or losses as the only insured peril would be accounted for as losses, while legal defense costs incurred under a duty to defend would be accounted for as Defense and Cost Containment (DCC). For policies where legal costs are the only insured peril, the insurer would record the legal costs that reimburse the policyholder as loss and, to the extent the insurer participated in the defense, would record its legal costs as DCC. This is not intended to change the classifications of legal expenses for existing long tailed lines of liability coverage, such as medical malpractice and workers' compensation insurance.

- (b) Fixed amounts for medical cost containment expenses;
 - (c) Litigation management expenses;
 - (d) Loss adjustment expenses for participation in voluntary and involuntary market pools if reported by accident year;
 - (e) Fees or salaries for appraisers, private investigators, hearing representatives, reinspectors and fraud investigators, if working in defense of a claim, and fees or salaries for rehabilitation nurses, if such cost is not included in losses;
 - (f) Attorney fees incurred owing to a duty to defend, even when other coverage does not exist; and
 - (g) The cost of engaging experts;
- ii. AO are those expenses other than DCC as defined in (i) above assigned to the expense group "Loss Adjustment Expense". AO include, but are not limited to, the following items:
- (a) Fees and expenses of adjusters and settling agents;
 - (b) Loss adjustment expenses for participation in voluntary and involuntary market pools if reported by calendar year;
 - (c) Attorney fees incurred in the determination of coverage, including litigation between the reporting entity and the policyholder;
 - (d) Fees and salaries for appraisers, private investigators, hearing representatives, reinspectors and fraud investigators, if working in the capacity of an adjuster; and
 - (e) Adjustment expenses arising from claims related lawsuits such as extra contractual obligations and bad faith lawsuits.
- d. The contractual terms for arrangements (i.e., variable, fixed or bundled amounts) to third-party administrators, management companies, or other entities for unpaid claims, losses and losses/claims adjustment expenses, shall be evaluated to determine if the arrangement meets the criteria to be reported as a prepaid asset and nonadmitted in accordance with *SSAP No. 29—Prepaid Expenses*. These payments shall not be offset against any amounts required to be reported in accordance with paragraph 4 or paragraph 5 within this guidance. Only when loss/claim and related adjusting expense payments, which are made by the third-party administrators, management companies or other entities, to the policyholder or claimant, shall the insurer's liability (loss/claim or loss/claim adjustment expense reserves) be reduced.
- e. Prepayments to third-party administrators, management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as aggregate write-ins for miscellaneous underwriting benefits in the Underwriting and Investment Exhibit Part 3.

Life, Accident and Health

7. The following future costs relating to life and accident and health indemnity contracts, as defined in SSAP No. 50, shall be considered in determining the liability for unpaid claims and claim adjustment expenses:

- a. Accident and Health Claim Reserves: Reserves for claims that involve a continuing loss. This reserve is a measure of the future benefits or amounts not yet due as of the statement date which are expected to arise under claims which have been incurred as of the statement date. This shall include the amount of claim payments that are not yet due such as those amounts commonly referred to as disabled life reserves for accident and health claims. The methodology used to establish claim reserves is discussed in SSAP No. 54R.
- b. Claim Liabilities for Life/Accident and Health Contracts:
 - i. Due and Unpaid Claims: Claims for which payments are due as of the statement date;
 - ii. Resisted Claims in Course of Settlement: Liability for claims that are in dispute and are unresolved on the statement date. The liability either may be the full amount of the submitted claim or a percentage of the claim based on the reporting entity's past experience with similar resisted claims;
 - iii. Other Claims in the Course of Settlement: Liability for claims that have been reported but the reporting entity has not received all of the required information or processing has not otherwise been completed as of the statement date;
 - iv. Incurred But Not Reported Claims: Liability for which a covered event has occurred (such as death, accident, or illness) but has not been reported to the reporting entity as of the statement date.
- c. Claim Adjustment Expenses for Accident and Health Reporting Entities are those costs expected to be incurred in connection with the adjustment and recording of accident and health claims defined in paragraphs 7.a. and 7.b. Certain claim adjustment expenses reduce the number or cost of health services thereby resulting in lower premiums or lower premium increases. These claim adjustment expenses shall be classified as cost containment expenses.
- d. Claim Adjustment Expenses for Life Reporting Entities: Costs expected to be incurred (including legal and investigation) in connection with the adjustment and recording of life claims defined in paragraph 7.b. This would include adjustment expenses arising from claims-related lawsuits such as extra contractual obligations and bad-faith lawsuits.
- e. In cases where insurers advance funds to third-party administrators, management companies or other entities prior to the occurrence of the claim who then, on behalf of the insurer, adjudicate the claim and make payments to insureds or other claimants, the guidance in paragraph 9 applies.

Managed Care

8. The following costs relating to managed care contracts as defined in SSAP No. 50 shall be considered in determining the claims unpaid and claims adjustment expenses:

- a. Claims unpaid for Managed Care Reporting Entities:

- i. Unpaid amounts for costs incurred in providing care to a subscriber, member or policyholder including inpatient claims, physician claims, referral claims, other medical claims, resisted claims in the course of settlement and other claims in the course of settlement;
 - ii. Incurred But Not Reported Claims: Liability for which a covered event has occurred (such as an accident, illness or other service) but has not been reported to the reporting entity as of the statement date;
 - iii. Additional unpaid medical costs resulting from failed contractors under capitation contracts and provision for losses incurred by contractors deemed to be related parties for which it is probable that the reporting entity will be required to provide funding;
- b. Claim Adjustment Expenses for Managed Care Reporting Entities are those costs expected to be incurred in connection with the adjustment and recording of managed care claims defined in paragraph 8.a. Certain claim adjustment expenses reduce the number or cost of health services thereby resulting in lower premiums or lower premium increases. These claim adjustment expenses shall be classified as cost containment expenses.
- c. Liabilities for percentage withholds (“withholds”) from payments made to contracted providers;
- d. Liabilities for accrued medical incentives under contractual arrangements with providers and other risk-sharing arrangements whereby the health entity agrees to share savings with contracted providers.
- e. In cases where insurers advance funds to third-party administrators, management companies or other entities prior to the occurrence of the claim who then, on behalf of the insurer, adjudicate the claim and make payments to insureds or other claimants, the guidance in paragraph 9 applies.

Managed Care and Accident and Health

9. In some instances, insurers advance funds to third-party administrators, management companies or other entities prior to the occurrence of the claim who then, on behalf of the insurer, adjudicate the claim and make payments to insureds or other claimants. In such cases the following guidance applies:

- a. For capitated payments under managed care contracts, the liability for claims and claim adjusting expenses shall be established in an amount necessary to adjudicate and pay all unpaid claims irrespective of payments to third-party administrators, management companies or other entities, and is reported net of capitated payments to providers.
- b. For non-capitated advance payments, the liability for unpaid losses/claims and related adjustment expenses shall be established regardless of any payments made to third-party administrators, management companies or other entities, and such payments shall be reported by the insurer as prepayments. All prepayments (i.e., variable, fixed or bundled amounts) to third-party administrators, management companies, or other entities for unpaid claims, losses and losses/claims adjustment expenses, shall be initially reported as a prepaid asset and nonadmitted in accordance with SSAP No. 29. These payments shall not be offset against any amounts required to be reported in accordance with paragraph 4 or paragraph 5 within this guidance. Only when loss/claim and related adjusting expense payments which are made by the third-party administrators, management companies or

other entities, to the policyholder or claimant, shall the insurer's liability (loss/claim or loss/claim adjustment expense reserves) be reduced.

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

Note that the guidance in paragraph 9 does not alter existing guidance regarding the admissibility of loans and advances to providers which apply to health insurance and managed care contracts which is addressed in *SSAP No. 84—Health Care and Government Insured Plan Receivables*.

10. Claim adjustment expenses for accident and health contracts and managed care contracts (identified in paragraphs 7.c. and 8.b.), including legal expenses, can be subdivided into cost containment expenses and other claim adjustment expenses:

- a. Cost containment expenses: Expenses that actually serve to reduce the number of health services provided or the cost of such services. The following are examples of items that shall be considered “cost containment expenses” only if they result in reduced levels of costs or services:
 - i. Case management activities;
 - ii. Utilization review;
 - iii. Detection and prevention of payment for fraudulent requests for reimbursement;
 - iv. Network access fees to Preferred Provider Organizations and other network-based health plans (including prescription drug networks), and allocated internal salaries and related costs associated with network development and/or provider contracting;
 - v. Consumer education solely relating to health improvement and relying on the direct involvement of health personnel (this would include smoking cessation and disease management programs, and other programs that involve hands on medical education); and
 - vi. Expenses for internal and external appeals processes.
- b. Other claim adjustment expenses: Claim adjustment expenses as defined in paragraph 7.c. or 8.b. that are not cost containment expenses. Examples of other claim adjustment expenses are:
 - i. Estimating the amounts of losses and disbursing loss payments;
 - ii. Maintaining records, general clerical, and secretarial;
 - iii. Office maintenance, occupancy costs, utilities, and computer maintenance;
 - iv. Supervisory and executive duties;
 - v. Supplies and postage;
 - vi. This would include adjustment expenses arising from claims-related lawsuits such as extra contractual obligations and bad-faith lawsuits; and

- vii. Interest paid in accordance with prompt payment laws or regulations to claimants. (Interest paid to regulatory authorities is reported as regulatory fines and fees.)

General

11. The liability for claim reserves and claim liabilities, unpaid losses, and loss/claim adjustment expenses shall be based upon the estimated ultimate cost of settling the claims (including the effects of inflation and other societal and economic factors), using past experience adjusted for current trends, and any other factors that would modify past experience. These liabilities shall not be discounted unless authorized for specific types of claims by specific SSAPs, including SSAP No. 54R and *SSAP No. 65—Property and Casualty Contracts*.

12. Various analytical techniques can be used to estimate the liability for IBNR claims, future development on reported losses/claims, and loss/claim adjustment expenses. These techniques generally consist of statistical analysis of historical experience and are commonly referred to as loss reserve projections. The estimation process is generally performed by line of business, grouping contracts with like characteristics and policy provisions. The decision to use a particular projection method and the results obtained from that method shall be evaluated by considering the inherent assumptions underlying the method and the appropriateness of those assumptions to the circumstances. No single projection method is inherently better than any other in all circumstances. The results of more than one method should be considered.

13. 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. Because the ultimate settlement of claims (including IBNR for death claims and accident and health claims) is subject to future events, no single claim or loss and loss/claim adjustment expense reserve can be considered accurate with certainty. Management's analysis of the reasonableness of claim or loss and loss/claim adjustment expense reserve estimates shall include an analysis of the amount of variability in the estimate. If, for a particular line of business, management develops its estimate considering a range of claim or loss and loss/claim adjustment expense reserve estimates bounded by a high and a low estimate, management's best estimate of the liability within that range shall be recorded. The high and low ends of the range shall not correspond to an absolute best-and-worst case scenario of ultimate settlements because such estimates may be the result of unlikely assumptions. Management's range shall be realistic and, therefore, shall not include the set of all possible outcomes but only those outcomes that are considered reasonable. Management shall also follow the concept of conservatism included in the Preamble when determining estimates for claim and loss and loss/claim adjustment expense reserves. However, there is not a specific requirement to include a provision for adverse deviation in claims.

14. In the rare instances when, for a particular line of business, after considering the relative probability of the points within management's estimated range, it is determined that no point within management's estimate of the range is a better estimate than any other point, the midpoint within management's estimate of the range shall be accrued. It is anticipated that using the midpoint in a range will be applicable only when there is a continuous range of possible values, and no amount within that range is any more probable than any other. For purposes of this statement, it is assumed that management can quantify the high end of the range. If management determines that the high end of the range cannot be quantified, then a range does not exist, and management's best estimate shall be accrued. This guidance is not applicable when there are several point estimates which have been determined as equally possible values, but those point estimates do not constitute a range. If there are several point estimates with equal probabilities, management should determine its best estimate of the liability.

15. If a reporting entity chooses to anticipate salvage and subrogation recoverables (including amounts recoverable from second injury funds, other governmental agencies, or quasi-governmental agencies, where applicable), the recoverables shall be estimated in a manner consistent with

paragraphs 11-13 of this statement. Estimated salvage and subrogation recoveries (net of associated recovery expenses) shall be deducted from the liability for unpaid claims, unpaid losses, and unpaid loss/claim adjustment expenses, depending on whether the subrogation represents a recovery of claims/losses or loss/claims adjustment expenses. If a reporting entity chooses to anticipate coordination of benefits (COB) recoverables of Individual and Group Accident and Health Contracts, the recoverables shall be estimated in a manner consistent with paragraphs 11-13 of this statement and shall be deducted from the liability for unpaid claims or losses. A separate receivable shall not be established for these recoverables. In addition, all of these recoverables are also subject to the impairment guidelines established in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* and an entity shall not reduce its reserves for any recoverables deemed to be impaired. Salvage and subrogation recoveries received (net of associated recovery expenses) are reported as a reduction to paid losses/claims and/or paid loss/claim adjustment expenses. Coordination of benefits (COB) recoveries received of Individual and Group Accident and Health Contracts (net of associated recovery expenses) are reported as a reduction to paid claims.

16. Changes in estimates of the liabilities for unpaid claims or losses and loss/claim adjustment expenses resulting from the continuous review process, including the consideration of differences between estimated and actual payments, shall be considered a change in estimate and shall be recorded in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. SSAP No. 3 requires changes in estimates to be included in the statement of operations in the period the change becomes known. This guidance also applies to the period subsequent to the March 1 filing deadline for annual financial statements through the filing deadline of June 1 for audited annual financial statements.

Disclosures

17. The financial statements shall include the following disclosures for each year full financial statements are presented. The disclosure requirement in paragraph 17.d. is also applicable to the interim financial statements if there is a material change from the amounts reported in the annual filing. Life and annuity contracts are not subject to this disclosure requirement.

- a. The balance in the liabilities for unpaid claims and unpaid losses and loss/claim adjustment expense reserves at the beginning and end of each year presented;
- b. Incurred claims, losses, and loss/claim adjustment expenses with separate disclosures of the provision for insured or covered events of the current year and increases or decreases in the provision for insured or covered events of prior years;
- c. Payments of claims, losses, and loss/claim adjustment expenses with separate disclosures of payments of losses and loss/claim adjustment expenses attributable to insured or covered events of the current year and insured or covered events of prior years;
- d. The reasons for the change in the provision for incurred claims, losses, and loss/claim adjustment expenses attributable to insured or covered events of prior years. The disclosure should indicate whether additional premiums or return premiums have been accrued as a result of the prior-year effects. (For Title reporting entities, “provision” refers to the known claims reserve included in Line 1 of the Liabilities page, and “prior years” refers to prior report years);
- e. Information about significant changes in methodologies and assumptions used in calculating the liability for unpaid claims and claim adjustment expenses, including reasons for the change and the effects on the financial statements for the most recent reporting period presented;

- f. A summary of management's policies and methodologies for estimating the liabilities for losses and loss/claim adjustment expenses, including discussion of claims for toxic waste cleanup, asbestos-related illnesses, or other environmental remediation exposures;
 - g. Disclosure of the amount paid and reserved for losses and loss/claim adjustment expenses for asbestos and/or environmental claims, on a direct, assumed and net of reinsurance basis (the reserves required to be disclosed in this section shall exclude amounts relating to policies specifically written to cover asbestos and environmental exposures). Each company should report only its share of a group amount (after applying its respective pooling percentage) if the company is a member of an intercompany pooling agreement; and
 - h. Estimates of anticipated salvage and subrogation (including amounts recoverable from second injury funds, other governmental agencies, or quasi-governmental agencies, where applicable), deducted from the liability for unpaid claims, losses or their associated adjusting expenses.
18. All reporting entity types are required to disclose the dollar amount of any claims/losses related to extra contractual obligation lawsuits or bad faith lawsuits paid during the reporting period on a direct basis. The number of such claims paid shall be disclosed in a note.
19. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

20. Although FASB *Statement No. 60, Accounting and Reporting by Insurance Enterprises* (FAS 60), is rejected in SSAP No. 50, this statement is consistent with the guidance provided for the recognition of claim costs in FAS 60 with the exception of the statutory requirement to accrue the midpoint of a range of loss or loss adjustment expense reserve estimates when no point within management's continuous range of reasonably possible estimates is determined to be a better estimate than any other point.
21. This statement also rejects *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts*, *AICPA Statement of Position 92-4, Auditing Insurance Entities' Loss Reserves* and *ASU 2015-09, Disclosures about Short-Duration Contracts*. Although the disclosures in ASU 2015-09 are similar to existing statutory accounting disclosures on claims development, the U.S. GAAP disclosures would reflect consolidated information, with potential for different aggregations than what is used for a legal entity basis under statutory accounting. As such, ASU 2015-09 is rejected for statutory accounting, and reporting entities shall follow the established statutory accounting disclosures.
22. Guidance in paragraphs 7.c., 8.b. and 10 was incorporated from SSAP No. 85. SSAP No. 85 was issued in 2002 to amend SSAP No. 55 and provide clarification regarding what costs should be classified as claim adjustment expenses on accident and health contracts. In August 2011, SSAP No. 85 was nullified and the guidance was incorporated into this SSAP. *Issue Paper No. 116—Claim Adjustment Expenses, Amendments to SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses* provides historical reference on the original guidance included in SSAP No. 55 as well as the revisions originally reflected in SSAP No. 85.

Effective Date and Transition

23. 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. Guidance reflected in paragraphs 7.c., 8.b. and 10, incorporated from SSAP No. 85, is effective for years ending on and after December 31, 2003. The guidance incorporated into paragraphs 1, 3, 6.c.ii., 7.d. and 10.b.vi. was originally included in *INT 03-17: Classification of Liabilities from Extra*

Contractual Obligation Lawsuits and was initially effective March 10, 2004. The guidance in paragraph 5 was previously included in *INT 02-21: Accounting for Prepaid Loss Adjustment Expenses and Claim Adjustment Expenses* effective for reporting periods ending on or after December 31, 2002, for all contracts except for capitated managed care contracts and December 31, 2006, for capitated managed care contracts. The guidance in paragraph 13 related to conservatism and adverse deviation was originally contained in *INT 01-28: Margin for Adverse Deviation in Claim Reserve* and was effective October 16, 2001. The guidance in paragraph 15 related to coordination of benefits was originally contained within *INT 00-31: Application of SSAP No. 55 Paragraph 12 to Health Entities* and was effective December 4, 2000. The guidance reflected in footnote 1, incorporated from *INT 06-14: Reporting of Litigation Costs Incurred for Lines of Business in which Legal Expenses Are the Only Insured Peril*, was effective June 2, 2007. The guidance in paragraph 10.b.vii. regarding interest on managed care and accident and health claims is effective January 1, 2020, with early adoption permitted, and shall be applied prospectively.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*
- *Issue Paper No. 116—Claim Adjustment Expenses, Amendments to SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*

Statement of Statutory Accounting Principles No. 56

Separate Accounts

STATUS

Type of Issue.....	Life, Accident and Health
Issued	Finalized March 13, 2000
Effective Date	January 1, 2001—Revised disclosures adopted September 2009 were required within the 2010 annual financial statements
Affects.....	Supersedes SSAP No. 80 with guidance incorporated August 2011
Affected by.....	No other pronouncements
Interpreted by	INT 00-03
Relevant Appendix A Guidance	A-200; A-250; A-255; A-270; A-585; A-588; A-620; A-695; A-812; A-820; A-821; A-822; A-830

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	2
Introduction.....	2
General Account Reporting	2
Separate Account Reporting	3
Separate Account AVR and IMR Reporting.....	4
Policy Reserves	5
Other Liabilities	5
Seed Money	6
Disclosures.....	6
Relevant Literature.....	9
Effective Date and Transition	9
REFERENCES.....	9
Other	9
Relevant Issue Papers	10
GLOSSARY	10

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for accounting and reporting for separate accounts in both the general account and separate account statements.

SUMMARY CONCLUSION

Introduction

2. Separate accounts are used to fund variable life insurance, variable annuities, modified guaranteed annuities and modified guaranteed life insurance, or various group contracts under pension or other employee benefit plans where funds are held in a separate account to support a liability. When separate accounts are established and filed accordingly, they may be used to fund guaranteed benefits. Separate account contracts may also be used to accumulate funds which are intended to be applied at some later time to provide life insurance or to accumulate proceeds applied under settlement or dividend options.

3. Assets held in separate accounts are owned by the insurer. All investment income and realized and unrealized capital gains and losses from assets allocated to a separate account, net of related investment expenses, are generally reflected in the separate account and, except for modified guaranteed annuities, modified guaranteed life insurance, and separate accounts established and filed to provide guaranteed benefits, investment performance is generally not guaranteed by the insurer. Charges relating to contract guarantees, administration, and investment management are deducted from separate accounts.

General Account Reporting

4. Insurance activities such as sales, underwriting and contract administration, premium collection and payment of premium taxes, claims, and benefits are functions of the insurance company distinct from the separate account and shall be accounted for as transactions of the general account.

5. For those separate account contracts classified as life contracts under *SSAP No. 50—Classification of Insurance or Managed Care Contracts*, premiums and annuity considerations shall be recorded as income in the Summary of Operations of the general account, and as transfers to premiums and considerations in the separate account statement. Deposit-type contracts shall be recorded in the general account in accordance with *SSAP No. 52—Deposit-Type Contracts*.^(INT 00-03) Charges (e.g., fees associated with investment management, administration, and contract guarantees) assessed on the separate accounts, as well as the net gain from operations of the separate account, shall be recorded as income in the Summary of Operations of the general account. Expenses relating to investment management, administration, and contract guarantees pertaining to separate account operations, as well as benefits and surrenders incurred on behalf of separate account contracts classified as life contracts, net transfers between separate accounts, commissions, and premium taxes (if any) shall be recorded as expenses in the Summary of Operations of the general account.

6. The general account shall include the total assets and liabilities, including transfers due or accrued, of any separate accounts business which it maintains and, therefore, the surplus, if any, of its separate accounts business. Transfers to the general account due or accrued shall be reported on a net basis so that the asset and the liability totals of the general account are not overstated. Changes in the surplus of the separate accounts business of an insurer, except for changes resulting from the net gain from operations of the separate account, shall be charged or credited directly to the unassigned funds (surplus) of the general account.

7. Where a variable annuity contract or variable life insurance contract contains a guaranteed minimum death benefit, any reserve liability for such death benefit provision shall be recorded and held in the general account based on the reserving guidance in paragraphs 25 and 26. Any differences between the benefit paid and the separate account asset value of the contract shall be charged against or credited to the general account in its net gain from operations.

8. Separate account surplus may not become negative. For example, for separate account contracts which have annuitized (i.e., contracts in the payout stage), lower than expected mortality on variable

annuity contracts containing mortality guarantees may cause a deficiency in the investment funds underlying the contract reserves. Thus the general account incurs an expense and the separate account realizes revenue to cover the deficiency, if necessary. Conversely, excess funds from higher than expected mortality will result in mortality gains, which are included in the Summary of Operations of the separate account and are ultimately recorded as equity in net income from separate account operations as discussed in paragraph 5.

9. Separate account surplus created through the use of the commissioners' reserve valuation method (CRVM), commissioners' annuity reserve valuation method (CARVM), or other reserving methods, shall be reported by the general account as an unsettled transfer from the separate account. The net change on such transfers shall be included as a part of the net gain from operations in the general account.

10. Surplus funds transferred from the general account to the separate account, commonly referred to as seed money, and earnings accumulated thereon shall be reported as surplus in the separate accounts until transferred or repatriated to the general account. The transfer of such funds between the separate account and the general account shall be reported as surplus contributed or withdrawn during the year.

11. If an Asset Valuation Reserve (AVR) is required for investments held by separate accounts, it is combined with the general account AVR and accounted for in the general account financial statements (see *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*). The criteria for determining when an AVR is required for separate accounts are described in paragraph 18 of this statement.

12. Reporting entities collect fees for managing Separate Account Guaranteed Investment Contracts (GICs), Synthetic GICs, as well as participating separate account group annuities. These are in the form of administrative fees, risk fees and some investment management fees. For defined contribution business, these are in the form of fees related to mutual fund management. These fees are meant to offset expenses and generate some profit.

13. Amounts receivable from contractholders for separate account management fees meet the definition of assets as set forth in *SSAP No. 4—Assets and Nonadmitted Assets*.

14. An evaluation shall be made of the amounts receivable to determine any nonadmitted amounts. Next, an evaluation shall be made in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*, to determine whether there is an impairment. This two-step process is set forth below:

- a. Uncollected separate account management fees receivable over ninety days due shall be accounted for as a nonadmitted asset. Reporting entities shall begin aging the receivable when it is contractually required to be billed, or in the absence of contract specifications, when the reporting entity actually sends the bill to the contractholder;
- b. Remaining amounts determined to be uncollectible shall be written off. If in accordance with *SSAP No. 5R*, it is "probable" the amount receivable is uncollectible, any uncollectible amount receivable shall be written off against operations in the period such determination is made. If it is "reasonably possible" the amount receivable is uncollectible, the disclosure requirements outlined in *SSAP No. 5R*, paragraph ~~34~~³², shall be made.

Separate Account Reporting

15. The separate accounts annual statement is concerned with the flow of funds related to investment activities and obligations of the separate accounts and with the transfer of funds between the separate account and the general account. As a result, the separate account statement shall report only the assets, liabilities, and operations of the separate account and shall not include general account expenses related to

investment management, administration, or contract guarantees pertaining to separate account operations which are recorded in the general account.

16. The separate account records premiums, considerations (net of loading for sales charges such as commissions and premium taxes) and receipts (other than for net investment income and realized capital gains and losses) as income transfers from the general account. Net investment income and realized and unrealized capital gains and losses relating to the investment operations of the separate account are recorded as income in the Summary of Operations. When the contract provides for such, expenses and taxes associated with the separate account investment operations shall be deducted in the determination of net investment income. Deposits and withdrawals on deposit-type contracts shall be recorded in the Summary of Operations. Benefits and surrenders, reserve transfers, policy loans¹, policyholder charges (e.g., fees associated with investment management, administration, and contract guarantees), and federal income taxes relating to the separate account are recorded as expense transfers to the general account in the Summary of Operations. The net change in aggregate reserves relating to separate account contracts is reported as an expense in the Summary of Operations.

17. Assets supporting fund accumulation contracts (GICs), which do not participate in underlying portfolio experience, with a fixed interest rate guarantee, purchased under a retirement plan or plan of deferred compensation, established or maintained by an employer, will be recorded as if the assets were held in the general account. Assets supporting all other contractual benefits shall be recorded at fair value on the date of valuation, or if there is no readily available market, then in accordance with the valuation procedures in the applicable contract.

Separate Account AVR and IMR Reporting

18. An AVR is generally required for separate accounts when the insurer, rather than the policyholder/contractholder, suffers the loss in the event of asset default or fair value loss. An AVR is required unless:

- a. The asset default or fair value risk is borne directly by the policyholders; or
- b. The regulatory authority for such separate accounts already explicitly provides for a reserve for asset default risk, where such reserves are essentially equivalent to the AVR.

19. Assets supporting traditional variable annuities and variable life insurance generally do not require an AVR because the policyholders/contractholders bear the risk of change in the value of the assets. However, an AVR is required for that portion of the assets representing the insurer's equity interest in the investments of the separate account (e.g., seed money).

20. Assets supporting typical modified guaranteed contracts, market value adjusted contracts, and contracts with book value guarantees similar to contracts generally found in the general account do require an AVR because the insurer is responsible for credit related asset or fair value loss.

21. Certain separate accounts are also required to maintain an Interest Maintenance Reserve (IMR). The IMR requirements for investments held in separate accounts are applied on an account by account basis. If an IMR is required for a separate account, all of the investments in that separate account are subject to the requirement. If an IMR is not required for a separate account, none of the investments in that separate account are subject to the requirement.

¹ Policy loans related to separate account products shall follow the guidance in *SSAP No. 49—Policy Loans*. As detailed within *SSAP No. 49*, as part of the expense transfer, policy loans related to separate account products require a liquidation of the separate account assets to fund the loan issued by the general account. A transfer of assets from the separate account to the general account must have occurred to fund the policy loan issuance; otherwise the policy loan is nonadmitted in the general account.

22. An IMR is required for separate accounts with assets recorded at book value, but is not required for separate accounts with assets recorded at fair value. For example, separate accounts for traditional variable annuities or variable life insurance do not require an IMR because assets and liabilities are valued at fair value.

23. If an IMR is required for investments held by separate accounts, it is kept separate from the general account IMR and accounted for in the separate accounts statement.

24. The AVR and IMR shall be calculated and reported in accordance with the NAIC *Annual Statement Instructions for Life, Accident and Health Insurance Companies*.

Policy Reserves

25. Statutory policy reserves shall be established for all contractual obligations of the insurer arising out of the provisions of the insurance contract. Where separate benefits are included in a contract, a reserve for each benefit shall be established as required in Appendix A-820. These statutory policy reserves are generally calculated as the excess of the present value of future benefits to be paid to or on behalf of policyholders less the present value of future net premiums. Statutory policy reserves meet the definition of liabilities as defined in SSAP No. 5R—*Liabilities, Contingencies and Impairments of Assets*. The actuarial methodologies referred to in the following paragraph meet the criteria required for reasonable estimates in SSAP No. 5R.

26. The reserving methodologies and assumptions used in computation of policy reserves shall also meet the provisions of Appendices A-200, A-250, A-255, A-270, A-585, A-588, A-620, A-695, A-820, A-822 and the actuarial guidelines found in Appendix C of this Manual. Where separate account contracts have guaranteed elements, the basis for determining the value of the liability shall be consistent with the basis used for asset values (i.e., valuation interest rates as defined in Appendix A-820 shall be used when assets are recorded as if held in the general account and current interest rates based on market rates shall be used when assets are recorded at fair value). Further, policy reserves shall be in compliance with those Actuarial Standards of Practice promulgated by the Actuarial Standards Board.

27. Statutory policy reserves for those group annuity contracts or other contracts that, in whole or in part, establish the insurer's obligations by reference to a segregated portfolio of assets not owned by the insurer shall be established in accordance with the guidance in Appendix A-695. Statutory policy reserves for those contracts with nonlevel premiums or benefits, or contracts with secondary guarantees shall be established in accordance with the guidance in Appendix A-830. Statutory policy reserves for those group life contracts utilizing a separate account that meet the requirements outlined in paragraph 1 of Appendix A-200 shall be computed in accordance with the guidance in that appendix.

Other Liabilities

28. The separate account shall accrue as a liability, subject to contractual provisions, amounts payable, including, but not limited to:

- a. Fees associated with investment management, administration, and contract guarantees;
- b. Investment expenses;
- c. Investment taxes, licenses, and fees (Investment taxes such as real estate taxes, licenses and fees (excluding federal income taxes) are usually paid directly by the separate account but may be transferred to the general account for payment);
- d. Federal income taxes;
- e. Unearned investment income;

- f. Net transfer due to (from) the general account;
- g. Remittances and items not allocated;
- h. Payable for investments purchased;
- i. Net adjustments in assets and liabilities due to foreign exchange rates.

Seed Money

29. When a new separate account is initiated, the insurer may make a temporary transfer of surplus funds commonly referred to as seed money to the separate account. Such funds and earnings accumulated thereon shall be reported as surplus in the separate accounts statement until transferred or repatriated to the general account. The transfer of such funds to and from the separate account shall be reported as surplus contributed or withdrawn during the year.

Disclosures

30. Paragraphs 31-35 detail the separate account disclosure requirements that shall be included within the Life, Accident and Health Annual Statement Blank. Paragraphs 36-38 detail the separate account disclosure requirements that shall be included within the Separate Account Annual Statement Blank.

31. The general account financial statement shall include detailed information on the reporting entity's separate account activity. These disclosures shall include:

- a. A narrative of the general nature of the reporting entity's separate account business.
- b. Identification of the separate account assets that are legally insulated from the general account claims.
- c. Identification of the separate account products that have guarantees backed by the general account. This shall include:
 - i. Amount of risk charges paid by the separate account to the general account for the past five (5) years² as compensation for the risk taken by the general account; and
 - ii. Amount paid by the general account due to separate account guarantees during the past five (5) years.
- d. Discussion of securities lending transactions within the separate account, separately including the amount of any loaned securities within the separate account, and if policy and procedures for the separate account differ from the general account.

32. For each grouping (as detailed in paragraph 33), the following shall be disclosed:

- a. Premiums, considerations or deposits received during the year;
- b. Reserves by the valuation basis of the investments supporting the reserves at the financial statement date. List reserves for separate accounts whose assets are carried at fair value separately from those whose assets are carried at amortized cost/book value;

² Reporting entities are permitted to prospectively 'build' the five-year disclosure. Thus, upon the first year of application of the disclosure requirements, reporting entities should illustrate one year of the disclosure requirement. In the second year, the reporting entity would disclose two years, and so forth until the disclosure includes five years of disclosures.

- c. Reserves by withdrawal characteristics, including whether or not the separate account is subject to discretionary withdrawal. For reserves subject to discretionary withdrawal, the below categories are included if applicable:
 - i. With market value adjustment;
 - ii. at book value without market value adjustment and with surrender charge of 5% or more;
 - iii. at fair value;
 - iv. at book value without market value adjustment and with surrender charge of less than 5%;
 - d. Reserves for asset default risk, as described in paragraph 18.b., that are recorded in lieu of AVR.
33. For the disclosures required in paragraph 32, separate accounts shall be addressed in the following groupings (which are the same as those used for risk-based capital):
- a. Separate Accounts with Guarantees:
 - i. Indexed separate accounts, which are invested to mirror an established index which is the basis of the guarantee;
 - ii. Nonindexed separate accounts, with reserve interest rate at no greater than 4% and/or fund long-term interest guarantee in excess of a year that does not exceed 4%;
 - iii. Nonindexed separate accounts, with reserve interest rate at greater than 4% and/or fund long-term interest guarantee in excess of a year that exceeds 4%.
 - b. Nonguaranteed Separate Accounts—Variable separate accounts, where the benefit is determined by the performance and/or fair value of the investments held in the separate account. Include variable accounts with incidental risks, nominal expense, and minimum death benefit guarantees.
34. Provide a reconciliation of the amount reported as transfers to and from separate accounts in the Summary of Operations of the separate accounts statement and the amount reported as net transfers to or from separate accounts in the Summary of Operations of the general accounts statement.
35. The disclosures in *SSAP No. 51R—Life Contracts*, and *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance* related to the withdrawal characteristics of products include separate account products and shall be completed in the general account disclosures.
36. The Separate Account Annual Statement Blank shall include detailed information on the characteristics of the separate account assets, specifically categorizing separate account assets in accordance with the following characteristics:
- a. Identification of separate account assets that are legally insulated from the general account and those which are not legally insulated.
 - b. Aggregation of separate account assets from products registered with the SEC and separate account assets from products excluded from registration. In addition to the overall aggregation, this disclosure shall specifically identify separate account assets

from private placement variable annuities (PPVA) and private placement life insurance (PPLI). The disclosures in this paragraph (36.b.) are effective December 31, 2018.

- c. Amount of separate account assets that represent seed money, other fees and expenses due to the general account, and additional required surplus amounts.³ This disclosure shall include the amount of seed money and other fees and expenses currently included in the separate account, as well as the amount of seed money received and repaid to the general account during the current year. This disclosure shall also include information on insulation (if applicable)⁴, the time duration for which seed money and other fees and expenses due the general account are retained in the separate account, and information on how whether seed money is invested pursuant to general account directives or in accordance with stated policies and procedures.
- d. Identification of the separate account assets in which the investment directive is not determined by a contractholder. (In most instances, having multiple investment choices at the option of a contractholder would be considered a situation in which the investment directive is determined by a contractholder. This is not true for situations in which the asset is invested in a manner that mirrors the investment directives of the general account.) Situations in which the investment directive is not determined by the contractholder (and situations in which the reporting entity is the contractholder) shall include disclosure regarding whether the investments of the respective separate account assets, if included within the general account investments, would have resulted with the reporting entity exceeding any investment limitations imposed on the general account.
- e. Identification of the separate account assets in which less than 100% of investment proceeds are attributed to a contractholder. This shall include identification of the separate account investment income attributed to the reporting entity during the reporting period and whether such income was transferred to the general account or reinvested within the separate account. Instances in which such income is reinvested within the separate account shall include disclosure on whether the subsequent investments, if categorized with investments in the general account, would have exceeded investment limitations imposed on the general account.

37. For all separate account assets not reported at fair value, indicate the measurement basis (amortized cost or other method) for each asset (or asset class) and whether the measurement method was grandfathered in under the transition guidance in this SSAP, or whether the measurement method is allowed under a prescribed or permitted practice. This disclosure shall include a comparison of the assets' reported value to fair value with identification of the resulting unrealized gain/loss that would have been recorded if the assets had been reported at fair value.

38. For all separate accounts that include securities lending transactions, disclose the reporting entity's use and policy of securities lending within the separate account, including the amount of loaned securities from the separate account at the reporting date, the percentage of separate account assets lent as of that date, a description for which type of accounts (e.g., book value accounts, market value account accounts) are lent, if the separate account policyholder is notified or approves of such practices, the policy for requiring collateral, whether the collateral is restricted and the amount of collateral for transactions that extend beyond one year from the reporting date. This disclosure requires the entity to provide the following information as of the date of the statement of financial position: (1) the aggregate amount of contractually obligated open collateral positions (aggregate amount of securities at current fair value or

³ Additional Required Surplus Amounts is defined as additional or permanent surplus that is required to be retained in the separate account in accordance with state law or regulations. These amounts should not include reinvested separate account investment proceeds that have not been allocated to separate account contract holders.

⁴ As seed money is considered a temporary transfer of funds, it is generally not considered insulated.

cash received for which the borrower may request the return of on demand) and the aggregate amount of contractually obligated collateral positions under 30-day, 60-day, 90-day, and greater than 90-day terms, (2) the aggregate fair value of all securities acquired from the sale, trade and use of the accepted collateral (reinvested collateral), and (3) information about the sources and uses of that collateral.

39. Identify all products reported as a separate account product under statutory accounting principles and identify whether each product was classified differently under GAAP. For products that resulted with different classifications between GAAP and SAP, identify the characteristic(s) of the product that prevented it from receiving a separate account classification under GAAP. This disclosure is applicable for all reporting entities. Thus, if GAAP financial statements were not filed, the reporting entity should complete this disclosure as if GAAP financials had been completed.

40. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

41. This statement rejects [*ASU 2022-05, Transition for Sold Contracts*](#), *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts*, and *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.

42. This statement incorporates the requirements of Appendices A-200, A-250, A-255, A-270, A-585, A-588, A-620, A-695, A-812, A-820, A-821, A-822 the Actuarial Standards Board *Actuarial Standards of Practice*, and the actuarial guidelines found in Appendix C of this Manual.

Effective Date and Transition

43. This statement is effective for years beginning January 1, 2001. Contracts with assets held in a Separate Account that were issued in accordance with applicable state laws and regulations and issued prior to that effective date, for which assets and liabilities have been recorded using a consistent basis since issue, i.e., both assets and liabilities are recorded either as if in the general account (“book value”) or as at fair value (current interest rates based on market rates shall be used for liabilities when assets are recorded at fair value), shall continue to be recorded using such basis until such time as the applicable contract terms or provisions are substantially changed, such as by a contract amendment modifying interest rate or withdrawal provisions. State laws and regulations shall be understood to include anything considered authoritative by the domiciliary state under the individual state’s statutory authority and due process procedures. Changes that do not require change in the basis of recording would include: address changes, continued deposits, and other non-substantive changes such as these. For example, additional funds received after January 1, 2001 under contracts issued prior to January 1, 2001 may continue to be recorded using the basis in effect prior to January 1, 2001 until such time as a triggering change is made. 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*.

44. Disclosure revisions adopted in September 2009 to paragraphs 30-39 shall initially be reported within the 2010 annual financial statements, with annual reporting thereafter.

REFERENCES

Other

- *NAIC Financial Condition Examiners Handbook*
- Actuarial Standards Board *Actuarial Standards of Practice*

Relevant Issue Papers

- *Issue Paper No. 89—Separate Accounts*
- *Issue Paper No. 110—Life Contracts, Deposit-Type Contracts and Separate Accounts, Amendments to SSAP No. 51—Life Contracts, SSAP No. 52—Deposit-Type Contracts, and SSAP No. 56—Separate Accounts*

GLOSSARY

Guarantee represents an insurance company's general account contractual obligation to reimburse life insurance and annuity policyholders for their separate account investment losses including the return of principal, minimum crediting rates, minimum death, withdrawal, accumulation of income benefits and no-lapse guarantees, and for separate account mortality losses.

Insulation is the legal protection of separate account assets equal to the reserves and supporting contract liabilities from the general account liabilities of the insurance enterprise ensuring that the separate account contract holder is not subjected to insurer default risk to the extent of their assets held in the separate account.

Risk Charge is the contractual amount the general account charges the separate account policyholders' account for compensation relating to the general account's guarantee on separate account assets or contract performance.

Total Maximum Guarantee is the difference between the total amount of liability the general account is subject to reimbursing as at the balance sheet date and the policyholder's contract value referenced by the guarantee (e.g., account value). For guarantees in the event of death, it is the minimum guaranteed amount available to the contractholder upon death in excess of the contractholder's contract value referenced by the guarantee (e.g., account balance) at the balance sheet date. For guarantees of amounts at annuitization, it is the present value of the minimum guaranteed annuity payments available to the contractholder determined in accordance with the terms of the contract in excess of the contract value referenced by the guarantee (e.g., account balance).

Statement of Statutory Accounting Principles No. 57

Title Insurance

STATUS

Type of Issue.....	Property and Casualty
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	No other pronouncements
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	A-628

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	2
General.....	2
Premium Revenue and Loss Reserve Recognition	2
Salvage and Subrogation.....	3
Reinsurance.....	4
Allocation of Expenses	4
Title Plant.....	5
Disclosures.....	7
Relevant Literature.....	7
Effective Date and Transition	7
REFERENCES.....	7
Relevant Issue Papers	7

SCOPE OF STATEMENT

1. Title insurance insures that the policyholder has title to the property on the subject real estate as of the date of policy issuance, subject to exceptions and exclusions in the policy. When issued, a title policy has a one-time premium and reserves are established by the title insurance company. Title insurance differs from other lines of property and casualty insurance because its basic goal is risk elimination.

2. This statement establishes statutory accounting principles for title insurance and addresses areas where title insurance accounting differs from other lines of insurance. To the extent a topic is not covered by this statement, title insurance accounting shall comply with statutory accounting guidance for other lines of property and casualty insurance.

SUMMARY CONCLUSION

General

3. Title insurers perform many services in connection with the transfer of real estate; however, their principal function involves insuring, guaranteeing, or indemnifying owners of real property or the holders of liens or encumbrances thereon against loss or damage due to defective titles, liens, or encumbrances or, in most states, the unmarketability of the title.

4. In addition to insuring against defective records or examination of those records, an insurer insures against “non-record defects” such as:

- a. Forgeries;
- b. Fraud;
- c. Confusion of name in change of title;
- d. Incompetence (minors or persons of unsound mind);
- e. Mistakes in public records;
- f. Undisclosed or missing heirs;
- g. Instruments executed under a fabricated or expired power of attorney;
- h. Deeds delivered after death of grantor or grantee or without the consent of the grantor;
- i. Deeds by persons supposedly single but actually married;
- j. Wills not probated;
- k. Liens against property (e.g., mechanics liens and tax liens);
- l. Falsified records.

5. Before a title insurance policy is issued, the title insurer, or its agent, must search and examine public records concerning the ownership, liens, and encumbrances on the subject real estate together with information relating to persons having an interest in the real property as well as maps and other records to determine that title to the property is insurable, or defects can be overcome.

Premium Revenue and Loss Reserve Recognition

6. A variety of services are generally provided (either by the title insurance underwriter, its agent, or others) in connection with the transfer of title to real estate. Title insurance premiums frequently are determined in the rate-making process based on the bundle of services provided, including some or all of title search and examination and closing or escrow fees. By statute or custom, certain states exclude a combination of title search, examination and closing or escrow fees from the rate-making process for title insurance premiums. Premiums shall be recorded at the date of policy issuance, on a gross premium basis, consistent with the rate-making method used. The premium related to a title insurance policy is due upon the effective date of the insurance and is not refundable. The term of a title insurance policy is indefinite because the policyholder is insured for as long as he or his heirs or devisees have an interest in the property.

7. Amounts paid to or retained by agents shall be reported as an expense.

8. A liability shall be established for all known unpaid claims and loss adjustment expenses (known claims reserve) with a corresponding charge to income. The known claim reserve is further detailed in the Title Annual Statement Operations and Investment Exhibit on Unpaid Losses and Loss Adjustment Expenses. The known claims reserve should be the estimated costs to settle reported claims based upon the most current information available to the company as of the balance sheet date. This amount cannot be less than the aggregate of the individual case reserves.

9. Premium revenue shall be deferred to the extent necessary to maintain a Statutory or Unearned Premium Reserve (SPR or UPR) determined in accordance with the reserve section of Appendix A-628.

10. If the actuarially determined liability (the sum of the known claims reserve, IBNR claims reserve, and loss adjustment expense reserve) exceeds the sum of the known claims reserve and SPR or UPR, a supplemental reserve shall be established that is equal to the difference between these sums. This calculation is explicitly detailed in the Title Annual Statement Operations and Investment Exhibit for Unpaid Losses and Loss Adjustment Expenses.

11. The actuarially determined liability for the sum of known claims reserve required in paragraph 8 and the IBNR claims and loss adjustment expenses required in paragraph 10 of this statement shall be determined consistently with the guidance detailed in *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses* and consistent with paragraph 13 of this statement.

12. Assets acquired in settlement of claims (e.g., mortgages and real estate) shall be accounted for consistent with the guidance related to the asset acquired. For example, an impaired loan shall be accounted for in accordance with *SSAP No. 37—Mortgage Loans*, and real estate acquired in foreclosure shall be accounted for in accordance with *SSAP No. 40R—Real Estate Investments*.

Salvage and Subrogation

13. Salvage and subrogation shall be reflected as follows:

- a. Paid losses shall be reported net of realized, but not anticipated, salvage and subrogation. Case basis loss and loss adjustment expense reserves shall not be reduced for anticipated salvage and subrogation, nor shall an asset be established;
- b. Paid salvage and subrogation is not realized until a salvage asset or an actual payment pursuant to a subrogation right is in the direct control of the insurer and admissible as an asset for statutory reporting purposes in its own right;
- c. Salvage assets and payments pursuant to a subrogation right shall be recorded at current fair value. Current fair value of real estate shall be established through an appraisal conducted by a qualified independent appraiser;
- d. If a salvage asset is sold or revalued by the insurer within twelve months of realization for an amount less than the value at which it was originally placed on the books of the insurer, then the loss on disposition shall be treated as a decrease in paid salvage (same effect as an addition to the paid loss) on the corresponding claim. After twelve months, such salvage revaluation will be treated as a loss on disposition or change in value of an asset, and shall not be deducted from the salvage on the corresponding claim;
- e. If a salvage asset is sold or revalued by the insurer within twelve months of realization for an amount greater than the value at which it was originally placed on the books of the insurer, then the gain on disposition shall be treated as an increase in paid salvage (same effect as a deduction to the paid loss) on the corresponding claim. After twelve months, such salvage revaluation shall be treated as a gain on disposition or change in value of an asset and shall not be added to the salvage on the corresponding claim;

- f. In completing Schedule P and Part 3B, IBNR reserves may make an actuarially determined provision for the expected value of future salvage and subrogation on open claims and IBNR claims.

Reinsurance

14. Although by their nature, title claims relate to errors or omissions that occurred prior to the inception of the reinsurance agreement, title reinsurance contracts shall be accounted for as prospective reinsurance agreements if they meet all of the other criteria established in *SSAP No. 62R—Property and Casualty Reinsurance*.

Allocation of Expenses

15. This statement establishes uniform allocation rules to classify title insurance expenses within prescribed principal groupings. It is necessary to allocate those expenses which may contain characteristics of more than one classification, which this statement will refer to as allocable expenses.

16. Allocable expenses for title insurance companies shall be classified into the following categories on the expense section of the Operations and Investment Exhibit of the annual statement.

- a. Title and Escrow Operating Expenses—Title and escrow operating expenses consist of all expenses incurred in relation to engaging in the business of title insurance, including costs associated with the following: (i) issuing or offering to issue a title insurance policy; (ii) soliciting or negotiating the issuance of a title insurance policy; (iii) guaranteeing, warranting or otherwise insuring the correctness of title searches affecting title to real property; (iv) handling of escrows, settlements or closings; (v) executing title insurance policies, effecting contracts of reinsurance, and abstracting, searching or examining titles. Also included are specifically identifiable and allocated expenses relating to the following activities; (i) supervision and training of employees and agents; (ii) operating costs for branch offices or agencies; (iii) underwriting activities; (iv) receiving and paying of premiums and commissions; (v) maintaining general and detailed records; (vi) data processing, advertising, and publicity, clerical, secretarial, office maintenance, supervisory, and executive duties; (vii) postage and delivery; and (viii) all other functions reasonably associated with the business of title insurance. Title and escrow operating expenses do not include losses, loss adjustment expenses (allocated or unallocated), expense of other operations, or investment expenses. The expenses include only amounts incurred directly by the insurer and do not include expenses incurred by any agents (regardless of ownership interest).
- b. Title and Escrow Operating Expenses are further broken down in the annual statement by the distribution network that gives rise to the expense incurrence. Accordingly, expenses are specifically identified or allocated (in accordance with reasonable allocation procedures consistently applied) to either Direct Operations, Non-affiliated Agency Operations, or Affiliated Agency Operations.
- c. Unallocated Loss Adjustment Expenses (ULAE)—ULAE are those indirect costs incurred by a title insurer, typically internal to the company, which are necessary to process claims or manage the claims settlement function and which are not incurred on a claim-specific basis. ULAE shall include all costs of outside parties involved in claims adjusting services, but shall not include any costs incurred by agents in settlement of title or other claims.
- d. Investment Expenses—Investment expenses are those expenses incurred in the investing of funds and the pursuit of investment income, including specifically identifiable and

allocated expenses related to such activities as: (i) initiating or handling orders and recommendations for investments; (ii) research, pricing, appraising, and valuing; (iii) disbursing funds and collecting income; (iv) safekeeping of securities and valuable papers; (v) maintaining general and detailed records; (vi) data processing; (vii) general clerical, secretarial, office maintenance, supervisory, and executive duties; (viii) supplies, postage, and the like; and (ix) all other functions reasonably attributable to the investment of funds. Real estate expenses and real estate taxes are attributable to the Investment Expenses group.

- e. Other Operations—The amounts shown for this category represent the allocable expenses incurred by the company in operations other than title and escrow, unallocated loss adjustment, or investment activities.

17. Allocation to the above categories should be based on a method that yields the most accurate results. Specific identification of an expense with an activity that is represented by one of the categories above will generally be the most accurate method. Where specific identification is not feasible, allocation of expenses should be based upon pertinent factors or ratios such as studies of employee activities, salary ratios, or similar analyses.

18. Many companies operate within a group where personnel and facilities are shared. Shared expenses, including expenses under the terms of a management contract, shall be apportioned to the companies incurring the expense as if the expense had been paid solely by the incurring company. The apportionment shall be completed based upon specific identification to the company incurring the expense. Where specific identification is not feasible, apportionment shall be based upon pertinent factors or ratios. Any basis adopted to apportion expenses shall be that which yields the most accurate results and may result from special studies of employee activities, salary ratios, premium ratios or similar analyses. Expenses that relate solely to the operations of an insurance company, such as personnel costs associated with the adjusting and paying of claims, must be borne solely by the insurance company and are not to be apportioned to other companies within a group. Pertinent factors in making this determination shall include which entity has the ultimate obligation to pay the expense. Apportioned expenses are subject to presentation and allocation as provided in paragraphs 16 and 17.

Title Plant

19. Title plants are an integrated and indexed collection of title records consisting of documents, maps, surveys, or entries affecting title to real property or any interest in or encumbrance on the property, which have been filed or recorded in the jurisdiction for which the title plant is established or maintained. They are tangible assets unique to the title insurance industry and are the principal productive asset used to generate title insurance revenue and to mitigate the risk of claims. Title plant shall be reported as an admitted asset, subject to the following valuation restrictions:

- a. Costs incurred to construct a title plant, including the costs incurred to obtain, organize, and summarize historical information in an efficient and useful manner, shall be capitalized until the title plant can be used by the company to conduct title searches and issue title insurance policies. The capitalized costs shall be directly related to, and properly identified with, the activities necessary to construct the title plant;
- b. Purchased title plants, including a purchased undivided interest in a title plant, shall be recorded at cost at the date of acquisition. For a title plant acquired separately, cost shall be measured by the fair value of the consideration given. For title plant acquired as part of a group of assets, cost shall be measured by the fair value of the consideration given and then cost shall be allocated to the title plant based on its fair value in relation to the total fair value of the group of assets acquired. For title plants acquired as part of a

purchase of assets or in a business combination, cost shall be determined in accordance with *SSAP No. 68—Business Combinations and Goodwill*;

- c. A backplant, i.e., a title plant that antedates the period of time covered by the existing title plant may be purchased or constructed. Costs to construct a backplant must be properly identifiable to qualify for capitalization;
- d. Costs incurred after a title plant is operational to (i) convert the information from one storage and retrieval system to another, or (ii) modify or modernize the storage and retrieval system shall not be capitalized;
- e. Costs incurred to maintain a title plant shall be expensed as incurred;
- f. Costs incurred to perform title searches shall be expensed as incurred;
- 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.

20. Certain circumstances may indicate that the value of the title plant may be impaired and, thus, the carrying value of the asset may not be recoverable. If there is an indication of possible impairment of value, the title plant shall be evaluated for impairment and recorded in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*. The following are examples of circumstances that may indicate impairment:

- a. Effects of obsolescence, demand, and other economic factors;
- b. A significant change in legal requirements or statutory practices in the jurisdiction for which the title plant is established and maintained;
- c. A current period operating or cash flow loss combined with a history of such losses or projections that indicate continued losses associated with the revenue produced by the title plant;
- d. Failure to maintain the title plant on a current basis and/or lack of appropriate maintenance to keep the title plant up to date; or,
- e. Abandonment of a title plant.

21. A properly maintained title plant has an indeterminate life and does not diminish in value with the passage of time, and accordingly, shall not be depreciated.

22. A title insurer may (a) sell its title plant and relinquish all rights to its future use, (b) sell an undivided ownership interest in its title plant, or (c) sell a copy of its title plant or the right to use it. Accounting and presentation for each type of sale noted shall be as follows:

- a. When a title insurer sells its title plant and relinquishes all rights to its future use, consideration received shall be presented as a separate component of revenue net of the carrying value of the title plant sold;

- b. When a title insurer sells an undivided ownership interest in its title plant, consideration received shall be presented as a separate component of revenue net of the pro rata portion of the carrying value of the title plant;
- c. When a title insurer sells a copy of its title plant or the right to use it, consideration received shall be presented as a separate component of revenue and the carrying value of the title plant shall not be reduced.

Disclosures

- 23. The financial statements shall disclose the following for each period presented:
 - a. The amount of the known claims reserve, SPR/UPR, and the supplemental reserve;
 - b. Whether the insurer uses discounting in the calculation of its supplemental reserve, the method and rate used to determine the discount, and the amount of such discount.
- 24. Any material individual component of the reported expense categories shall be presented either on the face of the Summary of Operations or within the footnotes or related exhibits to the financial statements.
- 25. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

- 26. This statement rejects *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises* (FAS 60); however, it is considered appropriate to use the factors to be considered in the determination of the ultimate cost of settling claims included in FAS 60 when establishing the reserves in accordance with paragraphs 8 and 10 of this statement.
- 27. This statement adopts *FASB Statement No. 61, Accounting for Title Plant*, with modification for carrying value restrictions. Restrictions on the total carrying value of an investment in a title plant or plants are determined by paragraph 19.g.

Effective Date and Transition

- 28. 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*.
- 29. Additions to the SPR or UPR as a result of the provisions of paragraph 17.b.v. of Appendix A-628 shall be phased in pursuant to the provisions of paragraph 17.b.iv. of Appendix A-628.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 57—Title Insurance*

Statement of Statutory Accounting Principles No. 58

Mortgage Guaranty Insurance

STATUS

Type of Issue.....	Property and Casualty
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	No other pronouncements
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	A-630

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	2
General.....	2
Insured Risk	2
Pool Insurance.....	3
Premium Revenue Recognition	4
Unpaid Losses and Loss Adjustment Expense Recognition.....	4
Contingency Reserve	4
Premium Deficiency Reserve	5
U.S. Mortgage Guaranty Tax and Loss Bonds	5
Contingency Reserve (for Tax Purposes, the Mortgage Guaranty Account).....	5
Disclosures.....	5
Effective Date and Transition	5
REFERENCES.....	6
Relevant Issue Papers	6

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for mortgage guaranty insurance and addresses areas where mortgage guaranty insurance accounting differs from other lines of insurance. To the extent a topic is not covered by this statement and Appendix A-630, mortgage guaranty insurance accounting shall comply with statutory accounting guidance for other lines of property and casualty insurance.
2. Mortgage guaranty insurance protects a lender against loss of all or a portion of the principal amount of a mortgage loan upon default of the mortgagor. Mortgage guaranty insurance differs from other types of property and casualty insurance in that coverage is long-term, and in most cases premiums are level and paid monthly. Most states require issuers of mortgage guaranty contracts to be monoline insurers and impose limitations on the aggregate amount of risk insured based on geographic territories. Additionally, states may require mortgage guaranty insurers to reinsure with only selected reinsurers.

SUMMARY CONCLUSION

General

3. Mortgage guaranty insurance is provided on residential loans (one to four family residences, including condominiums and townhouses). Coverage can range from as little as 5% on pool insurance to as much as 100% of the outstanding loan amount on individual policies. Most policies cover 10% to 30% of the loan amount and are written on first mortgage loans where the loan amount is a high percentage (generally 80% to 95%) of the value of the mortgaged property.

4. Lenders obtain mortgage guaranty insurance to facilitate sales of mortgage loans in secondary markets. It also enables lenders to make a greater number of high ratio (above 80%) loans and allows them to diversify their portfolio of loans.

5. Mortgage guaranty insurers market directly to mortgage lenders. Individual mortgage loans or pools of mortgage loans are insured under individual insurance certificates or policies; each loan, however, is separately underwritten.

6. Mortgage guaranty insurance companies generally offer the following premium payment plans: (a) monthly premiums, (b) a single premium which provides coverage for periods ranging from three to 15 years, (c) nonlevel annual premiums, and (d) level annual premiums. All policies are renewable at the discretion of the lender. The mortgage guaranty insurer does not have an option to cancel or nonrenew the policy, except for fraud or nonpayment of the premium.

7. Premiums are based upon: (a) the percentage of insurance coverage provided, (b) the ratio of the insured mortgage loan to the property value or sales price, and (c) the term and/or premium payment method selected by the lender. Premiums are quoted as a percentage of the total mortgage loan insured and increase as insurance coverage and loan-to-value ratio increases.

8. If a default occurs, the mortgage guaranty insurer generally requires the lender to foreclose and tender merchantable title to the mortgaged property in order to make a claim. The insurer may then, at its option: (a) purchase the property for the lender's cost (generally the entire remaining principal loan balance plus accumulated interest and allowable expenses), (b) pay the percentage of the lender's cost specified by the policy, or (c) arrange for the lender to sell the property and reimburse the lender for any loss up to an agreed amount. Under settlement option (a), the insurer intends to resell the property with the expectation of reducing the amount of loss which would have resulted if option (b) had been elected.

Insured Risk

9. The nature of the insured risk is influenced by certain factors which set mortgage guaranty insurance apart from other types of insurance. These factors are addressed in paragraphs 10-12.

Exposure Period

10. The exposure period is significantly longer for mortgage insurance than for most other property and casualty insurance products. The exposure period can run for the term of the mortgage; however, the average policy life is seven years. The policy is terminated when the mortgage obligation is satisfied or the lender elects to cancel or not renew the policy. In contrast to mortgage guaranty insurance, most property and casualty products need not be renewed by the insurer at the expiration of the policy. Mortgage insurance is renewable at the option of the insured at the renewal rate quoted when the policy commitment was issued.

Losses

11. Losses are affected by the following factors specific to mortgage guaranty insurance:
 - a. The insured peril—the default of a borrower arises from the credit risk associated with mortgage loans. The frequency of loss is strongly influenced by economic conditions. The likelihood of individual default is further increased if the property has deteriorated since a borrower in financial difficulty will be less able to sell the property at a price sufficient to discharge the mortgage;
 - b. Mortgage insurance losses can be divided into three categories:
 - i. Normal losses associated with regular business cycles, interruptions in the borrower's earning power, and errors made in evaluating the borrower's willingness or ability to meet mortgage obligations;
 - ii. Defaults caused by adverse local economic conditions;
 - iii. Widespread defaults caused by a severe depression in the U.S. economy.

Loss Incidence

12. Losses are incurred over the exposure period which runs for the term of the mortgage. However, loss incidence peaks in the earlier years. When a loan has been delinquent two to four months, the policy requires the lender to notify the insurer. The lender generally agrees to institute foreclosure proceedings six to nine months from the date of delinquency. Foreclosure can require an additional 18 months which means a considerable delay between the delinquency and the presentation of the claim. Without adverse economic conditions, most delinquencies do not result in a loss payment. Once a claim is presented, payment normally is made within one or two months and ultimate loss costs can be known relatively quickly.

Pool Insurance

13. Mortgage guaranty insurance may be provided on pools of mortgage loans. Typically, pool insurance supports mortgage-backed securities or group sales. Unlike other pool or group products, each loan is individually underwritten.

14. Pool insurance may be provided on loans that are already insured by primary insurance, in which case the pool insurance provides an additional level of coverage, or it may be provided on loans without primary insurance (usually loans with loan-to-value ratios below 80%). Generally, pool insurance provides 100% coverage and includes a stop-loss limit of liability which may range from 5% to 20% of the initial aggregate principal balance. Because of regulatory requirements in some states, pool insurance usually uses participating reinsurance arrangements to limit the exposure of any one mortgage insurer of a pool of loans to 25% of each mortgage insured.

15. Pool insurance policies are not cancelable by the insurer except for nonpayment of premium. These policies may be written on mortgage pools having terms of up to 30 years. However, the average policy life is 8 to 12 years.

16. Upon default, the insurer has the same options as with individual insured mortgage loans. However, pool insurance loss payments are reduced by settlements under primary insurance and subject to the stop-loss limit.

17. Three kinds of mortgage-backed securities which use pool insurance are:
- a. Mortgage-backed bonds—Issued by banks, savings and loan associations and other mortgage lenders as a general obligation of the issuing institution. These bonds are collateralized by a pool of mortgages and have a stated rate of return and maturity date;
 - b. Mortgage revenue bonds—Issued by state and local housing authorities to support housing affordability for targeted income groups;
 - c. Mortgage pass-through certificates—Issued by banks, savings and loan associations, mortgage bankers, and others providing an undivided interest in a pool of mortgages with principal and interest payment passed to the certificate holder as received.

Premium Revenue Recognition

18. Written premium shall be recorded in accordance with *SSAP No. 53—Property and Casualty Contracts—Premiums*. Premium revenue shall be earned as follows:

- a. For monthly premium plans, revenues shall be earned in the month to which they relate;
- b. For annual premium plans, revenues shall be earned on a pro rata basis over the applicable year;
- c. For single premium plans, revenues shall be earned over the policy life in relation to the expiration of risk;
- d. Additional first year premiums or initial renewal premiums on nonlevel policies shall be deferred and amortized to income over the anticipated premium paying period of the policy in relation to the expiration of risk.

Unpaid Losses and Loss Adjustment Expense Recognition

19. Unpaid losses and loss adjustment expenses shall be recognized in accordance with *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*. For mortgage guaranty insurance contracts, the default shall be considered the incident that gives rise to a claim as discussed in *SSAP No. 55*. If a claim is ultimately presented, the date of default shall be considered the loss incurred date.

20. The process for estimating the liability shall include projections for losses that have been reported as well as those that have been incurred but not reported. The estimates shall be made based on historical data, trends, economic factors, and other statistical information including paid claims, reported losses, insurance in force statistics, and risk statistics.

21. Real estate and mortgages are acquired by mortgage guaranty insurers to mitigate losses. These assets shall be shown on the balance sheet at the lower of cost or net realizable value, net of encumbrances. Gains or losses from the holding or disposition of these assets shall be recorded as a component of losses incurred. Rental income or holding expenses shall be included in loss adjustment expenses.

Contingency Reserve

22. In addition to the unearned premium reserve, mortgage guaranty insurers shall maintain a liability referred to as a statutory contingency reserve. The purpose of this reserve is to protect policyholders against loss during periods of extreme economic contraction. The annual addition to the liability shall equal 50% of the earned premium from mortgage guaranty insurance contracts and shall be maintained for ten years regardless of the coverage period for which premiums were paid. With commissioner

approval, when required by statute, the contingency reserve may be released in any year in which actual incurred losses exceed 35% of the corresponding earned premiums. Any such reductions shall be made on a first-in, first-out basis. Changes in the reserve shall be recorded directly to unassigned funds (surplus).

Premium Deficiency Reserve

23. When the anticipated losses, loss adjustment expenses, commissions and other acquisition costs, and maintenance costs exceed the recorded unearned premium reserve, contingency reserve, and the estimated future renewal premium on existing policies, a premium deficiency reserve shall be recognized by recording an additional liability for the deficiency with a corresponding charge to operations. Commissions and other acquisition costs need not be considered in the premium deficiency analysis to the extent they have been expensed. If an insurer utilizes anticipated investment income as a factor in the premium deficiency calculation, disclosure of such shall be made in the financial statements.

U.S. Mortgage Guaranty Tax and Loss Bonds

24. To obtain a current federal income tax benefit derived from annual additions to the statutory contingency reserve (for tax purposes, the mortgage guaranty account), mortgage guaranty insurers must purchase tax and loss bonds to the extent of the tax benefits. These bonds are noninterest bearing obligations of the U.S. Treasury and mature 10 years after issue. The usual purpose of tax and loss bonds is to satisfy taxes that will be due in 10 years when the tax benefit is reversed; however, the bonds may be redeemed earlier in the event of excess underwriting losses. These bonds are reported as admitted assets allowing mortgage insurers to conserve capital. In accordance with *SSAP No. 101—Income Taxes*, temporary differences (as defined in that statement) do not include amounts attributable to the statutory contingency reserve to the extent that “tax and loss” bonds have been purchased.

Contingency Reserve (for Tax Purposes, the Mortgage Guaranty Account)

25. Under IRS Code Section 832(e), mortgage guaranty insurers are permitted to deduct the annual addition to the contingency reserve from gross income. The tax deduction is generally an amount equal to (a) 50% of earned premium, or (b) taxable income as computed prior to this special deduction if less than 50% of earned premium. Annual deductions not utilized for tax purposes during the current period may be carried forward for eight years on a basis similar to net operating losses. The amount deducted must be restored to gross income after ten years; however, it may be restored to gross income at an earlier date in the event of a taxable net operating loss.

26. The tax deduction is permitted only if special U.S. Mortgage Guaranty Tax and Loss Bonds are purchased in an amount equal to the tax benefit derived from the deduction. Upon redemption the tax and loss bonds can be used to satisfy the additional tax liability that arises when the deduction is restored to income.

Disclosures

27. Mortgage guaranty insurers shall make all disclosures required by other statements within the *Accounting Practices and Procedures Manual*, including but not limited to the requirements of SSAP No. 55, and *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures*.

28. Refer to the Preamble for further discussion regarding disclosure requirements.

Effective Date and Transition

29. 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. 88—Mortgage Guaranty Insurance*

Not for Distribution

Statement of Statutory Accounting Principles No. 59

Credit Life and Accident and Health Insurance Contracts

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Nullifies and incorporates INT 01-29
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	A-010; A-225; A-812; A-818; A-820; A-822

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Definitions	1
Income Recognition	2
Policy Reserves	2
Change In Valuation Basis.....	3
Disclosures.....	3
Relevant Literature.....	4
Effective Date and Transition	4
REFERENCES.....	5
Other	5
Relevant Issue Papers	5

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for income recognition and policy reserves for all contracts classified as credit life and credit accident and health contracts defined in *SSAP No. 50—Classifications of Insurance or Managed Care Contracts*.

SUMMARY CONCLUSION

Definitions

2. Credit life and accident and health insurance contracts will be referred to collectively as “credit insurance” for purposes of this statement. Credit insurance is generally issued in connection with the issuance of credit to an individual by a bank, retailer, finance company, or other similar organization. This type of insurance most often protects the creditor to the extent of the unpaid balance of the loan. Contracts sold in connection with loans or other credit transactions not exceeding a stated duration shall be reported as credit insurance. Mortgage guaranty insurance is addressed in *SSAP No. 58—Mortgage Guaranty Insurance*. Credit policies are generally limited to issues of 120 months or less in most states. Credit insurance is sold as either an individual or group policy and may provide for single or joint life coverage.

3. Credit life insurance, generally in the form of decreasing term insurance, is issued on the lives of debtors to cover payment of loan balances in case of death. Credit accident and health insurance is insurance on a debtor to either provide indemnity for payments becoming due on a specific loan or other credit transaction while the debtor is disabled.
4. Premiums for credit insurance contracts shall be defined as the contractually determined amount charged by the reporting entity to the policyholder for the effective period of the contract.

Income Recognition

5. Consistent with *SSAP No. 51R—Life Contracts*, premiums shall be recognized in the summary of operations as income on the gross basis (amount charged to the policyholder) when due from policyholders under the terms of the insurance contract.

Policy Reserves

6. Statutory policy reserves shall be established for all unmatured contractual obligations of the reporting entity arising out of the provisions of the insurance contract. Where separate benefits are included in a contract, a reserve for each benefit shall be established as required in Appendix A-820. The statutory policy reserves for credit life contracts are generally calculated as the excess of the present value of future benefits to be paid to or on behalf of policyholders less the present value of future net premiums. The statutory policy reserves for credit accident and health contracts generally consist of an unearned premium reserve, and other reserves, as required, as further discussed in paragraphs 11-14. Statutory policy reserves meet the definition of liabilities as defined in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*. The actuarial methodologies referred to in the following paragraph meet the criteria required for reasonable estimates in SSAP No. 5R.
7. The reserving methodologies and assumptions used in computation of policy reserves shall meet the provisions of Appendices A-010, A-820 and A-822, and the actuarial guidelines found in Appendix C of this Manual. Further, policy reserves shall be in compliance with those Actuarial Standards of Practice promulgated by the Actuarial Standards Board.
8. Policy reserves are established through either a gross unearned premium reserve or a mortality/morbidity reserve. The gross unearned premium reserve represents the estimated amount of premium for insurance coverage that has not yet expired. The mortality/morbidity reserve represents the estimated amount of future anticipated benefits, discounted at valuation interest and mortality/morbidity, to be incurred on policies in force.
9. When the level of insurance risk is constant during the contract period, policy reserves shall be recognized over the period of risk using either the daily pro-rata or monthly pro-rata methods as described in *SSAP No. 53—Property and Casualty Contracts—Premiums*. Policy reserves for contracts where the level of insurance risk is not constant throughout the contract period shall be recognized over the period of risk in proportion to the amount of insurance protection provided. Various methods may be used to accomplish this as described below. The reporting entity shall select the method that most closely reflects the pattern of insurance protection provided. To the extent that these methods do not reflect the pattern of insurance protection provided, the reporting entity shall modify or develop, if necessary, a method that recognizes net income from the policy over the exposure period of the contract in proportion to the amount of insurance protection provided.
10. Single premium credit life policy reserves shall be based on either a gross unearned premium reserve based on a refund formula, or a reserve based on assumed risks using mortality factors. In practice, various methods exist and are currently used to estimate the amount of gross unearned premiums applicable to the unexpired portion of the policies in force. For decreasing gross coverage, the gross unearned premium may be estimated using a Rule of 78's method; for decreasing net payoff coverage,

either the Rule of 78's or the single-premium method is used; and for level coverage, the pro-rata method is generally used. The reporting entity shall select a method that reflects the pattern of insurance protection provided.

11. Except as noted in paragraph 12, policy reserves for credit A&H policies shall be based on either a gross unearned premium reserve using the pro rata, Rule of 78's, mean of pro rata and Rule of 78's, or actuarial methods. The gross unearned premium reserve is a measure of the single premium for the debt's remaining term and amount. Most states required reporting entities to record a gross unearned premium reserve using the Rule of 78's method. In practice, such a gross unearned premium reserve has been the average of the Rule of 78's and the pro rata methods. The reporting entity shall select a method that reflects the pattern of insurance protection provided. Also, the method should be consistent with the refund method actually used or required in the state.

12. For single premium credit disability policies issued on or after January 1, 2002, Appendix A-010 requires that a contract reserve be established using a standardized morbidity table. For single premium credit disability policies issued prior to January 1, 2002, reserves may be established either according to the standards in Appendix A-010 or paragraph 11. Once an insurer elects to calculate reserves for all contracts on the standard in Appendix A-010, all future valuations must be on that basis.

13. For all credit contracts in the aggregate, if the premium refund liability exceeds the aggregate recorded reserve, an additional liability shall be established. This premium refund (excess) liability may include consideration of commission, premium tax, and other expenses recoverable. The excess reserve shall be established for the surrender values (premium refund) in excess of the mortality reserves. As such, the surrender values may be net of commissions, premium taxes, etc. Additionally, the excess reserve is calculated on an aggregated basis by combining all credit life and accident and health policies and certificates.

14. When the anticipated benefits, expected dividends to policyholders and maintenance cost exceed the recorded policy reserve, a premium deficiency reserve shall be recognized by recording an additional liability for the excess deficiency with a corresponding charge to operations. Commission and other acquisition costs need not be considered in the premium deficiency analysis since they have previously been expensed.

15. The difference between the policy reserves at the beginning and end of the reporting period shall be reflected as the change in reserves or change in unearned premium, as appropriate, in the summary of operations, except for any difference due to a change in valuation basis as discussed in paragraph 16.

Change In Valuation Basis

16. A change in valuation basis shall be defined as a change in the interest rate, mortality assumption, or reserving method (e.g., net level, preliminary term, etc.) or other factors affecting the reserve computation of policies in force and meets the definition of an accounting change as defined in *SSAP No. 3—Accounting Changes and Corrections of Errors*. Consistent with SSAP No. 3, any increase (strengthening) or decrease (destrengthening) in policy reserves resulting from such a change in valuation basis shall be recorded directly to surplus rather than as a part of the reserve change recognized in the Summary of Operations. The impact on surplus is based on the difference between the reserve under the old and new methods as of the beginning of the year. This difference shall not be graded in over time unless an actuarial guideline adopted by the NAIC prescribes a new method and a specific transition that allows for grading.

Disclosures

17. For life reserves the financial statements shall disclose the following:

- a. A description of reserve practices concerning the following:

- i. Waiver of deduction of deferred fractional premiums upon death of insured;
 - ii. Return of portion of final premium for periods beyond the date of death;
 - b. The methods employed in the valuation of substandard policies;
 - c. The amount of insurance, if any, for which the gross premiums are less than the net premiums according to the valuation standards;
 - d. The method used to determine tabular interest, tabular less actual reserves released, and tabular cost (by formula or from the basic data for such items);
 - e. The nature of significant other reserve changes.
18. If the company has reported life insurance premiums deferred and uncollected on policies in force as of the financial statement date, disclose separately the amounts and the loading excluded for credit life business.
19. Disclose the aggregate amount of direct premiums written through managing general agents or third party administrators. For purposes of this disclosure, a managing general agent means the same as in Appendix A-225. If this amount is equal to or greater than 5% of surplus, provide the following information for each managing general agent and third party administrator:
- a. Name and address of managing general agent or third party administrator;
 - b. Federal Employer Identification Number;
 - c. Whether such person holds an exclusive contract;
 - d. Types of business written;
 - e. Type of authority granted (i.e., underwriting, claims payment, etc.);
 - f. Total premium written.
20. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

21. This statement incorporates the requirements of Appendices A-010, A-225, A-812, A-818, A-820 and A-822, the Actuarial Standards Board *Actuarial Standards of Practice* and the actuarial guidelines found in Appendix C of this Manual.
22. This statement rejects *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises* relating to accounting and reporting for credit life and accident and health insurance contracts.

Effective Date and Transition

23. This statement is effective for years beginning January 1, 2001. Contracts issued prior to January 1, 2001 shall be accounted for based on the laws and regulations of the domiciliary state. State laws and regulations shall be understood to include anything considered authoritative by the domiciliary state under the individual state's statutory authority and due process procedures. 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. The guidance in paragraph 13 pertaining to establishing the excess reserve for surrender

values was originally contained within *INT 01-29: SSAP No. 59 and Application to Credit Life* and was effective December 10, 2001.

REFERENCES

Other

- NAIC *Financial Condition Examiners Handbook*
- Actuarial Standards Board *Actuarial Standards of Practice*

Relevant Issue Papers

- *Issue Paper No. 59—Credit Life and Accident and Health Insurance Contracts*

Not for Distribution

Statement of Statutory Accounting Principles No. 60

Financial Guaranty Insurance

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Nullifies and incorporates INT 00-04
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Premium Revenue Recognition	2
Unpaid Losses and Loss Adjustment Expense Recognition.....	2
Contingency Reserve	2
Disclosures.....	4
Effective Date and Transition	7
REFERENCES.....	7
Relevant Issue Papers	7
EXHIBIT A – DISCLOSURE ILLUSTRATION	8

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for financial guaranty insurance and addresses areas where financial guaranty insurance accounting differs from other lines of insurance. To the extent a topic is not covered by this statement, financial guaranty insurance accounting shall comply with statutory accounting guidance for other lines of property and casualty insurance.

SUMMARY CONCLUSION

2. Financial guaranty insurance provides protection against financial loss as a result of default, changes in interest rate levels, differentials in interest rate levels between markets or products, fluctuations in exchange rates between currencies, inconvertibility of one currency into another, inability to withdraw funds held in a foreign country resulting from restrictions imposed by a governmental body, changes in the value of specific assets or commodities, financial or commodity indices, or price levels in general. Financial guaranty insurance does not provide protection from losses which occur due to fortuitous physical events, failure or deficiency in the operation of equipment, or the inability to extract natural resources. Additionally, it does not provide coverage from losses related to various types of bonds (e.g., individual or schedule public official bond; a contract bond; a court bond), credit insurance, guaranteed investment contracts, and residual value insurance.

3. Included in the definition of financial guaranty insurance is student loan insurance. Student loan insurance includes financial guarantees issued as a surety bond or financial guarantee policies issued to a bank or other lending financial institution, under which the insurer agrees to provide financial guaranty of each student loan made by the bank within specified underwriting criteria. As each loan is made, the premium for that loan is paid to the insurer by the bank from the proceeds of the loan that are retained by the bank at issuance. Usually repayment of the loan is expected to commence six months after graduation. If and when there is a default in repayment of the loan by the graduate, the insurer pays the bank or lending institution the unpaid principal and interest on the loan, takes possession of the loan, and initiates recovery efforts. Student loan insurance is subject to the provisions of this statement and the statutory contingency reserve.

Premium Revenue Recognition

4. Written premium shall be recorded in accordance with *SSAP No. 53—Property and Casualty Contracts—Premiums* except that installment premiums, which may vary substantially over the term of the contract since the total amount insured and the premium rate are contingent upon the performance of the insured obligations, shall be recorded when received.

5. When premiums are paid on the installment basis, premium revenue shall be recognized in the statement of operations using the monthly pro-rata method. Premiums not paid on the installment basis shall be recognized in the statement of operations in proportion with the amount and expected coverage period of the insured risk.

6. When the anticipated losses, loss adjustment expenses, and maintenance cost exceed the recorded unearned premium reserve and contingency reserve, a premium deficiency reserve shall be recognized by recording an additional liability for the deficiency with a corresponding charge to operations. Commission and other acquisition costs need not be considered in the premium deficiency analysis since they have previously been expensed. If a reporting entity utilizes anticipated investment income as a factor in the premium deficiency calculation, disclosure of such shall be made in the financial statements.

Unpaid Losses and Loss Adjustment Expense Recognition

7. Unpaid losses and loss adjustment expenses shall be recognized in accordance with *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*. Each financial guaranty insurer shall establish and maintain reserves for unpaid losses and loss adjustment expenses. The initial date of default shall be considered the incident which gives rise to a claim. Loss reserves shall include a reserve for claims reported and unpaid net of collateral.

8. A deduction from loss reserves shall be allowed for the time value of money by application of a discount rate equal to the average rate of return on the admitted assets of the financial guaranty insurer as of the date of the computation of the reserve. The discount rate shall be adjusted at the end of each calendar year. In addition, a reserve component for incurred but not reported claims shall be reasonably estimated, if deemed necessary by the financial guaranty insurer or required by the commissioner following an examination or actuarial analysis.

Contingency Reserve

9. In addition to the unearned premium reserve and the liability established for unpaid losses and loss adjustment expenses, financial guaranty insurers shall maintain a liability referred to as a statutory contingency reserve. The purpose of this reserve is to protect policyholders against loss during periods of extreme economic contraction.

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~~

11. Additions to the reserve for items a. through e. in paragraph 10, equal to one-eightieth of the amounts derived by applying the appropriate contribution specified above, shall be made each quarter for a period of twenty (20) years. Additions to the reserve for items f. through j. in paragraph 10, equal to one-sixtieth of the amounts derived by applying the appropriate contribution specified above, shall be made each quarter for a period of fifteen (15) years.

12. For contingency reserves required to be maintained for 20 years, contributions may be discontinued if the total reserve established for all categories in paragraphs 10.a. through 10.e. exceeds the sum of the percentages contained therein multiplied by the unpaid principal guaranteed. For contingency reserves required to be maintained for 15 years, contributions may be discontinued if the total reserve established for all categories in paragraphs 10.f. through 10.j. exceeds the sum of the percentages contained therein multiplied by the unpaid principal guaranteed.

13. The contingency reserve may also be released in the following circumstances:

- a. For contingency reserves required to be maintained for 20 years:
 - i. In any year in which actual incurred losses exceed 35% of the corresponding earned premiums, with commissioner approval;
 - ii. If the reserve has been in existence less than 40 quarters, upon demonstration that the amount is excessive in relation to the outstanding obligations under the insurer's financial guarantees, with commissioner approval;
 - iii. If the reserve has been in existence more than 40 quarters, upon demonstration that the amount is excessive in relation to the outstanding obligations under the insurer's financial guarantees, upon 30 days prior written notice to the commissioner.

- b. For contingency reserves required to be maintained for 15 years:
 - i. In any year in which actual incurred losses exceed 65% of the corresponding earned premiums, with commissioner approval;
 - ii. If the reserve has been in existence less than 30 quarters, upon demonstration that the amount is excessive in relation to the outstanding obligations under the insurer's financial guarantees, with commissioner approval;
 - iii. If the reserve has been in existence more than 30 quarters, upon demonstration that the amount is excessive in relation to the outstanding obligations under the insurer's financial guarantees, upon 30 days prior written notice to the commissioner.

Any reductions shall be made on a first-in first-out basis. Changes in the reserve shall be recorded through unassigned funds (surplus).

Disclosures

14. Financial guaranty insurers shall make all disclosures required by paragraphs 15-17 as well as other statements within the *Accounting Practices and Procedures Manual*, including but not limited to the requirements of SSAP No. 55 and *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures*. (For disclosures within paragraph 16 and 17, all “expected” amounts and terms should be determined in accordance with management estimates.) In all instances, the insurer shall disclose when they elect to reflect timeframes or recognition principles from *FASB Statement No. 163, Accounting for Financial Guarantee Insurance Contracts—an interpretation of FASB Statement No. 60* (FAS 163) as permitted within the disclosure requirements.

15. An insurance enterprise shall disclose information that enables users of its financial statements to understand the factors affecting the present and future recognition and measurement of financial guarantee insurance contracts.

16. To meet the disclosure objective in paragraph 15, an insurance enterprise shall disclose the following information for each annual reporting statement, and in any interim period if a significant change has occurred in that interim period:

- a. For financial guarantee insurance contracts where premiums are received as installment payments over the period of the contract, rather than at inception:
 - i. The unearned premium revenue as of the reporting date, in proportion with the amount and expected coverage period of the insured risk, which would have been reflected if the premium had been received at inception¹.
- b. A schedule of premiums (undiscounted) expected to be collected under all installment contracts detailing the following:
 - i. The four quarters of the subsequent annual period and each of the next four annual periods;
 - ii. The remaining periods aggregated in five-year increments;

¹ If desired, a reporting entity that follows FAS 163 for GAAP may elect to report this disclosure in accordance with the revenue recognition principles of FAS 163.

- c. A rollforward of the expected future premiums (undiscounted), including:
 - i. Expected future premiums – Beginning of Year;
 - ii. Less - Premium payments received for existing installment contracts;
 - iii. Add – Expected premium payments for new installment contracts;
 - iv. Adjustments to the expected future premium payments;
 - v. Expected future premiums – End of Year.
- d. For non-installment contracts for which premium revenue recognition has been accelerated, the amount and reasons for acceleration.
- e. A schedule of the future expected earned premium revenue on non-installment contracts as of the latest date of the statement of financial position detailing the following:
 - i. The four quarters of the subsequent annual period and each of the next four annual periods;
 - ii. The remaining periods aggregated in five year increments.
- f. For the claim liability:²
 - i. The rate used to discount the claim liability. This rate³ shall equal the average rate of return on the admitted assets of the financial guaranty insurer as of the annual date of the computation of the reserve.
 - ii. The significant component(s) of the change in the claim liability for the period (the accretion of the discount on the claim liability, changes in the timing, establishment of new reserves for defaults of insured contracts, changes or establishment of deficiency reserves, and changes or establishment of reserves for incurred but not reported claims), and the amount relating to each component(s).
- g. A description of the insurance enterprise's risk management activities used to track and monitor deteriorating insured financial obligations, including the following:
 - i. A description of each grouping or category used to track and monitor deteriorating insured financial obligations;
 - ii. The insurance enterprise's policies for placing an insured financial obligation in, and monitoring, each grouping or category;
 - iii. The insurance enterprise's policies for avoiding or mitigating claim liabilities, the related expense and liability reported during the period for those risk mitigation activities (not including reinsurance), and a description of where that expense and

² The reference to "claim liability" throughout the disclosure requirements shall reflect the "reserves for unpaid losses and loss adjustment expenses" from paragraphs 7 and 8 of this statement.

³ The annual discount rate calculated pursuant to this paragraph shall be utilized for the subsequent year's quarterly financial statements. Per paragraph 8, the discount rate shall be adjusted at the end of each year.

that liability are reported in the statement of income and the statement of financial position, respectively.

17. An insurance enterprise shall disclose the following information for each annual and interim period related to the claim liability:

- a. A schedule of insured financial obligations at the end of each interim period detailing, at a minimum, the following for each category or grouping of these financial obligations (see Exhibit A):
 - i. Number of issued and outstanding financial guarantee insurance contracts;
 - ii. Remaining weighted-average⁴ contract period;
 - iii. Insured contractual payments outstanding⁵, segregating principal and interest;
 - iv. Gross claim liability;⁶
 - v. Gross potential recoveries;⁷
 - vi. Discount, net (both claim liability and potential recoveries;⁸
 - vii. Net claim liability;⁹
 - viii. Reinsurance recoverables;¹⁰
 - ix. Unearned premium revenue;¹¹

18. Refer to the Preamble for further discussion regarding disclosure requirements.

⁴ Weighted average contract period shall be based on management's estimate of the weighted average life of the contracts. If desired, a reporting entity that follows FAS 163 for GAAP may elect to mirror the time period calculated under FAS 163.

⁵ Contractual payments outstanding shall be based on management's estimates of receivables. If desired, a reporting entity that follows FAS 163 for GAAP may elect to mirror the time period calculated under FAS 163.

⁶ Represents the unpaid losses and loss adjustment expenses calculated in accordance with SSAP No. 55 and SSAP No. 60, but excluding the effects of subrogation recoveries, ceded reinsurance and discounting.

⁷ Includes (a) subrogation recoveries, which are deducted from the gross claim liabilities in accordance with paragraph 15 of SSAP No. 55 and (b) ceded reinsurance recoveries on unpaid losses, which are deducted from the gross claim liability in accordance with paragraph 126.a. of SSAP No. 62R.

⁸ Represents the discounting effect of the gross claim liability, subrogation recoveries, and reinsurance recoveries.

⁹ Represents the gross claim liability less gross potential recoveries and the net discount. This line should reconcile to the sum of line 10, column 8 and column 9 (financial guaranty net unpaid losses and net unpaid loss adjustment expenses) of the Underwriting and Investment Exhibit, Part 2a – Unpaid Losses and Loss Adjustment Expenses.

¹⁰ Represents reinsurance recoverables on paid losses which is reported as an asset with paragraph 24 of SSAP No. 62R. This line should reconcile to "Amounts recoverable from reinsurers" on the balance sheet.

¹¹ Unearned premium revenue (UPR) should be consistent with the UPR measurement principles of SSAP No. 60. UPR reported in this schedule may not reconcile to line 10, column 5 of the Underwriting and Investment Exhibit, Part 1a – Recapitulation of all Premiums. To the extent that this amount does not reconcile to line 10, column 5 of the Underwriting and Investment Exhibit, Part 1a – Recapitulation of Premiums, provide an additional reconciliation to line 10, column 5 of the Underwriting and Investment Exhibit, Part 1a in a footnote to the tabular disclosures required in paragraph 17.

Effective Date and Transition

19. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The guidance in paragraph 3 was originally contained within *INT 00-04: Student Loan Insurance* and was effective June 12, 2000.

REFERENCES**Relevant Issue Papers**

- *Issue Paper No. 69—Financial Guaranty Insurance*

Not for Distribution

EXHIBIT A – DISCLOSURE ILLUSTRATION

A1. The example below assumes the insurance enterprise uses a surveillance list with four surveillance categories to track and monitor its insured financial obligations. The surveillance list and four surveillance categories are used for illustrative purposes only. The surveillance categories shown below describe the claim liability before the mitigating effects of potential recoveries. The following are brief descriptions of each surveillance category to provide context to the example:

- a. Category A includes insured financial obligations that are still currently performing (that is, insured contractual payments are made on time but the likelihood of an event of default has increased since the financial guarantee insurance contract was first issued), but if economic conditions persist for an extended period of time, they may not be performing in the future. The issuer of the insured financial obligation may have experienced credit deterioration as a result of a general economic downturn. As a result, the present value of expected net cash outflows may exceed the unearned premium revenue of the financial guarantee insurance contract some time in the future.
- b. Category B includes insured financial obligations that are currently characterized as potentially nonperforming and may require action by the insurance enterprise to avoid or mitigate an event of default.
- c. Category C includes insured financial obligations that are characterized as nonperforming and for which actions to date by the insurance enterprise have not been successful in avoiding or mitigating an event of default. The insurance enterprise continues its efforts to cure the claim, but an event of default is imminent.
- d. Category D includes insured financial obligations where an event of default has occurred.

	Surveillance Categories				Total
	A	B	C	D	
Number of policies	37	16	5	4	62
Remaining weighted-average contract period (in years)	16	14	11	12	
Insured contractual payments outstanding:					
Principal	\$ 656,000,000	\$ 409,000,000	\$ 196,000,000	\$ 111,000,000	\$ 1,372,000,000
Interest	478,000,000	298,000,000	150,000,000	73,000,000	999,000,000
Total	<u>\$ 1,134,000,000</u>	<u>\$ 707,000,000</u>	<u>\$ 346,000,000</u>	<u>\$ 184,000,000</u>	<u>\$ 2,371,000,000</u>
Gross claim liability	\$ 1,045,000,000	\$ 690,000,000	\$ 330,000,000	\$ 184,000,000	\$ 2,249,000,000
Less:					
Gross potential recoveries	752,000,000	381,000,000	29,000,000	7,000,000	1,169,000,000
Discount, net	159,000,000	153,000,000	125,000,000	78,000,000	515,000,000
Net claim liability	<u>\$ 134,000,000</u>	<u>\$ 156,000,000</u>	<u>\$ 176,000,000</u>	<u>\$ 99,000,000</u>	<u>\$ 565,000,000</u>
Unearned premium revenue	\$ 7,000,000	\$ 4,000,000	\$ 2,000,000	\$ - (a)	\$ 13,000,000
Reinsurance recoverables	\$ 10,000,000	\$ 19,000,000	\$ 25,000,000	\$ 27,000,000	\$ 81,000,000

(a) In this instance, it is assumed that once an insured financial obligation is in Category D, the only remaining obligation of the insurance enterprise is making claim payments. As such, all related balances of the insured financial obligation are written off, including the unearned premium revenue.

Statement of Statutory Accounting Principles No. 61 – Revised

Life, Deposit-Type and Accident and Health Reinsurance

STATUS

Type of Issue.....	Life, Accident and Health
Issued	Initial Draft; Substantively revised December 18, 2012
Effective Date	January 1, 2001; Certified reinsurer changes effective December 31, 2012
Affects.....	Nullifies and incorporates INT 02-04, INT 02-08 and INT 02-09; Nullifies INT 00-23
Affected by.....	No other pronouncements
Interpreted by.....	INT 03-02; INT 23-04
Relevant Appendix A Guidance	A-785; A-791

STATUS.....	1
SCOPE OF STATEMENT.....	2
SUMMARY CONCLUSION	2
Indemnity Reinsurance	2
Retention	2
Reinsurance Arrangements	3
Types of Reinsurance Arrangements	3
Transfer of Risk	4
Accounting and Reporting of Reinsurance	5
Reinsurance Premiums.....	6
Reinsurance Benefit Payments.....	6
Reinsurance of Deposit-Type Contracts	6
Expenses	6
Experience Refunds	7
Credits for Ceded Reinsurance	7
Reserves for Reinsurance Assumed.....	8
Accounting for Modified Coinsurance Arrangements	8
Accounting for Coinsurance With Funds Withheld Arrangements	9
Uncollectible Reinsurance	10
Reinsurance Ceded to a Certified Reinsurer	10
Unauthorized Reinsurance	11
Syndicated Letters of Credit	12
Funds Held Under Reinsurance Treaties with Unauthorized Reinsurers or Certified Reinsurers	12
Accounting for Interest Maintenance Reserve (IMR).....	12
Gains and Losses on Indemnity Reinsurance	12
Recaptures and Commutations.....	13
Deposit Accounting	13
Assumption Reinsurance	13
Accounting for Assumption Reinsurance Transactions	13
Accounting for Non-Economic Assumption Reinsurance Transactions.....	14
Disclosures.....	14
Relevant Literature.....	21

Effective Date and Transition	22
REFERENCES.....	22
Relevant Issue Papers	22
GLOSSARY.....	23

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for life, deposit-type and accident and health reinsurance. This statement applies to life, deposit-type and accident and health contracts as defined in *SSAP No. 50—Classifications of Insurance or Managed Care Contracts*.

SUMMARY CONCLUSION

Indemnity Reinsurance

2. Reinsurance is an agreement by which a reporting entity transfers all or part of its risk under a contract to another reporting entity. The entity that issued the policy is called the primary insurer, direct writer, or ceding entity and the entity to which the risk is transferred is called the reinsurer or assuming entity. The process of transferring the risk from the ceding entity to the reinsurer is known as a cession. If an assuming entity, in turn, transfers a portion of this risk, the process is called a retrocession. A retrocession is customarily made when the amount assumed is beyond the reinsurer's limits of retention.

3. There is no direct relationship between the reinsurer or the retrocessionaire and the ceding entity's policyholder unless there is a "cut-through endorsement." In the event of the ceding entity's insolvency, except in the case of a "cut-through endorsement," the policyholder or beneficiary under a contract that is reinsured has the same status as a policyholder or beneficiary of a policy that was not reinsured. An entity may not need to be licensed, have accredited reinsurer status or other means of authorization in a state in order to act as a reinsurer of a domestic entity. However, the domestic entity is not permitted to take reserve credits on the business ceded to any unauthorized reinsurers or certified reinsurers to the extent that they are not properly securitized by means of a trust, letter of credit or funds withheld or other acceptable forms of collateral.

4. Fronting arrangements, pools and association business are often accomplished using reinsurance contracts.^(INT 03-02) The guidance included in this statement also applies to these types of contracts except as specifically exempted.

Retention

5. In formulating its rules for accepting applications for insurance, an entity must decide upon three areas of action—retaining, reinsuring, or declining the risks presented. Entities of various sizes have different desired capacities to write insurance on a single life and/or entire blocks of business or portfolios. An entity determines the amount of risk exposure it is able to accept and retain as its own insurance business. Having made this determination, the entity then decides what to do with any risks presented that exceed the maximum amount it is willing to retain. It has two choices—accept the additional risk and reinsure it, or decline the extra risk.

6. Business to be written is expected to be profitable, so the direct writing entity will generally want to retain as much of the risk as possible, consistent with its overall objectives. The entity also will want to avoid exposure to large losses that could jeopardize its financial condition and the policy values of its policyholders. Consequently, a common practice in the life insurance industry is for a reporting entity to establish a schedule for maximum amounts of insurance, called retention limits, which it will retain at its

own risk on individual lives in various categories of insurance. By adopting a suitably chosen schedule of retention, the reporting entity eliminates exposure to large losses and reduces fluctuations in the cost of death claims from year to year, which could adversely affect the reporting entity's surplus position. In addition, the reporting entity can utilize aggregate stop loss reinsurance to protect it from aggregate claims exceeding a specific threshold.

7. There are also reasons why a reporting entity might retain less than its defined maximum. One is to transfer from the ceding entity to the reinsurer the part of the surplus strain that results from writing new life insurance. The ceding entity may wish to limit the risk of loss on substandard business. Testing new coverages or new classes of lives may lead to reinsurance.

Reinsurance Arrangements

8. Reinsurance can be on a facultative or an automatic basis. For facultative, each risk is handled separately at the time it is written. When the direct writing entity receives an application for a policy and it wishes to reinsure some or all of the risk, it negotiates with another entity for a transfer of all or a portion of that risk. For purely facultative cessions, the assuming entity is not obligated to assume any of the risk until its offer to reinsure is accepted. For facultative obligatory reinsurance, the assuming entity is obligated to reinsure the risk subject to its having sufficient available capacity.

9. For automatic reinsurance, the ceding entity agrees to reinsure with the reinsurance entity all cases which meet certain defined conditions for amounts as defined in the reinsurance agreement. The reinsurance entity is bound to accept all such amounts, up to a predetermined maximum. Amounts in excess of automatic limits set out in the reinsurance agreement may be handled as facultative cessions. When the amount lies within the automatic maximum limit, called the binding authority, the ceding entity issues its policy upon completion of its underwriting procedures and without securing the prior approval of the reinsurance entity. Notification of automatic reinsurance is sent to the reinsurer within a specified period after the ceding entity issues its policy.

10. By agreeing to accept all business automatically ceded to it, the reinsurer is relying on the underwriting judgment of the ceding entity and is bound to accept the case even when it, the reinsurer, may not agree with the underwriting action. The reinsurer is protected by the requirement that the ceding entity retains at its own risk its defined retention limit for the class of business that is involved and by the maximum which may be ceded automatically.

Types of Reinsurance Arrangements

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

Coinsurance

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

13. In coinsurance of participating policies, the reinsurer may reimburse the ceding entity for its portion of the dividends paid to the policyholder. In determining its schedule of dividends, the ceding entity takes into account the experience on the business as written. If the reinsurer reimburses dividends it will typically accept the ceding entity's schedule but may require input into the schedule. Changes to the schedule may have to be agreed to by the reinsurer. Coinsurance of all or a portion of a block of business also is used in situations where a severe strain is placed on the direct writing entity's surplus in the first policy year. For example, the premium received by the direct writer during the first policy year usually is insufficient to pay the high first-year commissions and other costs of issue and to establish the initial reserve. In such an example, coinsurance relieves some of the surplus strain of adding large amounts of new insurance.

Modified Coinsurance

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

Yearly Renewable Term (YRT)

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

Non-Proportional

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

Transfer of Risk

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

18. This paragraph applies to all life, deposit-type and accident and health reinsurance agreements except for yearly renewable term reinsurance agreements and non-proportional reinsurance agreements such as stop loss and catastrophe reinsurance. All reinsurance agreements covering products that transfer significant risk shall follow the guidance for reinsurance accounting contained in this statement. All

reinsurance contracts covering products that do not provide for sufficient transfer of risk shall follow the guidance for Deposit Accounting.

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

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

Accounting and Reporting of Reinsurance

21. The obligation of reporting reinsurance in force and of determining unpaid premiums and incurred claims and other balances is generally on the ceding entity because it knows the current status of the policies it has written directly and reinsured. A lag will develop between the time of the entry of the underlying policy transaction on the books of the ceding entity and the transmittal of information and its entry on the books of the assuming entity. The assuming entity shall estimate any material unreported premiums and related costs.

22. The ceding entity must report these items in its balance sheet:

- a. Credits (deductions) to its policy and claim reserves and unpaid claims;
- b. Premiums or other amounts payable on reinsured risks;
- c. Amounts recoverable on claims, surrender values, dividends, experience rating refunds, taxes, commissions, and other expenses;
- d. Modified coinsurance reserves; and,
- e. Amounts receivable or payable for funds withheld.

23. Similarly, in its balance sheet, the assuming entity must report:

- a. Reserves for reinsurance assumed reduced by any modified coinsurance reserves;
- b. Reinsurance premiums receivable or other amounts receivable;

- c. Amounts payable for claims, surrender values, dividends, experience rating refunds, taxes, commissions, and other expenses; and,
- d. Amounts receivable or payable for funds withheld by the ceding entity.

24. While the premiums, commissions, expense allowances, reserves, claims, etc. will result in a net amount, the proper way to report them is in their separate classifications on the balance sheet. Each reinsurance agreement must be accounted for separately. Certain assets and liabilities are created by entities when they engage in reinsurance contracts. Reinsurance assets meet the definition of assets as defined by *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted to the extent they conform to the requirements of this statement.

Reinsurance Premiums

25. For all reinsurance arrangements, the assuming entity must report premiums under the terms of the reinsurance contract as income and establish any asset or liability consistent with the methods and assumptions used to establish its policy reserves and guidance contained in *SSAP No. 51R—Life Contracts*, *SSAP No. 54R—Individual and Group Accident and Health Contracts*, and *SSAP No. 59—Credit Life and Accident and Health Insurance Contracts*. The ceding entity shall reduce premium income by the amounts paid or payable to the reinsurers. The ceding entity shall reduce its deferred and uncollected premiums reported as an asset by the corresponding proportionate amount of any deferred and uncollected premium attributable to those insurance policies reinsured. When the ceding entity has collected the premium but has not remitted the proportionate share to the reinsurer, the ceding entity shall establish a liability for the amount due the reinsurer. The assuming entity shall record an asset for premiums receivable from the ceding entity.

26. If the assuming entity receives reinsurance premium prior to the due date, consistent with *SSAP No. 51R* paragraph 7 and *SSAP No. 54R*, paragraph 6, advance premiums are reported as a liability for the reinsurer in the statutory financial statement and not considered income until due. Such amounts are not included in premium or the unearned premium reserve (if applicable) until the due date. If the ceding entity pays reinsurance premium prior to the due date, the amount of the prepaid item shall be reflected as a write-in admitted asset and it should not be recognized in the income statement until due. Such amounts are not included in ceded premiums or ceded unearned premium but should be subject to impairment analysis.

Reinsurance Benefit Payments

27. Policy benefit payments paid or payable by the reinsurer shall be reported in the summary of operations and reduces the ceding entity's reported benefit payments. The reinsurer shall establish a liability for its share of any unpaid claim payments and the ceding entity shall reduce any policy and contract claim liability with respect to the reinsured policies or establish a receivable for the amount due from the reinsurer for claims paid.

Reinsurance of Deposit-Type Contracts

28. At the outset of a reinsurance contract covering deposit-type contracts as defined in *SSAP No. 52—Deposit-Type Contracts*, the net consideration exchanged between the parties shall be recorded as a contra-liability (reduction of reserve) by the payer of the net considerations and as a liability (reserve) by the receiver. Throughout the life of the contract, receipts and disbursements shall be recorded through the asset/liability accounts.

Expenses

29. It is common for the assuming entity to provide an expense allowance to cover expenses of the ceding entity. The allowance is frequently nonspecific with respect to premium taxes and other general

expenses of the ceding entity and it is usually combined with and accounted for as part of the commissions on reinsurance assumed or ceded.

30. Commissions on direct business, commissions and expense allowances on reinsurance assumed, and commissions and expense allowances on reinsurance ceded are each accounted for separately in the summary of operations and on the balance sheet. Accordingly, for entities reporting on the Life, Accident and Health Annual Statement, commissions and expense allowances on reinsurance ceded are reported as income in the summary of operations and the balance sheet provision for due and accrued amounts is reported as an asset. For entities reporting on the Health Annual Statement commissions and expense allowance on reinsurance ceded are reported as an offset to administrative expenses.

31. The taxes, commissions, and other expenses that will be paid by the assuming entity to the ceding entity are agreed upon when the reinsurance agreement is negotiated. These items are calculated in accordance with the reinsurance agreement and usually relate to premiums or claims or both. At the statement date, the amount of unpaid expenses is generally based upon the amount of premiums and claims unpaid at that date.

32. Some coinsurance contracts provide that the assuming entity pay to the ceding entity a commission that exceeds the first-year premium. In the absence of any guarantees for payment of future premiums, or other similar persistency guarantees, these commissions are accounted for on the cash basis. If, however, the contract contains a persistency guarantee which provides for return of the excess commission, the ceding entity must record the excess commission as a liability. This liability is then released as future premiums are paid to the assuming entity or the persistency guarantee otherwise expires. The rate of release is determined in accordance with the anticipated experience and reasonable commission rate for first-year and renewal premiums. Excess commissions such as these are a means of financing for the ceding entity.

33. If renewal expense allowances in any accounting period are not sufficient to cover anticipated allocable renewal expenses of the ceding entity on the portion of the business reinsured, a liability is to be established by the ceding entity for the present value of the shortfall. In establishing this liability, assumptions are to be used equal to the applicable statutory reserve basis on the business reinsured. Anticipated allocable expenses include commissions, premium taxes and direct expenses including, but not limited to, billing, valuation, claims and maintenance expected by the entity at the time the business is reinsured.

Experience Refunds

34. Some reinsurance contracts, generally proportional reinsurance, provide that the reinsurer will refund an agreed upon portion of its profit to the ceding entity. The reinsurance contract will provide the calculation and the factors to be included.

35. If the contract provides for experience refunds, the ceding entity must record, as an asset, the amount of the refund receivable as of the statement date, but reduced by any amount that is contingent upon future experience. The assuming entity is also required to record, as a liability, the amount of the refund calculated at the statement date, but without regard to any effects that future experience might have.

Credits for Ceded Reinsurance

36. The credit taken by the ceding entity under the coinsurance arrangement is calculated using the same methodology and assumptions used in determining its policy and claim reserves. It is, of course, only for the percentage of the risk that was reinsured. Under modified coinsurance, the reserve credit is reduced by the modco deposit retained by the ceding entity. If the entity reinsures on a yearly renewable term basis, it is itself buying insurance for the portion of the ceded amount at risk. The amount of yearly

renewable term reinsurance that is required on a given policy generally decreases each year as the entity's reserve increases. The net amount at risk may increase, however, on interest sensitive products such as universal life. The amount at risk on accident and health yearly renewal term reinsurance will remain level and the reinsurance premium will increase each year.

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

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

Reserves for Reinsurance Assumed

39. In assuming any insurance risks, the assuming entity is required to establish policy reserves that are consistent with its obligations. The reserves it must establish, therefore, are also dependent upon the arrangement of reinsurance that is used. For risks transferred under the reinsurance arrangement, policy and claim reserves must be at least equal to the required reserves calculated using the same methodology and assumptions that would be used if the reinsurer had written the risk directly.

Accounting for Modified Coinsurance Arrangements

40. The following accounting applies to modified coinsurance arrangements:

- a. Ceding Entity—In a modified coinsurance arrangement, the ceding entity retains the assets equal to the modified coinsurance reserve. This reserve represents a prepayment of the reinsurer's future obligation. Premiums paid or payable to the reinsurer net of any experience refunds shall result in the reduction of premium income. Policy benefit

payments paid by the reinsurer shall reduce the ceding entity's reported policy benefits. Expense allowances paid by the reinsurer shall be reported separately in the summary of operations as they are earned. The modified coinsurance reserve is included in the category of policy reserves. The modified coinsurance reserve adjustment from period-to-period shall be reported separately in the summary of operations;

- b. Assuming Entity (Reinsurer)—Premiums received or receivable by the reinsurer shall increase premium income net of any experience refunds and policy benefit payments paid by the reinsurer shall increase the reported policy benefits. Expense allowances paid by the reinsurer shall be reported separately in the summary of operations when payable. The statutory policy reserves exclude the modified coinsurance reserve. The modified coinsurance reserve adjustment from period-to-period shall be reported separately in the summary of operations. The reinsurer's accounting of its obligations shall be consistent with the ceding entity's accounting for the transfer of the obligations.

For separate accounts: The assuming reinsurer should account for the CRVM/CARVM expense allowances belonging to the assuming company when the ceding company holds the assets supporting the full account balance (prior to modification for CRVM/CARVM expense allowances) in its separate accounts as follows:

- i. The assuming company records the CRVM/CARVM expense allowances in the Liabilities line, "Transfers to Separate Accounts due or accrued (net)" and includes them in the caption disclosure: "Including \$_____, accrued for expense allowances recognized in reserves net of reinsurance"
- ii. Period changes are recorded in the Summary of Operations Line, "Net transfers to or (from) Separate Accounts"

Accounting for Coinsurance With Funds Withheld Arrangements

41. The following accounting applies to coinsurance arrangements with funds withheld:

- a. Ceding Entity—Premiums paid or payable to the reinsurer net of any experience refunds shall reduce premium income. Policy benefit payments paid by the reinsurer shall reduce the ceding entity's reported policy benefits. Expense allowances paid by the reinsurer shall be reported separately in the summary of operations as they are earned. A net reduction to policy reserves shall be taken for the portion of the obligation assumed by the reinsurer. Any amounts withheld by the ceding entity shall be recorded as a separate liability. Reporting entities filing the annual statement for life and accident and health insurers shall record any interest due or payable on the amounts withheld as a component of aggregate write-ins for miscellaneous deductions. Reporting entities filing the health annual statement shall record any interest due or payable on the amounts withheld as a component of aggregate write-ins for other income or expense.
- b. Assuming Entity (Reinsurer)—Premiums received or receivable by the reinsurer net of any experience refunds shall increase premium income and policy benefit payments paid by the reinsurer shall increase the reported policy benefits. Expense allowances paid by the reinsurer shall be reported separately in the summary of operations when payable. The reinsurer shall record its share of the statutory policy reserves attributable to the business identified in the contract. Any funds withheld by the ceding entity shall be recorded as an accounts receivable. For reporting entities filing the annual statement for life and accident and health insurers shall record any interest earned or receivable on the funds withheld as a component of aggregate write-ins for miscellaneous income. Reporting entities filing the health annual statement shall record any interest earned or

receivable on the funds withheld as a component of aggregate write-ins for other income or expense.

Uncollectible Reinsurance

42. The ceding and assuming companies must determine if reinsurance recoverables are collectible. If it is probable that reinsurance recoverables on paid or unpaid claim or benefit payments will be uncollectible, consistent with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*, these amounts shall be written off through a charge to the Statement of Operations utilizing the same accounts which established the reinsurance recoverables.

Reinsurance Ceded to a Certified Reinsurer

43. A certified reinsurer is an assuming insurance entity that does not meet the requirements to be considered an authorized reinsurer in the domestic state of the ceding insurance entity, but has been certified by such state and is required to provide collateral as security for its reinsurance obligations incurred under contracts entered into or renewed on or after the effective date of certification.

44. Credit for reinsurance ceded to a certified reinsurer is permitted if security is held by or on behalf of the ceding entity in accordance with the certified reinsurer's rating assigned by the domestic state of the ceding insurance entity, and in accordance with requirements of Appendix A-785 of this manual. Such deposits are to be held under the control of the ceding entity. Additionally, any securities held under such an arrangement must be investments that the ceding entity is allowed to make under the provision of the investment sections of the insurance statutes of its domiciliary state. Other permissible arrangements include irrevocable trusts or "clean" letters of credit.

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

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

47. A liability is established by the ceding entity to offset credit taken in various balance sheet accounts for reinsurance ceded to a certified reinsurer in an amount proportionate to any deficiency in the amount of acceptable security that is provided by the certified reinsurer as compared to the amount of security that is required to be provided in accordance with the certified reinsurer's rating. In determining the amount of this liability, the ceding insurance entity must first determine the net obligations subject to collateral from the certified reinsurer, which is equal to the following:

- a. Reserve credits taken including any Interest Maintenance Reserve (IMR) liability adjustment; plus
- b. Claim liability credits taken on paid and unpaid (in course of settlement) claims recoverable; plus

- c. Other asset increases or liability reductions resulting from amounts recoverable from the assuming entity including commissions, expense allowances, modified coinsurance reserve adjustments, experience rating refunds, and estimated incurred but not reported claim liabilities; less
- d. Amounts contractually due the assuming entity.

48. The liability for reinsurance with certified reinsurers due to collateral deficiency is then determined as follows:

- a. The net obligations subject to collateral from the certified reinsurer as calculated in paragraph 47; less
- b. The net obligations subject to collateral from the certified reinsurer as calculated in paragraph 47 multiplied by the ratio of the amount of collateral provided by the certified reinsurer to the amount of collateral required to be provided by the certified reinsurer in accordance with its rating assigned by the domestic state of the ceding entity.

49. The net liability defined in paragraphs 47 and 48 shall never be less than zero for any particular certified reinsurer. The change in liability for reinsurance with certified reinsurers is a direct charge or credit to surplus.

Unauthorized Reinsurance

50. If the reinsurer is not authorized, otherwise approved or certified to do business, the reinsurance is considered to be unauthorized. A liability is established to offset credit taken in various balance sheet accounts for reinsurance ceded to unauthorized reinsurers. Credit for reinsurance with unauthorized companies shall be permitted if the ceding entity holds securities or cash of the assuming entity equal to the reserve credit taken. Such deposits are to be held under the control of the ceding entity. Additionally, any securities held under such an arrangement must be investments that the ceding entity is allowed to make under the provision of the investment sections of the insurance statutes. Other permissible arrangements include irrevocable trusts or “clean” letters of credit. If the assuming entity is not licensed or is not an authorized reinsurer in the domiciliary state of the ceding entity or if the reinsurance does not meet required standards, the ceding entity must set up a net liability equal to the following:

- a. Reserve credits taken including any IMR liability adjustment; plus
- b. Claim liability credits taken on paid and unpaid (in course of settlement) claims recoverable; plus
- c. Other asset increases or liability reductions resulting from amounts recoverable from the assuming entity including commissions, expense allowances, modified coinsurance reserve adjustments, experience rating refunds, and estimated incurred but not reported claim liabilities; less
- d. Deposits by or funds withheld from the reinsurer, as provided for in the reinsurance treaty and in compliance with the security requirements of Appendix A-785, pledged as security for the payment of reinsurance obligations. Such deposits or funds are typically held by the ceding entity or are placed in a trust or custodial account. Amounts placed in trust or custodial accounts are held subject to withdrawal by, and under the control of, the ceding entity; less
- e. Amounts of reinsurance recoverables covered by a clean, irrevocable letter of credit issued by a qualified U.S. financial institution as defined in Appendix A-785; less

- f. Amounts contractually due the assuming entity.

51. The net liability defined in paragraph 50 shall never be less than zero for any particular reinsurer. The change in liability for unauthorized reinsurance is a direct charge or credit to surplus.

Syndicated Letters of Credit

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

- a. All listed banks on the letter of credit are qualified and meet the criteria of the NAIC SVO approved bank listing;
- b. Banks are severally and not jointly liable; and
- c. Specific percentages for each assuming bank are listed in the letter of credit.

Funds Held Under Reinsurance Treaties with Unauthorized Reinsurers or Certified Reinsurers

53. This liability is established for funds deposited by or contractually withheld from unauthorized reinsurers or certified reinsurers.

Accounting for Interest Maintenance Reserve (IMR)

54. The interest-related gain or loss (net of taxes) associated with the sale, transfer or reinsurance of a block of liabilities must be credited or charged to the IMR in accordance with the IMR instructions contained in the NAIC Annual Statement Instructions for Life and Accident and Health Insurance Companies.

Gains and Losses on Indemnity Reinsurance

55. Under an indemnity reinsurance arrangement the ceding entity continues to be liable to the policyholders and the reinsurer has no obligations to them except in the case of cut-through agreements. Typically the ceding entity will continue to perform all functions in connection with claims and other policyholder services. Gains and losses on indemnity reinsurance are defined as the net experience under the reinsurance contract within a calendar year. Net experience (underwriting gains or loss) includes ceded premiums, claims, expense allowances, reserve adjustments, any IMR liability adjustment, and experience refunds and dividends.

56. Losses that occur in any year of an indemnity reinsurance contract are immediately recognized. For reinsurance of in-force blocks of business, gains that occur in the initial calendar year are accounted for in accordance with Appendix A-791, paragraph 3. If a retrocession of all or a portion of an in-force block of assumed business occurs contemporaneously with assuming the in-force block of business, any resulting net gain from assuming the in-force block of business and the retrocession shall be accounted for in accordance with Appendix A-791. Any resulting net loss shall be recognized immediately in earnings.

57. For indemnity reinsurance agreements entered into for other than in-force blocks of business, the gains and losses are immediately recognized by the ceding and assuming entity.

Recaptures and Commutations

58. A recapture or a commutation of a reinsurance agreement is a transaction which results in the complete and final settlement and discharge of all present and future obligations between the parties arising out of the agreement or a portion of the agreement. Commuted and recaptured balances shall be accounted for by writing them off through the accounts, exhibits and schedules in which they were originally recorded. The assumed reserves and reserve credits taken are eliminated by the reinsurer and ceding entity, respectively. The reinsurer and ceding entity must also make any required IMR liability adjustment changes. Any net gain or loss is reported in the summary of operations.

Deposit Accounting

59. To the extent that a reinsurance contract does not, despite its form, provide for sufficient transfer of risk amounts exchanged between the parties are to be accounted for and reported as follows:

- a. At the outset of the reinsurance contract, the net consideration exchanged between the parties shall be recorded as an asset by the payer of the net considerations and as a liability by the receiver. The amount to be admitted as an asset is subject to the limitations for transactions with unauthorized reinsurers described in Appendix A-785. Throughout the life of the contract, receipts and disbursements shall be recorded through the asset/liability accounts. Income and losses shall be recognized by a party when, according to the terms of the contract, it has earned the amount and the other party has no recourse to repayment of such amount in future periods. When the contract is completed, or when there is a loss payment in excess of the deposit, any difference between consideration and recoveries shall be recorded as other miscellaneous insurance income or miscellaneous insurance loss;
- b. No deduction shall be made from the policy or claim reserves on the balance sheet, schedules and exhibits.

Assumption Reinsurance

60. An entity may sell all or part of a block of insurance business through an assumption reinsurance agreement. Typically, under an assumption reinsurance arrangement, the reinsurance contract is intended to effect a novation, thereby to extinguish the ceding entity's liability to the policyholder. Assumption reinsurance requires that the reinsurer issue assumption certificates to the existing policyholders and take over responsibility for policyholder services. On occasion, the reinsurer will contract with the original entity to continue to provide such services on a fee basis or may contract with a third party. Regulatory approval of assumption reinsurance arrangements is usually required. Approval is also usually required from the policyholders, who have a predetermined time period in which to accept or reject the reinsurance transfer. After the deadline has passed, approval is considered implied for all outstanding responses. For those policyholders that reject the transfer, the reinsurance agreement typically converts to an indemnity arrangement. Under this circumstance, reinsurance accounting, as defined earlier in this statement, is to be followed.

Accounting for Assumption Reinsurance Transactions

61. Accounting for assumption reinsurance transactions involves all existing assets and liabilities with respect to the assumed policies. This involves policy reserves, policy loans, net due and deferred premiums, dividend accumulations, dividend liability, policy claims, advance premiums, unearned interest on policy loans, etc. The total effect of all of these assets and liabilities is collectively referred to as net policy liabilities.

62. Typically, because a block of in-force business has value, the sale transaction will result in a gain to the ceding entity. If the policies are somewhat mature and have reasonably large net policy liabilities,

the transaction probably will result in a transfer of cash or other assets by the ceding entity. In this case, the net policy liabilities released by the ceding entity will be greater than the value of the assets transferred. If the policies are young and have very small net policy liabilities, the assuming entity may pay some amount in the purchase. The ceding entity is to follow accounting for indemnity reinsurance for the policies sold until it has been formally relieved of the legal liability by either consent from the policyholders or when the expiration period for objecting to the transfer has expired. Upon release of the liability or risk, the ceding entity shall recognize any gain or loss immediately. The gain or loss shall be the difference between the book value of the assets and liabilities including any unamortized IMR allocated or related to the block of business transferred. Direct and ceded balances are to be eliminated and gains are to be taken into income proportionally as the policyholders approve the transfer or at the end of the response period.

63. The assuming entity is to value the assets acquired at the date of acquisition at their fair values, and the reserves are to be established according to statutory requirements based on the benefits in the individual policies reinsured. If the liabilities exceed the assets, the difference represents goodwill that must be amortized into operations using the interest method over the life of the policies, but for a period not to exceed 10 years. Goodwill resulting from assumption reinsurance transactions shall be included in the total goodwill of an entity when calculating the amount of goodwill that is a nonadmitted asset pursuant to *SSAP No. 68—Business Combinations and Goodwill*. If the assets exceed the liabilities, the assuming entity shall record a deferred liability and amortize the amount into operations using the interest method over the expected life of the business but not to exceed ten years.

64. Upon initiation of the assumption reinsurance contract, the ceding and assuming companies are to report all balances reinsured as direct adjustments to the balance sheet. Any net gain or loss is reported as miscellaneous income when recognized.

Accounting for Non-Economic Assumption Reinsurance Transactions

65. When the sale, transfer, or reinsurance of an in-force block of business occurs between affiliated companies that is not an economic transaction, the ceding and assuming entity shall not recognize any gain or loss. The statutory liabilities and any unamortized IMR shall be transferred from the ceding entity to the assuming entity without adjustment. The assuming entity shall amortize any transferred IMR at the same rate or amount that would have occurred for the ceding entity. To the extent that the value of the assets transferred by the ceding entity or the net asset value recorded by the assuming entity differs from the liabilities including any unamortized IMR, the ceding and assuming entity shall defer and amortize their respective differences consistent with the interest method described for non-affiliated transactions.

Disclosures

66. For life and annuity reserves the financial statements shall disclose the following:

- a. A description of reserve practices concerning the following:
 - i. Waiver of deduction of deferred fractional premiums upon death of insured;
 - ii. Return of portion of final premium for periods beyond the date of death;
 - iii. Amount of any surrender value promised in excess of the reserve as legally computed;
- b. The methods employed in the valuation of substandard policies;
- c. The amount of insurance, if any, for which the gross premiums are less than the net premiums according to the valuation standards;

- d. The method used to determine tabular interest, tabular less actual reserves released, and tabular cost (by formula or from the basic data for such items);
- e. The method of determination of tabular interest on funds not involving life contingencies; and
- f. The nature of significant other reserve changes.

67. For reinsurance of variable annuity contracts/certificates with an affiliated captive reinsurer¹, the reporting entity shall disclose the following for each transaction in the annual financial statements:

- a. The type of benefits being reinsured (e.g., GMDB, GLIB and other guaranteed benefits);
- b. A description that accurately conveys the purpose² of the transaction and significant terms of the reinsurance agreement;
- c. A description of any risks retroceded to a third party as well as the ultimate risks retained by the reporting entity and its parent, subsidiaries and affiliates;
- d. Whether the reporting entity reinsures variable annuities in a stand-alone captive arrangement, or a multi-product captive arrangement;
- e. The amount of reserves held by the affiliated captive reinsurer, the reserve methodology for the affiliated captive reinsurer's financial statements, a brief description of the hedge target and how the reserve methodology differs from the requirements of *Actuarial Guideline XLIII—CARVM For Variable Annuities* (AG 43).
- f. Identify any permitted or prescribed practices that apply to the affiliated captive reinsurer, in substance and form, following the guidance in *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures*.

¹ The purpose of this disclosure is to capture all cessions to affiliated insurance/reinsurance entities that are subject to a financial solvency regulatory system separate from that generally applicable to traditional insurers and/or reinsurers in the ceding entity's domestic jurisdiction. Given this purpose, an affiliated captive reinsurer is any entity that meets the definition of "affiliate" as established in the NAIC Model Holding Company Act. An affiliated non-traditional insurer/reinsurer is an insurance or reinsurance company that reinsures risks only from its parent or affiliates, and is subject to a financial solvency regulatory system separate from that generally applicable to traditional insurers and/or reinsurers in the ceding entity's domestic jurisdiction. For the purpose of annual statement reporting, this definition shall be presumed to include the following, subject to the cedant's rebuttal to its domicile:

- a. An affiliated insurance or reinsurance company licensed, authorized or otherwise granted the authority to operate in a single United States jurisdiction under any captive insurer law, special purpose insurer law, or other similar law separate from those applicable to traditional insurers and/or reinsurers.
- b. An affiliated insurance or reinsurance company licensed, authorized or otherwise granted the authority to operate in any jurisdiction outside the United States under any captive insurer law, special purpose insurer law, or other similar law separate from those applicable to traditional insurers and/or reinsurers in that non-United States jurisdiction.
- c. Any other affiliated insurance or reinsurance company that by law, regulation, or order, or contract is authorized to insure or reinsure only risks from its parent or affiliate.

² For purposes of this disclosure, "purpose" includes, but is not limited to, the following:

- a. Providing financing for the business outside of the company capital structure.
- b. Managing volatility of financial results.
- c. Managing risk mitigations by isolating risks in a legal entity.
- d. Enhancing the ability to align hedging activity with economic results.
- e. Any other sound business rationale, identified and justified.

68. For each reinsurance agreement with an affiliated captive reinsurer (same definition as paragraph 67), provide the following information in the annual financial statements:

- a. Reserve credit taken by the reporting entity for variable annuities.
- b. The total amount of collateral supporting any reserve credit taken, if applicable.
- c. A description of the nature of the collateral (funds withheld by the reporting entity, assets placed in trust for the benefit of the cedent, letters of credit (LOC), etc.), if applicable as well as a tabular presentation³ of the value⁴ of all assets held by or on behalf of the captive reinsurer that back the variable annuities liabilities (including capital).

69. For the disclosures noted below, disclose the amount of annuity actuarial reserves and deposit liabilities by withdrawal characteristics for the categories of general account, separate account with guarantees, separate account nonguaranteed as well as the total and percentage of the total, include a separate section for Individual Annuities, Group Annuities, and Deposit-Type Contracts (with no life contingencies). Supplementary contracts with life contingencies are reported in the appropriate Annuities section (Individual or Group).

- a. Subject to discretionary withdrawal:
 - i. With market value adjustment, where withdrawal of funds is payable at all times, or prior to specified maturity dates where such dates are more than one year after the statement date and;
 - (a) In a lump sum with adjustments to reflect general changes in interest rates, or asset values since receipt of funds by the entity;
 - (b) In installments over five years or more, with or without a reduction in the interest rate during the installment period.
 - ii. At book value less current surrender charge, where the withdrawal of funds is payable at all times, or at any time within one year from the statement date in a lump sum subject to a current fixed surrender charge of 5% or more and it does not contain a meaningful bail out rate as described in paragraph 69.a.v.(d) below;
 - iii. At fair value, where the withdrawal of funds is payable at current market value of the assets supporting the liabilities, the assets are stated at current fair value, and the liabilities are stated at the current fair value or per unit value of the assets supporting the liabilities. These liabilities are for contracts where the customer bears the entire investment risk;
 - iv. Total with adjustment or at fair value;
 - v. At book value without adjustment (minimal or no charge or adjustment), where the withdrawal of funds is either payable at all times, or at any time (including a withdrawal on a scheduled payment date) within one year from the statement date and:

³ List the major asset classes, such as bonds, unconditional LOC's, conditional LOC's and LOC-like instruments, parental guarantees, etc. Note which assets would not normally meet the definition of an admitted asset under SSAP No. 4.

⁴ Indicate the basis of the valuation of the assets (carrying value, fair value, statutory, etc.).

- (a) In a lump sum without adjustment;
 - (b) In installments over less than five years, with or without a reduction in interest rate during the installment period;
 - (c) In a lump sum subject to a fixed surrender charge of less than 5%;
 - (d) In a lump sum subject to surrender charge, but such charge is waived if the credited rate falls below a specified “bail out” rate and the “bail out” rate is more than the maximum statutory valuation rate for life insurance policies for more than 20 years for new issues.
- b. Not subject to discretionary withdrawal;
 - c. Total gross (Direct + Assumed);
 - d. Reinsurance ceded;
 - e. Total net (Net: Total gross (paragraph 69.c.) less Reinsurance ceded (paragraph 69.d.)); and
 - f. Amount with current surrender charge of 5% or more included in the current year in paragraph 69.a.ii. that will have less than a 5% surrender charge (and thus be reported with the amounts at book value with minimal or no charge or adjustment noted in paragraph 69.a.v.) for the first time within the year subsequent to the balance sheet year. (Note that percentage of total is not required for this item.)

70. Reconcile the total annuity reserves and deposit fund liabilities amount disclosed in the (non-life reserves) annual statement Aggregate Reserve for Life Contracts Exhibit 5 and the deposit-type contract fund liabilities from the Deposit-Type Contracts Exhibit 7 of the Life, Accident & Health Annual Statement and the corresponding lines in the Separate Accounts Statement. The reconciliation is a single presentation including all amounts from the sections on Individual Annuities, Group Annuities and Deposit-Type Contracts.

71. Reconcile total life insurance reserves amount disclosed to the appropriate sections of the Aggregate Reserves for Life Policies and Contracts Exhibit 5 of the Life, Accident and Health Annual Statement and the corresponding lines in the Separate Accounts Statement. The reconciliation is a single presentation including all amounts from the sections on Individual Life Insurance and Group Life Insurance.

72. Disclosures shall be made consistent with the interrogatories made under the “Ceded Reinsurance Report” detailed in the NAIC *Annual Statement Instructions For Life, Accident and Health Insurance Companies* in the Notes to the Financial Statements section.

73. Describe uncollectible reinsurance written off during the year reported in the following annual statement classifications, including the name or names of the reinsurer(s):

- a. Claims incurred;
- b. Claim adjustment expenses incurred;
- c. Premiums earned; and
- d. Other.

74. Describe commutation of ceded reinsurance during the year reported in the following annual statement classifications, including the name or names of the reinsurer(s):

- a. Claims incurred;
- b. Claim adjustment expenses incurred;
- c. Premiums earned; and
- d. Other.

75. The financial statements shall disclose the impact on any reporting period in which a certified reinsurer's rating has been downgraded or its certified reinsurer status is subject to revocation and additional collateral has not been received as of the filing date. The disclosure should include the following:

- a. Name of certified reinsurer downgraded or subject to revocation of certified reinsurer status and relationship to the reporting entity;
- b. Date of downgrade or revocation and jurisdiction of action;
- c. Collateral percentage requirements pre and post downgrade or revocation;
- d. Net obligation subject to collateral;
- e. As of the end of the current quarter, the estimated impact of the collateral deficiency to the reporting entity as a result of the assuming entity's downgrade or revocation of certified reinsurer status, (At year-end the actual impact of the collateral deficiency on the provision for reinsurance shall be disclosed).
- f. U.S. domiciled reinsurers are eligible for certified reinsurer status. If the reporting entity is a certified reinsurer, the financial statements shall disclose the impact on any reporting period in which its certified reinsurer rating is downgraded or status as a certified reinsurer is subject to revocation. Such disclosure shall include information similar to paragraphs 75.b., 75.c. and 75.d. and the expectation of its ability to meet the increased requirements.

76. The annual audited financial statements shall:

- a. Identify the applicable standard for the disclosure requirement set forth in paragraph 76.b. The applicable standard shall be (1) the Term and Universal Life Insurance Reserve Financing Model Regulation (Model #787), if such regulation has been adopted and is effective for the reporting period in the reporting entity's state of domicile; or (2) in all other cases, *Actuarial Guideline XLVIII—Actuarial Opinion and Memorandum Requirements for the Reinsurance of Policies Required to be Valued Under Sections 6 and 7 of the NAIC Valuation of Life Insurance Policies Model Regulation* (AG 48). Capitalized terms used herein shall have the meanings ascribed to them in the applicable standard. The disclosures in paragraph 76.b. apply to all XXX/AXXX risks ceded under Covered Policies unless an exemption set forth in the applicable standard exempts the insurer or transaction from its scope. For example, if no exemption is available under the terms of the applicable standard for XXX/AXXX risks ceded under Covered Policies, but a state nevertheless determines that the insurer or transaction will not be required to comply in full with all aspects of the applicable standard, then the disclosures in paragraph 76.b. will still apply.

- b. Disclose the number of reinsurance contracts in which risks under Covered Policies have been ceded by the reporting entity and the following details for each such contract:
 - i. Whether funds consisting of Primary Security, in an amount at least equal to the Required Level of Primary Security, are held by or on behalf of the reporting entity as security under the reinsurance contract within the meaning of paragraph 19 of *Appendix A-785—Credit for Reinsurance* on a funds withheld, Trust, or modified coinsurance basis, and, if not, the amount of the shortfall;
 - ii. Whether funds consisting of Other Security, in an amount at least equal to any portion of the statutory reserves as to which Primary Security is not held pursuant to paragraph 76.b.i., are held by or on behalf of the reporting entity as security under the reinsurance contract within the meaning of paragraph 19 of *Appendix A-785—Credit for Reinsurance*, and, if not, the amount of the shortfall;
 - iii. For any contract as to which a shortfall exists and is required to be disclosed under paragraphs 76.b.i. and 76.b.ii., identify all of the following:
 - (a) The assuming insurer by name and NAIC code (if any);
 - (b) The name and effective date of the contract;
 - (c) The total amount of XXX/AXXX statutory reserves ceded under the contract;
 - (d) The Required Level of Primary Security;
 - (e) The actual amount of Primary Security;
 - (f) The actual amount of Other Security; and
 - (g) The amount of the shortfall(s) in Primary Security and/or Other Security required to be disclosed under paragraphs 76.b.i. and 76.b.ii.

77. The disclosures in this paragraph are for ceding entities that utilize captives to assume reserves subject to the XXX/AXXX Captive framework and should be disclosed in the annual financial statements.

- a. For each captive in which a risk-based capital shortfall exists per the XXX/AXXX Captive Reinsurance Consolidated Exhibit:
 - i. List the name of the captive and the dollar amount of the risk-based capital shortfall.
 - ii. List the total adjusted capital (TAC) for the current year as reported in the Five-Year Historical Data page of the annual statement, along with the quantity of the sum of the total adjusted capital (TAC) and the total of the risk-based capital shortfalls shown in paragraph 77.a.i.
- b. For each reinsurer for which a non-zero primary security shortfall is shown on the XXX/AXXX Reinsurance Primary Security Shortfall by Cession exhibit, list the name of the reinsurer and the amount of primary security shortfall. Also show the total shortfall from that exhibit across all reinsurers.

78. Disclosures for paragraphs 79-84 apply to reinsurance contracts in effect for the current period covered by the statement and are required to be included with the annual audit report financial statements beginning with the period ended December 31, 2020, regarding reinsurance contracts. The disclosures required within paragraphs 79-84 shall be included in accompanying supplemental schedules of the annual audit report beginning in year-end 2020. If the disclosures are not applicable, an affirmative statement that no such contracts were identified is acceptable in the notes to the financial statements or the supplemental schedules. These disclosures shall be limited to reinsurance contracts entered into, renewed or amended on or after January 1, 1996. This limitation applies to the annual audit report only and does not apply to the statutory annual statement interrogatories and the property and casualty reinsurance summary supplemental filing.

79. Disclose any ceded reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) subject to A-791 that includes a provision, which limits the reinsurer's assumption of significant risks identified as in A-791. Examples of risk-limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. If true, indicate the number of reinsurance contracts to which such provisions apply. For contracts subject to A-791, indicate if deposit accounting was applied for all contracts, which limit significant risks.

80. Disclose any ceded reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) not subject to A-791, for which reinsurance accounting was applied and includes a provision that limits the reinsurer's assumption of risk. Examples of risk-limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. Note that a stop loss or excess of loss reinsurance agreement with deductibles or loss caps, which apply to the entire contract and are not adjustable based on other features, do not require disclosure under this paragraph. If true, indicate the number of reinsurance contracts to which such provisions apply. If affirmative, indicate if the reinsurance credit was reduced for the risk-limiting features.

81. Disclose if any ceded reinsurance contracts contain features (except reinsurance contracts with a federal or state facility) described below which result in delays in payment in form or in fact:

- a. Provisions which permit the reporting of losses, or settlements are made, less frequently than quarterly or payments due from the reinsurer are not made in cash within ninety (90) days of the settlement date (unless there is no activity during the period).
- b. Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.

82. Disclose if the reporting entity has reflected reinsurance accounting credit for any contracts not subject to Appendix A-791 and not yearly renewable term, which meet the risk-transfer requirements of SSAP No. 61R and identify the type of contracts and the reinsurance contracts.

- a. Assumption Reinsurance – As discussed in paragraph 60, which are new for the reporting period.

83. Disclose if the reporting entity ceded any risk which is not subject to A-791 and not yearly renewable term reinsurance, under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:

- a. Accounted for that contract as reinsurance under statutory accounting principles (SAP) and as a deposit under U.S. generally accepted accounting principles (GAAP); or
- b. Accounted for that contract as reinsurance under U.S. GAAP and as a deposit under SAP.

If the reporting entity does not prepare U.S. GAAP financial statements or its financial statements are not part of upstream U.S. GAAP financial statements, this disclosure can be answered not applicable.

84. If affirmative disclosure is required for paragraph 83, explain why the contract(s) is treated differently for GAAP and SAP.

85. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

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

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

87. This statement incorporates Appendices A-785 and A-791.

88. Effective December 31, 2023, this statement rejects ASU 2016-13 *Financial Instruments—Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments*, ASU 2018-19 *Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, ASU 2019-04 *Codification Improvements to Topics 326, 815, 825*, ASU 2019-10 *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815)*, and *Leases (Topic 842)*, ASU 2019-11 *Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, and ASU 2020-03 *Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB’s issuance of ASU 2016-13 and other related ASUs.

Effective Date and Transition

~~88.~~89. This statement is effective for years beginning January 1, 2001, and, except as noted in paragraphs 89-92, applies to all reinsurance contracts entered into or amended subsequent to January 1, 1996. Changes resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—*Accounting Changes and Corrections of Errors*.

~~89.~~90. The accounting and reporting practices revised by this statement shall not apply to reinsurance agreements in force on January 1, 1996.

~~90.~~91. The requirements of paragraph 18 relating to reinsurance of deposit-type contracts shall be effective for all accounting periods beginning on or after January 1, 2001. The guidance in paragraph 19 pertaining to applying deferral guidance to YRT treaties was originally contained within INT 02-08: *Application of A-791 to YRT Reinsurance of a Block of Business* and was effective January 1, 2003. The guidance in paragraph 40 related to separate accounts was originally contained within INT 02-04: *Recognition of CARVM and CRVM Expense Allowances by the Assuming Reinsurer in a Modified Coinsurance Agreement* and was effective March 18, 2002. The guidance in paragraph 52 was originally contained within INT 02-09: *A-785 and Syndicated Letters of Credit* and was effective September 12, 2004.

~~91.~~92. Agreements which were: a) entered into on or after January 1, 1996, and which do not transfer risk shall be accounted for as deposits; b) amended on or after January 1, 1996, and which do not transfer risk shall be accounted for prospectively as deposits with the appropriate reclassification of outstanding reinsurance balances as deposits with no surplus impact. For arrangements which were amended on or after January 1, 1996, a change in accounting principle associated with the revised accounting in this statement shall be applied prospectively with no adjustment to surplus as required by SSAP No. 3.

~~92.~~93. The guidance related to certified reinsurers is applicable only to cedants domiciled in states that have enacted/promulgated the certified reinsurer collateral framework, and only for their cessions to reinsurers certified under that domestic law/rule, and shall be effective for all reporting periods beginning on or after December 31, 2012.

~~93.~~94. The disclosure for compliance with Model #787 or AG 48 shall be effective for reporting periods ending on or after December 31, 2015. The revisions adopted in November 2018 to expand liquidity disclosures are effective year-end 2019, concurrent with the inclusion of data-captured financial statement disclosures. The disclosures captured in paragraphs 78-84 which help to identify certain reinsurance contract features are effective for reporting periods ending on or after December 31, 2020.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 74—Life, Deposit-Type and Accident and Health Reinsurance*

GLOSSARY⁵

Assume

To accept or take over an insurance risk; the reverse of cede.

Assumption Reinsurance

The form of reinsurance that extinguishes the ceding entity's liability to the policyholder. The reinsurer directly assumes all the service and financial obligations of the original entity on the block of business being assumed. Unlike indemnity reinsurance, assumption reinsurance makes the assuming entity (reinsurer) directly liable to the policyholders. In some instances, the original entity may continue to administer and service the business but, if it does so, it does it as the agent of the reinsurer.

Automatic Maximum Limit

The amount of risk which can be automatically ceded if all other conditions are met. Also called the binding authority.

Authorized Reinsurer

An assuming entity is considered an authorized reinsurer if either: 1) it is licensed in the domiciliary state of the ceding entity; 2) it is an accredited reinsurer in the domiciliary state of the ceding entity; 3) it is domiciled and licensed in a state which employs standards regarding credit for reinsurance substantially similar to those of the domiciliary state of the ceding entity and maintains surplus of at least \$20 million; 4) it maintains a trust for the benefit of all its U.S. policyholders and ceding entities equal to its U.S. liabilities plus a level of surplus prescribed in the NAIC model law on credit for reinsurance; or 5) it is a reinsurer accepting risks located in jurisdictions where the laws require reinsurance to be ceded to such entity.

Automatic Reinsurance

A reinsurance agreement under which the reinsurer is obligated to accept or assume risks which meet certain specific criteria based on the ceding entity's underwriting. The reinsurance is ceded on the underwriting judgment of the ceding entity without a case by case concurrence of the reinsurer, up to a specified amount, the automatic maximum limit. The ceding entity normally is required to keep its full stipulated retention for the class of business involved on any case ceded automatically. Often certain defined types of cases are not eligible for automatic treatment. Cases in excess of the automatic maximum limits or otherwise ineligible for automatic cover can usually be submitted for facultative consideration.

Binding Authority

The amount of risk over the ceding entity's retention which can be automatically ceded if all other conditions are met. Also called the automatic maximum limit.

Catastrophe Reinsurance

A form of non-proportional reinsurance offering the ceding entity protection against excess losses from multiple claims arising out of a single event or a single large loss. Typically, reinsurance benefits will be paid if at least a specified minimum number of claims exceeding a minimum threshold amount of benefits

⁵ Definitions in this glossary are adapted from the Society of Actuaries' Reinsurance Section Treaty Committee paper, "Discussion of Reinsurance Provisions in a Life Reinsurance Agreements," dated August 1, 1994, and the glossary contained in *Life, Health, and Annuity Reinsurance*, by John E. Tiller, Jr., FSA, and Denise Fagerbert, FSA (ACTEX Publications, Inc.).

arises out of a single event. When these conditions are met, the ceding entity is reimbursed for a percentage (often 100%) of the claims over the threshold attachment point up to the maximum reinsurance benefit specified in the treaty.

Cede

To transfer an insurance risk from the entity originally issuing the policy to another insurance entity known as the reinsurer; the reverse of assume.

Certified Reinsurer

A certified reinsurer is an assuming insurance entity that does not meet the requirements to be considered authorized in the domestic state of the ceding insurer, but has been certified by such state and is required to provide collateral as security for its reinsurance obligations incurred under contracts entered into or renewed on or after the effective date of certification. The amount of security required to be provided by the certified reinsurer in order for a domestic ceding insurer to be eligible to receive financial statement credit for the reinsurance ceded is determined by an evaluation and rating that is assigned to the certified reinsurer by the domestic state of the ceding insurance entity.

Cession

The process of transferring risk from the ceding entity to the reinsurer.

Coinsurance

Indemnity life reinsurance in which the reinsurer participates in the risks and rewards of the policy provisions; the ceding entity retains its liability to the contractual relationship with the insured. The reinsurer is liable not only for its portion of the death benefit, but also all the nonforfeiture values. The reinsurer receives its proportionate share of the ceding entity's gross premium less a coinsurance allowance for commissions and other expenses. The reinsurer holds the reserve on its portion of the policy and usually retains any excess investment earnings.

Commutation

The termination of all obligations between the parties to a reinsurance agreement, normally accompanied by a final cash settlement. Commutation may be required by the reinsurance agreement or may be effected by mutual agreement.

Credit for Reinsurance

Negative entries (i.e., reductions) to the ceding entity's policy reserves and positive entries (i.e., increases) to the ceding entity's assets (amounts recoverable from reinsurers). In the context of reinsurance, the term "credit" is the opposite of its meaning in pure accounting terminology. In balance sheet accounting, a credit is a positive entry to a liability (reserve).

Cut Through Endorsement

An endorsement to a policy and referred to in a reinsurance agreement which requires that, in the event of the ceding entity's insolvency, any loss covered under the reinsurance agreement will be paid by the reinsurer directly to the insured (or a third party beneficiary).

Experience Rating Refund

A part of the profits under a reinsurance agreement which is returned to the ceding entity, allowing the ceding entity to share in a portion of profits realized on the reinsurance.

Facultative Reinsurance

Reinsurance under which the ceding entity has the option (faculty) of submitting and the reinsurer has the option of accepting or declining individual risks. Thus it is reinsurance that the ceding entity chooses to submit to a reinsurer for its consideration and which may be ceded to the reinsurer only if the reinsurer makes an offer to reinsure. The underwriting classification assigned to the risk for purposes of the reinsurance is determined by the reinsurer. Facultative reinsurance may be ceded under the facultative terms of an automatic treaty for risks that the ceding entity cannot or does not wish to cede automatically, or it may be ceded under a purely facultative treaty.

Facultative Obligatory Reinsurance

A form of reinsurance that shares aspects of both facultative and automatic reinsurance. As with facultative reinsurance, the ceding entity has no obligation to offer specific cases to the reinsurer. However, once a case is offered to the facultative obligatory reinsurer, the case is treated largely as if it were automatic. The reinsurer receives no underwriting information and is offered the case at the ceding entity's rating with the option to accept or reject the case. While not always stated in the treaty, it is usually understood that the case will be rejected by the reinsurer only if the reinsurer does not have available capacity (i.e., its own retention and automatic retrocession facilities).

Fronting Arrangement

A situation where one insurance entity issues policies to specified applicants and reinsures all or substantially all of the risks on the insurance to another insurance entity for a fee or portion of the profits. Fronting typically is used in jurisdictions where the reinsuring entity is not licensed to do business.

Funds Withheld

Assets that would normally be paid over to a reinsurer but are withheld by the ceding entity to permit statutory credit for nonadmitted reinsurance, to reduce a potential credit risk, or to retain control over investments. Under certain conditions, the reinsurer may withhold funds from the ceding entity.

Indemnity Reinsurance

The form of reinsurance under which the ceding entity secures reinsurance as a partial or total reimbursement on the risks assumed on policies it has issued or reinsured. Under indemnity reinsurance, the reinsurer has no relationship with the original policyholders; the ceding entity continues to administer and service the insurance on which it has secured reinsurance and remains fully responsible for all the interests of the policyholders. If the reinsurer cannot or does not honor its obligations to the ceding entity, the ceding entity would still be fully liable to its policyholders.

Indemnity reinsurance may be employed, not only between a direct writing entity and a reinsurer, but also between two reinsurers when retrocession of risks is being implemented.

Mod-Co Reserve Adjustment

The net of two modified coinsurance items: the interest on reserves (payable by the ceding entity to the reinsurer) and the increase in the reserve (payable by the reinsurer to the ceding entity) or decrease in the reserve (payable by the ceding entity to the reinsurer).

Modified Coinsurance

Indemnity life insurance that differs from coinsurance only in that the reserves are retained by the ceding entity, which represents a prepayment of all or a portion of the reinsurer's future obligation. Periodically an adjustment is made to the mean reserve on deposit with the ceding entity. This is usually done

quarterly but may be done more frequently. If the reserve increases, the increase in mean reserve less interest on the mean reserve held at the end of the previous accounting period is paid by the reinsurer to the ceding entity. If the mean reserve decreases, the decrease and interest are paid by the ceding entity to the reinsurer. The appropriate interest rate is defined in the treaty.

Net Amount at Risk

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

Non-Proportional Reinsurance

Reinsurance that is not secured on individual lives for specific individual amounts of reinsurance, but rather reinsurance that protects the ceding entity's overall experience on its entire portfolio of business, or at least a broad segment of it. The most common forms of non-proportional reinsurance are stop loss reinsurance and catastrophe reinsurance.

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

Pool

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

Proportional Reinsurance

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

Recapture

The process by which the ceding entity recovers the liabilities transferred to a reinsurer. Reinsurance treaties often provide that if a ceding entity increases its retention, the ceding entity can, under previously agreed upon terms, take back (recapture) amounts of insurance previously ceded to fill up its new retention.

Reinsurer

An insurance entity to which another insurance entity can transfer, through the mechanism of reinsurance, part or all of its risk under a policy or policies it has issued or reinsured. If the transfer of risk is secured through indemnity reinsurance, the reinsurer becomes liable to the ceding entity for the reinsured benefits while the original entity, the ceding entity, remains fully liable to its insured policyholders. If the transfer of risk is secured through assumption reinsurance, the original entity steps out of the picture and transfers all of its liabilities and responsibilities to the reinsurer, who then is henceforth directly responsible to the original policyholders.

Retention

The portion of a policy which the ceding entity retains for its own liability on life insurance. It is normally expressed in terms of face amount of insurance, especially if more than the mortality risk is reinsured. It is sometimes expressed in terms of risk amount, particularly with single premium products.

An entity's retention is often graded by age and/or underwriting classification. Less frequently, special reduced retentions apply to specified risks, such as those engaging in aviation activities or with histories of coronary artery disease.

Retrocession

A form of reinsurance under which a reinsurer cedes to another insurer (the retrocessionaire) part or all of the reinsurance it has assumed from another entity. The original ceding entity has no relationship or recourse to the retrocessionaire and the original reinsurer remains fully liable to its client, the original ceding entity.

Retrocession provides a reinsurer with a method of accommodating its clients with respect to larger risks while still managing its own risk exposure.

Stop Loss Reinsurance

A form of non-proportional reinsurance under which the reinsurer pays some or all of a ceding entity's aggregate retained losses in excess of a predetermined dollar amount or in excess of a percentage of premium. Stop loss coverage provides protection against an excessive number or amount of claims in any given contract period.

Unauthorized Reinsurer

A reinsurer that is neither authorized, certified nor accredited (see "Authorized Reinsurer" and "Certified Reinsurer"). The ceding entity still may be able to take credit in its financial statements for reinsurance ceded to an unauthorized reinsurer if the reinsurer provides sufficient security for amounts due under the reinsurance treaty. This can usually be accomplished by permitting the ceding entity to withhold funds due the reinsurer (funds withheld approach) or by the reinsurer providing the ceding entity with a letter of credit, in a form acceptable to the state in question, or by the reinsurer establishing a trust agreement for the benefit of the ceding entity.

Yearly Renewable Term (YRT)

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

Statement of Statutory Accounting Principles No. 62 – Revised

Property and Casualty Reinsurance

STATUS

Type of Issue.....	Common Area
Issued	Finalized March 13, 2000; Substantively revised December 5, 2009, and December 18, 2012; November 15, 2018
Effective Date	January 1, 2001; Substantive revisions in paragraphs 36.e., 102-105 and 120 (detailed in Issue Paper No. 137) effective January 1, 2010; Certified reinsurer changes effective December 31, 2012; Substantive revisions adopted November 2018 are effective January 1, 2019
Affects.....	Supersedes SSAP No. 75 with guidance incorporated August 2011; Nullifies and incorporates INT 02-06 and INT 02-09
Affected by	No other pronouncements
Interpreted by	INT 02-22; INT 03-02
Relevant Appendix A Guidance	A-440; A-785

STATUS.....	1
SCOPE OF STATEMENT.....	2
SUMMARY CONCLUSION	2
General.....	2
Characteristics of Reinsurance Agreements	3
Required Terms for Reinsurance Agreements	4
Reinsurance Agreements with Multiple Cedents.....	5
Reinsurance Contracts Must Include Transfer of Risk	5
Accounting for Reinsurance.....	7
Accounting for Prospective Reinsurance Agreements.....	8
Accounting for Retroactive Reinsurance Agreements.....	9
Deposit Accounting	11
Assumed Reinsurance.....	12
Ceded Reinsurance.....	13
Adjustable Features/Retroactive Rating	13
Multiple-Year Retrospectively-Rated Contracts.....	15
Multiple-Year Retrospectively-Rated Contracts by Ceding and Assuming Entities	15
Obligatory Retrospective Rating Provisions.....	16
Allocation of Certain Payments Between Coverage and Past Losses.....	16
Contractual Termination Features.....	16
Impairment.....	17
Commissions.....	17
Unauthorized Reinsurance	17
Reinsurance Ceded to a Certified Reinsurer	17
Funds Held Under Reinsurance Treaties	18
Provision for Reinsurance.....	18
Asbestos and Pollution Contracts – Counterparty Reporting Exception	18

Syndicated Letters of Credit	19
Disputed Items	20
Uncollectible Reinsurance	20
Commutations	20
National Flood Insurance Program	20
Accounting for the Transfer of Property and Casualty Run-Off Agreements	21
Disclosures.....	22
Relevant Literature.....	26
Effective Date and Transition	27
REFERENCES.....	28
Relevant Issue Papers	28
CLASSIFYING REINSURANCE CONTRACTS.....	30
EXHIBIT A – IMPLEMENTATION QUESTIONS AND ANSWERS.....	31
EXHIBIT B – P&C RUNOFF REINSURANCE TRANSACTIONS.....	45
EXHIBIT C – ILLUSTRATION OF A REINSURANCE CONTRACT THAT IS ACCOUNTED FOR AS A DEPOSIT USING THE INTEREST METHOD	48
EXHIBIT D – ILLUSTRATION OF ASBESTOS AND POLLUTION COUNTERPARTY REPORTING EXCEPTION	49

SCOPE OF STATEMENT

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

SUMMARY CONCLUSION

General

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

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

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

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

- a. Treaty Reinsurance Contracts—Pro Rata:
 - i. Quota Share Reinsurance—The ceding entity is indemnified against a fixed percentage of loss on each risk covered in the agreement;
 - ii. Surplus Share Reinsurance—The ceding entity establishes a retention or “line” on the risks to be covered and cedes a fraction or a multiple of that line on each policy subject to a specified maximum cession;
- b. Treaty Reinsurance Contracts—Excess of Loss:
 - i. Excess Per Risk Reinsurance—The ceding entity is indemnified, subject to a specified limit, against the amount of loss in excess of a specified retention with respect to each risk covered by a treaty;
 - ii. Aggregate Excess of Loss Reinsurance—The ceding entity is indemnified against the amount by which the ceding entity’s net retained losses incurred during a specific period exceed either a predetermined dollar amount or a percentage of the entity’s subject premiums for the specific period subject to a specified limit;
- c. Treaty Reinsurance Contracts—Catastrophe: The ceding entity is indemnified, subject to a specified limit, against the amount of loss in excess of a specified retention with respect to an accumulation of losses resulting from a catastrophic event or series of events;
- d. Facultative Reinsurance Contracts—Pro Rata: The ceding entity is indemnified for a specified percentage of losses and loss expenses arising under a specific insurance policy in exchange for that percentage of the policy’s premium;
- e. Facultative Reinsurance Contracts—Excess of Loss: The ceding entity is indemnified, subject to a specified limit, for losses in excess of its retention with respect to a particular risk.

Characteristics of Reinsurance Agreements

- 6. Common contract provisions that may affect accounting practices include:
 - a. Reporting responsibility of the ceding entity—Details required and time schedules shall be established;
 - b. Payment terms—Time schedules, currencies intended, and the rights of the parties to withhold funds shall be established;
 - c. Payment of premium taxes—Customarily the responsibility of the ceding entity, a recital of nonliability of the reinsurer may be found;
 - d. Termination—May be on a cut-off or run-off basis. A cut-off provision stipulates that the reinsurer shall not be liable for loss as a result of occurrences taking place after the date of termination. A run-off provision stipulates that the reinsurer shall remain liable for loss under reinsured policies in force at the date of termination as a result of occurrences taking place after the date of termination until such time as the policies expire or are canceled; and
 - e. Insolvency clause—Provides for the survival of the reinsurer’s obligations in the event of insolvency of the ceding entity, without diminution because of the insolvency.

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

Required Terms for Reinsurance Agreements

8. In addition to credit for reinsurance requirements applicable to reinsurance transactions generally, no credit or deduction from liabilities shall be allowed by the ceding entity for reinsurance recoverable where the agreement was entered into after the effective date of these requirements (see paragraphs ~~129~~130 and ~~130~~131) unless each of the following conditions is satisfied:

- a. The agreement must contain an acceptable insolvency clause;
- b. Recoveries due the ceding entity must be available without delay for payment of losses and claim obligations incurred under the agreement, in a manner consistent with orderly payment of incurred policy obligations by the ceding entity;
- c. The agreement shall constitute the entire contract between the parties and must provide no guarantee of profit, directly or indirectly, from the reinsurer to the ceding entity or from the ceding entity to the reinsurer;
- d. The agreement must provide for reports of premiums and losses, and payment of losses, no less frequently than on a quarterly basis, unless there is no activity during the period. The report of premiums and losses shall set forth the ceding entity's total loss and loss expense reserves on the policy obligations subject to the agreement, so that the respective obligations of the ceding entity and reinsurer will be recorded and reported on a basis consistent with this statement;
- e. The agreement must include a proper reinsurance intermediary clause, if applicable, which stipulates that the credit risk for the intermediary is carried by the assuming insurance entity;
- f. With respect to reinsurance contracts involving a certified reinsurer, the agreement must include a proper funding clause, which requires the certified reinsurer to provide and maintain security in an amount sufficient to avoid the imposition of any financial statement penalty on the ceding insurance entity for reinsurance ceded to the certified reinsurer. However, this does not preclude negotiation for higher contractual collateral amounts; and
- g. With respect to retroactive reinsurance agreements, the following additional conditions apply:
 - i. The consideration to be paid by the ceding entity for the retroactive reinsurance must be a sum certain stated in the agreement;
 - ii. Direct or indirect compensation to the ceding entity or reinsurer is prohibited;
 - iii. Any provision for subsequent adjustment on the basis of actual experience in regard to policy obligations transferred, or on the basis of any other formula, is prohibited in connection with a retroactive reinsurance transaction, except that provision may be made for the ceding entity's participation in the reinsurer's ultimate profit, if any, under the agreement;
 - iv. A retroactive reinsurance agreement shall not be canceled or rescinded without the approval of the commissioner of the domiciliary state of the ceding entity.

Reinsurance Agreements with Multiple Cedents

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

- a. The allocation must be in writing and
- b. The terms of the allocation agreement must be fair and equitable.

Reinsurance Contracts Must Include Transfer of Risk

10. The essential ingredient of a reinsurance contract is the transfer of risk¹. The essential element of every true reinsurance agreement is the undertaking by the reinsurer to indemnify the ceding entity, i.e., reinsured entity, not only in form but in fact, against loss or liability by reason of the original insurance. Unless the agreement contains this essential element of risk transfer, no credit shall be recorded. (INT 02-22)

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

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

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

- a. The reinsurer assumes significant insurance risk under the reinsured portions of the underlying insurance agreements; and
- b. It is reasonably possible that the reinsurer may realize a significant loss from the transaction.

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

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

15. The word “timely” is used in paragraph 12 in the ordinary temporal sense to refer to the length of time between payment of the underlying reinsured claims and reimbursement by the reinsurer. While the test for reasonable possibility of significant loss to the reinsurer provides for a present-value-based assessment of the economic characteristics of the reinsurance contract, the concept of timely reimbursement

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

relates to the transfer of insurance risk (the condition in paragraph 13.a.), not the reasonable possibility of significant loss (the condition in paragraph 13.b.). Accordingly, timely reimbursement shall be evaluated based solely on the length of time between payment of the underlying reinsured claims and reimbursement by the reinsurer.

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

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

- a. The expected timing of payments to the reinsurer; and
- b. The duration over which those cash flows are expected to be invested by the reinsurer.

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

- a. The net cash flows of the reinsurer under the reinsurance contract; and
- b. The net cash flows of the ceding entity on the reinsured portions of the underlying insurance contracts.

If the economic position of the reinsurer relative to the insurer cannot be determined, the contract shall not qualify under the exception in this paragraph².

19. An extremely narrow and limited exemption is provided for contracts that reinsure either an individual risk or an underlying book of business that is inherently profitable. When substantially all of the insurance risk relating to the reinsured portions of the underlying insurance contracts has been assumed by the reinsurer, the contract meets the conditions for reinsurance accounting. To qualify under this exception,

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

no more than insignificant insurance risk on the reinsured portions of the underlying insurance contracts may be retained by the ceding entity.

20. Payment schedules and accumulating retentions from multiple years are contractual features inherently designed to delay the timing of reimbursement to the ceding entity. Regardless of what a particular feature might be called, any feature that can delay timely reimbursement violates the conditions for reinsurance accounting. Transfer of insurance risk requires that the reinsurer's payment to the ceding entity depend on and directly vary with the amount and timing of claims settled under the reinsured contracts. Contractual features that can delay timely reimbursement prevent this condition from being met. Therefore, any feature that may affect the timing of the reinsurer's reimbursement to the ceding entity shall be closely scrutinized.

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

- a. Premiums are deferred over a period beyond the term of the underlying insurance contracts;
- b. Losses are recognized in a different period than the period in which the event causing the loss takes place; or
- c. Both events, 21.a. and 21.b., occur at different points in time.

Contracts that are in substance financing receive deposit accounting treatment.

Accounting for Reinsurance

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

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

24. Reinsurance recoverable on loss payments is an admitted asset. Notwithstanding the fact that reinsurance recoverables on paid losses may meet the criteria for offsetting under the provisions of *SSAP No. 64—Offsetting and Netting of Assets and Liabilities*, reinsurance recoverables on paid losses shall be reported as an asset without any available offset. Unauthorized reinsurance and reinsurance ceded to certified reinsurers is included in this asset and reflected separately as a liability to the extent required. Penalty for overdue authorized reinsurance shall be reflected as a liability.

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

26. Prospective reinsurance is defined as reinsurance in which a reinsurer agrees to reimburse a ceding entity for losses that may be incurred as a result of future insurable events covered under contracts subject to the reinsurance. Retroactive reinsurance is defined as reinsurance in which a reinsurer agrees to reimburse a ceding entity for liabilities incurred as a result of past insurable events covered under contracts subject to

the reinsurance. A reinsurance agreement may include both prospective and retroactive reinsurance provisions.

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

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

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

Accounting for Prospective Reinsurance Agreements

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

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

losses and loss adjustment expenses shall be netted against the liability for gross losses and loss adjustment expenses.

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

Accounting for Retroactive Reinsurance Agreements

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

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

- a. The ceding entity shall record, without recognition of the retroactive reinsurance, loss and loss expense reserves on a gross basis on the balance sheet and in all schedules and exhibits;
- b. The assuming entity shall exclude the retroactive reinsurance from loss and loss expense reserves and from all schedules and exhibits;
- c. The ceding entity and the assuming entity shall report by write-in item on the balance sheet, the total amount of all retroactive reinsurance, identified as retroactive reinsurance reserve ceded or assumed, recorded as a contra-liability by the ceding entity and as a liability by the assuming entity;
- d. The ceding entity shall, by write-in item on the balance sheet, restrict surplus resulting from any retroactive reinsurance as a special surplus fund, designated as special surplus from retroactive reinsurance account;
- e. The surplus gain from any retroactive reinsurance shall not be classified as unassigned funds (surplus) until the actual retroactive reinsurance recovered exceeds the consideration paid;
- f. The special surplus from retroactive reinsurance account for each respective retroactive reinsurance agreement shall be reduced at the time the ceding entity begins to recover funds from the assuming entity in amounts exceeding the consideration paid by the ceding entity under such agreement, or adjusted as provided in paragraph 34.j.;
- g. For each agreement, the reduction in the special surplus from retroactive reinsurance account shall be limited to the lesser of (i) the actual amount recovered in excess of consideration paid or (ii) the initial surplus gain resulting from the respective retroactive reinsurance agreement. Any remaining balance in the special surplus from retroactive reinsurance account derived from any such agreement shall be returned to unassigned funds (surplus) upon elimination of all policy obligations subject to the retroactive reinsurance agreement;

- h. The ceding entity shall report the initial gain arising from a retroactive reinsurance transaction (i.e., the difference between the consideration paid to the reinsurer and the total reserves ceded to the reinsurer) as a write-in item on the statement of income, to be identified as Retroactive Reinsurance Gain and included under Other Income;
- i. The assuming entity shall report the initial loss arising from a retroactive reinsurance transaction, as defined in the preceding paragraph 34.g., as a write-in item on the statement of income, to be identified as Retroactive Reinsurance Loss and included under Other Income;
- j. Any subsequent increase or reduction in the total reserves ceded under a retroactive reinsurance agreement shall be reported in the manner described in the preceding paragraphs 34.h. and 34.i., in order to recognize the gain or loss arising from such increase or reduction in reserves ceded. The Special Surplus from Retroactive Reinsurance Account write-in entry on the balance sheet shall be adjusted, upward or downward, to reflect such increase or reduction in reserves ceded. The Special Surplus from Retroactive Reinsurance Account write-in entry shall be equal to or less than the total ceded reserves under all retroactive reinsurance agreements in-force as of the date of the financial statement. Special surplus arising from a retroactive reinsurance transaction shall be considered to be earned surplus (i.e., transferred to unassigned funds (surplus)) only when cash recoveries from the assuming entity exceed the consideration paid by the ceding entity as respects such retroactive reinsurance transaction; and
- k. The consideration paid for a retroactive reinsurance agreement shall be reported as a decrease in ledger assets by the ceding entity and as an increase in ledger assets by the assuming entity.

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

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

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

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

- d. Intercompany reinsurance agreements, and any amendments thereto, among companies 100% owned by a common parent or ultimate controlling person provided there is no gain in surplus as a result of the transaction; or
- e. Reinsurance/retrocession agreements that meet the criteria of property/casualty run-off agreements described in paragraphs 102-105.

37. Retroactive reinsurance agreements resulting in surplus gain to the ceding entity (with or without risk transfer) entered into between affiliates or between insurers under common control (as those terms are defined in Appendix A-440) shall be reported as follows:

- a. The consideration paid by the ceding entity shall be recorded as a deposit and reported as a nonadmitted asset; and
- b. No deduction shall be made from loss and loss adjustment expense reserves on the ceding entity's balance sheet, schedules, and exhibits.

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

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

Deposit Accounting

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

- a. At the outset of the reinsurance agreement, the net consideration paid by the ceding entity (premiums less commissions or other allowances) shall be recorded as a deposit by the ceding company and as a liability by the assuming entity. The deposit shall be reported as an admitted asset by the ceding company if (i) the assuming company is licensed, accredited or otherwise qualified in the ceding company's state of domicile as described in Appendix A-785 or (ii) there are funds held by or on behalf of the ceding company which meet the requirements of paragraph 19 of Appendix A-785;
- b. At subsequent reporting dates, the amount of the deposit/liability shall be adjusted by calculating the effective yield on the deposit agreement to reflect actual payments to date (receipts and disbursements shall be recorded through the deposit/liability accounts) and expected future payments (as discussed below), with a corresponding credit or charge to interest income or interest expense;
- c. The calculation of the effective yield shall use the estimated amount and timing of cash flows. If a change in the actual or estimated timing or amount of cash flows occurs, the effective yield shall be recalculated to reflect the revised actual or estimated cash flows. The deposit shall be adjusted to the amount that would have existed at the reporting date

had the new effective yield been applied since the inception of the reinsurance agreement. Changes in the carrying amount of the deposit asset/liability resulting from changes in the effective yield shall be recorded as interest income or interest expense;

- d. It shall be assumed that any cash transactions for the settlement of losses will reduce the asset/liability accounts by the amount of the cash transferred. When the remaining losses are revalued upward, an increase in the deposit liability shall be recorded as interest expense – by the assuming company. Conversely, the ceding company shall increase its deposit (asset) with an offsetting credit to interest income; and increase its outstanding loss liability with an offsetting charge to incurred losses;
- e. No deduction shall be made from the loss and loss adjustment expense reserves on the ceding company's Statement of Financial Position, schedules, and exhibits;
- f. The assuming company shall record net consideration to be returned to the ceding company as a liability.

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

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

Assumed Reinsurance

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

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

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

45. A lag will develop between the time of the entry of the underlying policy transaction on the books of the ceding entity and the transmittal of information and entry on the books of the assuming entity. Assuming companies shall estimate unreported premiums and related costs to the extent necessary to

prevent material distortions in the loss development contained in the assuming entity's annual statement schedules where calendar year premiums are compared to accident year losses.

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

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

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

Ceded Reinsurance

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

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

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

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

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

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

Adjustable Features/Retropective Rating

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

Commission Adjustments

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

- a. **Contingent or Straight Profit**—The reinsurer returns to the ceding entity a stipulated percentage of the profit produced by the business assumed from the ceding entity. Profit may be calculated for any specified period of time, but the calculation is often based on an average over a period of years; and
- b. **Sliding Scale**—A provisional rate of commission is paid over the course of the agreement, with a final adjustment based on the experience of the business ceded under the agreement.

Premium Adjustments

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

Adjustments in the Amount of Coverage

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

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

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

Multiple-Year Retrospectively-Rated Contracts

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

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

- a. Changes in the amount or timing of future contractual cash flows, including premium adjustments, settlement adjustments, or refunds to the ceding entity; or
- b. Changes in the contract's future coverage.

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

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

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

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

- a. The contract shall not contain features that prevent the risk transfer criteria from being reasonably applied and the risk transfer criteria shall be met.
- b. The ultimate premium expected to be paid or received under the contract shall be reasonably estimable and allocable in proportion to the reinsurance protection provided.

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

66. The condition in paragraph 65.a. applies to a contract and determining the substance of a contract is a judgmental matter. If an agreement with a reinsurer consists of both risk transfer and non-risk transfer coverages that have been combined into a single legal document, those coverages must be considered separately for accounting purposes. This statement does not intend for different kinds of exposures combined in a program of reinsurance to be evaluated for risk transfer and accounted for together because that would allow contracts that do not meet the conditions for reinsurance accounting to be accounted for as reinsurance by being designated as part of a program that in total meets the conditions for reinsurance accounting.

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

Obligatory Retrospective Rating Provisions

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

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

Allocation of Certain Payments Between Coverage and Past Losses

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

Contractual Termination Features

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

- a. The contract remains in force; or
- b. The ceding entity cancels before the end of the contract term.

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

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

Impairment

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

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

Commissions

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

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

Unauthorized Reinsurance

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

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

Reinsurance Ceded to a Certified Reinsurer

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

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

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

such rating downgrade and increased collateral requirement for all reinsurance ceded to such assuming insurer under its certified reinsurer status, unless the reinsurance is found by the commissioner of the reporting entity's domestic state to be at high risk of uncollectibility.

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

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

Funds Held Under Reinsurance Treaties

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

Provision for Reinsurance

85. The NAIC Property/Casualty Annual Statement Instructions, Schedule F, Part 3 – Ceded Reinsurance, references the provision for overdue reinsurance, which provides for a minimum reserve for uncollectible reinsurance with an additional reserve required if an entity's experience indicates that a higher amount should be provided. The minimum reserve provision for reinsurance is recorded as a liability and the change between years is recorded as a gain or loss directly to unassigned funds (surplus). Any reserve over the minimum amount shall be recorded on the statement of income by reversing the accounts previously utilized to establish the reinsurance recoverable.

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

Asbestos and Pollution Contracts – Counterparty Reporting Exception

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

- a. The underlying agreement clearly indicates the credit risk associated with the collection of the reporting entity's insuring reinsurance recoverables and losses related to the credit risk will be covered by the retroactive reinsurance counterparty.
- b. The retroactive reinsurance agreement must transfer significant risk of loss.
- c. The assuming retroactive reinsurance counterparty must have a financial strength rating from at least two nationally recognized statistical rating organizations (NRSRO), the lowest of which is higher than or equal to the NRSRO ratings of the underlying third-party reinsurers.
- d. The transaction is limited to reinsurance recoverables attributable to asbestos, and/or pollution.
- e. The recoverables from the insuring reinsurers remain subject to credit analysis and contingent liability analysis.

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

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

Syndicated Letters of Credit

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

- a. All listed banks on the letter of credit are qualified and meet the criteria of the NAIC SVO approved bank listing;
- b. Banks are severally and not jointly liable; and
- c. Specific percentages for each assuming bank are listed in the letter of credit.

Disputed Items

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

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

Uncollectible Reinsurance

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

Commutations

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

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

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

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

National Flood Insurance Program

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

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

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

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

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

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

Criteria

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

- a. **Assuming Entity Properly Licensed** – The entity assuming the run-off agreement must have the appropriate authority or license to write the business being assumed.
- b. **Limits and Coverages** – The reinsurance or retrocession agreement shall provide the same limits and coverages that were afforded in the original insurance or reinsurance agreement.
- c. **Non-recourse** – The reinsurance or retrocession agreement shall not contain any adjustable features or profit share or retrospective rating, and there shall be no recourse (other than normal representations and warranties that would be associated with a purchase and sale agreement) directly or indirectly against the transferring entity.
- d. **Risk Transfer** – The reinsurance or retrocession agreement must meet the requirements of risk transfer as described in this statement.
- e. **Financial Strength of Reinsurer** – The assuming reinsurer shall have a financial strength rating from at least two independent rating agencies (from NAIC credit rating providers (CRP)) which is equal to or greater than the current ratings of the transferring entity. The lowest financial strength rating received from an NAIC acceptable rating organization rating agency will be used to compare the financial strength ratings of the transferring and assuming entities.
- f. **Assessments** – The assuming reinsurer or retrocessionaire (if required in the original reinsurance contract) shall be financially responsible for any and all assessments, including

guaranty fund assessments, that are assessed against the transferring entity related to the insurance business being assumed.

- g. Applicable Only to “Run-off” Business – The reinsurance or retrocession agreement shall only cover liabilities relating to a line(s) of business or specific market segments no longer actively marketed by the transferring entity.
- h. Non-cancelable Reinsurance – The reinsurance or retrocession agreement shall provide that the reinsurance or retrocessional coverage provided by the proposed agreement cannot be cancelable by either party for any reason. (However, this provision will not override standard contracts law and principles and will not prevent any remedies, including rescission or termination that might be available for breach, misrepresentation, etc.)

Statutory Schedules and Exhibits

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

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

Disclosures

106. Unsecured Reinsurance Recoverables:

- a. If the entity has with any individual reinsurers, authorized, reciprocal jurisdiction, unauthorized, or certified an unsecured aggregate recoverable for losses, paid and unpaid including IBNR, loss adjustment expenses, and unearned premium, that exceeds 3% of the entity’s policyholder surplus, list each individual reinsurer and the unsecured aggregate recoverable pertaining to that reinsurer; and
- b. If the individual reinsurer is part of a group, list the individual reinsurers, each of its related group members having reinsurance with the reporting entity, and the total unsecured aggregate recoverables for the entire group.

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

108. Uncollectible Reinsurance—Describe uncollectible reinsurance written off during the year reported in the following annual statement classifications, including the name(s) of the reinsurer(s):

- a. Losses incurred;
- b. Loss adjustment expenses incurred;

- c. Premiums earned; and
- d. Other.

109. Commutation of Ceded Reinsurance—Describe commutation of ceded reinsurance during the year reported in the following annual statement classifications, including the name(s) of the reinsurer(s):

- a. Losses incurred;
- b. Loss adjustment expenses incurred;
- c. Premiums earned; and
- d. Other.

110. Retroactive Reinsurance—The table illustrated in the NAIC Annual Statement Instructions for Property and Casualty Companies under Retroactive Reinsurance in the Notes to Financial Statements section shall be completed for all retroactive reinsurance agreements that transfer liabilities for losses that have already occurred and that will generate special surplus transactions. The insurer (assuming or ceding) shall assign a unique number to each retroactive reinsurance agreement and shall utilize this number for as long as the agreement exists. Transactions utilizing deposit accounting shall not be reported in this note.

111. Reinsurance Assumed and Ceded—The tables illustrated in the NAIC Annual Statement Instructions for Property and Casualty Companies under “Reinsurance Assumed and Ceded in the Notes to Financial Statements” section shall be completed as follows:

- a. The financial statements shall disclose the maximum amount of return commission which would have been due reinsurers if all reinsurance were canceled with the return of the unearned premium reserve; and
- b. The financial statements shall disclose the accrual of additional or return commission, predicated on loss experience or on any other form of profit sharing arrangements as a result of existing contractual arrangements.

112. A specific interrogatory requires information on reinsurance of risk accompanied by an agreement to release the reinsurer from liability, in whole or in part, from any loss that may occur on the risk or portion thereof.

113. Disclosures for paragraphs 114-119 represent annual statement interrogatories, which are required to be included with the annual audit report beginning with audit reports on financial statements as of and for the period ended December 31, 2006. The disclosures required within paragraphs 114-119 shall be included in accompanying supplemental schedules of the annual audit report beginning in year-end 2006. These disclosures shall be limited to reinsurance contracts entered into, renewed or amended on or after January 1, 1994. This limitation applies to the annual audit report only and does not apply to the statutory annual statement interrogatories and the reinsurance summary supplemental filing.

114. Disclose if any risks are reinsured under a quota share reinsurance contract with any other entity that includes a provision that would limit the reinsurer’s losses below the stated quota share percentage (e.g. a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions)? If yes, indicate the number of reinsurance contracts containing such provisions and if the amount of reinsurance credit taken reflects the reduction in quota share coverage caused by any applicable limiting provision(s).

115. Disclose if the reporting entity ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement: (i) it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards

policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contract(s) contain one or more of the following features or other features that would have similar results:

- a. A contract term longer than two years and the contract is noncancellable by the reporting entity during the contract term;
- b. A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;
- c. Aggregate stop loss reinsurance coverage;
- d. A unilateral right by either party (or both parties) to commute the reinsurance contract, whether conditional or not, except for such provisions which are only triggered by a decline in the credit status of the other party;
- e. A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or
- f. Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.

116. Disclose if the reporting entity during the period covered by the statement ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders. This disclosure is limited to reinsurance contracts with written premium cessions or loss and loss expense reserve cessions described in this paragraph that meet the criteria of paragraph 116.a. or paragraph 116.b. This disclosure excludes cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member.

- a. The written premium ceded to the reinsurer by the reporting entity or its affiliates represents ~~fifty percent (50%)~~ or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or
- b. Twenty-five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates in separate reinsurance contract.

117. If affirmative disclosure is required for paragraph 115 or 116, provide the following information:

- a. A summary of the reinsurance contract terms and indicate whether it applies to the contracts meeting paragraph 115 or 116;
- b. A brief discussion of management's principal objectives in entering into the reinsurance contract including the economic purpose to be achieved; and
- c. The aggregate financial statement impact gross of all such ceded reinsurance contracts on the balance sheet and statement of income.

118. Except for transactions meeting the requirements of paragraph 36, disclose if the reporting entity ceded any risk under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:

- a. Accounted for that contract as reinsurance (either prospective or retroactive) under statutory accounting principles (SAP) and as a deposit under generally accepted accounting principles (GAAP); or
- b. Accounted for that contract as reinsurance under GAAP and as a deposit under SAP.

119. If affirmative disclosure is required for paragraph 118, explain in a supplemental filing why the contract(s) is treated differently for GAAP and SAP.

120. Disclosures for the Transfer of Property and Casualty Run-off Agreements

- a. Disclose if the reporting entity has entered into any agreements which have been approved by their domiciliary regulator and have qualified pursuant to paragraph 36.e. (also see paragraphs 102-105).
- b. If affirmative, provide a description of the agreement and the amount of consideration paid and liabilities transferred.

121. The financial statements shall disclose the following with respect to reinsurance agreements which qualify for reinsurer aggregation in accordance with paragraphs 87-89:

- a. A description of the significant terms of the reinsurance agreement, including established limits and collateral, and
- b. The amount of unexhausted limit as of the reporting date.
- c. To the extent that the domestic state insurance department approves the use of the retroactive contract as an acceptable form of security related to the original reinsurers under the applicable provisions of the state's credit for reinsurance law, the use of such discretion shall be disclosed in the annual statement Note 1 as a prescribed or permitted practice. In addition, Note 1 shall disclose as part of the total impact on the provision for reinsurance the impact on the overdue aspects of the calculation if the reporting entity also receives commissioner approval pursuant to paragraph 87 related to overdue paid amounts (both authorized and unauthorized).

122. The financial statements shall disclose the following with respect to reinsurance agreements that have been accounted for as deposits:

- a. A description of the reinsurance agreements.
- b. Any adjustment of the amounts initially recognized for expected recoveries. The individual components of the adjustment (e.g., interest accrual, change due to a change in estimated or actual cash flow) shall be disclosed separately.

123. The financial statements shall disclose the impact on any reporting period in which a certified reinsurer's rating has been downgraded or its certified reinsurer status is subject to revocation and additional collateral has not been received as of the filing date. The disclosure should include the following:

- a. Name of certified reinsurer downgraded or subject to revocation of certified reinsurer status and relationship to the reporting entity;

- b. Date of downgrade or revocation and jurisdiction of action;
- c. Collateral percentage requirements pre and post downgrade or revocation;
- d. Net ceded recoverable subject to collateral;
- e. As of the end of the current quarter, the estimated impact of the collateral deficiency to the reporting entity as a result of the assuming entity's downgrade or revocation of certified reinsurer status. (At year-end the actual impact of the collateral deficiency on the provision for reinsurance shall be disclosed.)

124. U.S. domiciled reinsurers are eligible for certified reinsurer status. If the reporting entity is a certified reinsurer, the financial statements shall disclose the impact on any reporting period in which its certified reinsurer rating is downgraded or status as a certified reinsurer is subject to revocation. Such disclosure shall include information similar to paragraphs 123.b., 123.c. and 123.d. and the expectation of its certified reinsurer's ability to meet the increased requirements.

125. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

126. This statement adopts with modification *FASB Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts* (FAS 113) and *FASB Emerging Issues Task Force No. 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises* for the following:

- a. Reinsurance recoverables on unpaid case-basis and incurred but not reported losses and loss adjustment expenses shall be reported as a contra-liability netted against the liability for gross losses and loss adjustment expenses;
- b. Amounts paid for prospective reinsurance that meet the conditions for reinsurance accounting shall be reported as a reduction of unearned premiums;
- c. The gain created by a retroactive reinsurance agreement because the amount paid to the reinsurer is less than the gross liabilities for losses and loss adjustment expenses ceded to the reinsurer is reported in the statement of income as a write-in gain in other income by the ceding entity and a write-in loss by the assuming entity. The gain created by a retroactive reinsurance agreement is restricted as a special surplus account until the actual retroactive reinsurance recovered is in excess of the consideration paid;
- d. This statement requires that a liability (provision for reinsurance) be established through a provision reducing unassigned funds (surplus) for unsecured reinsurance recoverables from unauthorized or certified reinsurers and for certain overdue balances due from authorized reinsurers;
- e. Some reinsurance agreements contain adjustable features that provide for adjustment of commission, premium or amount of coverage, based on loss experience. This statement requires that the asset or liability arising from the adjustable feature be computed based on experience to date under the agreement, and the impact of early termination may only be considered at the time the agreement has actually been terminated;
- f. Structured settlements are addressed in *SSAP No. 65—Property and Casualty Contracts*. Statutory accounting and FAS 113 are consistent in accounting for structured settlement annuities where the reporting entity is the owner and payee and where the claimant is the payee and the reporting entity has been released from its obligation. FAS 113 distinguishes

structured settlement annuities where the claimant is the payee and a legally enforceable release from the reporting entity's liability is obtained from those where the claimant is the payee but the reporting entity has not been released from its obligation. GAAP requires the deferral of any gain resulting from the purchase of a structured settlement annuity where the reporting entity has not been released from its obligation; and

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

127. This statement adopts American Institute of Certified Public Accountants (AICPA) *Statement of Position 98-7, Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk* (SOP 98-7) paragraphs 10-12 and 19 (subsection b only). This statement rejects AICPA SOP 98-7 paragraphs 13-17 and 19 (subsections a and c).

128. This statement rejects AICPA *Statement of Position No. 92-5, Accounting for Foreign Property and Liability Reinsurance*. This statement incorporates Appendix A-785 as applicable.

129. Effective December 31, 2023, this statement rejects ASU 2016-13 *Financial Instruments—Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments*, ASU 2018-19 *Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, ASU 2019-04 *Codification Improvements to Topics 326, 815, 825, ASU 2019-10 *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842)*, ASU 2019-11 *Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, and ASU 2020-03 *Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.*

Effective Date and Transition

~~129.~~130. This statement shall apply to:

- a. Reinsurance agreements entered into, renewed, or amended on or after January 1, 1994. An amendment is any revision or adjustment of contractual terms. The payment of premiums or reimbursement of losses recoverable under the agreement shall not constitute an amendment; and
- b. Reinsurance agreements in force on January 1, 1995, which cover losses occurring or claims made on or after that date on policies reinsured under such agreements.

~~130.~~131. The guidance shall not apply to:

- a. Reinsurance agreements which cover only losses occurring or claims made before January 1, 1994, and which were entered into before January 1, 1994, and were not subsequently renewed or amended; and
- b. Reinsurance agreements that expired before and were not renewed or amended after January 1, 1995.

~~131.~~132. The guidance in paragraphs 55-74 shall be effective for all accounting periods beginning on or after January 1, 1996, and shall apply to reinsurance agreements entered into, renewed or amended on or after January 1, 1994.

~~132.~~133. This statement, including the guidance in paragraph 40 incorporated from SSAP No. 75, is effective for years beginning January 1, 2001. Changes resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

- a. Revisions to paragraph 36.e., related to paragraphs 102-105, and disclosures in paragraph 120 documented in *Issue Paper No. 137—Transfer of Property and Casualty Reinsurance Run-off Agreements* are effective for contracts entered on or after January 1, 2010.
- b. The guidance in paragraphs 40, 122 and 127 was previously included within *SSAP No. 75—Reinsurance Deposit Accounting—An Amendment to SSAP No. 62R, Property and Casualty Reinsurance* and was also effective for years beginning January 1, 2001. In 2011, the guidance from SSAP No. 75 was incorporated within this statement, with SSAP No. 75 nullified. The original guidance included in this statement for deposit accounting, as well as the original guidance adopted in SSAP No. 75, are retained for historical purposes in *Issue Paper No. 104*. The guidance in paragraph 54 was originally contained within *INT 02-06: Indemnification in Modeled Trigger Transactions* and was effective June 9, 2002. The guidance in paragraph 90 was originally contained within *INT 02-09: A-785 and Syndicated Letters of Credit* and was effective September 12, 2004.
- c. The guidance related to certified reinsurers is applicable only to cedents domiciled in states that have enacted/promulgated the new collateral framework and only for their cessions to reinsurers certified under that domestic law/rule. The requirements applicable to contracts with certified reinsurers shall be effective for all reporting periods beginning on or after December 31, 2012.

~~133.~~134. The guidance in paragraphs 87-89 and 121 which allowed retroactive reinsurance exceptions for asbestos and pollution contracts was effective for all accounting periods beginning on or after January 1, 2014, for paid losses. This guidance was revised to also allow for unpaid losses effective for reporting periods ending on and after December 31, 2015.

~~134.~~135. The substantive revisions adopted November 15, 2018, which primarily incorporated guidance originally from *EITF 93-6, Accounting for Multiple-Year Retrospectively-Rated Contracts by Ceding and Assuming Enterprises*, and from *EITF Topic D-35, FASB Staff Views on Issue No. 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises*, are effective for contracts in effect on or after January 1, 2019. These revisions are required for contracts in effect as EITF 93-6 had been adopted with modification in this statement from its original 2001 effective date. The revisions adopted in November 2018 primarily added clarification and implementation guidance. (Companies that have previously been following the original intent, as clarified in the revisions, should not be impacted by the November 2018 revisions.) However, if a reporting entity becomes aware that the prior application of reinsurance credit guidance was not consistent with the adopted guidance, the updates should be applied as a change in accounting principle to contracts in effect as of January 1, 2019.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 75—Property and Casualty Reinsurance*
- *Issue Paper No. 104—Reinsurance Deposit Accounting – An Amendment to SSAP No. 62R—Property and Casualty Reinsurance*
- *Issue Paper No. 137—Transfer of Property and Casualty Reinsurance Run-off Agreements*

- *Issue Paper No. 153—Counterparty Reporting Exception for Asbestos and Pollution Contracts*

Not for Distribution

CLASSIFYING REINSURANCE CONTRACTS

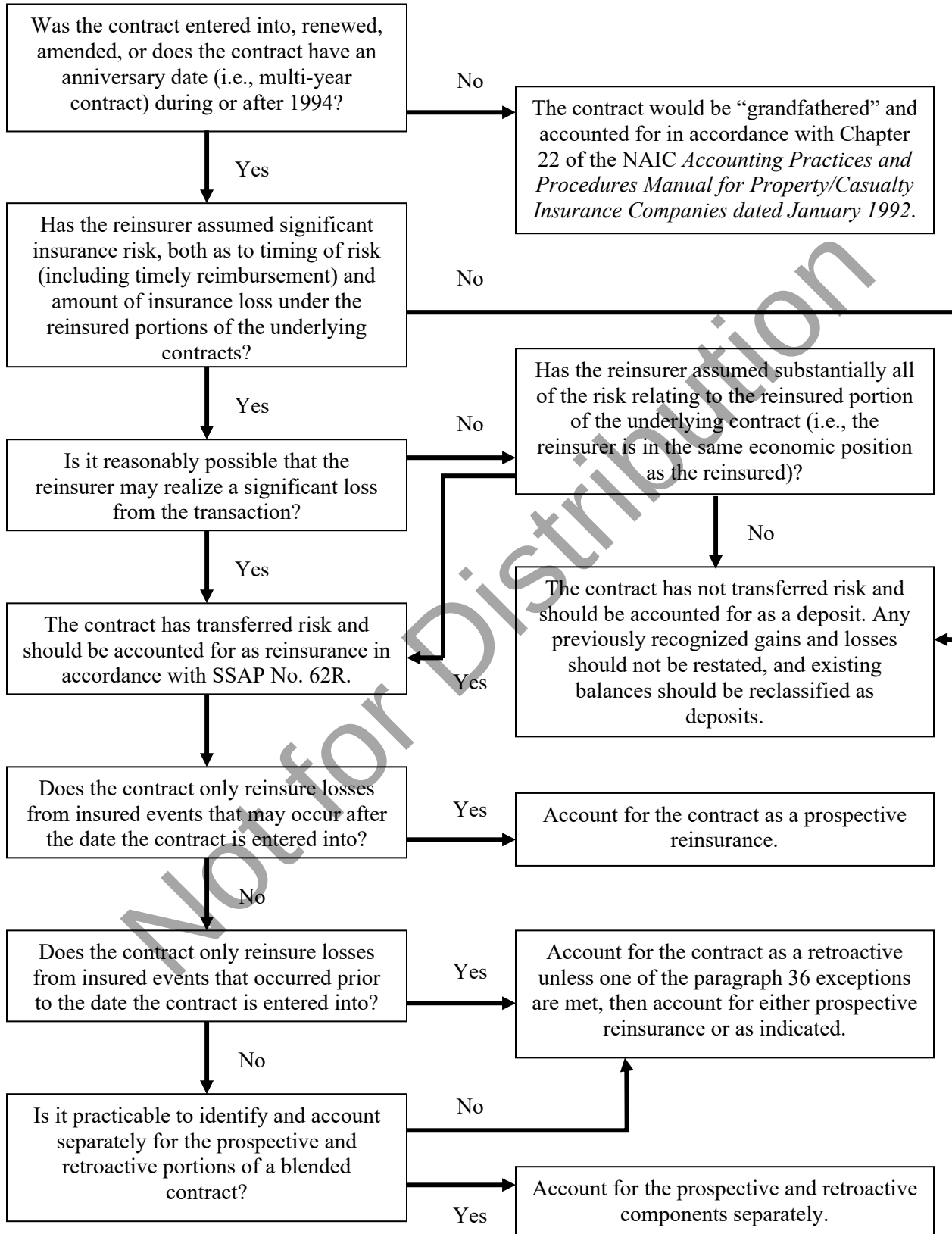


EXHIBIT A – IMPLEMENTATION QUESTIONS AND ANSWERS

This exhibit addresses common questions regarding implementation of the property and casualty reinsurance accounting standards.

Index to Questions

No.	Question
Applicability	
1	The accounting practices in SSAP No. 62R specify the accounting and reporting for reinsurance contracts. What contracts are considered reinsurance contracts for purposes of applying these accounting practices?
2	The provisions of this statement will apply to (a) reinsurance contracts entered into, renewed or amended on or after January 1, 1994, and (b) any other reinsurance contracts that are in force on January 1, 1995, and cover insurable events on the underlying insurance policies that occur on or after that date. What contracts would be exempt from the accounting rules included in SSAP No. 62R?
3	This statement is to be applied to contracts which are amended on or after January 1, 1994. What if the change in terms is not significant, or the terms changed have no financial effect on the contract?
4	Must the accounting provisions of SSAP No. 62R be applied to an <i>otherwise exempt</i> contract if the ceding entity pays additional premiums under the contract on or after January 1, 1994?
5	Prospective and retroactive portions of a reinsurance contract are allowed to be accounted for separately, if practicable. Can the retroactive portion of an existing contract be segregated and, therefore, exempted with other retroactive contracts covering insured events occurring prior to January 1, 1994?
Risk Transfer	
6	Do the risk transfer provisions apply to existing contracts?
7	How does the effective date affect the assessment of whether a significant loss to the reinsurer was reasonably possible?
8	Should risk transfer be reassessed if contractual terms are subsequently amended?
9	How should the risk transfer assessment be made when a contract has been amended?
10	For purposes of evaluating whether a contract with a reinsurer transfers risk, what constitutes a contract?
11	If the assessment of risk transfer changes after the initial assessment at contract inception, how should the ceding entity account for the change?
12	SSAP No. 62R requires that reasonably possible outcomes be evaluated to determine the reinsurer's exposure to significant loss. What factors should be considered in determining whether a scenario being evaluated is reasonably possible?

No.	Question
13	In determining the amount of the reinsurer's loss under reasonably possible outcomes, may cash flows directly related to the contract other than those between the ceding and assuming companies, such as taxes and operating expenses of the reinsurer, be considered in the calculation?
14	In evaluating the significance of a reasonably possible loss, should the reasonably possible loss be compared to gross or net premiums?
15	How does a commutation clause affect the period of time over which cash flows are evaluated for reasonable possibility of significant loss to the reinsurer?
16	SSAP No. 62R refers to payment schedules and accumulating retentions from multiple years as features that delay timely reimbursement of claims. Does the presence of those features generally prevent a contract from meeting the conditions for reinsurance accounting?
17	What if a contract contains a feature such as a payment schedule or accumulating retention but could still result in the reasonable possibility of significant loss to the reinsurer?
18	Can a reinsurance agreement compensate a reinsurer for losses?
19	In determining whether a reinsurance contract qualifies under the exception referred to in paragraph 18 of SSAP No. 62R, how should the economic position of the reinsurer be assessed in relation to that of the ceding entity?
Accounting Provisions	
20	An existing contract that was accounted for as reinsurance no longer qualifies for reinsurance accounting under the accounting rules included in SSAP No. 62R. How should the ceding and assuming companies account for the contract in future periods?
21	What is the definition of past insurable events that governs whether reinsurance coverage is prospective or retroactive? For example, could a reinsurance contract that covers losses from asbestos and pollution claims on occurrence-based insurance policies effective during previous periods be considered prospective if the reinsurance coverage is triggered by a court interpretation that a loss is covered within the terms of the underlying insurance policies?
22	Would the answer to the above question change if the reinsurance were written on a claims-made basis?
23	What is the effect of adjustments to future premiums or coverage in determining whether reinsurance is prospective or retroactive?
24	A reinsurance contract is entered into after the contract's effective date. Is the coverage between the contract's effective date and the date the contract was entered into prospective or retroactive?
25	How is the date the reinsurance contract was entered into determined?
26	Are contracts to reinsure calendar-year incurred losses considered blended contracts that have both prospective and retroactive elements?
27	When the prospective and retroactive portions of a contract are being accounted for separately, how should premiums be allocated to each portion of the contract?

No.	Question
28	A retroactive reinsurance contract contains a cut-through provision that provides the ceding entity's policyholders and claimants with the right to recover their claims directly from the reinsurer. May the ceding entity immediately recognize earned surplus associated with this type of contract?
29	A ceding entity enters into a retroactive reinsurance agreement that gives rise to segregated surplus. If the reinsurer prepays its obligation under the contract, may the ceding entity recognize earned surplus at the time the prepayment is received?
30	If the ceding entity does not expect to receive any recoveries because the reinsurer has agreed to reimburse claimants under the reinsured contracts directly, would the ceding entity be considered to have recovered or terminated its transferred liabilities?
31	What accounting entries would a ceding entity make to report a retroactive reinsurance contract?
32	How should the parties account for an adverse loss development reinsurance contract where, as of the statement date, the attachment level of the contract exceeds the ceding company's current case and IBNR reserves for the covered accident years (i.e., no surplus gain and no reinsurance recoverable as of the statement date), and the ceding company transferred cash to the reinsurer at the inception of the contract?
33	How should a ceding company account for payment of the premium for a retroactive reinsurance contract by the ceding company's parent company or some other person not a party to the reinsurance contract (for example, adverse loss development reinsurance contracts purchased by the parent company in the context of the purchase or sale of the ceding company)?

Applicability

1. Q: The accounting practices in SSAP No. 62R specify the accounting and reporting for reinsurance contracts. What contracts are considered reinsurance contracts for purposes of applying these accounting practices?

A: Any transaction that indemnifies an insurer against loss or liability relating to insurance risk shall be accounted for in accordance with the accounting practices included in SSAP No. 62R. Therefore, all contracts, including contracts that may not be structured or described as reinsurance, shall be accounted for as reinsurance when those conditions are met.
2. Q: The provisions of this statement will apply to (a) reinsurance contracts entered into, renewed or amended on or after January 1, 1994, and (b) any other reinsurance contracts that are in force on January 1, 1995 and cover insurable events on the underlying insurance policies that occur on or after that date. What contracts would be exempt from the accounting rules included in SSAP No. 62R?

A: The only exempt contracts are:

 - 1) Purely retroactive reinsurance contracts that cover only insured events occurring before January 1, 1994, provided those contracts were entered into before that date and are not subsequently amended and
 - 2) Contracts that expired before January 1, 1995 and are not amended after that date.

3. Q: This statement is to be applied to contracts which are amended on or after January 1, 1994. What if the change in terms is not significant, or the terms changed have no financial effect on the contract?
- A: In general, the term amendment should be viewed broadly to include all but the most trivial changes. Examples of amendments include, but are not limited to, replacing one assuming entity with another (including an affiliated entity), or modifying the contract's limit, coverage, premiums, commissions, or experience-related adjustable features. No distinction is made between financial and non-financial terms.
4. Q: Must the accounting provisions of SSAP No. 62R be applied to an *otherwise exempt* contract if the ceding entity pays additional premiums under the contract on or after January 1, 1994?
- A: The answer depends on why the additional premiums are paid. If the additional premiums are the result of a renegotiation, adjustment, or extension of terms, the contract is subject to the accounting provisions of SSAP No. 62R. However, additional premiums paid without renegotiation, adjustment, or extension of terms would not make an otherwise exempt contract subject to those provisions.
5. Q: Prospective and retroactive portions of a reinsurance contract are allowed to be accounted for separately, if practicable. Can the retroactive portion of an existing contract be segregated and, therefore, exempted with other retroactive contracts covering insured events occurring prior to January 1, 1994?
- A: No. The transition provisions apply to an entire contract, which is either subject to or exempt from the provisions of SSAP No. 62R. A ceding entity may bifurcate a contract already subject to the accounting rules in SSAP No. 62R and then account for both the prospective and retroactive portions in accordance with the accounting standard.

Risk Transfer

6. Q: Do the risk transfer provisions apply to existing contracts?
- A: Yes, the risk transfer provisions apply to some existing contracts. SSAP No. 62R applies in its entirety only to existing contracts which were renewed or amended on or after January 1, 1994, or which cover losses occurring or claims made after that date. Therefore, those contracts must be evaluated to determine whether they transfer risk and qualify for reinsurance accounting. For accounting periods commencing on or after January 1, 1995, balances relating to such contracts which do not transfer insurance risk shall be reclassified as deposits and shall be accounted for and reported in the manner described under the caption Reinsurance Contracts Must Include Transfer of Risk.
- SSAP No. 62R does not apply to existing contracts which were entered into before, and were not renewed or amended on or after, January 1, 1994, and which cover only losses occurring or claims made before that date, nor to contracts which expired before, and were not renewed or amended on or after, January 1, 1995. Those contracts will continue to be accounted for in the manner provided by SSAP No. 62R before these revisions.
7. Q: How does the effective date affect the assessment of whether a significant loss to the reinsurer was reasonably possible?
- A: The risk transfer assessment is made at contract inception, based on facts and circumstances known at the time. Because that point in time has passed for existing contracts, some have suggested that the risk transfer provisions be applied as of the effective date. However, that approach to the risk transfer assessment would violate the requirement to consider all cash flows from the contract.

Therefore, the test must be applied from contract inception, considering the effect of any subsequent contract amendments. Careful evaluation and considered judgment will be required to determine whether a significant loss to the reinsurer was reasonably possible at inception.

8. Q: Should risk transfer be reassessed if contractual terms are subsequently amended?

A: Yes. When contractual terms are amended, risk transfer should be reassessed. For example, a contract that upon inception met the conditions for reinsurance accounting could later be amended so that it no longer meets those conditions. The contract should then be reclassified and accounted for as a deposit.

9. Q: How should the risk transfer assessment be made when a contract has been amended?

A: No particular method is prescribed for assessing risk transfer in light of a contract amendment. Whether an amended contract in substance transfers risk must be determined considering all of the facts and circumstances in light of the risk transfer requirements. Judgment also will be required to determine whether an amendment in effect creates a new contract.

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

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

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

11. Q: If the assessment of risk transfer changes after the initial assessment at contract inception, how should the ceding entity account for the change?

A: The status of a contract should be determinable at inception and, absent amendment, subsequent changes should be very rare. If the risk of significant loss was not deemed reasonably possible at inception, and a significant loss subsequently occurred, the initial assessment was not necessarily wrong, because remote events do occur. Likewise, once a reasonable possibility of significant loss has been established, such loss need not occur in order to maintain the contract's status as reinsurance.

12. Q: SSAP No. 62R requires that reasonably possible outcomes be evaluated to determine the reinsurer's exposure to significant loss. What factors should be considered in determining whether a scenario being evaluated is reasonably possible?

A: The term *reasonably possible* means that the probability is more than remote. The test is applied to a particular scenario, not to the individual assumptions used in the scenario. Therefore, a scenario is not reasonably possible unless the likelihood of the entire set of assumptions used in the scenario occurring together is reasonably possible.

13. Q: In determining the amount of the reinsurer's loss under reasonably possible outcomes, may cash flows directly related to the contract other than those between the ceding and assuming companies, such as taxes and operating expenses of the reinsurer, be considered in the calculation?

A: No. The evaluation is based on the present value of all cash flows *between the ceding and assuming enterprises* under reasonably possible outcomes and, therefore, precludes considering other expenses of the reinsurer in the calculation.

14. Q: In evaluating the significance of a reasonably possible loss, should the reasonably possible loss be compared to gross or net premiums?

A: Gross premiums should be used.

15. Q: How does a commutation clause affect the period of time over which cash flows are evaluated for reasonable possibility of significant loss to the reinsurer?

A: All cash flows are to be assessed under reasonably possible outcomes. Therefore, unless commutation is expected in the scenario being evaluated, it should not be assumed in the calculation. Further, the assumptions used in a scenario must be internally consistent and economically rational in order for that scenario's outcome to be considered reasonably possible.

16. Q: SSAP No. 62R refers to payment schedules and accumulating retentions from multiple years as features that delay timely reimbursement of claims. Does the presence of those features generally prevent a contract from meeting the conditions for reinsurance accounting?

A: Yes. Payment schedules and accumulating retentions from multiple years are contractual features inherently designed to delay the timing of reimbursement to the ceding entity. Regardless of what a particular feature might be called, any feature that can delay timely reimbursement violates the conditions for reinsurance accounting. Transfer of insurance risk requires that the reinsurer's payments to the ceding entity depend on and directly vary with the amount and timing of claims settled under the reinsured contracts. Contractual features that can delay timely reimbursement prevent this condition from being met. Therefore, any feature that may affect the timing of the reinsurer's reimbursement to the ceding entity should be closely scrutinized.

17. Q: What if a contract contains a feature such as a payment schedule or accumulating retention but could still result in the reasonable possibility of significant loss to the reinsurer?

A: Both of the following conditions are required for reinsurance accounting:

- a. Transfer of significant risk arising from uncertainties about both (i) the ultimate amount of net cash flows from premiums, commission, claims, and claim settlement expenses paid under a contract (underwriting risk) and (ii) the timing of the receipt and payment of those cash flows (timing risk); and
- b. Reasonable possibility of significant loss to the reinsurer.

Because both condition (a) and condition (b) must be met, failure to transfer significant timing and underwriting risk is not overcome by the possibility of significant loss to the reinsurer.

18. Q: Can a reinsurance agreement compensate a reinsurer for losses?

A: A contract does not meet the conditions for reinsurance accounting if features of the reinsurance contract or other contracts or agreements directly or indirectly compensate the reinsurer or related reinsurers for losses to an extent that risk-transfer criteria is violated. That compensation may take many forms, and an understanding of the substance of the contracts or agreements is required to determine whether the ceding entity has been indemnified against loss or liability relating to insurance risk. For example, contractual features may limit the reinsurer's exposure to insurance risk or delay the reimbursement of claims so that investment income mitigates exposure to insurance risk. Examples of those contractual features noted in paragraph 12 are not all-inclusive.

19. Q: In determining whether a reinsurance contract qualifies under the exception referred to in paragraph 18, how should the economic position of the reinsurer be assessed in relation to that of the ceding entity?

A: The assessment should be made by comparing the net cash flows of the reinsurer under the reinsurance contract with the net cash flows of ceding entity on the reinsured portions of the underlying insurance contracts. This may be relatively easy for reinsurance of individual risks or for unlimited-risk quota-share reinsurance, because the premiums and losses on these types of reinsurance generally are the same as the premiums and losses on the reinsured portions of the underlying insurance policies.

In other types of reinsurance, determining the reinsurer's net cash flows relative to the insurer is likely to be substantially more difficult. For example, it generally would be difficult to demonstrate that the ceding entity's premiums and losses for a particular layer of insurance are the same as the reinsurer's premiums and losses related to that layer. If the economic position of the reinsurer relative to the insurer cannot be determined, the contract would not qualify under the exception.

Accounting Provisions

20. Q: An existing contract that was accounted for as reinsurance no longer qualifies for reinsurance accounting under the accounting rules included in SSAP No. 62R. How should the ceding and assuming companies account for the contract in future periods?

A: Because the statement of income cannot be restated, previously recognized gains and losses are not revised. If the contract was entered into before, and not renewed or amended on or after, January 1, 1994 and covers only losses occurring or claims made before that date, or the contract expired before January 1, 1995 and was not renewed or amended on or after that date, it would continue to be accounted for in the manner provided before these revisions.

For accounting periods commencing on or after January 1, 1995, existing balances relating to contracts which do not transfer insurance risk and which were entered into on or after January 1, 1994 (covering losses occurring or claims made after that date) would be reclassified as deposits.

Premium payments to a reinsurer would be recorded as deposits. Likewise, losses recoverable from a reinsurer would not be recognized as receivables. Rather, any reimbursement for losses would be accounted for upon receipt as a refund of a deposit.

21. Q: What is the definition of past insurable events that governs whether reinsurance coverage is prospective or retroactive? For example, could a reinsurance contract that covers losses from asbestos and pollution claims on occurrence-based insurance policies effective during previous periods be considered prospective if the reinsurance coverage is triggered by a court interpretation that a loss is covered within the terms of the underlying insurance policies?

A: The distinction between prospective and retroactive reinsurance is based on whether a contract reinsures future or past insured events covered by the underlying reinsurance contracts. In the example above, the insured event is the occurrence of loss within the coverage of the underlying insurance contracts, not the finding of a court. Therefore, the fact that the asbestos exposure or pollution is covered under insurance policies effective during prior periods makes the reinsurance coverage in this example retroactive.

22. Q: Would the answer to the above question change if the reinsurance were written on a claims-made basis?

A: No. The form of the reinsurance—whether claims-made or occurrence-based—does not determine whether the reinsurance is prospective or retroactive. A claims-made reinsurance contract that reinsures claims asserted to the reinsurer in a future period as a result of insured events that occurred prior to entering into the reinsurance contract is a retroactive contract.

23. Q: What is the effect of adjustments to future premiums or coverage in determining whether reinsurance is prospective or retroactive?

A: Adjustments to future premiums or coverage may affect the accounting for a reinsurance contract. Whenever an adjustment results in a reinsurer providing new or additional coverage for past insurable events, that coverage is retroactive. For example, if subsequent years' premiums under a multiple accident year contract create additional coverage for previous accident years, the additional coverage is retroactive, even if the original coverage provided in the contract for those accident years was prospective. Likewise, if current losses under a multiple-year contract eliminate coverage in future periods, some or all of the premiums to be paid in those future periods should be charged to the current period.

24. Q: A reinsurance contract is entered into after the contract's effective date. Is the coverage between the contract's effective date and the date the contract was entered into prospective or retroactive?

A: The portion of the contract related to the period of time between the effective date of the contract and the date the contract was entered into is retroactive because it covers insured events that occurred prior to entering into the reinsurance contract.

25. Q: How is the date the reinsurance contract was entered into determined?

A: It is not uncommon for a reinsurance arrangement to be initiated before the beginning of a policy period but not finalized until after the policy period begins. Whether there was agreement in principle at the beginning of the policy period and, therefore, the contract is substantively prospective must be determined based on the facts and circumstances. For example, a contract may be considered to have been substantively entered into even though regulatory approval of that contract has not taken place.

The absence of agreement on significant terms, or the intention to establish or amend those terms at a later date based on experience or other factors, generally indicates that the parties to the contract have not entered into a reinsurance contract, but rather have agreed to enter into a reinsurance contract at a future date. If contractual provisions under a contract substantively entered into at a future date covered insurable events prior to that date, that coverage is retroactive.

In any event, SSAP No. 62R provides that if a contract (except facultative contracts and contracts signed by the lead reinsurer and certain cover notes or similar documents signed by reinsurers representing more than 50% of the capacity on the contract) has not been finalized, reduced to written form and signed by the parties within 9 months after its effective date, it is presumed to be retroactive.

26. Q: Are contracts to reinsure calendar-year incurred losses considered blended contracts that have both prospective and retroactive elements?

A: Yes. Most reinsurance contracts covering calendar-year incurred losses combine coverage for insured events that occurred prior to entering into the reinsurance contract with coverage for future insured events and, therefore, include both prospective and retroactive elements.

In any event, SSAP No. 62R provides that if a contract (except facultative contracts, contracts signed by the lead reinsurer and certain cover notes or similar documents signed by reinsurers representing more than 50% of the capacity on the contract) has not been finalized, reduced to written form and signed by the parties within 9 months after its effective date it is presumed retroactive.

27. Q: When the prospective and retroactive portions of a contract are being accounted for separately, how should premiums be allocated to each portion of the contract?

A: No specific method for allocating the reinsurance premiums to the risks covered by the prospective and retroactive portions of a contract is required. However, separate accounting for the prospective and retroactive portions of a contract may take place only when an allocation is practicable.

Practicability requires a reasonable basis for allocating the reinsurance premiums to the risks covered by the prospective and retroactive portions of the contract, considering all amounts paid or deemed to have been paid regardless of the timing of payment. If a reasonable basis for allocating the premiums between the prospective and retroactive coverage does not exist, the entire contract must be accounted for as a retroactive contract.

28. Q: A retroactive reinsurance contract contains a cut-through provision that provides the ceding entity's policyholders and claimants with the right to recover their claims directly from the reinsurer. May the ceding entity immediately recognize earned surplus associated with this type of contract?

A: No. SSAP No. 62R states that earned surplus may not be recognized "until the actual retroactive reinsurance recovered exceeds the consideration paid."

29. Q: A ceding entity enters into a retroactive reinsurance agreement that gives rise to segregated surplus. If the reinsurer prepays its obligation under the contract, may the ceding entity recognize earned surplus at the time the prepayment is received?

A: Segregated surplus arising from retroactive reinsurance transactions is earned as actual liabilities that have been transferred are recovered or terminated. Therefore, earned surplus is based on when the reinsurer settles its obligations to the ceding entity, and it may be appropriate to recognize earned surplus at the time the prepayment is received.

However, all of the facts and circumstances must be considered to determine whether the ceding entity has substantively recovered the liabilities transferred to the reinsurer. For example, if the ceding entity agrees to compensate the reinsurer for the prepayment, such as by crediting the reinsurer with investment income on prepaid amounts or balances held, the ceding entity has not, in substance, recovered its transferred liabilities but rather has received a deposit from the reinsurer that should be accounted for accordingly.

30. Q: If the ceding entity does not expect to receive any recoveries because the reinsurer has agreed to reimburse claimants under the reinsured contracts directly, would the ceding entity be considered to have recovered or terminated its transferred liabilities?

A: No. In the example given, the reinsurer is substantively acting as disbursing agent for the ceding entity. Therefore, the ceding entity cannot be said to have recovered amounts due from the reinsurer before payment is made to the claimant.

31. Q: What accounting entries would a ceding entity make to report a retroactive reinsurance contract?

A: Accounting Entries for a Ceding Entity to Report a Retroactive Reinsurance Contract:

Entry 1

Retroactive Reinsurance Reserves		
Ceded or Assumed (B/S)	10,000	
Retroactive Reinsurance Gain (I/S)		2,000
Cash		8,000

To record initial portfolio transfer, see paragraph 34.c. and paragraph 34.h. The ceding entity must establish the segregated surplus per paragraph 34.d.

Entry 1A

Retro. Reins. Gain	2,000	
Profit/Loss Account		2,000

To close gain from retroactive transaction.

Entry 1B

Profit/Loss Account	2,000	
Special Surplus from Retro. Reins.		2,000

To close profit from retroactive reinsurance to special surplus.

Entry 2

Cash	2,000	
Retroactive Reinsurance Reserves		2,000
Ceded or Assumed (B/S)		

To record recovery of paid losses from the reinsurer. Outstanding ceded reserves after this recovery equals \$8,000, and special surplus from retroactive reinsurance account equals \$2,000; therefore, segregated surplus account is not changed per paragraph 34.j.

Entry 3

Retroactive Reinsurance Reserves		
Ceded or Assumed (B/S)	3,000	
Retroactive Reinsurance Gain (I/S)		3,000

To record subsequent revision of the initial reserves ceded per paragraph 34.j. The segregated surplus account is increased to \$5,000 as a result of this upward development.

Entry 3A

Retro. Reinsurance Gain	3,000	
Profit/Loss Account		3,000

To close profit from retroactive reinsurance.

Entry 3B

Profit/Loss (I/S)	3,000	
Special Surplus from Retro. Reins.		3,000

To close profit and loss account to special surplus. (Retroactive reinsurance reserves ceded or assumed account balance equals \$11,000. Special Surplus from retroactive reinsurance balance equals \$5,000.)

Entry 4

Cash	4,000	
Retroactive Reinsurance Reserves		
Ceded or Assumed (B/S)		4,000

To record recovery of paid losses from the reinsurer. Outstanding ceded reserves after this recovery equals \$7,000, therefore segregated surplus account is not changed per paragraph 34.j.

Entry 5

Cash	3,000	
Retroactive Reinsurance Reserves		
Ceded or Assumed (B/S)		3,000

To record recovery of paid losses from reinsurer. Outstanding ceded reserves after recovery equals \$4,000, therefore the following entry is needed per paragraph 34.f. and paragraph 34.j.

Entry 5A

Special Surplus—Retro. Reins.	1,000	
Unassigned Funds		1,000
Retroactive Reinsurance reserves ceded or assumed after this entry equals \$4,000.		

Entry 6

Retroactive Reinsurance Loss (I/S)	1,000	
Retroactive Reinsurance Reserves		
Ceded or Assumed (B/S)		1,000

To record subsequent revision of the initial reserves ceded per paragraph 34.j. The segregated surplus account is decreased as a result of this downward development to \$3,000. The following entry is needed per paragraph 34.f. and paragraph 34.j.

Entry 6A

Profit/Loss Account	1,000	
Retro. Reins. Loss		1,000

To close loss to profit and loss account.

Entry 6B

Special Surplus from Retro. Reins.	1,000	
Profit/Loss Account		1,000

To close profit and loss account to special surplus. (Remaining balance of retroactive reinsurance reserve ceded or assumed account equals \$3,000.) (Special surplus from retro. reins. account balance equals \$3,000.)

Entry 7

Cash	2,500	
Retroactive Reinsurance Gain (I/S)	500	
Retroactive Reinsurance Reserves		
Ceded or Assumed (B/S)		3,000

Entry 7A

Profit and Loss Account	500	
Retro. Reins. Gain		500

To close other income to profit and loss account.

Entry 7B

Special Surplus from Retro. Reins.	500	
Profit/Loss Account		500

To close profit and loss account to special surplus. (Remaining balance of special surplus from retro. reins. account equals \$2,500.) (Remaining balance of retroactive reinsurance reserve ceded or assumed account -0-.)

Entry 7C

Special Surplus from Retro. Reins.	2,500	
Unassigned Funds		2,500

To close remaining special surplus account to unassigned surplus.

32. Q: How should the parties account for an adverse loss development reinsurance contract where, as of the statement date, the attachment level of the contract exceeds the ceding company's current case and IBNR reserves for the covered accident years (i.e. no surplus gain and no reinsurance recoverable as of the statement date), and the ceding company transferred cash to the reinsurer at the inception of the contract?

A: An adverse loss development reinsurance contract covering prior accident years meets the definition of "retroactive reinsurance" set forth in paragraph 26 of SSAP No. 62R:

....reinsurance in which a reinsurer agrees to reimburse a ceding entity for liabilities incurred as a result of past insurable events covered under contracts subject to the reinsurance....

Paragraph 34.k. of SSAP No. 62R specifically provides that the consideration paid for a retroactive reinsurance contract is to be recorded as a decrease in ledger assets by the ceding entity and an increase in ledger assets by the assuming entity.

Question 31 illustrates the accounting entries for retroactive reinsurance contracts.

If the retroactive reinsurance contract transfers both components of insurance risk then, pursuant to paragraph 34 of SSAP No. 62R, the ceding company would record the consideration paid as a decrease in ledger assets, recognize an expense for the reinsurance ceded through Other Income or Loss accounts as a write-in item identified as "Retroactive Reinsurance Ceded", and record the recoverable from the reinsurer as a contra liability.

No contra liability is established until and unless (and then only to the extent that) the ceding company establishes reserves which exceed the attachment point.

For the contract described, at inception no contra liability is recorded to offset current liability for the business ceded, since the ceded retroactive reinsurance premium relates to coverage in excess of the current liabilities recorded by the ceding company.

Once the ceding company's recorded liabilities exceed the attachment point of the adverse loss development reinsurance contract and triggers reinsurance recoverable from the reinsurer, a contra

liability is established by the ceding company for the amount of the reinsurance recoverable. Any surplus resulting from the retroactive reinsurance is carried as a write-in item on the balance sheet designated as "Special Surplus from Retroactive Reinsurance Account." The surplus gain may not be classified as unassigned funds (surplus) until the actual retroactive reinsurance recovered exceeds the consideration paid.

If any portion of a retroactive reinsurance contract does not transfer insurance risk, then the portion which does not transfer risk is accounted for as a deposit pursuant to paragraph 40. The deposit is reported as an admitted asset of the ceding company if the reinsurer is licensed, accredited, certified or otherwise qualified in the ceding company's state of domicile as described in Appendix A-785, or if there are funds held by or on behalf of the ceding company as described in that appendix. Receipts and disbursements under the contract are recorded through the deposit/liability accounts. Amounts received in excess of the deposit made are recognized as a gain in the Other Income or Loss account.

Accounting entries for a ceding entity to report a retroactive reinsurance contract at the inception of which the cedent's reserves are lower than the attachment point of the reinsurance coverage:

Assume the company pays \$16m to purchase adverse development coverage of \$50m, above an attachment point.

Entry 1: Payment of Retrospective Reinsurance Premium

Retrospective Reinsurance Expense*	\$16m	
Cash		\$16m

The company pays \$16m premium for the retrospective reinsurance contract.

*This is an Other Expense item, it does not flow through Schedule F or Schedule P.

Entry 2: Adverse Development Reaches the Attachment Point

Losses Incurred	\$25m	
Gross Loss Reserve		\$25m
Recoverable on Retro Reinsurance Contract**	\$25m	
Other Income*		\$9m
Contra – Retro Reinsurance Expense*		\$16m
Surplus***	\$9m	
Segregated Surplus***		\$9m

The company incurs \$25m development on reserves related to the contract.

*These are Other Income/Expense items do not flow through Schedule F or Schedule P.

**A contra-liability write-in item, not netted against loss reserves.

***Surplus is segregated in the amount of [\$25m - \$16m = \$9m] recoverables less consideration paid.

Entry 3: Cash is Recovered on Paid Losses

Cash	\$20m	
Recoverable on Retrospective Reinsurance Contract		\$20m
Segregated Surplus	\$4m	
Surplus		\$4m

The company recovers \$20m cash from reinsurer on this retro contract. Segregated Surplus decreases in the amount of [$\$20\text{m} - \$16\text{m} = \$4\text{m}$] (decreases for amount recovered in excess of consideration paid).

33. Q: How should a ceding company account for payment of the premium for a retroactive reinsurance contract by the ceding company's parent company or some other person not a party to the reinsurance contract (for example, adverse loss development reinsurance contracts purchased by the parent company in the context of the purchase or sale of the ceding company)?
- A: If the reinsurance premium is not paid directly by the ceding company but is instead paid on behalf of the ceding company by the ceding company's parent company or some other entity not a party to the reinsurance contract, then the ceding company should (1) record an increase in gross paid in and contributed surplus in the amount of the reinsurance premium to reflect the contribution to surplus by the parent or third party payor, and (2) record an expense in the amount of the reinsurance premium and account for the contract as provided in questions 31 and 32.

Not for Distribution

EXHIBIT B – P&C RUNOFF REINSURANCE TRANSACTIONS

The following provides illustrative journal entries for P&C Runoff Reinsurance Transactions.

Example 1: Transfer of existing block of runoff business **with no residual UPR** on books of Transferor

Cedent/Transferor		DR	CR
Day 1 – Cedent transfers 50,000 in reserves for 50,000			
Ceded Reinsurance Recoverable (U&I Part 2A & Sch. F)	Contra Liab ↑	50,000	
Cash	Asset ↓		50,000
Losses Paid (U/W Part 2 & Sch. P)	I/S ↓	50,000	
Change in Reserves - Incurred Losses (U&I Part 2)	I/S ↑		50,000
<i>Unlike novation, gross reserves stay on books of transferor</i>			
Day 360 – Negative Development on Transferred Business - 3,000			
Reinsurance Recoverable on Unpaid Losses (Sch. F)	Contra Liab ↑	3,000	
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↑		3,000
Day 540 – Reinsurer Pays the Loss @ Reported Reserve			
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↓	53,000	
Ceded Reinsurance Recoverable (U&I Part 2A & Sch. F)	Contra Liab ↓		53,000
Reinsurer/ Transferee			
Day 1 – Cedent transfers 50,000 in reserves for 50,000			
Cash	Asset ↑	50,000	
Reported Losses on Reins. Assumed (U&I Part 2A & Sch. P)	Liab ↑		50,000
Change In Reserves – Incurred Losses (U&I Part 2)	I/S ↓	50,000	
Losses Paid or Incurred (negative) (U&I Part 2 & Sch. P)	I/S ↑		50,000
Day 360 – Negative Development on Transferred Business - 3,000:			
Change in Reserves – Incurred Losses (U&I Part 2)	I/S ↓	3,000	
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↑		3,000
Day 540 – Reinsurer Pays the Loss			
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↓	53,000	
Cash	Asset ↓		53,000

Comments:

Since the Transferor is ceding incurred losses neither party should have premium impacted. To do that would distort many financial ratios.

Example 2: Transfer of existing block of runoff business **with some residual UPR** of 10,000 on books of Transferor (this should be less common).

Cedent/Transferor		DR	CR
Day 1 – Cedent transfers 50k in reserves & 10k UPR for 60,000			
Ceded Reinsurance Recoverable (U&I Part 2A & Sch. F)	Contra Liab ↑	50,000	
Unearned Premium Reserve (U&I Part 1 & 1A)	Liab ↓	10,000	
Cash	Asset ↓		60,000
Ceded Premium Written (U&I Part 1B)	I/S ↓	10,000	
Losses Paid (U&I Part 2 & Sch. P)	I/S ↓	50,000	
Change in Reserves - Incurred Losses (U&I Part 2)	I/S ↑		50,000
Change in UPR (U&I Part 1 & 1A)	I/S ↑		10,000
<i>Unlike novation, gross reserves stay on books of transferor</i>			
Day 180 – Premium is Fully Earned (Assumes 80% Loss Ratio)			
Ceded Reinsurance Recoverable (U&I Part 2A & Sch. F)	Contra Liab ↑	8,000	
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↑		8,000
<i>To mirror the increase in unpaid losses by the transferee</i>			
Day 360 – Negative Development on Transferred Business - 3,000:			
Reinsurance Recoverable on Unpaid Losses (Sch. F)	Contra Liab ↑	3,000	
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↑		3,000
Day 540 – Reinsurer Pays the Loss @ Reported Reserves (50+8+3)			
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↓	61,000	
Ceded Reinsurance Recoverable (U&I Part 2A & Sch. F)	Contra Liab ↓		61,000

Reinsurer/Transferee			
Day 1 – Cedent transfers 50k in reserves & 10k UPR for 60,000			
Cash	Asset ↑	60,000	
Reported Losses on Reins. Assumed (U&I Part 2A & Sch. P)	Liab ↑		50,000
Unearned Premium Reserve (U&I Part 1 & 1A)	Liab ↑		10,000
Assumed Premium Written (U&I Part 1B)	I/S ↑		10,000
Change In Reserves – Incurred Losses (U&I Part 2)	I/S ↓	50,000	
Change in UPR (U&I Part 1 & 1A)	I/S ↓	10,000	
Losses Paid or Incurred (negative) (U&I Part 2 & Sch. P)	I/S ↑		50,000
Day 180 – Premium is Fully Earned (Assumes 80% Loss Ratio)			
Unearned Premium Reserve (U&I Part 1 & 1A)	Liab ↓	10,000	
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↑		8,000
Change In Reserves – Incurred Losses (U&I Part 2)	I/S ↓	8,000	
Change in UPR (U&I Part 1 & 1A)	I/S ↑		10,000
<i>To record the increase in unpaid losses by the transferee</i>			
Day 360 – Negative Development on Transferred Business -3,000:			
Change In Reserves – Incurred Losses (U&I Part 2)	I/S ↓	3,000	
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↑		3,000
Day 540 – Reinsurer Pays the Loss @ Reported Reserves (50+8+3)			
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↓	61,000	
Cash	Asset ↓		61,000

Comments:

In this second example, the portion of the runoff business that has an UPR associated with it is essentially booked as prospective reinsurance. Other elements of the example are the same except that we assumed an 80% loss ratio on the unearned portion of the business.

EXHIBIT C – ILLUSTRATION OF A REINSURANCE CONTRACT THAT IS ACCOUNTED FOR AS A DEPOSIT USING THE INTEREST METHOD
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.

<u>Description</u>	<u>Interest Income</u>	<u>Cash Recoveries</u>	<u>Deposit Balance</u>
Initial payment			\$1,000
Year 1 (4%)	\$ 40		\$1,040
End of Year 1		\$ (225)	\$ 815
Year 2 (4%)	\$ 33		\$ 848
End of Year 2		\$ (200)	\$ 648
Yield Adjustment	\$ (8)		\$ 640
Year 3 (3.63%)	\$ 23		\$ 663
End of Year 3		\$ (175)	\$ 488
Year 4 (3.63%)	\$ 18		\$ 506
End of Year 4		\$ (175)	\$ 331
Year 5 (3.63%)	\$ 12		\$ 343
End of Year 5		\$ (175)	\$ 168
Year 6 (3.63%)	\$ 7		\$ 175
End of Year 6		\$ (175)	\$ 0

At the inception of the contract, the ceding insurer records a deposit asset of \$ 1,000 and the assuming company, a \$1,000 deposit liability. The asset is admitted providing the conditions for credit for reinsurance are met.

At subsequent reporting dates, the deposit asset is adjusted by calculating the effective yield on the reinsurance agreement to reflect actual payments to date and expected future payments with a corresponding credit to interest income by the ceding company and interest expense by the assuming company.

At the end of year two, it is determined that the expected cash flows will differ from previous estimates, resulting in a lower effective yield on the deposit asset. The deposit asset is adjusted to the amount that would have existed at the reporting date had the new effective yield been applied from the inception of the reinsurance agreement. The adjustment is charged to interest income, i.e., as a reduction of interest income. Interest income during the remaining term of the agreement is reduced accordingly (i.e., the yield is reduced from 4.0% to 3.63%).

EXHIBIT D – ILLUSTRATION OF ASBESTOS AND POLLUTION COUNTERPARTY REPORTING EXCEPTION

SCHEDULE F – PART 3³ Aging of Ceded Reinsurance as of December 31, Current Year (000 Omitted)

1 ID Number	2 NAIC Company Code	3 Name of Reinsurer	4 Domiciliary Jurisdiction	5 Special Code	6 Reinsurance Premiums Ceded	Reinsurance Recoverable On		
						7 Paid Losses	8 Paid LAE	9 Known Case Loss Reserves
FEIN	####	Retroactive Reinsurer X	NE	3		3,000	3,000	15,000
FEIN	####	Original Company A	US	3				5,000
Subtotal Other U.S. Authorized						3,000	3,000	20,000
AA-	####	Original Company B	UK	3		12,000	9,000	2,500
AA-	####	Original Company C	UK	3		6,000	3,000	7,500
Subtotal Other Non-U.S. Unauthorized						18,000	12,000	10,000
999999 Totals						21,000	15,000	30,000

Reinsurance Recoverable On				16 Amount in Dispute Included in Column 15	Reinsurance Payable		19 Net Amount Recoverable from Reinsurers Cols. 15 – [17 + 18]	Collateral	
10 Known Case LAE Reserves	11 IBNR Loss Reserves	12 IBNR LAE Reserves	15 Cols. 7 through 14 Totals		17 Ceded Balances Payable	18 Other Amounts Due to Reinsurers		24 Single Beneficiary Trusts Other Allowable Collateral	25 Total Funds Held Payables and Collateral
15,000	25,000 ⁴	37,500	98,500		6,000		92,500		
2,500	10,000	15,000	32,500				32,500		
17,500	35,000	52,500	131,000		6,000		125,000		
7,500	12,500	5,000	48,500				48,500	48,500	48,500
5,000	2,500	17,500	41,500				41,500	41,500	41,500
12,500	15,000	22,500	90,000				90,000	90,000	90,000
30,000	50,000	75,000	221,000		6,000		215,000	90,000	90,000

Reinsurance Recoverable on Paid Losses and Paid Loss Adjustment Expenses						
Overdue						
37 Current Reinsurance Recoverable on Paid Losses and Paid LAE	38 1 to 29 days Reinsurance Recoverable on Paid Losses and Paid LAE	39 30 to 90 days Reinsurance Recoverable on Paid Losses and Paid LAE	40 91 to 120 days Reinsurance Recoverable on Paid Losses and Paid LAE	41 Over 120 days Reinsurance Recoverable on Paid Losses and Paid LAE	42 Total Overdue Reinsurance Recoverable on Paid Losses and Paid LAE	43 Total Due Reinsurance Recoverable on Paid Losses and Paid LAE Cols. 37 + 42 (In total should equal Cols. 7 + 8)
6,000						6,000
6,000						6,000
21,000						21,000
9,000						9,000
30,000						30,000
36,000						36,000

³ Note that unused columns have been removed for this exhibit.

⁴ This example assumes 1/2 of the original company reinsurers' unpaid recoverables are Asbestos and Pollution related.

**SUPPLEMENTAL SCHEDULE FOR REINSURANCE COUNTERPARTY
REPORTING EXCEPTION – ASBESTOS AND POLLUTION CONTRACTS**
For The Year Ended December 31, 20__ (\$000 Omitted)

1 ID Number (Original Reinsurer)	2 NAIC Company Code (Original Reinsurer)	3 Name of Reinsurer (Original Reinsurer)	4 Domiciliary Jurisdiction (Original Reinsurer)	5 IDJ Number (Retroactive Reinsurer)	6 Name of Retroactive Reinsurer Reported in Sch. F Part 3 (Retroactive Reinsurer)	Reinsurance Recoverable On				
						7 Paid Losses	8 Paid LAE	9 Unpaid Case Losses & LAE	10 IBNR Losses & LAE	11 Cols. 7+ 8+9+10 Totals
		Original Company A	US		Retroactive Reinsurer X	1,000	1,000	7,500	25,000	34,500
Subtotal Authorized						1,000	1,000	7,500	25,000	34,500
		Original Company B	UK		Retroactive Reinsurer X	1,000	1,000	10,000	17,500	29,500
		Original Company C	UK		Retroactive Reinsurer X	1,000	1,000	12,500	20,000	34,500
Subtotal Other Non-U.S. Unauthorized						2,000	2,000	22,500	37,500	64,000
9999999 Totals						3,000	3,000	30,000	62,500	98,500

Original Reinsurer Collateral			15 Amounts Approved As Other Allowed Offset Items	Reinsurance Recoverable On Paid Losses and Paid Loss Adjustment Expenses							23 Percentage Overdue	24 Percentage More Than 90 Days Overdue
12 Funds Held (Original Reinsurer)	13 Letters Of Credit (Original Reinsurer)	14 Trust Funds And Other Allowed Offset Items		16 Current	Overdue					22 Total Due		
					17 1 – 29 Days	18 30 – 90 Days	19 91 – 120 Days	20 Over 120 Days	21 Total Overdue			
-	-	-	(a)	2,000	-	-	-	-	-	2,000	-	-
-	-	-	-	2,000						2,000		
-	-	-	29,500	2,000	-	-	-	-	-	2,000	-	-
-	-	-	34,500	2,000	-	-	-	-	-	2,000	-	-
-	-	-	64,000	4,000						4,000		
-	-	-	64,000 (b)	6,000	-	-	-	-	-	6,000		

- (a) Amount is zero because available offsets are not applied for authorized reinsurers under the credit for reinsurance model.
- (b) Annual statement Note 1 would disclose total impacts to the provision for reinsurance composed of 1) \$64,000 (impact for unauthorized/uncollateralized) plus 2) reduction to the provision for overdue.

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.....	2
Effective Date and Transition	3
REFERENCES	3
Relevant Issue Papers	3

SCOPE OF STATEMENT

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

SUMMARY CONCLUSION

2. Underwriting pools and associations can be categorized as follows: (a) involuntary, (b) voluntary, and (c) intercompany.

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

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

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

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.

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

- a. A description of the basic terms of the arrangement and the related accounting;

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

Effective Date and Transition

13. 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*

Statement of Statutory Accounting Principles No. 64

Offsetting and Netting of Assets and Liabilities

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 20-06
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Disclosures.....	2
Relevant Literature.....	2
Effective Date and Transition	3
REFERENCES.....	3
Relevant Issue Papers	3

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for offsetting and netting of assets and liabilities.

SUMMARY CONCLUSION

2. Assets and liabilities shall be offset and reported net only when a valid right of setoff exists except as provided for in paragraphs 3 and 4. A right of setoff is a reporting entity's legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying an amount that the other party owes to the reporting entity against the debt. A valid right of setoff exists only when all the following conditions are met:

- a. Each of the two parties owes the other determinable amounts. An amount shall be considered determinable for purposes of this provision when it is reliably estimable by both parties to the agreement;
- b. The reporting party has the right to set off the amount owed with the amount owed by the other party;
- c. The reporting party intends to setoff; and
- d. The right of setoff is enforceable at law.

3. Assets and liabilities that meet the criteria for offset shall not be netted when prohibited by specific statements of statutory accounting principles. An example of such is in the case of reinsurance recoverables on paid losses and ceded premiums payable as provided for in *SSAP No. 62R—Property and Casualty Reinsurance*.

4. Netting of assets and liabilities for reporting purposes when no valid right of setoff exists shall be allowed only when provided for by specific statements of statutory accounting principles. An example of such is in the case of real estate investments required to be shown net of encumbrances as provided for in *SSAP No. 40R—Real Estate Investments*.

5. Amounts due to or from affiliates shall be offset and reported net only when the provisions of paragraph 2 are met.

Disclosures

6. The following quantitative information shall be disclosed (separately for assets and liabilities) at the end of each reporting period (interim and annual) when derivative, repurchase and reverse repurchase, and securities borrowing and securities lending assets and liabilities are offset and reported net in accordance with paragraph 2 (valid right to offset):

- a. The gross amounts of recognized assets and recognized liabilities
- b. The amounts offset in accordance with paragraph 2 (valid right to offset)
- c. The net amounts presented in the statement of financial positions.

7. Assets and liabilities that have a valid right to offset under paragraph 2, but are not netted as they are prohibited under paragraph 3, are not required to be captured in the disclosures in paragraph 6.

Relevant Literature

8. This statement adopts paragraphs 1, 7 and 13 of *APB Opinion No. 10, Omnibus Opinion—1966* and *FASB Interpretation No. 39, Offsetting of Amounts Related to Certain Contracts* with modifications (1) to prohibit offsetting as provided in specific statements and require netting when provided in specific statements, and (2) to reject guidance in paragraphs 10, 10A, and 10B of FIN 39, as amended by FSP FIN 39-1, that permits a reporting entity election to offset fair value amounts recognized for derivative instruments and fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral arising from the derivative instruments with the same counterparty under a master netting agreement. Offsetting for statutory accounting purposes is limited to situations meeting the conditions in paragraph 2 and 4 of this SSAP. This statement adopts *FASB Emerging Issues Task Force No. 86-25, Offsetting Foreign Currency Swaps*.

9. This statement rejects *FSP FIN 39-1, Amendment of FASB Interpretation 39*. This statement rejects *FASB Interpretation No. 41, Offsetting of Amounts Related to Certain Repurchase and Reverse Repurchase Agreements*. FIN 41 has an offsetting exception for repurchase and reverse repurchase agreements and permits offsetting when the reporting parties do not intend to set off. This guidance is rejected for statutory accounting, and payables under repurchase agreements may only be offset against amounts recognized as receivables under reverse repurchase agreements if there is a valid right to offset meeting all the conditions, including the intent to offset, detailed in paragraph 2. This statement rejects *ASU 2011-11, Disclosures about Offsetting Assets and Liabilities* and *ASU 2013-01, Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*. Statutory disclosure requirements for assets and liabilities reported net under a valid right to offset are detailed in paragraph 6.

Effective Date and Transition

10. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The revisions to paragraphs 8-9 are effective January 1, 2013. The revisions to paragraph 9 rejecting FIN 41 reflects a reversal of a prior decision to adopt FIN 41.

REFERENCES**Relevant Issue Papers**

- *Issue Paper No. 76—Offsetting and Netting of Assets and Liabilities*

Not for Distribution

Statement of Statutory Accounting Principles No. 65

Property and Casualty Contracts

STATUS

Type of Issue.....	Property and Casualty
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Nullifies and incorporates INT 02-10
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	2
Claims-Made Policies	2
Discounting	3
Structured Settlements	4
Policies with Coverage Periods Equal to or in Excess of Thirteen Months.....	4
High Deductible Policies	6
Asbestos and Environmental Exposures	8
Excess Statutory Reserve	9
Policyholder Dividends.....	9
Relevant Literature.....	9
Effective Date and Transition	9
REFERENCES.....	9
Other	9
Relevant Issue Papers	9
EXHIBIT A – GUIDELINES FOR STATES WHO PRESCRIBE OR PERMIT DISCOUNTING ON A NON-TABULAR BASIS	10

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for property and casualty insurance contracts. Topics not covered by this statement shall comply with the more general statutory accounting guidance.
2. Topics specific to title insurance, mortgage guaranty insurance, and financial guaranty insurance are not within the scope of this statement. These topics are addressed in *SSAP No. 57—Title Insurance*, *SSAP No. 58—Mortgage Guaranty Insurance*, and *SSAP No. 60—Financial Guaranty Insurance*.

SUMMARY CONCLUSION

3. Property and casualty insurance contracts can be written to cover insured events on the following reporting bases:

- a. Occurrence—These policies cover insured events that occur within the effective dates of the policy regardless of when they are reported to the reporting entity. Liabilities for losses on these policies shall be recorded when the insured event occurs;
- b. Claims-made—These policies cover insured events that are reported (as defined in the policy) within the effective dates of the policy, subject to retroactive dates when applicable. Liabilities for losses on these policies shall be recorded when the event is reported to the reporting entity; and
- c. Extended reporting—Endorsements to claims-made policies covering insured events reported after the termination of a claims-made contract but subject to the same retroactive dates where applicable. See paragraphs 7 and 8 for guidance for when premium shall be earned and losses shall be recorded.

Claims-Made Policies

4. Normally, when claims-made coverage is obtained, existing coverage is being replaced. The existing coverage may have been a claims-made policy or an occurrence policy. In either case, in an effort to reduce premium costs, the insured may request that the claims-made coverage cover only claims reported within the effective dates of the policy that occur after a specified date. This specified date is referred to as the retroactive date of the claims-made policy and eliminates duplicate coverage when converting from occurrence coverage to claims-made coverage.

5. The liability for an insured event shall be determined in accordance with *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*.

6. Extended reporting endorsements, commonly referred to as tail coverage, allow extended reporting of insured events after the termination of a claims-made contract. Extended reporting endorsements modify the exposure period of the underlying contract and can be for a defined period (e.g., six months, one year, five years) or can be for an indefinite period.

7. When a reporting entity issues an extended reporting endorsement or contract and the preceding claims-made policy terminates, the reporting entity assumes liability for unreported claims and expense. This extended reporting coverage can be issued for an indefinite period or a fixed period. For indefinite reporting periods, premium shall be fully earned and loss and expense liability associated with unreported claims shall be recognized immediately. For coverage for a fixed period, premium shall be earned over the term of the fixed period, the reporting entity shall establish an unearned premium reserve for the unexpired portion of the premium and shall record losses as reported.

8. Some claims-made policies provide extended reporting coverage at no additional charge in the event of death, disability, or retirement of a natural person insured. In such instance, a policy reserve is required to assure that premiums are not earned prematurely. The amount of the reserve should be adequate to pay for all future claims arising from these coverage features, after recognition of future premiums to be paid by current insureds for these benefits. The reserve, entitled “extended reporting endorsement policy reserve” shall be classified as a component part of the unearned premium reserve considered to run more than one year from the date of the policy.

9. When the anticipated losses, loss adjustment expenses, and maintenance costs anticipated to be reported during the extended reporting period exceed the recorded unearned premium reserve for a

claims-made policy, a premium deficiency reserve shall be recognized in accordance with *SSAP No. 53—Property and Casualty Contracts—Premiums*.

Discounting

10. With the exception of fixed and reasonably determinable payments such as those emanating from workers' compensation tabular indemnity reserves and long-term disability claims, property and casualty loss reserves shall not be discounted. No loss adjustment expense reserves shall be discounted.

11. Tabular reserves are indemnity reserves that are calculated using discounts determined with reference to actuarial tables which incorporate interest and contingencies such as mortality, remarriage, inflation, or recovery from disability applied to a reasonably determinable payment stream. Tabular reserves shall not include medical loss reserves or loss adjustment expense reserves.

12. Due to several instances in which states have prescribed or permitted practices to allow discounting on a non-tabular basis, recommended guidelines for discounting non-tabular unpaid loss and LAE are provided within Exhibit A. If a state has a prescribed or permitted practice allowing the use of discounts, or if discounting is utilized in accordance with this SSAP, financial statement disclosures are required in accordance with paragraphs 13-16.

13. In accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*, a change in the discount rate used in discounting loss reserves shall be accounted for as a change in estimate. SSAP No. 3 requires changes in estimates to be included in the statement of income in the period the change becomes known.

14. The financial statements shall disclose whether or not any of the liabilities for unpaid losses or unpaid loss adjustment expenses are discounted, including liabilities for workers' compensation. The following disclosures, for each line of business, shall be made separately:

- a. Table(s) used;
- b. Rate(s) used;
- c. The amount of discounted liability reported in the financial statement;
- d. The amount of tabular discount, by the line of business and reserve category (i.e., case and Incurred But Not Reported (IBNR));
- e. The amount of interest accretion recognized in the statement of income; and
- f. The line item(s) in the statement of income in which the interest accretion is classified.

15. If the rate(s) used to discount prior accident years' liabilities have changed from the previous financial statement or if there have been changes in other key discount assumptions such as payout patterns, the financial statements shall disclose:

- a. Amount of discounted current liabilities at current rate(s) and assumption(s) (exclude the current accident year);
- b. Amount of discounted current liabilities at previous rate(s) and assumption(s) (exclude the current accident year);
- c. Change in discounted liability due to change in interest rate(s) and assumption(s); and

- d. Amount of non-tabular discount, by line of business and reserve category (i.e., case, defense and cost containment, adjusting and other).

16. Refer to the Preamble for further discussion regarding disclosure requirements.

Structured Settlements

17. Structured settlements are periodic fixed payments to a claimant for a determinable period, or for life, for the settlement of a claim. Frequently a reporting entity will purchase an annuity to fund the future payments. Reporting entities may purchase an annuity in which the entity is the owner and payee, or an annuity in which the claimant is the payee. When annuities are purchased to fund periodic fixed payments, they shall be accounted for as follows:

- a. When the reporting entity is the owner and payee, no reduction shall be made to loss reserves. The annuity shall be recorded at its present value and reported as an other-than-invested asset. Income from the annuities shall be recorded as miscellaneous income. The present value of the annuity and the related amortization schedule shall be obtained from the issuing life insurance company at the time the annuity is purchased; and
- b. When the claimant is the payee, loss reserves shall be reduced to the extent that the annuity provides for funding of future payments. The cost of the annuities shall be recorded as paid losses.

18. Statutory accounting and Generally Accepted Accounting Principles (GAAP) are consistent for the accounting of structured settlement annuities where the reporting entity is the owner and payee, and where the claimant is the owner and payee and the reporting entity has been released from its obligation. GAAP distinguishes structured settlement annuities where the owner is the claimant and a legally enforceable release from the reporting entity's liability is obtained from those where the claimant is the owner and payee but the reporting entity has not been released from its obligation. GAAP requires the deferral of any gain resulting from the purchase of a structured settlement annuity where the claimant is the owner and payee yet the reporting entity has not been released from its obligation. Statutory accounting treats these settlements as completed transactions and considers the earnings process complete, thereby allowing for immediate gain recognition.

19. The following information regarding structured settlements shall be disclosed in the financial statements:

- a. The amount of reserves no longer carried by the reporting entity because it has purchased annuities with the claimant as payee, and the extent to which the reporting entity is contingently liable for such amounts should the issuers of the annuities fail to perform under the terms of the annuities; and
- b. The name, location, and aggregate statement value of annuities due from any life insurer to the extent that the aggregate value of those annuities equal or exceed 1% of policyholders' surplus. This disclosure shall only include those annuities for which the reporting entity has not obtained a release of liability from the claimant as a result of the purchase of an annuity. The reporting entity shall also disclose whether the life insurers are licensed in the reporting entity's state of domicile.

20. Refer to the Preamble for further discussion regarding disclosure requirements.

Policies with Coverage Periods Equal to or in Excess of Thirteen Months

21. Some property and casualty insurance contracts are written for coverage periods that equal or exceed thirteen months. These contracts may be single premium or fixed premium policies, and generally

are not subject to cancellation or premium modification by the reporting entity. The most common policies with such coverage periods are home warranty and mechanical breakdown policies. Accordingly, this guidance is primarily focused on home warranty and mechanical breakdown policies and does not apply to multiple-year contracts comprised of single-year policies, each of which have separate premiums and annual aggregate deductibles.

22. Revenues are generally not received in proportion to the level of exposure or period of exposure. In order to recognize the economic results of the contract over the contract period, a liability shall be established for the estimated future policy benefits while taking into account estimated future premiums to be received. Unearned premiums shall be recorded in accordance with paragraphs 23-33 of this statement.

23. Paragraphs 24-33 shall apply to all direct and assumed contracts or policies (“contracts”), excluding financial guaranty contracts, mortgage guaranty contracts, and surety contracts, that fulfill both of the following conditions:

- a. The policy or contract term is greater than or equal to 13 months; and
- b. The reporting entity can neither cancel the contract, nor increase the premium during the policy or contract term.

24. At any reporting date prior to the expiration of the contracts, the reporting entity is required to establish an adequate unearned premium reserve, to be reported as the unearned premium reserve. For each of the three most recent policy years, the gross (i.e., direct plus assumed) unearned premium reserve shall be no less than the largest result of the three tests described in paragraphs 27-29. For years prior to the three most recent policy years, the gross unearned premium reserve shall be no less than the larger of the aggregate result of Test 1 or the aggregate result of Test 2 or the aggregate result of Test 3 taken over all of those policy years.

25. Any reserve credit applicable for reinsurance ceded shall be appropriately reflected in the financial statements with the resulting net unearned premium reserve being established by the reporting entity.

26. The projected losses and expenses may be reduced for expected salvage and subrogation recoveries, but may not be reduced for anticipated deductible recoveries, unless the deductibles are secured by a letter of credit (LOC) or like security. Projected salvage and subrogation recoveries (net of associated expenses) shall be established based on reporting entity experience, if credible; otherwise, based on industry experience.

27. Test 1 is management’s best estimate of the amounts refundable to the contractholders at the reporting date.

28. Test 2 is the gross premium multiplied by the ratio of paragraph 28.a. to paragraph 28.b.:

- a. Projected future gross losses and expenses to be incurred during the unexpired term of the contracts; and
- b. Projected total gross losses and expenses under the contracts.

29. Test 3 is the projected future gross losses and expenses to be incurred during the unexpired term of the contracts as adjusted below, reduced by the present value of the future guaranteed gross premiums, if any.

- a. A provision for investment income is permitted in the unearned premium reserve only with respect to the projected future losses and expenses used to determine the unearned premium reserve, and not with respect to incurred but unpaid losses and expenses;
- b. A provision for investment income on projected future losses and expenses may be calculated to the expected date the loss or expense is incurred, not from the expected date of payment;
- c. The rate of interest used to calculate the provision for investment income shall be reviewed and changed as necessary at each reporting date and shall not exceed the lesser of the following two standards:
 - i. The reporting entity's future net yield to maturity on statutory invested assets as shown in Schedule D, less a 1.5% actuarial provision for adverse deviations; or
 - ii. The current yield to maturity on a United States Treasury debt instrument maturing in five (5) years as of the reporting date.
- d. The reporting entity's statutory invested assets shall be reduced by the loss and loss adjustment expense reserves on unpaid losses and expenses to calculate "available invested assets." If the available invested assets are less than the result of Test 3, as calculated above, an "invested asset shortfall" exists. In this event, the Test 3 reserve shall be recalculated with the provision for investment income based on the restricted amount of available invested assets.

30. For the purposes of Tests 2 and 3 of paragraphs 28 and 29, "expenses" shall include all incurred and anticipated expenses related to the issuance and maintenance of the policy, including loss adjustment expenses, policy issuance and maintenance expenses, commissions, and premium taxes.

31. The projected future losses and expenses are to be re-estimated for each reporting date, and the most recent estimate of these projected losses and expenses is to be used in these Tests. If a range is selected and no single point in the range is identified as being the most likely, then the midpoint of management's estimate of the range shall be used. For purposes of this statement, it is assumed that management can quantify the high end of the range. If management determines that the high end of the range cannot be quantified, then a range does not exist, and management's best estimate shall be accrued.

32. The reporting entity shall provide an Actuarial Opinion and Report in conformity with the NAIC *Annual Statement Instructions for Property and Casualty Insurers*. Exhibit A of the actuarial opinion shall include the following three items: 1) the Reserve for Direct and Assumed Unearned Premiums; 2) the Reserve for Net Unearned Premiums; and 3) any other premium reserve items on which an opinion is being expressed. If any of these three items are material, the material item(s) must also be covered in the opinion and relevant comments of the actuarial opinion.

33. The actuarial report shall include a description of the manner in which the adequacy of the amount of security for deductibles and self-insured retentions is determined. The actuarial report need not assess the credit-worthiness of the specific securities (e.g. LOC's), but the actuarial opinion must report collectibility problems if known to the actuary.

High Deductible Policies

34. Certain policies, particularly workers' compensation coverage, are available under high deductible plans. High deductible plans differ from self insurance coupled with an excess of loss policy because state laws generally require the reporting entity to fund the deductible and to periodically review the financial viability of the insured and make an assessment of the suitability of the deductible plan to the insured.

35. The liability for loss reserves shall be determined in accordance with SSAP No. 55. Because the risk of loss is present from the inception date, the reporting entity shall reserve losses throughout the policy period, not over the period after the deductible has been reached. Reserves for claims arising under high deductible plans shall be established net of the deductible, however, no reserve credit shall be permitted for any claim where any amount due from the insured has been determined to be uncollectible.

36. If the policy form requires the reporting entity to fund all claims including those under the deductible limit, the reporting entity is subject to credit risk, not underwriting risk. Reimbursement of the deductible shall be accrued and recorded as a reduction of paid losses simultaneously with the recording of the paid loss by the reporting entity.

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.

38. The financial statements shall disclose the following related to high deductible policies:

- a. Gross (of high deductible) amount of loss reserves, unpaid by line of business.
- b. The amount of reserve credit that has been recorded for high deductibles on unpaid claims and the amounts that have been billed and are recoverable on paid claims, by line of business and the total of these two numbers.
- c. Related to the amounts that have been billed and are recoverable on paid claims,
 - i. paid recoverable amounts that are over 90 days overdue, and
 - ii. the amounts nonadmitted (per paragraph 37).
- d. Total collateral pledged to the reporting entity related to deductible and paid recoverables:
 - i. the amount of collateral on balance sheet, and
 - ii. the amount of collateral off balance sheet.
- e. The total amount of unsecured high deductible amounts related to unpaid claims and for paid recoverables and the total percentage that is unsecured.
- f. Highest ten unsecured high deductible amounts by counterparty ranking. Note that the counterparty does not have to be named, just amount by counterparty 1, counterparty 2,

etc. For this purpose, a group of entities under common control shall be regarded as a single customer.

39. Unsecured High Deductible Recoverables: If the individual obligor is part of a group under the same management or control, such as a professional employer organization (PEO), list the individual obligors, each of its related group members, and the total unsecured aggregate recoverables on high deductible policies for the entire group, which are greater than 1% of capital and surplus. For this purpose, a group of entities under common control shall be regarded as a single customer.

40. Refer to the Preamble for further discussion regarding disclosure requirements.

Asbestos and Environmental Exposures

41. Asbestos exposures are defined as any loss or potential loss (including both first party and third party claims) related directly or indirectly to the manufacture, distribution, installation, use, and abatement of asbestos-containing material, excluding policies specifically written to cover these exposures. Environmental exposures are defined as any loss or potential loss, including third party claims, related directly or indirectly to the remediation of a site arising from past operations or waste disposal. Examples of environmental exposures include but are not limited to chemical waste, hazardous waste treatment, storage and disposal facilities, industrial waste disposal facilities, landfills, superfund sites, toxic waste pits, and underground storage tanks.

42. Reporting entities that are potentially exposed to asbestos and/or environmental claims shall record reserves consistently with SSAP No. 55.

43. The financial statements shall disclose the following if the reporting entity is potentially exposed to asbestos and/or environmental claims:

- a. The reserving methodology for both case and IBNR reserves;
- b. The amount paid and reserved for losses and loss adjustment expenses for asbestos and/or environmental claims, on a direct, assumed and net of reinsurance basis. Each company should report only its share of a group amount (after applying its respective pooling percentage) if the company is a member of an intercompany pooling agreement;
- c. Description of the lines of business written for which there is potential exposure of a liability due to asbestos and/or environmental claims, and the nature of the exposure(s);
- d. The following for each of the five most current calendar years¹ on both a gross and net of reinsurance basis, separately for asbestos and environmental losses (including coverage dispute costs):

Beginning reserves	\$ _____
Incurred losses and loss adjustment expenses	_____
Calendar year payments for losses and loss adjustment expenses	_____
Ending reserves	\$ _____

¹ The requirement for five years of data is only applicable to the annual statement blank. The audited statutory financial report is only required to report two years. Additionally, the audited statutory financial statement shall include items not included in the notes to the annual statement blank where the blank's schedules and exhibits satisfy disclosure requirements that are not included in the audited statutory financial statement (i.e., Since the audited financial statements do not include Schedule P, all of the SSAP No. 55 disclosures shall be included in the audited notes to financial statements).

44. Refer to the Preamble for further discussion regarding disclosure requirements.

Excess Statutory Reserve

45. This statement eliminates the requirement to record excess statutory reserves. Excess statutory reserves do not meet the definition of a liability established in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*.

Policyholder Dividends

46. Dividends to policyholders immediately become liabilities of the reporting entity when they are declared by the board of directors and shall be recorded as a liability. Incurred policyholder dividends are reported in the statement of income.

47. The financial statements shall disclose the terms of dividend restrictions, if any. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

48. Structured settlements are addressed in *FASB Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts* (FAS 113). FAS 113 is addressed in *SSAP No. 62R—Property and Casualty Reinsurance*. This statement rejects the *AICPA Audit and Accounting Guide—Audits of Property and Liability Insurance Companies*.

Effective Date and Transition

49. This statement is effective for years beginning January 1, 2001. To the extent that the requirements of paragraphs 23-33 produce a higher reserve than the reporting entity would have established through the use of their previous methodology, the reporting entity may phase in the additional reserve over a period not to exceed three years. Such a phase in period shall only be permitted if the reporting entity is able to demonstrate that it would not be operating in a hazardous financial condition and that there is not adverse risk to its insureds. The phase in shall be at least 60% of the difference between the reserve required by this statement and the reserve determined by the previous methodology during the first year, 80% in the second year, and 100% in the third year. 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. The guidance in the footnote of paragraph 43.d. was originally contained within *INT 02-10: Statutory Audit Report Notes and the Reporting Requirements Related to Disclosures Containing Multiple Year Information* and was effective June 9, 2002.

REFERENCES

Other

- *Actuarial Standard of Practice No. 20, Discounting of Property and Casualty Loss and Loss Adjustment Expense*
- *NAIC Annual Statement Instructions for Property and Casualty Insurers*

Relevant Issue Papers

- *Issue Paper No. 65—Property and Casualty Contracts*

EXHIBIT A – GUIDELINES FOR STATES WHO PRESCRIBE OR PERMIT DISCOUNTING ON A NON-TABULAR BASIS

As discussed in paragraph 10 of this statement, with the exception of fixed and reasonably determinable payments such as those emanating from workers' compensation tabular indemnity reserves and long-term disability claims, property and casualty loss reserves shall not be discounted. However, one of the most common prescribed or permitted state practices is to allow discounting of unpaid losses and unpaid loss adjustment expenses on a non-tabular basis. The recommendations in this exhibit are not requirements and therefore should only be viewed as a recommendation to those states that prescribe or permit non-tabular discounting.

Recommended Prescribed or Permitted Practice Guidelines

The state of XYZ office will permit [insert domestic companies if prescribed or insert insurance company name if prescribed] to discount its December 20XX unpaid loss (i.e., reported losses and incurred but not reported losses) and unpaid loss adjustment expense (LAE) reserves on a non-tabular basis subject to the following conditions:

1. The unpaid loss and LAE reserves shall be determined in accordance with *Actuarial Standard of Practice No. 20, Discounting of Property and Casualty Loss and Loss Adjustment Expense* (and as agreed to by an actuary) but in no event shall the rate used exceed the lesser of the following two standards:
 - a. If the reporting entity's statutory invested assets are at least equal to the total of all policyholder reserves, the reporting entity's net rate of return on statutory invested assets, less 1.5%, otherwise, the reporting entity's average net portfolio yield rate less 1.5% as indicated by dividing the net investment income earned by the average of the reporting entity's current and prior year total assets; or
 - b. The current yield to maturity on a United States Treasury debt instrument with maturities consistent with the expected payout of the liabilities.
2. Disclosure of the [insert either prescribed or permitted practice] in compliance with the requirements of the NAIC *Accounting Practices and Procedures Manual* and the *NAIC Annual Statement Instructions – Property and Casualty*, including but not limited to:

Note 1 – Summary of Significant Accounting Policies

A. Disclosure of permitted practice

- a. Disclose that the reporting entity employs a prescribed or permitted accounting practice that departs from the *Accounting Practices and Procedures Manual*; and
- b. Disclose the monetary effect on net income and statutory surplus of using the practice of discounting on a non-tabular basis rather than the NAIC statutory accounting practice of discounting fixed and reasonably determinable payments such as those emanating from workers' compensation tabular indemnity reserves and long-term disability claims.

Note 32 – Discounting of Liabilities for Unpaid Losses or Unpaid Loss Adjustment Expenses

XX. Non-tabular discounting

- a. Disclosure of whether the reporting entity is applying non-tabular discounting based upon a state prescribed or permitted practice. If permitted, provide further disclosure as to the date domiciliary state issued permitted practice and the

expiration date of such practice;

- b. Rate(s) used and the basis for the rate(s) used;
- c. Amount of non-tabular discount disclosed by line of business and reserve category (i.e., unpaid loss, incurred but not reported, defense and cost containment expense, and adjusting and other expense); and
- d. The amount of non-tabular discount reported in the statement.

Non-tabular discounting illustration:

	(1) Case	(2) IBNR	(3) Defense & Cost Containment Expense	(4) Adjusting & Other Expense
1. Homeowners/Farmowners				
2. Private Passenger Auto Liability/Medical				
3. Commercial Auto/Truck Liability/Medical				
4. Workers' Compensation				
5. Commercial Multiple Peril				
6. Medical Malpractice – Occurrence				
7. Medical Malpractice – Claims-Made				
8. Special Liability				
9. Other Liability – Occurrence				
10. Other Liability – Claims-Made				
11. Special Property				
12. Auto Physical Damage				
13. Fidelity, Surety				
14. Other (including Credit, Accident & Health)				
15. International				
16. Reinsurance Nonproportional Assumed Property				
17. Reinsurance Nonproportional Assumed Liability				
18. Reinsurance Nonproportional Assumed Financial Lines				
19. Products Liability – Occurrence				
20. Products Liability – Claims-Made				
21. Financial Guaranty/Mortgage Guaranty				
22. Total				

The rates used to discount Medical Malpractice unpaid losses at December 31, 20X2 have changed from the rates used at December 31, 20X1. At December 31, 20X2, the amount of discounted Medical Malpractice unpaid losses, excluding the current accident year, is \$ _____. Had these unpaid losses been discounted at the rates used at December 31, 20X1 the amount of discounted liabilities would be \$ _____. The reduction in the discounted liability due to the change in rates is \$ _____.

This illustration neither regulates, permits, nor prohibits the practice of discounting liabilities for unpaid losses or unpaid loss adjustment expenses.

Statement of Statutory Accounting Principles No. 66

Retrospectively Rated Contracts

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 05-05
Relevant Appendix A Guidance	A-785

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Disclosures.....	5
Relevant Literature.....	5
Effective Date and Transition	5
REFERENCES.....	6
Other	6
Relevant Issue Papers	6

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for retrospectively rated contracts. This statement applies to property and casualty contracts, life insurance contracts, and accident and health contracts.
2. Retrospective reinsurance contracts are not within the scope of this statement. They are addressed in *SSAP No. 62R—Property and Casualty Reinsurance*.

SUMMARY CONCLUSION

3. A retrospectively rated contract is one which has the final policy premium calculated based on the loss experience of the insured during the term of the policy (including loss development after the term of the policy) and the stipulated formula set forth in the policy or a formula required by law. The periodic adjustments may involve either the payment of return premium to the insured or payment of an additional premium by the insured, or both, depending on experience. Retrospective rating features are common in certain property and casualty contracts, group life, and group accident and health contracts. Some contracts have retrospective features required by law. Contracts with retrospective rating features are referred to as loss sensitive contracts.
4. Amounts due from insureds and amounts due to insureds under retrospectively rated contracts meet the definitions of assets and liabilities as set forth in *SSAP No. 4—Assets and Nonadmitted Assets*

and SSAP No. 5R—*Liabilities, Contingencies and Impairment of Assets*, respectively. Amounts due from insureds and amounts due to insureds under retrospectively rated contracts are admitted assets to the extent they conform to the requirements of this statement.

5. Initial premiums shall be recognized in accordance with SSAP No. 51R—*Life Contracts*, SSAP No. 53—*Property and Casualty Contracts—Premiums*, and SSAP No. 54R—*Individual and Group Accident and Health Contracts*.

6. Specific funds received by the prescription drug plan sponsor from either the Medicare Part D enrollee or the government as payment for standard coverage that will be subject to retrospective premium adjustments should be accounted for under this statement. These funds include ‘Direct Subsidy’, ‘Low-Income Subsidy (premium portion)’, ‘Beneficiary Premium (standard coverage portion)’, ‘Part D Payment Demonstration’ and ‘Risk Corridor Payment Adjustment’. The funds noted above have a final policy amount that is calculated based on the loss experience of the insured during the term of the policy, therefore should be treated as such. Refer to INT 05-05: *Accounting for Revenues Under Medicare Part D Coverage* for additional information and definitions of terms specifically related to Medicare Part D business.

7. Because policy periods do not always correspond to reporting periods and because an insured’s loss experience may not be known with certainty until sometime after the policy period expires, retrospective premium adjustments shall be estimated based on the experience to date using one of the following methods:

a. Property and Casualty Contracts:

- i. Use of actuarially accepted methods in accordance with filed and approved retrospective rating plans. This includes but is not limited to the application of historical ratios of retrospective rated developments to earned standard premium to develop a ratio which is then applied to those policies for which no retrospective calculation has been recorded or for which no modification to the recorded calculation is needed. This method results in the calculation of one amount which is either a net asset or a net liability;
- ii. Reviewing each individual retrospectively rated risk, comparing known loss development (including IBNR) with that anticipated in the policy contract to arrive at the best estimate of return or additional premium earned at that point in time. This method results in the calculation of an asset or a liability for each risk. The total of all receivables shall be recorded as an asset and the total of all return premiums shall be recorded as a liability.

b. Life and Accident & Health Contracts: Reporting entities offering group coverage have extensive underwriting procedures and complex individually negotiated benefits and contracts. Due to cost and reporting deadlines, these factors make it difficult to establish an exact valuation of retrospective premium adjustments. The method used to estimate the liability shall be reasonable based on the reporting entity’s procedures and consistent among reporting periods. Common methods include a mathematical approach using a complex algorithm of the reporting entity’s underwriting rules and experience rating practices, and an aggregate or group approach.

8. Assumptions used in estimating retrospective premium adjustments shall be consistent with the assumptions made in recording other assets and liabilities necessary to reflect the underwriting results of the reporting entity such as claim and loss reserves (including IBNR) and contingent commissions. Contingent commissions and other related expenses shall be adjusted in the same period the additional or return retrospective premiums are recorded.

9. Retrospective premium adjustments are estimated for the portion of the policy period that has expired and shall be considered an immediate adjustment to premium. Additional retrospective premiums and return retrospective premiums shall be recorded as follows:

a. Property and Casualty Reporting Entities:

- i. Accrued additional retrospective premiums shall be recorded as a receivable with a corresponding entry made either to written premiums or as an adjustment to earned premiums. Premiums not recorded through written premium when accrued shall be recorded through written premium when billed;
- ii. Accrued return retrospective premiums shall be recorded as part of the change in unearned premium (detailed in the underwriting and investment exhibit) liability with a corresponding entry made either to written premiums or as an adjustment to earned premiums. Premiums not recorded through written premium when accrued shall be recorded through written premium when billed;
- iii. Ceded retrospective premium balances payable shall be recorded as liabilities, consistent with SSAP No. 62R. Ceded retrospective premiums recoverable shall be recorded as an asset. Consistent with *SSAP No. 64—Offsetting and Netting of Assets and Liabilities*, ceded retrospective premium balances payable may be deducted from ceded retrospective premiums recoverable when a legal right of setoff exists.

b. Life and Accident and Health Reporting Entities:

- i. Accrued additional retrospective premiums shall be recorded as an asset, accrued retrospective premiums, with a corresponding entry to premiums;
- ii. Accrued return retrospective premiums shall be recorded as a liability, provision for experience rating refunds, with a corresponding entry to premiums.

c. Managed Care/Accident and Health Reporting Entities

- i. Accrued additional retrospective premiums shall be recorded as an asset, accrued retrospective premiums with a corresponding entry to premiums;
- ii. Accrued return retrospective premiums shall be recorded as a liability, as part of Accident and Health Reserves (reserve for rate credits or experience rating refunds), with a corresponding entry to premiums.

10. The amount of accrued estimated retrospective premiums to be recorded as a nonadmitted asset for property and casualty insurers shall be determined as follows:

- a. 100% of the amount recoverable from any person for whom any agents' balances or uncollected premiums are classified as nonadmitted, and item (b), plus item (c) or (d) below. Once an insurer has elected either (c) or (d) below, a change from one to the other requires approval from the insurer's domiciliary state and such change must be disclosed in the financial statements.
- b. Retrospective premium adjustments shall be determined and billed or refunded in accordance with the policy provisions or contract provisions. If accrued additional retrospective premiums are not billed in accordance with the policy provisions or contract provisions, the accrual shall be nonadmitted.

- c. 10% of any accrued retrospective premiums not offset by retrospective return premiums, other liabilities to the same party (other than loss and loss adjustment expense reserves), or collateral, not otherwise used. Collateral shall be of the same types and quality permitted for use in connection with reinsurance (types of acceptable collateral vary from state to state) or by financial guaranty coverage issued by an insurer having an “A” or better rating from a nationally recognized rating agency. The financial guaranty coverage must allow the insured under the financial guaranty policy the same degree of access to payments under that policy as a beneficiary has under a qualified letter of credit as described in Appendix A-785. Accrued retrospectively rated premiums relating to bulk IBNR must be allocated to individual policyholder accounts prior to applying collateral by account. If the insurer is unable to allocate amounts by account, no credit may be taken for collateral.
- d. An amount calculated using the factors below for accrued retrospective premiums not offset by retrospective return premiums, other liabilities to the same party (other than loss and loss expense reserves), or collateral, not otherwise used. Collateral shall be of the same types and quality permitted for use in connection with reinsurance (types of acceptable collateral vary from state to state) or by financial guaranty coverage issued by an insurer having an “A” or better rating from a nationally recognized rating agency. The financial guaranty coverage must allow the insured under the financial guaranty policy the same degree of access to payments under that policy as a beneficiary has under a qualified letter of credit as described in Appendix A-785.

Accrued retrospectively rated premiums relating to bulk IBNR must be allocated to individual policyholder accounts prior to categorizing by Quality Rating.

Insured's Current Quality Rating*	Insured's Corporate Debt Equivalent to (S&P/Moody's)**	Percentage of Retro Premium to be Nonadmitted***
1	AAA, AA, A/Aaa, Aa, A	1%
2	BBB/Baa	2%
3	BB/Ba	5%
4	B/B	10%
5	CCC, CC, C/Caa, Ca	20%
6	CI, D/C, or insured in default on debt service payments, or insured's debt service payments are jeopardized upon filing of a bankruptcy petition	100%

* The Percentage of Retro Premium to be Nonadmitted is based upon the Insured's Current Quality Rating (i.e., if an insured's quality rating drops, the percentage relating to the lower quality rating is used in calculating the amount to be nonadmitted and vice versa).

** Insureds that do not have a debt rating issued by a publicly recognized rating agency are required to be rated by the NAIC's Securities Valuation Office (SVO).

*** In the event the insured has no debt rating (either from a publicly recognized rating agency or from the SVO) the insured's quality rating will be considered category 5 for purposes of this calculation (i.e., a factor of 20% shall be applied), unless the insurer is aware of conditions of the insured that would warrant a category 6 classification (i.e., a factor of 100%).

11. Once accrued retrospective premium is billed, the due date is governed by *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*. Life and accident and health reporting entities shall nonadmit any accrued retrospective premium that is more than 90 days due. If a reporting entity has issued more than one policy to the same insured, retrospective balances shall be netted in accordance with SSAP No. 64.

12. If, in accordance with SSAP No. 5R, it is probable that the additional retrospective premium is uncollectible, any uncollectible additional retrospective premium shall be written off against operations in the period the determination is made. If it is reasonably possible a portion of the balance in excess of the nonadmitted portion determined in accordance with paragraph 10 is not anticipated to be collected, the disclosure requirements outlined in SSAP No. 5R shall be made.

Disclosures

13. The financial statements shall disclose the method used by the reporting entity to estimate retrospective premium adjustments. The amount of net premiums written that are subject to retrospective rating features, as well as the corresponding percentage to total net premiums written, shall be disclosed. In addition, disclose whether accrued retrospective premiums are recorded through written premium or as an adjustment to earned premium.

14. The financial statements shall disclose the calculation of nonadmitted retrospective premium. If a reporting entity chooses treatment described in paragraph 10.c. or 10.d., the appropriate exhibit must be included in the Notes to Financial Statements in the annual statement. Once a reporting entity has elected either 10.c. or 10.d., a change from one to the other requires approval from the reporting entity's domiciliary state and such change must be disclosed in the financial statements.

15. The financial statements shall disclose the following amounts for medical loss ratio rebates required pursuant to the Public Health Service Act for the current reporting period year-to-date and prior reporting period year: incurred rebates, amounts paid and unpaid liabilities segregated into the following categories: individual, small group employer, large group employer and other. In addition, the impact of reinsurance assumed, ceded and net on the total medical loss ratio rebate shall be disclosed.

16. Refer to the Preamble for further discussion of the disclosure requirements.

Relevant Literature

17. This statement rejects *FASB Emerging Issues Task Force No. 93-14, Accounting for Multiple Year Retrospectively Rated Insurance Contracts* (EITF 93-14) since it applies only to multiple-year retrospectively rated contracts. The statutory principles outlined in the conclusion above are consistent with the guidance provided for accounting and retrospectively rated contracts in *FASB Statement No. 60, Accounting and Reporting by Insurance Companies* (FAS 60) and EITF 93-14, with the exception of the requirement to record certain amounts as nonadmitted. Although FAS 60 is rejected in *SSAP No. 50—Classifications of Insurance or Managed Care Contracts* and EITF 93-14 is rejected in this statement, it is considered appropriate that the accounting for retrospectively rated contracts be consistent with those provisions of both FAS 60 and EITF 93-14 as they are consistent with the Statement of Concepts.

Effective Date and Transition

18. 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**Other**

- NAIC *Annual Statement Instructions for Property and Casualty Insurance Companies*

Relevant Issue Papers

- *Issue Paper No. 66—Accounting for Retrospectively Rated Contracts*

Not for Distribution

Statement of Statutory Accounting Principles No. 67

Other Liabilities

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	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Self-Insurance	1
Amounts Withheld or Retained by Company as Agent or Trustee.....	2
Remittances and Items Not Allocated.....	2
Interest Payable.....	3
Payable to Parent, Subsidiaries and Affiliates	3
Relevant Literature.....	3
Effective Date and Transition	3
REFERENCES.....	3
Relevant Issue Papers	3

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for other liabilities.

SUMMARY CONCLUSION

2. For purposes of identifying other liabilities, the guidance outlined in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* must be considered. This statement is not an all-inclusive list of other liabilities. Certain other liabilities are covered in other statements. All other liabilities, whether or not specifically identified in this statement, shall be recorded and disclosed in accordance with SSAP No. 5R, which states that “Liabilities shall be recorded on a reporting entity’s financial statements when incurred.”

Self-Insurance

3. Self-insurance occurs when an entity retains insurance risks associated with the entity’s day-to-day operations that are commonly transferred to an insurer through an insurance contract.

4. The fact that a decision is made not to insure against losses that can reasonably be expected sometime in the future does not necessitate accrual by the entity if it is not probable that an asset has been impaired or a liability incurred at the date of the financial statements.

5. If an uninsured (self-insured) event occurs, which either creates a liability or impairs an asset, the entity shall either establish a liability or write-down the impaired asset. The liability shall be established using the same estimation methodology an insurance company uses when an insurance contract is issued for the type of insurance risk which is self-insured. *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses* describes the specific reserving guidance which shall be followed.

6. The related costs shall be recorded based on the nature of the underlying expenses, and allocated in accordance with *SSAP No. 70—Allocation of Expenses*. Related costs shall be recorded based on the nature of the underlying expenses.

Amounts Withheld or Retained by Company as Agent or Trustee

7. A reporting entity may, in the normal course of its business, withhold funds as an agent or trustee which will ultimately be paid to others.

8. Amounts withheld or retained by an entity as trustee or agent shall be recorded as a liability when the salaries or other compensation are expensed (paragraphs 8.a. and 8.b.) or the funds are received (paragraphs 8.c. through 8.e.). Examples of such occurrences are:

- a. As an employer, the reporting entity deducts and withholds federal and state income taxes, social security taxes, charitable contributions, savings plan deductions, garnishments, employee contributions to pension plans, employee share of group life and health insurance premiums, and other employee salary withholdings or deductions;
- b. Amounts due under deferred compensation arrangements shall be accrued in accordance with the provisions of *SSAP No. 92—Postretirement Benefits Other Than Pensions*. Segregated funds (i.e., Rabbi trusts and similar arrangements) shall not be netted against the accrued liability unless the requirements of *SSAP No. 64—Offsetting and Netting of Assets and Liabilities* are met.
- c. For a reporting entity that invests in commercial and residential mortgages, the entity may require the mortgagor to prepay real estate taxes and property insurance premiums which the entity will hold in escrow and pay when due;
- d. The reporting entity holds deposits in connection with leases of investment property; and
- e. The reporting entity may receive and hold other funds in a fiduciary capacity.

Remittances and Items Not Allocated

9. Cash receipts cannot always be identified for a specific purpose or, for other reasons, applied to a specific account when received. The reporting entity shall record a liability for these cash receipts when the funds are received. These liability accounts are generally referred to as suspense accounts. Examples include:

- a. Premium payments received with the application for policies which have not yet been issued;
- b. Premium payments in an amount different than the amount billed by the reporting entity; and

- c. Unidentified cash receipts.

Interest Payable

10. Interest payable includes interest on debt, interest on real estate obligations, and approved interest on surplus notes. It also includes interest on funds held as a deposit or security, such as those held by a ceding company against a reinsurer. The amount to be reported is the amount which has accrued and is unpaid at the balance sheet date.

Payable to Parent, Subsidiaries and Affiliates

11. A liability shall be recognized and identified as due to affiliates for expenditures incurred on behalf of the reporting entity by a parent, affiliates, or subsidiaries or for amounts owed through other intercompany transactions. Amounts due to or from affiliates shall be offset and reported net only when the provisions of SSAP No. 64 are met. Examples of these expenses are executive salaries, workers' compensation insurance premiums, and pension contributions.

12. Reinsurance transactions are not considered liabilities of this nature and are covered in *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance* and *SSAP No. 62R—Property and Casualty Reinsurance*.

Relevant Literature

13. This statement adopts *FASB Statement No. 116, Accounting for Contributions Received and Contributions Made* and *AICPA Statement of Position 96-1, Environmental Remediation Liabilities*. This statement is consistent with *FASB Statement No. 5, Accounting for Contingencies* as discussed in SSAP No. 5R.

Effective Date and Transition

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

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 96—Other Liabilities*

Statement of Statutory Accounting Principles No. 68

Business Combinations and Goodwill

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Nullifies and incorporates INT 99-10 and INT 03-16
Affected by.....	No other pronouncements
Interpreted by	INT 00-28; INT 01-18; INT 06-07
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	2
Business Combinations.....	2
Statutory Purchases of SCA Investments.....	2
Impairment.....	3
Statutory Mergers.....	4
Treatment of Goodwill When Previously Purchased or Merged Entity Ceases to Exist	4
Disclosures.....	4
Relevant Literature.....	5
Effective Date and Transition	8
REFERENCES.....	8
Other	8
Relevant Issue Papers	8

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for business combinations. It addresses: (a) accounting for purchases of subsidiary, controlled and affiliated (SCA) investments (defined in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*); (b) accounting for purchases of partnerships, joint ventures, and limited liability companies (defined in *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*); (c) accounting for goodwill; and (d) accounting for mergers. This statement does not include guidance for stock of an affiliated company received as a capital contribution, rather than through a purchase. Stock received as a capital contribution is addressed by *SSAP No. 25—Affiliates and Other Related Parties*, *SSAP No. 95—Nonmonetary Transactions*, or *SSAP No. 97*, based on the details of each transaction. The statutory purchase method within this statement is not applicable for stock received as a capital contribution.

SUMMARY CONCLUSION

Business Combinations

2. A business combination shall be accounted for as either a statutory purchase or a statutory merger. Business combinations that create a parent-subsidiary relationship shall be accounted for as a statutory purchase. Business combinations where equity of one entity is issued in exchange for the equity of another entity, which is then canceled, and prospectively only one entity exists, shall be accounted for as a statutory merger.

Statutory Purchases of SCA Investments

3. The statutory purchase method of accounting is defined as accounting for a business combination as the acquisition of one entity by another. It shall be used for all purchases of SCA entities including partnerships, joint ventures, and limited liability companies. The acquiring reporting entity shall record its investment at cost. Cost is defined as the sum of: (a) any cash payment, (b) the fair value of other assets distributed, (c) the fair value of any liabilities assumed, and (d) any direct costs of the acquisition.^(INT 00-28) Contingent consideration issued in a purchase business combination that is embedded in a security or that is in the form of a separate financial instrument shall be recorded by the issuer at fair value at the acquisition date.

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

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

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

7. Positive goodwill recorded under the statutory purchase method of accounting shall be admitted subject to the following limitation: Positive goodwill from all sources, including life, accident and health, and deposit-type assumption reinsurance and goodwill resulting from the acquisition of an SCA by the insurance reporting entity that is reported on the SCA's financial statements (resulting from the application of pushdown accounting), is limited in the aggregate to 10% of the acquiring¹ entity's capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for its most

¹ The "acquiring" entity is intended to reflect the insurance reporting entity that reports the investment resulting in goodwill. The goodwill limitation test shall be completed at the individual reporting company level.

recently filed statement with the domiciliary state commissioner adjusted to exclude any net positive goodwill, EDP equipment and operating system software, and net deferred tax assets. Additionally, all positive goodwill shall be nonadmitted when the underlying investment in the SCA or partnership, joint venture and limited liability company is nonadmitted². When negative goodwill exists, it shall be recorded as a contra-asset.

8. Positive or negative goodwill resulting from the purchase of an SCA, joint venture, partnership or limited liability company shall be amortized to unrealized capital gains and losses on investments over the period in which the acquiring entity benefits economically, not to exceed 10 years. Positive or negative goodwill resulting from life, accident and health, and deposit-type assumption reinsurance shall be amortized to operations as a component of general insurance expenses over the period in which the assuming entity benefits economically, not to exceed 10 years. Goodwill shall be evaluated separately for each transaction. (INT 01-18)

Impairment

9. For any decline in the fair value of an entity, acquired through a purchase, that is other than temporary (INT 06-07), the investment shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. The write down shall first be considered as an adjustment to any portion of the investment that is nonadmitted (e.g., nonadmitted goodwill). The new cost basis shall not be changed for subsequent recoveries in fair value. Future declines in fair value, which are determined to be other than temporary, shall be recorded as realized losses. A long-lived asset shall be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. The following are examples of such triggering events or changes in circumstances:

- a. A significant decrease in the fair value of a long-lived asset
- b. A significant adverse change in the extent or manner in which a long-lived asset is being used or in its physical condition
- c. A significant adverse change in legal factors or in the business climate that could affect the value of a long-lived asset, including an adverse action or assessment by a regulator
- d. An accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of a long-lived asset
- e. A current period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset
- f. A current expectation that, more likely than not, a long-lived asset will be sold or otherwise disposed of significantly before the end of its previously estimated useful life

10. An impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to recover the carrying amount of the investment or there is evidence indicating inability of the investee to sustain earnings which would justify the carrying amount of the investment. A fair value of an investment that is below the carrying amount based on the statutory equity method or the existence of investee operating losses may indicate a loss in value; however, they are not necessarily indicative of a loss in value that is other than temporary.

² This includes, but is not limited to, situations in which the investment is nonadmitted as the audited financial statements for the SCA, joint venture, partnership or limited liability company includes substantial doubt on the entity's ability to continue as a going concern, or on the basis/contents of the audit opinion pursuant to paragraph 21 of SSAP No. 97.

Statutory Mergers

11. The statutory merger method of accounting is defined as accounting for a business combination in which the original investors in the investee receive equity of the reporting entity for their interest in the investee and only one entity survives. It shall be used for all business combinations accomplished by (a) issuing equity of a newly formed entity for the equity of the merging entities; (b) one entity issuing equity in exchange for the equity of another entity and immediately canceling the equity of that entity; (c) cancelling equity of an owned entity, without issuance of new equity, and incorporating the assets and liabilities of the owned entity directly within the reporting entity's financial statements (e.g., dissolving the SCA entity and absorbing their assets and liabilities); or (d) the exchange of membership interest.

12. Under the statutory merger method, no acquisition shall be recognized because the combination is accomplished without disbursing resources of the constituents. Ownership interest continues and the former statutory bases of accounting shall be retained. However, if one of the merged entities did not employ the statutory basis of accounting, the accounts shall be adjusted to the statutory bases with an offsetting adjustment to beginning surplus of the earliest period presented. The recorded assets, liabilities, and related surplus accounts of the constituents shall be carried forward to the combined corporation at their recorded statutory amounts. The capital accounts of the entities shall be adjusted as necessary to reflect the appropriate par values of the capital stock of the new entity. Adjustments to the capital stock account shall be made to gross paid-in and contributed surplus, to the extent there is a balance in the account.

13. Income of the combined reporting entity shall include income of the constituents for the entire fiscal period in which the combination occurs and the balance sheet and the statement of operations for the two years presented shall be restated, as required by *SSAP No. 3—Accounting Changes and Corrections of Errors*. A reporting entity that merges with an entity which effectively is a shell company³ (i.e., the reporting entity has no outstanding underwriting liabilities) shall be exempt from prior year restatement.

Treatment of Goodwill When Previously Purchased or Merged Entity Ceases to Exist

14. Goodwill carried by an entity related to a previous business combination shall be charged or credited to surplus immediately in the event that the investee or previous investor that the goodwill relates to ceases to exist (e.g., by merger or dissolution). This guidance is intended to prevent recognition of goodwill when the acquisition, merger or dissolution of the investor or investee would result with the remaining entity reporting goodwill in itself. Internally generated goodwill, or amounts that reflect the goodwill of the reporting entity are not permitted under statutory accounting principles.

Disclosures

15. For business combinations accounted for under the statutory purchase method, the financial statements shall disclose the following for as long as unamortized goodwill is reported as a component of the investment:

- a. The name and brief description of the acquired entity;
- b. Method of accounting, that is the statutory purchase method;
- c. Acquisition date, cost of the acquired entity, the original amount of goodwill and the original amount of admitted goodwill;

³ When one of the entities is a "shell company," the prior year amounts shall only consist of the "non-shell company." The merger with a shell entity shall be reflected as of January 1 of the current year.

- d. Each SCA's book value, the amount of amortization of goodwill recorded for the period; the SCA's admitted goodwill as of the reporting date;
 - e. Total admitted goodwill as of the reporting date; and
 - f. Admitted goodwill as a percentage of the SCA's book adjusted carrying value (gross of admitted goodwill).
16. For business combinations taking the form of a statutory merger, the financial statements shall disclose:
- a. The names and brief description of the combined entities;
 - b. Method of accounting, that is the statutory merger method;
 - c. Description of the shares of stock issued or cancelled in the transaction;
 - d. Details of the results of operations of the previously separate entities for the period before the combination is consummated that are included in the current combined net income, including revenue, net income, and other changes in surplus; and
 - e. A description of any adjustments recorded directly to surplus for any entity that previously did not prepare statutory statements.
17. The financial statements shall disclose the following information regarding goodwill resulting from assumption reinsurance:
- a. The name of the ceding entity;
 - b. The type of business assumed;
 - c. The cost of the acquired business and the amount of goodwill; and
 - d. The amount of amortization of goodwill recorded for the period.
18. A reporting entity that recognizes an impairment loss shall disclose the following in the financial statements that include the period of the impairment write-down:
- a. A description of the impaired assets and the facts and circumstances leading to the impairment; and
 - b. The amount of the impairment charged to realized capital gains and losses and how fair value was determined.
19. A reporting entity shall disclose the subcomponents and calculation of adjusted surplus and total admitted goodwill as a percentage of adjusted surplus.

Relevant Literature

20. This statement adopts paragraph 12 of *FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* (FAS 121) to the extent that it addresses impairment of goodwill. Paragraphs 14.a. and 14.b. of FAS 121 are also adopted. Paragraphs 13, 14.c. and 14.d. of FAS 121 are rejected. *FASB Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets* (FAS 144) supersedes FAS 121, but specifically scopes out the concept of goodwill. Given the applicability of the guidance found in paragraph 12 of FAS 121 to statutory accounting principles, the impairment guidance found in FAS 121, paragraph 12 is retained.

21. This statement adopts *FASB Emerging Issues Task Force No. 95-19, Determination of the Measurement Date for the Market Price of Securities Issued in a Purchase Business Combination* and *FASB Emerging Issues Task Force No. 97-8: Accounting for Contingent Consideration Issued in a Purchase Business Combination*.

22. This statement rejects *ASU 2021-08, Business Combinations, Accounting for Contract Assets and Contract Liabilities from Contracts with Customers*; however, the rejection of which shall not modify the U.S. GAAP accounting standards as required within this standard, *ASU 2021-03, Intangibles – Goodwill and Other – Accounting Alternative for Evaluating Triggering Events*, *ASU 2019-06, Intangibles—Goodwill and Other Business Combinations, and Non-for-Profit Entities*, *ASU 2017-04, Simplifying the Test for Goodwill Impairment*, *ASU 2016-03, Intangibles—Goodwill and Other, Business Combinations, Consolidation, Derivatives and Hedging*; *ASU 2014-02, Accounting for Goodwill (a consensus of the Private Company Council)*, *ASU 2012-02, Testing Indefinite-Lived Intangible Assets for Impairment*, *ASU 2011-08, Testing Goodwill for Impairment* and *ASU 2010-28, When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts*; *Accounting Principles Board Opinion No. 16, Business Combinations*; *FASB Statement No. 38, Accounting for Preacquisition Contingencies of Purchased Enterprises, an amendment of APB Opinion No. 16*; *Accounting Principles Board Opinion No. 17, Intangible Assets*; *FASB Statement No. 79, Elimination of Certain Disclosures for Business Combinations by Nonpublic Enterprises*; *FASB Statement No. 141, Business Combinations*; and *FASB Statement No. 142, Goodwill and Other Intangible Assets*. The following related interpretative pronouncements are also rejected:

- a. *AICPA Accounting Interpretations, Business Combinations: Accounting Interpretations of APB Opinion No. 16*;
- b. *FASB Statement No. 10, Extension of "Grandfather" Provisions for Business Combinations*;
- c. *AICPA Accounting Interpretations, Intangible Assets: Unofficial Accounting Interpretations of APB Opinion No. 17*;
- d. *FASB Emerging Issues Task Force No. 85-14, Securities That Can Be Acquired for Cash in a Pooling of Interests*;
- e. *FASB Emerging Issues Task Force No. 86-9, IRC Section 338 and Push-Down Accounting*;
- f. *FASB Emerging Issues Task Force No. 86-10, Pooling with 10 Percent Cash Payout Determined by Lottery*;
- g. *FASB Emerging Issues Task Force No. 87-11, Allocation of Purchase Price to Assets to Be Sold*;
- h. *FASB Emerging Issues Task Force No. 87-15, Effect of a Standstill Agreement on Pooling-of-Interests Accounting*;
- i. *FASB Emerging Issues Task Force No. 87-16, Whether the 90 Percent Test for a Pooling of Interests Is Applied Separately to Each Company or on a Combined Basis*;
- j. *FASB Emerging Issues Task Force No. 87-27, Poolings of Companies that Do Not Have a Controlling Class of Common Stock*;
- k. *FASB Emerging Issues Task Force No. 88-26, Controlling Preferred Stock in a Pooling of Interests*;

- l. *FASB Emerging Issues Task Force No. 88-27, Effect of Unallocated Shares in an Employee Stock Ownership Plan on Accounting for Business Combinations;*
- m. *FASB Emerging Issues Task Force No. 89-7, Exchange of Assets or Interest in a Subsidiary for a Noncontrolling Equity Interest in a New Entity;*
- n. *FASB Emerging Issues Task Force No. 90-5, Exchanges of Ownership Interest between Entities under Common Control;*
- o. *FASB Emerging Issues Task Force No. 90-6, Accounting for Certain Events Not Addressed in Issue No. 87-11 Relating to an Acquired Operating Unit to Be Sold;*
- p. *FASB Emerging Issues Task Force No. 90-12, Allocating Basis to Individual Assets and Liabilities for Transactions within the Scope of Issue No. 88-16;*
- q. *FASB Emerging Issues Task Force No. 90-13, Accounting for Simultaneous Common Control Mergers;*
- r. *FASB Emerging Issues Task Force No. 91-5, Nonmonetary Exchange of Cost-Method Investments;*
- s. *FASB Emerging Issues Task Force No. 92-9, Accounting for the Present Value of Future Profits Resulting from the Acquisition of a Life Insurance Company;*
- t. *FASB Emerging Issues Task Force No. 93-7, Uncertainties Related to Income Taxes in a Purchase Business Combination;*
- u. *FASB Emerging Issues Task Force No. 95-3, Recognition of Liabilities in Connection with a Purchase Business Combination;*
- v. *FASB Emerging Issues Task Force No. 95-8, Accounting for Contingent Consideration Paid to the Shareholders of an Acquired Enterprise in a Purchase Business Combination;*
- w. *FASB Emerging Issues Task Force No. 95-12, Pooling of Interests with a Common Interest in a Joint Venture;*
- x. *FASB Emerging Issues Task Force No. 95-14, Recognition of Liabilities in Anticipation of a Business Combination;*
- y. *FASB Emerging Issues Task Force No. 96-8, Accounting for a Business Combination When the Issuing Company Has Targeted Stock;*
- z. *FASB Technical Bulletin 85-5, Issues Related to Accounting for Business Combinations;*
- aa. *FASB Interpretations No. 4, Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method, an interpretation of FASB Statement No. 2.*
- bb. *FASB Staff Position FAS 141/142-1: Interaction of FASB Statements No. 141 and No. 142 and EITF Issue No. 04-2.*
- cc. *FASB Staff Position FAS 142-3, Determination of the Useful Life of Intangible Assets*

Effective Date and Transition

23. This statement is effective for years beginning January 1, 2001. The provisions of this statement shall be applied to all business combinations entered into on or after January 1, 2001. Goodwill that had been written off prior to the effective date of this statement is prohibited from being restored for purposes of applying the provisions of this statement. The guidance in paragraphs 4-6 was previously included within *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* and was effective for reporting periods ending on and after December 31, 2007. In 2011, the guidance related to goodwill included in SSAP No. 97 was incorporated into this statement. The original guidance included in this standard, and the substantive revisions reflected in SSAP No. 97 are retained for historical purposes within Issue Paper No. 118. Guidance reflected in paragraph 1, incorporated from *INT 03-16: Contribution of Stock*, was effective December 7, 2003. Guidance reflected in paragraph 3 incorporated from *INT 99-10: EITF No. 97-8: Accounting for Contingent Consideration Issued in a Purchase Business Combination* was effective June 7, 1999. Disclosure modifications adopted in July 2020, reflected in agenda item 2020-03, are effective for the year-end 2021 financial statements.

REFERENCES**Other**

- *Purposes and Procedures Manual of the NAIC Investment Analysis Office*

Relevant Issue Papers

- *Issue Paper No. 68—Business Combinations and Goodwill*
- *Issue Paper No. 118—Investments in Subsidiary, Controlled and Affiliated Entities, A Replacement of SSAP No. 46*

Statement of Statutory Accounting Principles No. 69

Statement of Cash Flow

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	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Disclosures.....	1
Relevant Literature.....	2
Effective Date and Transition	2
REFERENCES.....	3
Relevant Issue Papers	3

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for the Statement of Cash Flow.

SUMMARY CONCLUSION

2. For purposes of the Statement of Cash Flow, cash shall include cash, cash equivalents¹ and short-term investments. The Statement of Cash Flow shall be prepared using the direct method and shall only include transactions involving cash. Cash from operations shall be reported consistent with the Statement of Income, excluding the effect of current and prior year accruals. Worksheets to facilitate completion of the cash flow statement, which necessitate adjustments for reporting entity-specific insurance operations and for non-cash transactions, are provided in the annual statement instructions.

Disclosures

3. The financial statements shall disclose the following:
 - a. Transactions considered to be operating, investing and financing activities (consistent with the classifications in the annual statement) that affect recognized assets or liabilities

¹ Amounts generally described as restricted cash or restricted cash equivalents shall be included in the beginning and ending balance in the cash flow statement. Transfers between cash, cash equivalents, amounts generally described as restricted cash or restricted cash equivalents, and short-term investments are not part of the entity's operating, investing and financing activities, and details of those transfers are not reported as cash flow activities in the statement of cash flows.

but do not result in cash receipts or cash payments in the period (in narrative or schedule form); and

- b. The cash and noncash aspects of the above transactions identified as operating, investing or financing consistent with the classifications provided by the annual statement instructions. Examples of noncash operating, investing and financing transactions include:
 - i. Receiving non-cash financial assets from parent as a capital contribution;
 - ii. Settling reinsurance transactions with exchange of non-cash financial assets;
 - iii. Converting debt to equity;
 - iv. Acquiring assets by assuming directly related liabilities, such as purchasing a building by incurring a mortgage to the seller; and
 - v. Exchanging noncash assets or liabilities for other noncash assets or liabilities.

- 4. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

5. This statement adopts *ASU 2016-15, Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments*, including the related effective date and transition guidance of ASU 2016-15. This statement adopts *FASB Emerging Issues Task Force Issue No. 95-13, Classification of Debt Issue Costs in the Statement of Cash Flows* which requires that cash payments for debt issue costs shall be classified as a financing activity in the Statement of Cash Flow. This statement adopts with modification *ASU 2012-05, Not-For-Profit Entities: Classification of the Sale Proceeds of Donated Financial Assets in the Statement of Cash Flows* for all reporting entities. Donated assets with donor-restrictions as to the sale or use of the contributed financial assets, or cash receipts from the sale of donated assets that are restricted as to use are not considered available to meet policyholder obligations and are nonadmitted in accordance with *SSAP No. 4—Assets and Nonadmitted Assets*. This statement adopts *ASU 2016-18, Statement of Cash Flows: Restricted Cash* and requires restricted cash and restricted cash equivalents to be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows.

6. *FASB Statement No. 95, Statement of Cash Flows, FASB Statement No. 102, Statement of Cash Flows—Exemption of Certain Enterprises and Classification of Cash Flows from Certain Securities Acquired for Resale, an amendment of FASB Statement No. 95, and FASB Statement No. 104, Statement of Cash Flows—Net Reporting of Certain Cash Receipts and Cash Payments and Classification of Cash Flows from Hedging Transactions, an amendment of FASB Statement No. 95*, are rejected in this statement.

Effective Date and Transition

7. 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*. Revisions incorporated to clarify that only transactions involving cash shall be included in the cash flow statement and to expand the disclosure to include non-cash operating transactions are effective December 31, 2015. Revisions to adopt ASU 2016-18 and include restricted cash and restricted cash equivalents with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows are effective December 31, 2019, with early adoption permitted. This revision shall be shown retrospectively, allowing for comparative cash flow statements.

REFERENCES**Relevant Issue Papers**

- *Issue Paper No. 92—Statement of Cash Flow*

Not for Distribution

Statement of Statutory Accounting Principles No. 70

Allocation of Expenses

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 No other pronouncements
Relevant Appendix A Guidance None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Effective Date and Transition	2
REFERENCES.....	3
Other	3
Relevant Issue Papers	3

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for presentation and allocation of certain expenses of reporting entities into general categories and the apportionment of shared expenses between members of a group of entities.

SUMMARY CONCLUSION

2. This statement establishes uniform expense allocation rules to classify expenses within prescribed principal groupings. It is necessary to allocate those expenses which may contain characteristics of more than one classification, which this statement will refer to as allocable expenses.

3. Allocable expenses for property and casualty insurance companies shall be classified into one of three categories on the Underwriting and Investment Exhibit as follows:

- a. Loss adjustment expenses—Expenses incurred in the adjusting, recording and paying of claims (including expenses associated with commutations);
- b. Investment expenses—Expenses incurred in the investing of funds and pursuit of investment income. Such expenses include those specifically identifiable and allocated costs related to activities such as initiating and handling orders, researching and recommending investments (i.e., investment strategy), appraising, valuing, disbursing funds and collecting income, securities safekeeping, real estate taxes, records maintenance, data processing, support personnel, postage and supplies, office overhead,

management and executive duties and all other functions reasonably associated with the investment of funds; or

- c. Other underwriting expenses—Allocable expenses other than loss adjustment expenses and investment related expenses.
4. Similarly for life and accident and health insurers allocable expenses shall be categorized as general insurance expenses; insurance taxes, licenses and fees; or investment expenses which are netted against investment income on the Summary of Operations.
5. Allocable expenses for health insurers shall be classified as claim adjustment expenses; general administrative expenses; or investment expenses which are netted against investment income on the Statement of Revenue and Expenses.
6. Allocation to the above categories should be based on a method that yields the most accurate results. Specific identification of an expense with an activity that is represented by one of the categories above will generally be the most accurate method. Where specific identification is not feasible allocation of expenses should be based upon pertinent factors or ratios such as studies of employee activities, salary ratios or similar analyses.
7. Allocation may be entirely to one expense category based upon the type of expense incurred, for example, premium taxes would be 100% allocated to Other Underwriting Expenses for property and casualty companies. Other expenses may be allocated across several categories, such as salaries, which may be allocated to both general insurance expenses and net investment income of a life and accident and health company.
8. Many entities operate within a group where personnel and facilities are shared. Shared expenses, including expenses under the terms of a management contract, shall be apportioned to the entities incurring the expense as if the expense had been paid solely by the incurring entity. The apportionment shall be completed based upon specific identification to the entity incurring the expense. Where specific identification is not feasible apportionment shall be based upon pertinent factors or ratios.
9. Any basis adopted to apportion expenses shall be that which yields the most accurate results and may result from special studies of employee activities, salary ratios, premium ratios or similar analyses. Expenses that relate solely to the operations of a reporting entity, such as personnel costs associated with the adjusting and paying of claims, must be borne solely by the reporting entity and are not to be apportioned to other entities within a group.
10. Apportioned expenses are subject to presentation and allocation as provided in paragraphs 3-6.
11. Any material individual component of the reported expense categories shall be presented either on the face of the Summary of Operations or within the footnotes or related Exhibits to the financial statements of the Life and Accident and Health annual statement, the Property and Casualty annual statement or the Health annual statement.
12. Refer to the Preamble for further discussion regarding disclosure requirements.

Effective Date and Transition

13. 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**Other**

- NAIC *Annual Statement Instructions for Property and Casualty Insurance Companies, “Underwriting and Investment Exhibit”*
- NAIC *Annual Statement Instructions for Life and Accident and Health Insurance Companies*

Relevant Issue Papers

- *Issue Paper No. 94—Allocation of Expenses*

Not for Distribution

Statement of Statutory Accounting Principles No. 71

Policy Acquisition Costs and Commissions

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 No other pronouncements
Relevant Appendix A Guidance None

STATUS	1
SCOPE OF STATEMENT	1
SUMMARY CONCLUSION	1
Relevant Literature.....	2
Effective Date and Transition	2
REFERENCES	3
Relevant Issue Papers	3

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for policy acquisition costs and commissions.

SUMMARY CONCLUSION

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid

to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. These transactions are, in fact, funding agreements between a reporting entity and a third party, regardless of how the payment to the third party is characterized. The continuance of the stream of payments specified in the levelized commission contract is a mechanism which attempts to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement such as a levelized commission arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount paid by a third party to the direct selling agents requires the establishment of a liability by the reporting entity for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions. Arrangements that use a third party to pay agents who write policies for the reporting entity and the insured can be an attempt to de-link the relationship between the insurer and those agents and defer or levelize the acquisition commissions. The insurance reporting entity is required to recognize the full amount of earned commission costs to the direct policy writing agents even if those costs are paid indirectly to the agents by a third party through the use of levelized commission, or similar arrangement, which is in substance a funding arrangement. Having a third party pay commission costs to the selling agent is strong evidence of a potential funding arrangement which shall be recognized as a liability because the substance of the arrangement indicates that repayment is reasonable and probable, even if a contingency has been incorporated into the funding arrangement, until the underlying policy has been cancelled. A third-party structure cannot recharacterize (e.g., by referencing policy persistency) and delay recognition of liabilities for initial sales commission owed from the writing of policies regardless of how a third-party arrangement is structured with regard to the timing of payment from the insurer. The amount owed for full initial sales commission shall be recognized immediately as the writing of an insurance contract is the event that obligates the insurer, and such action shall occur consistently among insurers. As such, this recognition is required regardless of if the insurer owes a selling agent directly or if a third party has been contracted to provide payment to the selling agent.

Relevant Literature

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*.

Effective Date and Transition

7. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The nonsubstantive revisions adopted on March 15, 2021, regarding levelized commission are to clarify the original intent of this statement and apply to existing contracts in effect as of December 31, 2021, and new contracts thereafter.

REFERENCES**Relevant Issue Papers**

- *Issue Paper No. 71—Policy Acquisition Costs and Commissions*
- *Issue Paper 165—Levelized Commission*

Not for Distribution

Statement of Statutory Accounting Principles No. 72

Surplus and Quasi-Reorganizations

STATUS

Type of Issue.....	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Nullifies and incorporates INT 99-01 and INT 00-12
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	A-791

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Capital Stock.....	2
Treasury Stock	2
Gross Paid-in and Contributed Surplus.....	2
Surplus Notes	3
Unassigned Funds (Surplus)	3
Special Surplus Funds.....	5
Other-Than-Special Surplus Funds.....	6
Quasi-Reorganizations	6
Demutualizations	7
Changes in Statutory Surplus.....	7
Disclosures.....	7
Relevant Literature.....	8
Effective Date and Transition	9
REFERENCES.....	9
Relevant Issue Papers	9

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for statutory surplus and quasi-reorganizations.

SUMMARY CONCLUSION

2. Statutory surplus of a reporting entity consists of the following:
- a. Capital stock;
 - b. Treasury stock;
 - c. Gross paid-in and contributed surplus;

- d. Surplus notes;
- e. Unassigned funds (surplus);
- f. Special surplus funds; and
- g. Other-than-special surplus funds.

Capital Stock

3. The articles of incorporation set forth the number of authorized shares of capital stock and the par value of each share. The capital stock account represents the number of shares issued times the par value of each share. When no par value is set forth, the reporting entity shall declare a “stated value” and record such amount in the capital stock account. Changes in the par value of a reporting entity’s capital stock shall be reflected as a reclassification between the capital stock account and gross paid-in and contributed surplus. Issued, free-standing financial instruments with characteristics of both liability and equity shall be reported as a liability to the extent described in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*.

4. Notes or other receivables received for the issuance of capital stock which have been approved by the domiciliary commissioner and have been satisfied by receipt of cash or readily marketable securities prior to the filing of the statutory financial statement shall be treated as a Type I subsequent event in accordance with *SSAP No. 9—Subsequent Events* and as such shall be considered an admitted asset. To the extent that the notes or other receivables are not satisfied, they shall be nonadmitted.

5. Stock splits, similar to stock dividends, have no impact on the overall surplus of a reporting entity. The distinction between a stock split and a stock dividend shall be made in accordance with *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins*, “Chapter 7, Capital Accounts, Section B-Stock Dividends and Split-ups” (ARB 43). Stock splits shall be recorded by adjusting the capital stock account to reflect the par value of the outstanding number of shares after the split. An offsetting entry shall be made to paid-in or contributed surplus. Stock dividends shall be recorded in a manner consistent with paragraph 13.i.

Treasury Stock

6. Treasury stock is capital stock that has been issued and subsequently reacquired by the reporting entity. It is held for either reissuance or cancellation in the future. When a reporting entity’s stock is acquired for purposes other than retirement, or when ultimate disposition has not yet been decided, the cost of acquired stock shall be reported as treasury stock which reduces statutory surplus. The acquisition of treasury stock has no effect on either the number of shares issued or the amount of paid up capital shown in the capital stock account. Cancellation of treasury stock shall reduce the capital stock account by the par value and reduce paid-in or contributed surplus by the excess of cost over par value or stated value.

Gross Paid-in and Contributed Surplus

7. Gross paid-in and contributed surplus is the amount of capital received in excess of the par value of the stock issued. Changes in the par value of a reporting entity’s capital stock shall be reflected as a reclassification between the capital stock account and gross paid-in and contributed surplus. Forgiveness of a reporting entity’s obligations to its parent or other stockholders shall be accounted for as contributed surplus.

8. Notes or other receivables received as additional capital contributions satisfied by receipt of cash or readily marketable securities prior to the filing of the statutory financial statement shall be treated as a Type I subsequent event in accordance with *SSAP No. 9* and as such shall be considered an admitted

asset based on the evidence of collection and approval of the domiciliary commissioner. To the extent that the notes or other receivables are not satisfied, they shall be nonadmitted.

9. Bonds received as capital contributions, reflecting economic transactions, shall be recognized at fair value in accordance with *SSAP No. 25—Affiliates and Other Related Parties*. Real estate or other assets received as additional capital contributions shall be recognized in accordance with *SSAP No. 25* or as nonreciprocal transfers as defined in *SSAP No. 95—Nonmonetary Transactions*, in accordance with the details of the transaction.

10. Stock purchase warrants issued in return for cash shall be credited to gross paid-in and contributed surplus. An entity shall treat a modification of the terms or conditions or an exchange of a freestanding equity-classified written call option as an exchange of the original instrument for a new instrument. In substance, the entity repurchases the original instrument by issuing a new instrument. The total effect of the modification or exchange shall be allocated to the respective elements in the transaction. When debt instruments are issued with conversion features, no value shall be assigned to the conversion features unless the conversion feature is clearly separable from the debt obligation in the form of a detachable stock purchase warrant. In such instances the relative fair value of the detachable stock purchase warrant at time of issue shall be credited to gross paid-in and contributed surplus. For instances in which a reporting entity has issued puttable warrants or mandatorily redeemable warrants, such items shall be reflected as liabilities as the warrants obligate the reporting entity to ultimately transfer cash or other assets to the holder in order to repurchase the shares.

11. Distributions that reflect a return of capital shall be charged directly to gross paid in and contributed surplus. (A return of capital will reduce the adjusted cost basis of the parent/stockholder in the reporting entity.)

Surplus Notes

12. Surplus notes are financial instruments that are subject to strict control by the commissioner of the reporting entity's state of domicile and have been approved by the commissioner as to form and content. These instruments are commonly referred to as surplus notes but are also referred to as surplus debentures or contribution certificates. *SSAP No. 41R—Surplus Notes* provides the specific characteristics of surplus notes and provides accounting guidance for surplus notes. Only notes meeting the requirements of *SSAP No. 41R* shall be accounted for as surplus notes.

Unassigned Funds (Surplus)

13. Unassigned funds (surplus) represents the undistributed and unappropriated amount of surplus at the balance sheet date. Certain components of unassigned funds (surplus) are addressed in more detail in other issue papers. Unassigned funds (surplus) is comprised of the cumulative effect of:

a. Net Income

Net income resulting from insurance and other operating activities of the reporting entity since its inception is a component of unassigned funds (surplus);

b. Unrealized Capital Gains and Losses on Investments

The cumulative unrealized capital gain or loss that results from differences between the prescribed statement value of investments carried at fair value and the cost of those investments is a component of unassigned funds (surplus). This component changes as periodic unrealized gains and losses are credited or charged directly to unassigned funds (surplus);

c. Effect of Exchange Rate Fluctuations

The cumulative gain or loss due to translating foreign operations to U.S. dollars and changes in balance sheet asset and liability values due to foreign currency translation is recorded as an unrealized capital gain or and loss and therefore is a component of unassigned funds (surplus). This component changes as the exchange rates fluctuate;

d. Nonadmitted Assets

The nonadmitted values of assets owned by a reporting entity are a reduction of unassigned funds (surplus). This component of unassigned funds (surplus) changes as nonadmitted asset values change. Changes in nonadmitted asset values are charged or credited directly to unassigned funds (surplus);

e. Provision for Reinsurance

A reporting entity must establish a statutory liability, provision for reinsurance, for unsecured reinsurance recoverables from unauthorized reinsurers and certain overdue balances from authorized reinsurers. The liability is charged directly to unassigned funds (surplus). Therefore, at any point in time there is a reduction of unassigned funds (surplus) equal to a reporting entity's liability for unauthorized reinsurance;

f. Asset Valuation Reserves

Where an Asset Valuation Reserve is required to be recorded as a statutory liability, there is a reduction of unassigned funds (surplus) in an amount equal to the liability. Changes to the Asset Valuation Reserve are charged or credited directly to unassigned funds (surplus);

g. Separate Accounts

A life insurer's balance sheet includes the total assets and liabilities of any separate accounts business which it maintains and, therefore, the surplus, if any, of its separate accounts business. Changes in the surplus of the separate accounts business of an insurer are charged or credited directly to unassigned funds (surplus);

h. Subscribers Savings Accounts

Subscribers Savings Accounts (SSAs) are unique to reciprocals. SSAs represent a portion of a reciprocal insurance company's surplus that has been identified as subscribers (policyholders) accounts. When the source of amounts credited to the subscriber accounts is from the reciprocal's operations, the amounts are reported as unassigned funds (surplus);

i. Dividends to Stockholders

Dividends¹ declared are charged directly to unassigned funds (surplus) on the declaration date and are carried as a liability until paid. The amount of the dividend is the cash paid if

¹ As a dividend represents the distribution of earnings, in any event in which unassigned funds is negative or goes below zero as a result of a distribution to a parent or stockholder, the distribution (or portion thereof that does not reflect undistributed accumulated earnings in unassigned funds) shall be considered a return of capital and captured in paragraph 11. Determining whether a distribution is a dividend or a return of capital does not impact consideration of whether the distribution is "extraordinary" as both dividends and other distributions (e.g., return of capital) are subject to that assessment. (Reporting entities with positive unassigned funds may choose to make return of capital distributions. Those distributions are also captured in paragraph 11.)

it is a cash dividend, the fair value of the assets distributed if it is property dividend, or the par value of the company's stock if it is a stock dividend. A stock dividend is recorded as a transfer from unassigned funds (surplus) to capital stock. Stock dividends have no effect on total capital and surplus while other forms of dividends reduce surplus. Forgiveness by a reporting entity of any debt, surplus note or other obligation of its parent or other stockholders shall be accounted for as a dividend. Dividends paid to related parties are subject to the requirements of SSAP No. 25;

j. Change in Accounting Principles

The effects of a change in accounting principle or the application of an accounting principle, such as a change in reserve account because of a change in valuation basis, are reported as a charge or credit to unassigned funds (surplus). The effect of these changes shall not be included in the determination of net income or loss;

k. Correction of an Error

Corrections of errors in previously issued financial statements are charged or credited directly to unassigned funds (surplus). The effect of corrections of errors shall not be included in the determination of net income or loss;

l. Stock Issuance Expenses

Expenses relating to the issuance of capital stock, for example underwriting commissions and filing fees are charged to unassigned funds (surplus);

m. Change in Surplus as a Result of Reinsurance

Life and accident and health insurers report increases in surplus that result from certain types of reinsurance transactions on a net of tax basis. As profits emerge from the ceded business the increase in surplus is amortized to income as provided for in Appendix A-791;

n. Changes in Deferred Tax Assets and Deferred Tax Liabilities

Consistent with the conclusions reached in *SSAP No. 101—Income Taxes*, changes in deferred tax assets and deferred tax liabilities, including changes attributable to changes in tax rates and changes in tax status, if any, shall be recognized as a separate component of unassigned funds (surplus);

o. Other

This category includes other gains and losses in surplus not specifically identified elsewhere in this statement including but not limited to net proceeds from life insurance on employees, changes in the additional minimum pension liability as discussed in *SSAP No. 102—Pensions* and unearned compensation relating to stock issuances made under compensatory Employee Stock Ownership Plans, Stock Option Plans and Stock Purchase Plans.

Special Surplus Funds

14. A company may establish a segregated surplus account to provide for contingencies. Surplus thus appropriated is called appropriated surplus or special surplus funds. Surplus resulting from any retroactive reinsurance transaction entered by a property and casualty insurer must be recorded as an appropriation of surplus by the ceding company (special surplus from retroactive reinsurance account). Voluntary and

general contingency reserves which are not actual liabilities of the company are shown as appropriated surplus or special surplus funds.

Other-Than-Special Surplus Funds

15. Amounts provided to reporting entities, other than stock companies, in the organization stage to defray the expenses and meet initial minimum surplus requirements required to obtain a license to do the business of insurance or for the ongoing operations shall be reported as Other-Than-Special Surplus Funds. Examples of these types of deposits include but are not limited to: guaranty fund notes and subscriber accounts that represent individual subscriber contributions.

Quasi-Reorganizations

16. Restatement of gross paid-in and contributed surplus and unassigned funds (surplus) under a quasi-reorganization shall be permitted only if the criteria in both paragraphs 16.a. and 16.b. and either paragraph 16.c. or 16.d. are met:

- a. The restatement is approved in writing by the domiciliary commissioner;
- b. An 80% or greater change in the ultimate ownership of the reporting entity has occurred within six months prior to approval of the restatement;
- c. A new business plan has been adopted that results in a substantive change in the operations and business mix of the reporting entity and the situation or circumstances that gave rise to the negative unassigned funds (surplus) will not be part of the ongoing operations;
- d. The reporting entity is a shell company with no existing operations, in force policies or outstanding claims.

17. Restatement shall not result in the unassigned funds (surplus) account being greater than zero or the gross paid-in and contributed surplus account being less than zero immediately following the restatement. Total surplus as regards policyholders shall remain unchanged following restatement. The following components of unassigned funds (surplus) shall be considered in determining the amount available for restatement:

- a. Net Income;
- b. Effect of Exchange Rate Fluctuations;
- c. Dividends to Stockholders;
- d. Change in Accounting Principles;
- e. Correction of an Error and
- f. Stock Issuance Expenses.

18. The assets and liabilities of the reporting entity shall continue to be carried at historical cost or other value required by statutory accounting principles. No adjustments to assets or liabilities shall be made to reflect the effect of a quasi-reorganization.

19. The tax benefits of operating losses or tax credits existing at the date of a quasi-reorganization and subsequently recognized after the quasi-reorganization shall be recognized as an adjustment to gross paid-in and contributed surplus.

Demutualizations

20. Mutual insurance companies may undergo demutualization transactions and convert to stock enterprises. In order to effect a demutualization, a company may be required to issue consideration, often in the form of stock, to existing participating policyholders in exchange for their current membership interests. The receipt of such stock has no direct effect on the policyholders' contractual interests of their insurance policies (for example, it does not alter the cash surrender value of their life insurance policies). However, the governance of the mutual insurance company and, in particular, the participating policyholders' interest in that governance are modified. Stock received from a demutualization shall be accounted for at fair value with a gain recognized in income from continuing operations.

Changes in Statutory Surplus

21. The components of the change in the capital and surplus accounts shall be presented for each year for which an income statement is presented.

Disclosures

22. The financial statements shall disclose the following:

- a. The number of shares of each class of capital stock authorized, issued and outstanding as of the balance sheet date and the par value or stated value of each class;
- b. The dividend rate, liquidation value and redemption schedule (including prices and dates) of any preferred stock issues;
- c. Dividend restrictions, if any, and an indication if the dividends are cumulative;
- d. The dates and amounts of dividends, or distributions paid. Note for each payment whether the dividend or distribution was ordinary or extraordinary.
- e. The portion of the reporting entity profits that may be paid as ordinary dividends to stockholders;
- f. A description of any restrictions placed on the unassigned funds (surplus) including for whom the surplus is being held;
- g. For mutual reciprocals and similarly organized entities, the total amount of advances to surplus not repaid, if any;
- h. The total amount of stock held by the reporting entity, including stock of affiliated entities, for special purposes such as conversion of preferred stock, employee stock options, and stock purchase warrants;
- i. A description of the reasons for changes in the balances of any special surplus funds from the prior period;
- j. The portion of unassigned funds (surplus) represented or reduced by each of the following items:
 - i. unrealized gains and losses;
 - ii. nonadmitted asset values;
 - iii. separate account business;

- iv. asset valuation reserves;
 - v. provision for reinsurance.
 - k. For reciprocal insurance companies only:
 - i. the amount of surplus identified as subscriber savings accounts;
 - ii. the source of the funds (either from the reciprocal's operations or contributed by the individual subscriber) and, the reporting location in surplus;
 - iii. the conditions upon which the balances are paid to the subscribers.
 - l. Disclosures required by SSAP No. 41R;
 - m. Disclosures required by SSAP No. 9;
 - n. The impact of the restatement in a quasi-reorganization as long as financial statements for the period of the reorganization are presented; and
 - o. The effective date of a quasi-reorganization for a period of ten years following the reorganization.
23. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

24. Paragraphs 9 and 10 of *Accounting Principles Board Opinion No. 12, Omnibus Opinion—1967*, are adopted with modification to eliminate the option of disclosing changes in the notes to the financial statements rather than in the Statement of Capital and Surplus. This statement originally adopted paragraphs 10 and 11 of *Accounting Principles Board Opinion No. 10, Omnibus Opinion—1966* (APB 10). However, for reporting periods ending after December 15, 1997, paragraphs 10 and 11 of APB 10 were deleted by paragraph 9, and replaced by paragraphs 6 and 7 of *FASB Statement No. 129, Disclosure of Information About Capital Structure* (FAS 129). As such, this statement adopts paragraphs 6, 7 and 9 of FAS 129. All other paragraphs of FAS 129 are rejected. This statement also adopts with modification paragraph 12 of *Accounting Principles Board Opinion No. 6* (APB 6), *Status of Accounting Research Bulletins*, to eliminate the option of recording treasury stock as an asset.

25. Paragraph 15 of *FASB Statement No. 5, Accounting For Contingencies*, is adopted by this statement. Paragraphs 1-4 and 10-16 of *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins*, "Chapter 7, Capital Accounts, Section B—Stock Dividends and Stock Split-ups" are adopted by this statement.

26. This statement adopts with modification *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins*, "Chapter 7, Capital Accounts, Section A—Quasi-Reorganization or Corporate Readjustment," to permit restatement of gross paid-in and contributed surplus and unassigned funds (surplus) only in certain limited circumstances. This statement adopts *FASB Emerging Issues Task Force 99-4, Accounting for Stock Received from the Demutualization of a Mutual Insurance Company*.

27. This statement adopts with modification *Accounting Research Bulletin No. 46, Discontinuance of Dating Earned Surplus*, to require disclosure of the impact of the restatement in the financial statements as long as financial statements for the period of reorganization are presented and paragraph 28 of *Accounting Principles Board Opinion No. 9, Reporting the Results of Operations*. This statement rejects *FASB Emerging Issues Task Force No. 88-9, Put Warrants*, *FAS 150, Accounting for Certain Financial*

Instruments with Characteristics of both Liabilities and Equity (FAS 150), *FSP FAS 150-3, Effective Date, Disclosures and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests Under FASB Statement No. 150* (FSP FAS 150-3) and *FSP FAS 150-5, Issuer's Accounting Under FASB Statement No. 150 for Freestanding Warrants and Other Similar Instruments on Shares That Are Redeemable* (FSP FAS 150-5). FAS 150, and the corresponding FSPs are rejected as insurers do not prevalently issue financial instruments within the confines of these standards. However, guidance has been incorporated within this SSAP to ensure that puttable warrants and mandatorily redeemable warrants are reflected as liabilities, and not equity, within the financial statements.

28. This statement rejects paragraphs 1-11 and 13-24 of APB 6, *FASB Emerging Issue Task Force No. 85-1, Classifying Notes Received for Capital Stock*, and *FASB Emerging Issue Task Force No. 85-2, Classification of Costs Incurred in a Takeover Defense*.

29. This statement also rejects *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins*, "Chapter 1, Prior Opinions," paragraph 12 of APB 10, *FASB Technical Bulletin No. 85-6, Accounting for a Purchase of Treasury Shares at a Price Significantly in Excess of the Current Market Price of the Shares and the Income Statement Classification of Costs Incurred in Defending against a Takeover Attempt*, and *Accounting Standard Update (ASU) 2021-04, Earnings Per Share (Topic 260), Debt—Modifications and Extinguishments (Subtopic 470-50), Compensation—Stock Compensation (Topic 718), and Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40)—Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options*, while incorporating guidance that clarifies that an entity shall treat a modification of the terms or conditions or an exchange of a freestanding equity-classified written call option as an exchange of the original instrument for a new instrument.

30. This statement rejects *ASU 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*.

Effective Date and Transition

31. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The guidance in paragraph 19 of this statement was originally contained within *INT 99-01: Accounting for Tax Benefits of Operating Losses and Tax Credit in Quasi-Reorganizations* and was effective March 8, 1999. The guidance in paragraph 20 of this statement was originally contained within *INT 00-12: EITF No. 99-4, Accounting for Stock Received from the Demutualization of a Mutual Insurance Company* and was effective June 12, 2000.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 72—Statutory Surplus*
- *Issue Paper No. 84—Quasi-Reorganizations*

Statement of Statutory Accounting Principles No. 73

Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities

STATUS

Type of Issue.....	Health Entities
Issued	Initial Draft
Effective Date	January 1, 2001
Affects.....	Supersedes SSAP No. 87 with guidance incorporated August 2011
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Disclosures.....	2
Relevant Literature.....	3
Effective Date and Transition	3
REFERENCES.....	3
Relevant Issue Papers	3

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for health care delivery assets - supplies, pharmaceuticals and surgical supplies, durable medical equipment, furniture, medical equipment and fixtures and leasehold improvements.

SUMMARY CONCLUSION

2. This statement applies only to reporting entities which directly provide health care services to subscribers, members or policyholders. Such providers acquire and retain assets commonly referred to as “health care delivery assets” used in connection with the direct delivery of health care services in facilities owned or operated by the reporting entity and include supplies, pharmaceuticals and surgical supplies, durable medical equipment, furniture, medical equipment and fixtures and leasehold improvements in health care facilities.

3. Furniture, medical equipment and fixtures used in connection with the direct provision of health care services include diagnostic equipment, laboratory equipment, patient monitoring equipment, hospital beds, examining tables, and operating room equipment.

4. Supplies, pharmaceuticals and surgical supplies, durable medical equipment, furniture, medical equipment and fixtures, and leasehold improvements in health care facilities owned or operated by the reporting entity meet the definition of assets established in *SSAP No. 4—Assets and Nonadmitted Assets*.

Pharmaceuticals and surgical supplies, and durable medical equipment held by reporting entities and used for the direct delivery of health care services are assets which are used to fulfill policyholder obligations within the meaning of SSAP No. 4 and are admitted assets to the extent that they conform to the requirements of this statement. Furniture, medical equipment and fixtures, and leasehold improvements held by health reporting entities and used for the direct delivery of health care services are admitted assets to the extent that they conform to the requirements of this statement. Furniture, fixtures and equipment, and leasehold improvements which are not used in the direct delivery of health care (e.g., for administrative activities including claims processing, billing, and maintenance of medical records) are nonadmitted assets and are addressed in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements*.

5. The reporting entity shall maintain a control system that provides for identification of quantities on hand and appropriate valuation (lower of cost or fair value) of supplies, pharmaceuticals and surgical supplies, and durable medical equipment.

6. Supplies except for pharmaceuticals and surgical supplies discussed in paragraph 7 (e.g., linens, uniforms and garments, food and other commodities, and housekeeping, maintenance, and office supplies) shall be nonadmitted assets.

7. Pharmaceutical and surgical supplies (e.g. drugs, surgical items (such as implants), and medical dressings) used directly in the treatment of medical conditions shall be admitted assets.

8. Durable medical equipment includes consumable or salable equipment such as wheelchairs, crutches, braces, that is generally classified as inventory, and is of a nature that it may be reused. Subscribers, members or policyholders may utilize durable medical equipment on a temporary basis and later return the equipment to the provider. The provider shall recognize the diminution in value, if any, as a result of use of such equipment.

9. Furniture, medical equipment and fixtures, and leasehold improvements shall be depreciated over their estimated useful lives but for a period not to exceed three years, except for a leasehold improvement which shall be amortized against net income over the shorter of its estimated useful life or the remaining lease term, using methods detailed in SSAP No. 19. The amortization of leasehold improvements (including property improvements and integral equipment) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity lessee but excludes situations where the real estate lease agreement has a purchase option that contains language that allows leasehold improvements necessary for the functionality of specific health care delivery assets¹ to be excluded from the purchase cost of the real estate. Upon acquisition, such leasehold improvements necessary for the functionality of healthcare delivery assets shall follow the guidance for health care delivery assets in this statement. If leased real estate is acquired, recognition of the real estate shall follow the provisions in *SSAP No. 40R—Real Estate Investments*.

10. In accordance with the reporting entity's written capitalization policy, amounts less than a predefined threshold of medical supplies, pharmaceuticals and surgical supplies, durable medical equipment, furniture, medical equipment and fixtures, and leasehold improvements shall be expensed when purchased. 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.

Disclosures

11. The financial statements shall disclose if the written capitalization policy and the resultant predefined thresholds changed from the prior period and the reason(s) for such change.

¹ The application of this exception is limited to leasehold improvements necessary for the functionality of health care delivery assets that qualified for admittance under SSAP No. 73.

Relevant Literature

12. This statement rejects the *AICPA Audit and Accounting Guide: Health Care Organizations*.

Effective Date and Transition

13. 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*. Guidance reflected in paragraphs 10 and 11, incorporated from SSAP No. 87, was originally effective for years beginning on and after January 1, 2004.

14. Medical supplies, pharmaceuticals and surgical supplies, durable medical equipment, furniture, medical equipment and fixtures, and leasehold improvements capitalized prior to January 1, 2001 shall be depreciated over the shorter of its remaining useful life or three years.

REFERENCES**Relevant Issue Papers**

- *Issue Paper No. 100—Health Care Delivery Assets—Supplies, Pharmaceuticals and Surgical Supplies, and Durable Medical Equipment*
- *Issue Paper No. 101—Health Care Delivery Assets—Furniture, Medical Equipment and Fixtures, and Leasehold Improvements in Health Care Facilities*
- *Issue Paper No. 119—Capitalization Policy, An Amendment to SSAP Nos. 4, 19, 29, 73, 79 and 82*

Statement of Statutory Accounting Principles No. 74

Insurance-Linked Securities Issued Through a Protected Cell

STATUS

Type of Issue.....	Property and Casualty
Issued	Finalized September 12, 2000
Effective Date	January 1, 2001
Affects.....	No other pronouncements
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Accounting for Prefunded Insurance-Linked Securities for Business Attributed to the Protected Cell from the General Account	2
General Account Reporting	2
Protected Cell Reporting.....	2
Disclosures.....	3
Relevant Literature.....	4
Effective Date and Transition	4
REFERENCES.....	4
Relevant Issue Papers	4
GLOSSARY	5

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for the issuance of insurance-linked securities issued by a property and casualty insurer through a protected cell. This statement applies to property and casualty contracts as defined in *SSAP No. 50—Classifications of Insurance or Managed Care Contracts*.

SUMMARY CONCLUSION

2. An insurance-linked security can be issued by the insurer through a protected cell for purchase by investors. A protected cell is retained within the insurance or reinsurance company and is used to insulate the proceeds of the securities offering from the general business risks of the insurer, granting an additional comfort level for investors of the securitized instrument. The insurance exposures that have been securitized by the insurance-linked security are attributed to the protected cell.

3. Under the terms of the security, the principal may be paid to the investor on a specified maturity date, with interest, unless a trigger event occurs. The proceeds of the security offering will collateralize (i)

the issuer's obligation under an insurance or reinsurance agreement if a trigger event occurs and (ii) the issuer's obligation to repay the security if a trigger event does not occur.

4. If the trigger event takes place before a specified date, the issuer is relieved of some or its entire obligation to repay the securityholders, and the investor incurs a loss of some or all of its investment. The security must be issued with an indemnity trigger.

5. In an insurance-linked security, the insurer that originated the transaction has hedged its portfolio of insurance risks by transferring certain of those risks to the securityholders. Should the triggering event occur, the issuer would incur a loss that would be partly offset by the amount of liability to securityholders from which it is relieved. This statement provides statutory accounting guidance solely for indemnity triggered insurance securitization transactions conducted through a protected cell.

Accounting for Prefunded Insurance-Linked Securities for Business Attributed to the Protected Cell from the General Account

General Account Reporting

6. Activities such as sales, underwriting and contract administration, premium collection and payment of premium taxes, and claims processing are activities of the insurance company distinct from the protected cell and shall be accounted for as transactions of the general account.

7. Amounts paid to the protected cell for underwriting risks, which ultimately will be securitized by the protected cell, shall be reported separately as a reduction of written and earned premiums in the current period general account's statement of income. This premium is earned by the general account in accordance with *SSAP No. 53—Property and Casualty Contracts—Premiums*.

8. At the maturity of the protected cell all assets and liabilities of the protected cell are distributed based on the contractual agreement with the securityholders. If after this distribution assets still reside in the protected cell, these assets shall be attributed to the general account and recognized as an adjustment to surplus.

9. Insurance claim liabilities arising from past insurable events attributed to the protected cell account from the general account shall be accounted for as retroactive reinsurance as prescribed in *SSAP No. 62R—Property and Casualty Reinsurance*.

10. General account recoverables from the protected cell as a result of an indemnity based securitized event, shall be recognized separately as a reduction of gross losses and loss expenses incurred in the current period general account's statement of income. General account recoverables from the protected cell on unpaid reported and incurred but not reported losses and loss adjustment expenses shall be netted against the liability for gross losses and loss adjustment expenses in the general account's balance sheet. Recoverables from the protected cell shall not exceed the assets carried at fair value in the protected cell.

11. The general account shall include aggregate amounts on the designated lines in the balance sheet and income statement for any protected cell which it maintains. Transfers to the general account due or accrued shall be reported on a net basis so that the asset and the liability totals of the general account are not overstated.

Protected Cell Reporting

12. The protected cell annual statement is concerned with the investment activities and obligations relating to insurance-linked securities attributed to that protected cell. As a result, the protected cell statement shall report only the financial activities of the protected cell and shall not include general account expenses related to insurance activities which are recorded for in the general account.

13. The protected cell shall record premium income for transactions attributed to it by the general account as income reported in the protected cell's statement of income. This premium attribution is earned by the protected cell in accordance with SSAP No. 53.

14. The obligation from the issuance of the insurance-linked security is recorded as Funds Held Under Securitization Agreement, a liability on the protected cell balance sheet which is reported at its contractual value which will be the lower of the scheduled amount to be repaid to investors or the fair value of the investments in the protected cell. All protected cell assets shall be reported at fair value. Interest expenses payable to securityholders associated with the protected cell investment operations shall be deducted in the determination of net operating income of the cell. Net investment income and realized capital gains and losses relating to the investment operations of the protected cell are recorded as net investment income. Payables to the general account shall not exceed the assets carried at fair value in the protected cell.

15. Changes in both (i) the fair value of the protected cell invested assets and (ii) the protected cell contractual value of liabilities to investors shall be reported as an unrealized gain/loss in the equity section of the protected cell balance sheet.

16. If the trigger event occurs with respect to the underlying exposures attributed to the protected cell, the protected cell shall record the appropriate incurred losses in its current period statement of income. Correspondingly, the Funds Held Under Securitization Agreement shall be reduced and offset by gross losses incurred in the current period Statement of Income. The applicable funds to cover the subject exposure are then attributed to the general account via a balance sheet account, "Due to/from the General Account."

17. If the trigger event does not take place on or before the contractual maturity date, the protected cell repays the security as prescribed in the debt contract by reducing Funds Held Under Securitization Agreement.

Disclosures

General Account

18. The general account shall reflect all activities with its protected cells on the designated lines within its statutory balance sheet and income statement. The general account shall also disclose in its notes to the financial statements the types and amounts of exposures/risks attributed to each of its protected cells.

Protected Cells

19. Each protected cell of a protected cell company shall prepare and submit to all states where the protected cell company is licensed and the NAIC the following supplemental financial information:

- a. Balance Sheet
- b. Income Statement
- c. Statement of Cash Flows
- d. Investment Schedules as typically required for a property/casualty insurer
- e. Schedule P

20. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

21. This statement only contemplates transactions with an indemnity-based trigger, as such they would be excluded from *FAS No. 133, Accounting for Derivative Instruments and Hedging Activities*.

Effective Date and Transition

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

REFERENCES**Relevant Issue Papers**

- *Issue Paper No. 103—Accounting for the Issuance of Insurance-Linked Securities Issued by a Property and Casualty Insurer through a Protected Cell*

Not for Distribution

GLOSSARY¹

Fair Value – See SSAP No. 100R—*Fair Value*

Fully Funded – With respect to any exposure attributed to a protected cell, the fair value of the protected cell assets, on the date on which the insurance securitization is effected, equals or exceeds the maximum possible exposure attributable to the protected cell with respect to such exposures.

General Account – The assets and liabilities of a protected cell company other than protected cell assets and protected cell liabilities.

Indemnity Trigger – A transaction term by which relief of the issuer's obligation to repay investors is triggered by its incurring a specified level of losses under its insurance or reinsurance contracts.

Protected Cell – An identified pool of assets and liabilities of a protected cell company segregated and insulated by means of this Act from the remainder of the protected cell company's assets and liabilities.

Protected Cell Account – A specifically identified bank or custodial account established by a protected cell company for the purpose of segregating the protected cell assets of one protected cell from the protected cell assets of other protected cells and from the assets of the protected cell company's general account.

Protected Cell Assets – All assets, contract rights and general intangibles, identified with and attributable to a specific protected cell of a protected cell company.

Protected Cell Company – A domestic insurer that has one or more protected cells.

Protected Cell Company Insurance Securitization – The issuance of debt instruments, the proceeds from which support the exposures attributed to the protected cell, by a protected cell company where repayment of principal or interest, or both, to investors pursuant to the transaction terms is contingent upon the occurrence or nonoccurrence of an event with respect to which the protected cell company is exposed to loss under insurance or reinsurance contracts it has issued.

Protected Cell Liabilities – All liabilities and other obligations identified with and attributable to a specific protected cell of a protected cell company.

¹ Definitions in this glossary were adapted from the Protected Cell Company Model Act as adopted by the Insurance Securitization Working Group of the Financial Condition (E) Committee in 1999. These definitions are not intended to change the meaning of any terms used elsewhere in the *Accounting Practices and Procedures Manual*, and should only be used in the context of SSAP No. 74.

Statement of Statutory Accounting Principles No. 76

Start-Up Costs

STATUS

Type of Issue..... Common Area
Issued Finalized December 4, 2000
Effective Date January 1, 2002
Affects..... No other pronouncements
Affected by..... No other pronouncements
Interpreted by No other pronouncements
Relevant Appendix A Guidance None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Disclosures.....	1
Relevant Literature.....	2
Effective Date and Transition	2
REFERENCES.....	2
Relevant Issue Papers	2

SCOPE OF STATEMENT

1. This statement addresses start-up costs. In practice, various terms are used to refer to start-up costs, such as pre-opening, pre-operating, and organization costs. For purpose of this statement, these costs are referred to as start-up costs.

SUMMARY CONCLUSION

2. Costs of start-up activities, including activities related to organizing a new entity (commonly referred to as organization costs), shall be expensed as incurred. Start-up activities are defined broadly as those one-time activities related to: (1) opening a new facility; (2) introducing a new product or service; (3) conducting business in a new territory; (4) conducting business with a new class of customer or beneficiary; (5) initiating a new process in an existing facility; or (6) commencing some new operation.

Disclosures

3. Cost of start-up activities incurred in an accounting period shall be disclosed in the annual audited statutory financial report only.

4. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

5. This statement adopts American Institute of Certified Public Accountants (AICPA) *Statement of Position SOP 98-5, Reporting on the Costs of Start-Up Activities* (SOP 98-5), which requires costs of start-up activities and organization costs to be expensed as incurred. This statement is consistent with *SSAP No. 17—Preoperating and Research and Development Costs*.

Effective Date and Transition

6. This statement is effective for years beginning January 1, 2002. Adoption as of January 1, 2001 is encouraged but not required. Changes resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

REFERENCES**Relevant Issue Papers**

- *Issue Paper No. 105—Reporting on the Costs of Start-Up Activities*

Not for Distribution

Statement of Statutory Accounting Principles No. 78

Multiple Peril Crop Insurance

STATUS

Type of Issue..... Property and Casualty
Issued Finalized December 4, 2000
Effective Date January 1, 2001
Affects..... No other pronouncements
Affected by..... No other pronouncements
Interpreted by No other pronouncements
Relevant Appendix A Guidance None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Introduction.....	1
Premium Recognition	2
Amounts Receivable or Payable	3
Unpaid Losses and Loss Adjustment Expenses.....	3
Administrative Expense Payment	3
Escrow Account.....	4
Effective Date	4
REFERENCES.....	4
Relevant Issue Papers	4
EXHIBIT A - ILLUSTRATION OF CEDED PREMIUMS AND LOSSES	5

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for Multiple Peril Crop Insurance (MPCI). This statement also establishes statutory accounting principles for the Aquatic Crop Reinsurance Agreement (hereinafter included in the term MPCI).

SUMMARY CONCLUSION

Introduction

2. Farming has always been an inherently risky enterprise because farmers operate at the mercy of nature and frequently are subjected to weather-related perils such as droughts, floods, hurricanes, and other natural disasters. Since the 1930s, many farmers have been able to transfer part of the risk of loss in production to the federal government through the subsidized MPCI program administered by the Federal Crop Insurance Corporation (FCIC), an agency of the United States Department of Agriculture. Major legislation enacted in 1980 and 1994 restructured the MPCI program. The 1980 legislation enlisted, for the first time, private insurance companies to sell, service, and share the risk of MPCI insurance policies.

Subsequently, in 1994, the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act revised the program to offer farmers two primary levels of insurance coverage, catastrophic and buy-up.

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.

4. In recent years, FCIC has introduced a new risk management tool called revenue insurance. Unlike traditional crop insurance, which insures against losses in the level of crop production, revenue insurance plans insure against losses in revenue. The plans protect the farmer from the effects of declines in crop prices or declines in crop yields, or both. Like traditional buy-up insurance, the government subsidizes a portion of the premiums. One of the plans, called Crop Revenue Coverage, is available in many states for major crops. Two other plans, called Income Protection and Revenue Assurance, are available to farmers in only limited areas.

5. Companies participate in the MPCCI 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. MPCCI 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.

6. The FCIC utilizes an escrow account to distribute or collect additional funds. Premium (collected from the policyholders and the federal government subsidy) is deposited in the escrow account and is available to pay the claims arising under the program.

Premium Recognition

7. MPCCI gross premium is defined as the contractually determined amount specified by FCIC to the policyholder for the effective period of the contract based on the actuarially determined expectation of risk and policy benefits associated with the coverage provided by the terms of the insurance contract. In addition, gross premium shall also include the government premium subsidy paid on behalf of the policyholder.

8. MPCCI ceded premium and losses are defined as the amount calculated by applying the proportional and non-proportional factors as stated in the SRA. An example of this application is shown in Exhibit A to this statement.

9. MPCCI written premium shall be recorded as soon as an estimate can be made, but no later than the processing date. Upon recording written premium, a liability for the unearned premium reserve shall be established to reflect the amount of premium for the portion of the insurance coverage that has not yet expired. Premiums shall be recognized as revenue over the period of risk in proportion to the amount of insurance protection provided.

10. The company shall disclose the method used to compute the unearned premium reserve in the financial statements.

Amounts Receivable or Payable

11. The company shares underwriting risk with FCIC and can earn or lose money according to the claims it must pay farmers for crop losses. The company earns underwriting profits when the net retained premiums exceed the net crop loss claims paid. The company incurs underwriting losses when the net claims paid for crop losses exceed the net retained premiums. These definitions do not consider underwriting expenses, which would be included for traditional statutory accounting underwriting gains and losses. The use of the terms underwriting gains and losses in this issue paper are unique to the MPCCI program. As the premiums of the program are held by FCIC in escrow, the company shall recognize as a write-in asset a receivable from FCIC for the amount of the underwriting gain (as defined in this paragraph). Whereas, when the company is in an underwriting loss position, the company shall recognize a write-in liability to the FCIC for the amount of the underwriting loss (as defined in this paragraph), as the monies held in the escrow account are not sufficient to cover the company's claims. In accordance with the SRA, funds that remain in escrow will be distributed to the company at the conclusion of the contract period if the contract results in a gain to the company. If the company owes additional funds to the escrow (i.e., it is in a loss position), those funds are remitted on a periodic basis until the contract expires. These amounts shall be recorded net as the program meets the requirements of offsetting as defined in *SSAP No. 64—Offsetting and Netting of Assets and Liabilities*. In accordance with *SSAP No. 21R—Other Admitted Assets*, the amount receivable under the Federal Crop Insurance program shall be reported as an admitted asset.

12. Amounts receivable from policyholders meet the definition of an admitted asset as set forth in *SSAP No. 4—Assets and Nonadmitted Assets* and should be accounted for in accordance with *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*. The due date shall be governed by contractual due date of the premium billing, and not the effective date of the contract.

Unpaid Losses and Loss Adjustment Expenses

13. In accordance with *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*, losses and loss adjustment expenses shall be recognized as expense when a covered or insured event occurs.

14. The covered or insured event is the occurrence of an incident which gives rise to a claim or the incurring of costs. Claim payments and related expense payments are made subsequent to the occurrence of a covered or insured event and, in order to recognize the expense of a covered or insured event, it is necessary to establish a liability. The following are the types of future costs relating to the MPCCI program:

- a. Reported Losses: Expected payments for losses relating to insured events that have occurred and have been reported to, but not paid by, the insurer as of the statement date;
- b. Incurred But Not Reported Losses, (IBNR): Expected payments for losses relating to insured events that have occurred but have not been reported to the insurer as of the statement date;
- c. Loss Adjustment Expenses: Costs expected to be incurred in connection with the adjustment and recording of losses defined in paragraphs 14.a. and 14.b. of this statement.

Administrative Expense Payment

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.

Escrow Account

16. The escrow account shall not be recorded on the financial statements of the insurance company. This account is considered an FCIC account and as such is not owned by the insurance company, however, the company's underwriting gain is reflected as a receivable in accordance with paragraph 11.

Effective Date

17. This statement is effective for SRA contracts entered into on or after 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 Correction of Errors*.

REFERENCES**Relevant Issue Papers**

- *Issue Paper No. 108—Multiple Peril Crop Insurance*

EXHIBIT A - ILLUSTRATION OF CEDED PREMIUMS AND LOSSES

NOTES TO THE ILLUSTRATION

Fund	The reinsurance fund specified in the Standard Reinsurance Agreement (SRA).
Column 1	Reinsured Company proportional reinsurance retention percentage.
Column 2	Gross Written Premium equals the insured paid premium amount plus premium subsidy provided by FCIC.
Column 3	Net Retained Premium is the Reinsured Company retained premium after proportional reinsurance. Gross Written Premium (Column 2) times the Reinsured Company retention percentage (Column 1).
Column 4	Proportional Ceded Premium is the premium retained by FCIC after proportional reinsurance. Gross Written Premium (Column 2) minus the Reinsured Company Net Retained Premium (Column 3).
Column 5	Reinsured Company proportional reinsurance retention percentage (Column 1).
Column 6	Gross Losses equals total claim payments to insured.
Column 7	Net Retained Losses are the Reinsured Company retained losses after proportional reinsurance. Gross Losses (Column 6) times the Reinsured Company retention percentage (Column 5).
Column 8	Proportional Ceded Losses are the losses retained by FCIC after proportional reinsurance. Gross Losses (Column 6) minus the Reinsured Company Net Retained Losses (Column 7).
Column 9	Retained Loss Ratio is the Reinsured Company's Net Retained Losses (Column 7) divided by the Reinsured Company's Net Retained Premium (Column 3).
Column 10	Underwriting (Gain)/Loss is the Reinsured Company share of the MPCIC program gain or loss after calculating the non-proportional reinsurance provided in the SRA.
Column 11	Non-Proportional Ceded Premium is equal to the Reinsured Company Net Retained Premium (Column 3) minus Net Retained Losses (Column 7) minus an Underwriting (Gain) (Column 10) if one exists. This is FCIC's share of the underwriting gain after proportional reinsurance, based on the non-proportional reinsurance gain sharing factors specified in the SRA.
Column 12	Non-Proportional Ceded Losses is equal to the Reinsured Company Net Retained Premium (Column 3) minus Net Retained Losses (Column 7) minus an Underwriting Loss (Column 10) if one exists. This is FCIC's share of the underwriting loss after proportional reinsurance, based on the non-proportional reinsurance loss sharing factors specified in the SRA.
Column 13	Final Retained Premium is equal to the Reinsured Company Net Retained Premium (Column 3) minus the Non-Proportional Ceded Premium (Column 11). The Reinsured Company Net Retained Premium after proportional reinsurance is reduced by the amount of FCIC's underwriting gain share after non-proportional reinsurance.

- Column 14 Final Retained Losses is equal to the Reinsured Company Net Retained Premium (Column 3) minus the Non-Proportional Ceded Losses (Column 12). The Reinsured Company Net Retained Losses after proportional reinsurance are reduced by the amount of FCIC's underwriting loss share after non-proportional reinsurance.
- Column 15 Final Retained Loss Ratio is equal to Final Retained Losses divided by Final Retained Premium.
- (a) Calculated based on the loss ratios for each fund by state. Net Retained Premium (Col 3) is applied to the percentages of Section II. C. and D. of the Standard Reinsurance Agreement.
 - (b) If the fund is in a GAIN position then there would be Non-proportional ceded premium. If the fund is in a LOSS position then there would be Non-proportional ceded losses.

Since each fund and state stands alone in the calculations, there is a possibility of Non-proportional ceded premium AND ceded losses within the same reinsurance year. There is also the possibility of this within the same fund (some states with a Gain and some states with a Loss).

EXHIBIT A - ILLUSTRATION OF CEDED PREMIUMS AND LOSSES

	(1)	(2)	(3)	(4)
Fund	Retention %	Gross Written Premium	Net Retained Premium (Col 2 x Col 1)	Proportional Ceded Premium (Col 2 - Col 3)
Assigned Risk	20%	20,000,000	4,000,000	16,000,000
Developmental	35%	10,000,000	3,500,000	6,500,000
Dev - CRC	35%	5,000,000	1,750,000	3,250,000
Dev - CAT	35%	5,000,000	1,750,000	3,250,000
Commercial	100%	100,000,000	100,000,000	0
Comm - CRC	100%	20,000,000	20,000,000	0
Comm - CAT	100%	40,000,000	40,000,000	0
Total Premium		200,000,000	171,000,000	29,000,000

	(5)	(6)	(7)	(8)	(9)	(10)
Fund	Retention %	Gross Losses	Net Retained Losses (Col 6 x Col 5)	Proportional Ceded Losses (Col 6 - Col 7)	Retained Loss Ratio (Col 7/Col 3)	Underwriting (Gain)Loss (a)
Assigned Risk	20%	40,000,000	8,000,000	32,000,000	200.0%	184,000
Developmental	35%	16,000,000	5,600,000	10,400,000	160.0%	525,000
Dev - CRC	35%	7,000,000	2,450,000	4,550,000	140.0%	210,000
Dev - CAT	35%	4,000,000	1,400,000	2,600,000	80.0%	(157,500)
Commercial	100%	80,000,000	80,000,000	0	80.0%	(18,800,000)
Comm - CRC	100%	18,000,000	18,000,000	0	90.0%	(1,880,000)
Comm - CAT	100%	22,000,000	22,000,000	0	55.0%	(12,500,000)
Total Losses		187,000,000	137,450,000	49,550,000	80.4%	(32,418,500)

	(11)	(12)	(13)	(14)	(15)
Fund	Non-Proportional Ceded Premium (b) (Col 3 - Col 7 - Col 10 "Gain")	Non-Proportional Ceded Losses (b) (Col 3 - Col 7 + Col 10 "Loss")	Final Retained Premium (Col 3 - Col 11)	Final Retained Losses (Col 7 - Col 12)	Final Retained Loss Ratio (Col 14/Col 13)
Assigned Risk	0	3,816,000	4,000,000	4,184,000	104.6%
Developmental	0	1,575,000	3,500,000	4,025,000	115.0%
Dev - CRC	0	490,000	1,750,000	1,960,000	112.0%
Dev - CAT	192,500	0	1,557,500	1,400,000	89.9%
Commercial	1,200,000	0	98,800,000	80,000,000	81.0%
Comm - CRC	120,000	0	19,880,000	18,000,000	90.5%
Comm - CAT	5,500,000	0	34,500,000	22,000,000	63.8%
Total	7,012,500	5,881,000	163,987,500	131,569,000	80.2%

Statement of Statutory Accounting Principles No. 83

Mezzanine Real Estate Loans

STATUS

Type of Issue.....	Common Area
Issued	Finalized October 16, 2001
Effective Date	December 31, 2001
Affects.....	No other pronouncements
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	A-001

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

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for Mezzanine Real Estate Loans (MREL). An MREL is a loan secured by a pledge of direct or indirect equity interests in an entity that owns real estate (the “real estate owner”). The real estate owner is typically the borrower under a mortgage loan secured by the same real estate. The MREL borrower (the “mezz borrower”) may be the real estate owner or one or more of the holder(s) of the direct or indirect equity interest(s) in the real estate owner. As used herein, “direct equity interests” means the then issued and outstanding shares or units of partnership, membership or other beneficial interests in the real estate owner, and “indirect equity interests” means the then issued and outstanding shares or units of partnership, membership or other beneficial interests in a member, partner, shareholder or other holder of direct equity interests in the real estate owner.

SUMMARY CONCLUSION

2. For statutory accounting purposes, a MREL shall be defined as a debt obligation, that is not a security, which is secured by a pledge of equity interest in an entity that owns real estate. A security is a share, participation, or other interest in property or in an enterprise of the issuer or an obligation of the issuer that:

- a. Either is 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. 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; and
 - c. Either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.
- 3. MREL's meet the definition of assets as specified in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement.
- 4. Reporting entities holding MREL's shall follow the accounting, reporting and disclosure requirements defined within *SSAP No. 37—Mortgage Loans*.
- 5. In order for a MREL to qualify as an admitted asset, the MREL agreement (the agreement) shall:
 - a. Require that each pledgor abstain from granting additional security interests in the equity interest pledged; and
 - b. In addition to satisfaction of the requirements set forth in paragraphs 5.c. and 5.d., the MREL lender shall employ techniques to minimize the likelihood or impact of a bankruptcy filing on the part of the real estate owner and, if different, on the part of the mezz borrower. These techniques may include (by way of example and not limitation) one or more of the following: (i) separateness covenants, (ii) cash management techniques, (iii) exceptions to the non-recourse provisions for damages arising out of the mezz borrower's failure to comply with covenants prohibiting additional debt, transfers of the real estate, transfers of pledged interests, and violation of the single asset/single purpose covenants, (iv) full recourse liability in the event of a bankruptcy filing on the part of the real estate owner and, if different, on the part of the mezz borrower, and (v) loan guaranties. The selection of techniques that are applied in the instance of any particular MREL to achieve said purposes requires an exercise of judgement by the MREL lender. The reasonableness of the techniques utilized in any particular MREL will be assessed in light of the credit characteristics of the MREL borrower, any guarantors and the underlying real estate at the time of origination. Utilizing this standard provides flexibility to the MREL lender and provides a basis for the regulator and auditor in analyzing the reasonableness of the judgement of the MREL lender; and
 - c. The real estate owner and, if different, the mezz borrower shall:
 - i. Hold no assets other than, in the case of the real estate owner, the real property, and in the case of the mezz borrower (if different), the equity interest in the real estate owner;
 - ii. Not engage in any business other than, in the case of the real estate owner, the ownership and operation of the real estate, and in the case of the mezz borrower (if different), holding an ownership interest in the real estate owner; and
 - iii. Not incur additional debt, other than limited trade payables, a first mortgage loan (in the case of the real estate owner), and the MREL (in the case of the mezz borrower, if different).
 - d. At the time of the initial investment, the MREL lender shall corroborate that the sum of the first mortgage and the MREL does not exceed 100% of the value of the real estate as evidenced by a current appraisal. Acceptable appraisal methods are described in paragraph 13 of *SSAP No. 40R—Real Estate Investments*.

Disclosures

6. The financial statements shall disclose, as applicable, the requirements of SSAP No. 37, paragraphs 25-27. The MREL lender shall report in Appendix A-001 to its annual statement the amount and percentages of its total admitted assets held in MREL and the largest three investments held in MREL except that such detail shall not be required for assets held in MREL totaling less than 2.5% of its total admitted assets.

Effective Date and Transition

7. This statement is effective for years ending on and after December 31, 2001. Any 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. 113—Mezzanine Real Estate Loans*

Not for Distribution

Statement of Statutory Accounting Principles No. 84

Health Care and Government Insured Plan Receivables

STATUS

Type of Issue.....	Common Area
Issued	Finalized October 16, 2001
Effective Date	December 31, 2001
Affects.....	No other pronouncements
Affected by.....	No other pronouncements
Interpreted by	INT 05-05
Relevant Appendix A Guidance	None

STATUS	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	2
Overview.....	2
Pharmaceutical Rebate Receivables.....	2
Claim Overpayment Receivables.....	3
Loans and Advances to Providers.....	3
Capitation Arrangement Receivables.....	4
Risk-Sharing Receivables	4
Amounts Receivable Under Government Insured Plans.....	5
Disclosures.....	5
Effective Date and Transition	6
REFERENCES.....	6
Relevant Issue Papers	6
EXHIBIT A – ILLUSTRATION OF PHARMACEUTICAL REBATE RECEIVABLES	7
EXHIBIT B – ILLUSTRATION OF RISK-SHARING RECEIVABLES	8
EXHIBIT C – IMPLEMENTATION GUIDE	9

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for pharmaceutical rebate receivables, claim overpayment receivables, loans and advances to providers who do not meet the definition of related parties, capitation arrangement receivables, risk-sharing receivables, and amounts receivable under government insured plans.

SUMMARY CONCLUSION

Overview

2. Pharmaceutical rebates are arrangements between pharmaceutical companies and reporting entities in which the reporting entities receive rebates based upon the drug utilization of its subscribers at participating pharmacies. These rebates are sometimes recorded as receivables by reporting entities using estimates based upon historical trends which should be adjusted to reflect significant variables involved in the calculation, such as number of prescriptions written/filled, type of drugs prescribed, use of generic vs. brand-name drugs, etc. In other cases, the reporting entity determines the amount of the rebate due based on the actual use of various prescription drugs during the accumulation period and then bills the pharmaceutical company. Oftentimes, a pharmacy benefits management company may determine the amount of the rebate based on a listing (of prescription drugs filled) prepared for the reporting entity's review. The reporting entity will confirm the listing and the pharmaceutical rebate receivable.

3. Claim overpayments may occur as a result of several events, including but not limited to claim payments made in error to a provider. Reporting entities often establish receivables for claim overpayments.

4. A health entity may make loans or advances to large hospitals or other providers. Such loans or advances are supported by legally enforceable contracts and are generally entered into at the request of the provider. In many cases, loans or advances are paid monthly and are intended to represent one month of fee-for-service claims activity with the respective provider.

5. A capitation arrangement is a compensation plan used in connection with some managed care contracts in which a physician or other medical provider is paid a flat amount, usually on a monthly basis, for each subscriber who has elected to use that physician or medical provider. In some instances, advances are made to a provider under a capitation arrangement in anticipation of future services.

6. Risk-sharing agreements are contracts between reporting entities and providers with a risk-sharing element based upon utilization. The compensation payments for risk-sharing agreements are typically estimated monthly and settled annually. These agreements can result in receivables due from the providers if annual utilization is different than that used in estimating the monthly compensation.

7. The definition and accounting treatment for nonadmitted assets is outlined in paragraph 3 of *SSAP No. 4—Assets and Nonadmitted Assets*. Pharmaceutical rebate receivables, claim overpayment receivables, loans and advances to providers, capitation arrangement receivables, risk-sharing receivables, and amounts receivable under government insured plans meet the definition of assets as set forth in SSAP No. 4, and are admitted assets to the extent that the requirements for admission defined in this statement are met.

8. This statement shall not be considered an all-inclusive list of health care receivables. Certain health care receivables are addressed in other statements. Health care receivable assets not addressed in other statements or this statement are nonadmitted assets.

Pharmaceutical Rebate Receivables

9. Pharmaceutical rebates receivables consist of reasonably estimated amounts and billed amounts. Both the billed amount and the estimated amount shall be admitted assets subject to the conditions specified below:

- a. Estimated amounts shall be related solely to actual prescriptions filled during the 3 months immediately preceding the reporting date;

- b. Billed amounts represent pharmaceutical rebate receivables that have been invoiced or confirmed in writing but not collected as of the reporting date. Billed amounts for an estimated amount under paragraph 9.a. shall be admitted only if the determination of the rebate, based on actual prescriptions filled, occurs and is invoiced or confirmed in writing within the 2 months following the reporting date of the estimated amount. Adjustments to previously billed amounts related to prior periods shall be nonadmitted until invoiced or confirmed in writing. Pharmaceutical rebates that have not been collected within 90 days of the invoice date or confirmation date shall be nonadmitted. Furthermore, if accrued pharmaceutical rebate receivables are not invoiced or confirmed in writing in accordance with the contract provisions, the accrual shall be nonadmitted; and
 - c. Evaluation of the collectibility of pharmaceutical rebate receivables shall be made periodically. If in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made.
10. The method used to reasonably estimate the receivable shall be consistent from period to period and shall be adjusted periodically for any changes in the underlying pharmaceutical rebate contract provisions. The financial statements shall disclose information regarding the reporting entity's pharmaceutical rebates in accordance with paragraph 23 of this statement.
11. Income from pharmaceutical rebates of insured plans shall be reported as a reduction to claims expense on the summary of operations.
12. Receivable and payable balances related to uncollected pharmaceutical rebates of uninsured plans shall be recorded on the financial statements of the reporting entity. Any pharmaceutical rebates earned by the reporting entity that are in excess of the amounts to be remitted to the uninsured plan pursuant to an administrative services agreement shall be determined consistent with the requirements of paragraphs 9 and 10 and shall be reported on the balance sheet as an amount receivable relating to uninsured accident and health plans, and as a reduction to general expenses on the statement of operations.

Claim Overpayment Receivables

13. A claim overpayment shall not be recorded as a receivable until invoiced. To the extent that the claim overpayment meets the setoff conditions in *SSAP No. 64—Offsetting and Netting of Assets and Liabilities* and the overpayment is a specific identifiable payment and not an estimate, the receivable may be admitted up to the amount of the payable to the provider for reported claims (i.e., excluding incurred but not reported claims). The receivable and payable shall be reported gross rather than netted on the balance sheet. Evaluation of the collectibility of claim overpayment receivables shall be made periodically. If in accordance with *SSAP No. 5R*, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. Amounts in excess of that written off that do not meet the right of offset conditions shall be nonadmitted as they are not available to satisfy policyholder obligations.

Loans and Advances to Providers

14. Loans or advances to providers who meet the definition of related parties in *SSAP No. 25—Affiliates and Other Related Parties* shall follow the guidance in that statement. To the extent a loan or advance to a non-related party provider meets the setoff conditions in *SSAP No. 64*, the loan or advance may be admitted up to the amount of the payable to the provider for reported claims (i.e., excluding incurred but not reported claims).

15. In addition, a loan or advance to a non-related party hospital shall be admitted up to the amount of claims incurred and payable to the hospital if all of the following conditions are met:

- a. The loan or advance meets the setoff conditions in SSAP No. 64;
- b. The loan or advance is supported by a legally enforceable contract;
- c. The loan or advance is administered pursuant to contractual terms;
- d. The contractual terms of the agreement provide for separate quarterly reconciliations;
- e. Each quarterly reconciliation shall be completed within nine months of the end of such quarter; and
- f. A quarterly reconciled difference shall be settled within 90 days of the date the reconciliation is completed.

16. If a quarterly reconciliation is not performed or settled in accordance with paragraphs 15.e. and 15.f., all assets for loans or advances to that hospital shall be nonadmitted.

17. The receivable and payable shall be reported gross rather than netted on the balance sheet. Evaluation of the collectibility of loans and advances to providers shall be made periodically. If in accordance with SSAP No. 5R, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. Amounts in excess of that written off that do not meet the right of offset conditions shall be nonadmitted as they are not available to satisfy policyholder obligations.

Capitation Arrangement Receivables

18. Advances to providers under capitation arrangements that are made under the terms of an approved provider services contract in anticipation of future services shall be admitted to the extent that the advanced amount does not exceed one month of average capitation payments for the subject provider during the preceding twelve months, and provided that the contract cannot be terminated before the end of the month for which the advanced amount was paid. Evaluation of the collectibility of capitation arrangement receivables shall be made periodically. If in accordance with SSAP No. 5R, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made.

Risk-Sharing Receivables

19. Risk-sharing receivables may consist of reasonably estimated amounts and billed amounts. Both the billed amount and the estimated amount shall be admitted assets subject to the conditions specified below:

- a. Risk-sharing receivables and payables shall only be recorded when reasonably estimated. Estimates of risk-sharing receivables may be admitted if based on at least six months of actual claims experience for each risk-sharing contract. The contractual terms of any risk-sharing agreement shall provide for evaluation of the experience under the contract at least annually. The determination of the risk-sharing balance shall commence no later than 6 months following the close of such annual period, and the balance shall be invoiced no later than 8 months following close of the annual period;
- b. Billed amounts represent risk-sharing receivables that have been invoiced but not collected as of the reporting date. Risk-sharing receivables and payables shall be invoiced or refunded in accordance with the contractual provisions of the risk-sharing agreement.

Adjustments resulting in increases to previously billed amounts related to prior periods shall be nonadmitted until invoiced. Adjustments resulting in decreases to previously billed amounts shall be recognized immediately. Risk-sharing receivables that have not been collected within 90 days of the date of billing shall be nonadmitted;

- c. Risk-sharing receivables and payables shall be reported gross rather than netted on the balance sheet. However, if a reporting entity has both a receivable and payable balance with the same provider and the balances meet the setoff conditions in SSAP No. 64, those balances shall be netted in accordance with SSAP No. 64; and
- d. Evaluation of the collectibility of risk-sharing receivables shall be made quarterly. If in accordance with SSAP No. 5R, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made.

20. The method used to reasonably estimate the receivable shall be consistent from period to period and shall be adjusted periodically for any changes in the underlying risk-sharing contract. The financial statements shall disclose information regarding the reporting entity's risk-sharing receivables in accordance with paragraph 24 of this statement.

21. Income/expense from risk-sharing contracts shall be reported as a component of claims expense on the summary of operations.

Amounts Receivable Under Government Insured Plans

22. Amounts receivable that originate from the government, under government insured plans, including amounts over 90 days due, that qualify as accident and health contracts in accordance with *SSAP No. 50—Classifications of Insurance or Managed Care Contracts* shall be admitted assets. These receivables may include, but are not limited to, receivables due from the government under Medicare, Medicaid and similarly funded government insured plans. Evaluation of the collectibility of amounts receivable under government insured plans shall be made periodically. If in accordance with SSAP No. 5R, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. The collectibility and any nonadmission of amounts receivable from the government insured or uninsured plans are addressed here and in *SSAP No. 47—Uninsured Plans*, paragraph 11.c. Refer to *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage* for additional information and definitions of terms specifically related to Medicare Part D business¹.

Disclosures

23. The financial statements shall disclose the method used by the reporting entity to estimate pharmaceutical rebate receivables. Furthermore, for the most recent three years and for each quarter therein, the reporting entity shall also disclose the following:

- a. Estimated balance of pharmacy rebate receivable as reported on the financial statements;
- b. Pharmacy rebates as invoiced or confirmed in writing; and
- c. Pharmacy rebates collected.

An example of this disclosure is shown in Exhibit A to this statement.

¹ Although Medicare Part D business is considered a government plan, performance network rebate-based receivables under such plans may or may not originate from the government. Only receivables that originate from the government are captured within paragraph 22.

24. The financial statements shall disclose the method used by the reporting entity to estimate its risk-sharing receivables. If any receivable and payable balances with the same provider are netted, the reporting entity shall disclose the gross receivable and payable balances in the notes to the financial statements. Furthermore, for the most recent three years, the reporting entity shall also disclose the following:

- a. Risk-sharing receivables as estimated and reported on the prior year financial statements for annual periods ending in the current year;
- b. Risk-sharing receivables as estimated and reported on the financial statements for annual periods ending in the current year and the following year;
- c. Risk-sharing receivables invoiced as determined after the annual period;
- d. Risk-sharing receivables not yet invoiced; and
- e. Amounts collected from providers as payments under risk-sharing contracts.

An example of this disclosure is shown in Exhibit B to this statement.

Effective Date and Transition

25. This statement is effective for years ending on and after December 31, 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*.

26. Prior to January 1, 2003, reporting entities may transition the invoicing provision outlined in paragraph 9 and shall invoice pharmaceutical rebates on no less than a semi-annual basis. Furthermore, prior to January 1, 2003, reporting entities may transition the 90 day admissibility provision outlined in paragraph 9 and shall nonadmit pharmaceutical rebates if such rebates have not been collected within 180 days of the billing date.

27. Prior to January 1, 2003, reporting entities may transition the invoicing provision outlined in paragraph 19 and shall invoice the risk-sharing balance no later than 11 months following the close of the annual period.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 107—Certain Health Care Receivables and Receivables Under Government Insured Plans*

EXHIBIT A – ILLUSTRATION OF PHARMACEUTICAL REBATE RECEIVABLES

(000 omitted)

Quarter	Estimated Pharmacy Rebates as Reported on Financial Statements	Pharmacy Rebates as Invoiced/ Confirmed	Actual Rebates Collected Within 90 Days of Invoicing/ Confirmation	Actual Rebates Collected Within 91 to 180 Days of Invoicing/ Confirmation	Actual Rebates Collected More Than 180 Days After Invoicing/ Confirmation
12/31/2003	\$150	\$147			
9/30/2003	130	133	\$62		
6/30/2003	142	143	70	\$55	
3/30/2003	157	152	65	42	\$20
12/31/2002	125	132	70	27	20
9/30/2002	123	129	62	31	14
6/30/2002	112	120	54	20	16
3/31/2002	110	118	57	39	20
12/31/2001	68	75	34	20	10
9/30/2001	60	59	27	17	10
6/30/2001	57	60	31	15	10
3/31/2001	45	50	25	18	7

EXHIBIT B – ILLUSTRATION OF RISK-SHARING RECEIVABLES

(000 omitted)

Calendar Year	Evaluation Period Year Ending	Risk-Sharing Receivable as Estimated and Reported in the Prior Year	Risk-Sharing Receivable as Estimated and Reported in the Current Year	Risk-Sharing Receivable Invoiced	Risk-Sharing Receivable Not Invoiced	Actual Risk-Sharing Amounts Collected in Year Invoiced	Actual Risk-Sharing Amounts Collected First Year Subsequent	Actual Risk-Sharing Amounts Collected Second Year Subsequent	Actual Risk-Sharing Amounts Collected – All Other
2003	2003	\$245	\$232	\$155	\$77	\$0			
	2004	XXX	\$189	XXX	\$189	XXX	XXX		
2002	2002	\$223	\$225	\$203	\$22	\$0	\$200		
	2003	XXX	\$245	XXX	\$245	XXX	XXX	XXX	XXX
2001	2001	\$190	\$178	\$174	\$4	\$0	\$170	\$5	
	2002	XXX	\$223	XXX	\$223	\$XXX	XXX	XXX	XXX

If there were only one contract or if all contracts have the same experience period, then there would only be an entry in either the “Invoiced” or “Not Invoiced” column for the current year. This example assumes varying dates on experience periods for multiple contracts. Assumptions: Two risk-sharing contracts are in place, one with an experience period that ends 3/31/03 and one with an experience period that ends 10/31/03.

The \$155,000 receivable for the contract period that ends 3/31/03 would be invoiced no later than 11/30/03 (or 8 months following close of the contract period) and could be collected no later than 2/28/04. Therefore, the \$155,000 would appear in the “Invoiced” column in 2003 but not shown as collected in 2003. Further, the \$189,000 estimate for the experience period that ends 3/31/04 could be recorded on the December 31, 2003 financial statement, since there is more than six months of experience under the contract.

The contract with the experience period that ends 10/31/03 with an estimated \$77,000 receivable would be invoiced by 6/30/04 and collected by 09/30/04. Therefore, it would appear in the “Not Invoiced” column and not shown as collected in 2003. However, no estimate could be reported on the December 31, 2003 financial statement for the experience period that ends 10/31/04, because there is less than six months of experience under the contract.

EXHIBIT C – IMPLEMENTATION GUIDE

The purpose of this guide is to assist regulators as well as reporting entities in the practical application of SSAP No. 84.

Pharmaceutical Rebate Receivables

1. Q: What is a reasonable method of determining receivables for estimated amounts?

A: At any one reporting date, a reporting entity's receivable for pharmaceutical rebates can consist of two distinct amounts: 1) an estimated amount, and 2) a billed amount (that can include adjustments to previously billed amounts). The estimated amount represents the reporting entity's best estimate of the rebates it expects to receive for those prescriptions drugs filled during the most recent quarter, i.e. at 12/31/20X1, the estimate would relate to those prescriptions filled during the fourth quarter of 20X1. Estimated rebate amounts for prescription drugs filled in any other quarter must be nonadmitted.

When determining its estimate, the reporting entity should use the most accurate methods possible that utilize historical information relative to pharmaceutical rebates received. The reporting entity should use methods that consider contractual changes in rebate amounts, seasonality differences, changes in membership or premium revenue, changes in utilization of drugs with varying rebate levels, etc.

2. Q: Paragraph 9.b. states, "Billed amounts for an estimated amount under paragraph 9.a. shall be admitted only if the determination of the rebate, based on actual prescriptions filled, occurs and is invoiced or confirmed in writing within the 2 months following the reporting date of the estimated amount." What is meant by the phrase "within 2 months following the reporting date of the estimated amount?" Why does the SSAP make a distinction between those rebates that are invoiced and those that are confirmed in writing?

A: This sentence is worded in this fashion in order to show the relationship between an estimated amount and the related billed amount. At any reporting date, a billed amount will qualify as an admitted asset only if it was invoiced or confirmed in writing within the two months following the most previously filed financial statement, or the financial statement in which the related estimate was reported. E.g., using the example in Q&A 1, the reporting entity could admit billed amounts for rebates attributable to prescriptions drugs filled in *third quarter* of 20X1, only if the rebates were invoiced or confirmed in writing no later than 11/30/20X1. Further, the billed amount must be collected by 2/28/20X2 or it will become a nonadmitted asset.

Secondly, reporting entities typically administer their pharmaceutical benefit programs in one of two fashions, either directly or through a pharmaceutical benefit manager (PBM). The SSAP makes a distinction for these two instances. Entities that contract directly with the pharmaceutical company will invoice the pharmaceutical company for its rebates. However, for those entities that use a PBM, the SSAP requires that to admit billed amounts the reporting entity must receive reports from the PBM on a quarterly basis; the reports should provide fairly detailed information as to the number of each prescription drug filled, the rebate for each individual drug, the total amount of rebates to be received, any rebates to be received that relate to prior periods, etc. The reporting entity must then accept or "confirm" the report, and then communicate formal acceptance of the report to the PBM. Only after this occurs is the amount considered confirmed as required by the SSAP.

3. Q: What is a reasonable method of confirming a report received from our PBM?
- A: The reporting entity should perform whatever verification procedures it deems necessary to provide adequate assurance that the report is accurate. These procedures might include, but are not limited to, reviewing the information required from the PBM as discussed in Q&A 2, verification of payments for prescription drug charges, trend testing, etc.
4. Q: Rebates relating to uninsured plans have been included in the gross receivable for pharmaceutical rebates. However, much of the amount was nonadmitted because of the requirement to bill within two months was not met. Is it still necessary to record the payable to the uninsured plan, even though the liability is essentially a pass-through?
- A: Yes, the liability must still be recorded, regardless of the fact that the related asset may be nonadmitted.
5. Q: Should the disclosure in Exhibit A include rebates for both insured and uninsured business?
- A: Yes, the disclosure to be included in the Notes to Financial Statements for pharmaceutical rebate receivables should include pharmaceutical rebates of insured and uninsured business. However, ultimately the reporting entity must have the ability to separately identify rebates for insured and uninsured business, given the distinct difference in treatment on the Statement of Revenue and Expenses.
6. Q: Please explain the transition period related to the invoicing of pharmaceutical rebate receivables.
- A: The transition applies to all reporting periods preceding January 1, 2003, and allows transition for the invoicing and collection provisions found in paragraph 9.b. Throughout the transition period, the reporting entity may invoice (or confirm in writing) its pharmaceutical rebates semi-annually, i.e. the receivable for the estimated or billed amount may include two quarters, depending upon the invoice dates elected. However, reporting entities must still invoice or confirm in writing their rebates within 2 months of the end of each semi-annual period for the billed amount to be admitted.

For example, during the transition period B&P HMO elected to invoice its pharmaceutical rebates with semi-annual periods ending 12/31/2001 and 6/30/2002. B&Ps admitted asset for pharmaceutical rebate receivables for reporting periods ending 12/31/2001 through 3/31/2003 would be comprised of the following:

Transition period:

12/31/2001	Estimated amounts: third and fourth quarters of 2001 Billed amounts: none
3/31/2002	Estimated amounts: first quarter of 2002 Billed amounts: third and fourth quarters of 2001 if billed by 2/28/2002 (note that these billed amounts must be collected by 8/31/2002)
6/30/2002	Estimated amounts: first and second quarters of 2002 Billed amounts: third and fourth quarters of 2001 if billed by 2/28/2002 (note that these billed amounts must be collected by 8/31/2002)

- 9/30/2002 Estimated amounts: third quarter of 2002
Billed amounts: first and second quarters of 2002 if billed by 8/31/2002 (these billed amounts must be collected by 1/1/2003, the date of full implementation of SSAP No. 84)
- 12/31/2002 Estimated amounts: third and fourth quarters of 2002
Billed amounts: first and second quarters of 2002 if billed by 8/31/2002 (take note that these billed amounts must be collected by 1/1/2003, the date of full implementation of SSAP No. 84)

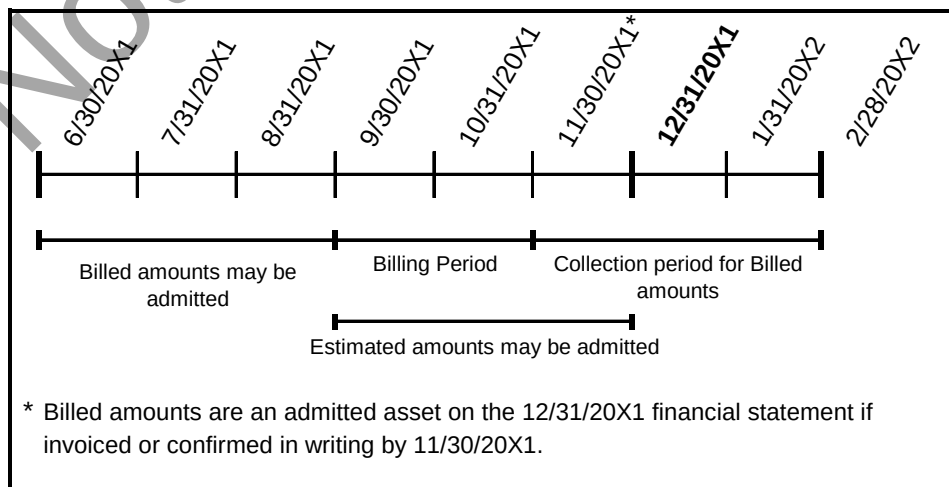
Full implementation of SSAP No. 84

- 3/31/2003 Estimated amounts: first quarter of 2003
Billed amounts: fourth quarter of 2002 if billed by 2/28/2003

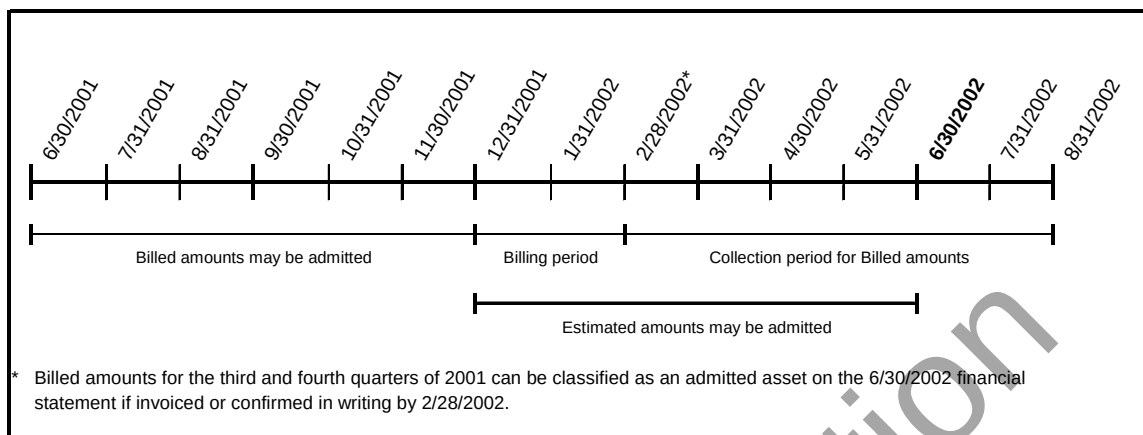
Note that this situation will result in no admitted asset allowed for the billed amount related to the third quarter of 2002, given that the requirements of the SSAP are fully effective on 1/1/2003. B&P should consider invoicing its rebates as required by the SSAP prior to the close of the transition period to avoid this situation.

7. Q: How much historical data is required in the pharmaceutical rebates disclosure in 2001 and 2002?
- A: Reporting entities should include as much information as possible when completing this disclosure in 2001 and 2002. Be aware that in 2001 and 2002, this disclosure will be included under Note 20, Other Items. In 2003, this disclosure will be a separate note.
8. Q: Should the disclosure include rebates invoiced or confirmed in writing that relate to prior periods?
- A: Yes. The disclosure should include all rebates invoiced or confirmed in writing during the respective quarter, whether such rebates relate to the most recently invoiced quarter or any quarter preceding that.

Illustrative timeline of SSAP No. 84 requirements relative to pharmaceutical rebate receivables, assuming a financial statement date of 12/31/20X1:



Illustrative timeline of SSAP No. 84 transition guidance as related to pharmaceutical rebate receivables, assuming a financial statement date of 6/30/2002 and that the reporting entity has elected to invoice/confirm in writing its rebates at 12/31/2001 and 6/30/2002:



Loans and Advances to Providers

9. Q: Why was a distinction made between loans and advances to providers and loans and advances to hospitals?

A: This distinction was made to recognize the unique nature of certain arrangements between reporting entities and hospitals, whereby the participating hospitals are loaned and advanced amounts monthly or quarterly. Such arrangements oftentimes result in lower charges to the reporting entity and work to the benefit of the reporting entity.

10. Q: With regard to the phrase “a loan or advance to a non-related party hospital shall be admitted up to the amount of claims incurred and payable to the hospital,” what does this mean? Does this require that the IBNR valuation be performed for each hospital in which funds are loaned or advanced?

A: In a situation in which amounts are loaned/advanced to a hospital, as the hospital provides services and reports such to the reporting entity, the costs of such services are applied against the outstanding loan. Also applied against the loan is the reporting entity’s estimate of the amount of services provided but not yet reported, i.e. IBNR. The remaining portion of the loan represents the receivable subject to the requirements of the SSAP.

In determining the amount of claims incurred and payable to a particular hospital, the reporting entity should use the most accurate method available. In most instances an IBNR calculation would be the most accurate method of determining this amount.

11. Q: Please explain the reconciliation requirements in paragraph 15.d. and 15.e. related to loans and advances to hospitals.

A: While loans and advances to hospitals are typically paid monthly, the SSAP requires that such balances be reconciled at least quarterly on a per-hospital basis. The SSAP further requires that each quarter’s account be reconciled within nine months of the end of that quarter, i.e. the reconciliation for the quarter ending 3/31/20X1 must be completed by 12/31/20X1.

Therefore, at 12/31/20X1, a reporting entity can have four quarters of loans and advances in its receivable: three quarters worth of unreconciled amounts and one quarter that has been reconciled but not settled.

12. Q: If amounts are loaned or advanced to a hospital but the reconciliation requirements of paragraph 15 are not met, must these amounts be nonadmitted?

A: Not necessarily. In this event, the guidance in paragraph 14 can be followed to determine admissibility, in that the loan or advance may be admitted up to the amount of the payable to the provider for reported claims.

Risk-Sharing Receivables

13. Q: The SSAP allows for the classification of certain estimates of risk-sharing receivables as admitted assets. In what instances may estimates be admitted, and what is a reasonable method of determining receivables for estimated amounts?

A: At any reporting date, a reporting entity's receivable for any one risk-sharing arrangement can consist of two amounts: 1) an estimated amount, and 2) a billed amount (that can include adjustments to previously billed amounts). An estimate can be admitted only if at least six months have passed since the commencement of the annual experience period. The estimated amount represents the reporting entity's best estimate of the receivable related to the contract period from inception to the reporting date.

When determining its estimate, the reporting entity should use the most accurate methods possible that utilize inception-to-date encounter data relative to outpatient surgery encounters, hospital days, etc. If the reporting entity cannot reasonably estimate its risk-sharing receivables, then such amounts must be nonadmitted.

14. Q: The SSAP requires that the determination of the risk share balance begin within six months from the end of the annual experience period, and further requires that the final amount must be invoiced no later than eight months following the close of such period. Must data accumulation stop with month six? Can the reporting entity utilize experience data from months seven and eight in its calculation?

A: The reporting entity should use as much experience data as possible within the 8-month invoicing requirement of paragraph 19.a. This requirement was included to ensure that reporting entities are being proactive when determining risk share balances but was in no way intended to limit the amount of experience data considered.

15. Q: Describe a situation when a receivable and payable would exist with the same provider under a risk-sharing arrangement?

A: This could happen 1) if the risk-share arrangement requires separate risk sharing for each line of business, for certain large groups, etc. or 2) where two contract/evaluation periods under a risk-sharing arrangement are involved.

16. Q: Please explain the transition period related to the invoicing of risk-sharing receivables.

A: The transition applies to all reporting periods preceding January 1, 2003, and allows transition for the invoicing provision found in paragraph 19. Throughout the transition period, the reporting entity may invoice its risk-sharing receivables within 11 months of the end of the contract period, i.e. 11/30/20X2 for a risk-sharing contract with an annual period ending

12/31/20X1. Therefore, during the transition period estimated amounts may be admitted for an additional three-month time period, i.e. from 7/1/20X1 through 11/30/20X2.

17. Q: The disclosure for risk-sharing receivables seems confusing. Please explain what should be included in columns three through six that address estimated and billed/invoiced balances.

A: The third column from the left contains the heading “Risk-Sharing Receivable as Estimated and Reported in the Prior Year.” This column should reflect the amount of risk-sharing receivables as determined in the prior year and reported as admitted assets on the prior year’s financial statement. Therefore, there will never be information reported for the year subsequent to the year in question, as contracts with evaluation periods ending in the following year cannot have risk-sharing receivables recorded in the previous year.

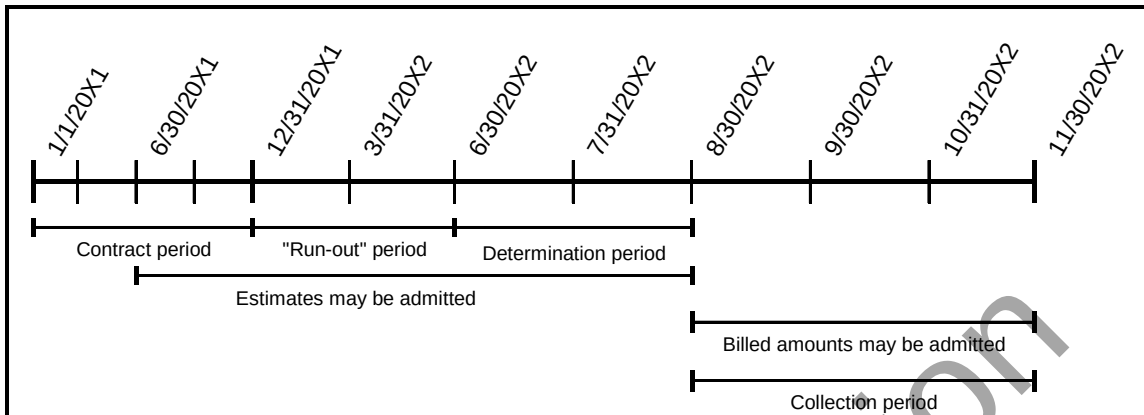
The fourth column, “Risk-Sharing Receivable as Estimated and Reported in the Current Year,” should contain the admitted amounts of risk-sharing receivables on the current year’s financial statement. These amounts should be segregated between those agreements with contract periods ending in the current year and those ending in the following year.

The fifth column from the left contains the heading “Risk-Sharing Receivable Invoiced” and will contain the amount of risk-sharing receivables invoiced during the designated year, regardless of whether such are outstanding as of the financial statement date.

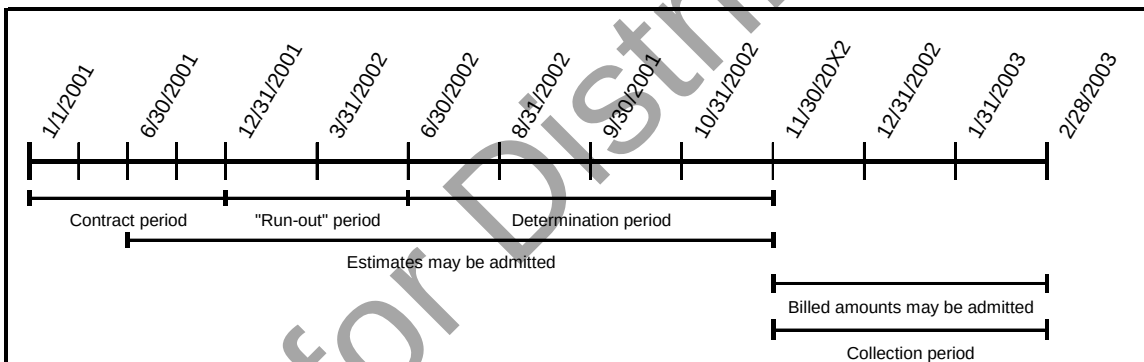
The sixth column, reflecting the heading “Risk-Sharing Receivable Not Invoiced,” should contain the current year-end receivable balance for agreements which qualify for estimation under paragraph 19.b., i.e., the contract has been in effect for at least six months but no amounts have been invoiced. Note that a particular reporting entity might not have any estimated receivables, if that entity’s risk-sharing contracts have not been in effect for at least six months.

Be aware that in 2001 and 2002, this disclosure will be included under Note 20, Other Items. In 2003, this disclosure will be a separate note.

Illustrative timeline of SSAP No. 84 requirements relative to risk-sharing receivables, assuming the reporting entity has one risk-sharing agreement in place with an effective date of 1/1/20X1:



Illustrative timeline of SSAP No. 84 transition guidance as related to risk-sharing receivables, assuming the reporting entity has one risk-sharing agreement in place with an effective date of 1/1/2001:



Statement of Statutory Accounting Principles No. 86

Derivatives

STATUS

Type of Issue.....	Common Area
Issued	Finalized May 14, 2002; Substantively revised August 10, 2022, and December 13, 2022
Effective Date	January 1, 2003; Substantive revisions in 2022 effective January 1, 2023
Affects.....	Supersedes SSAP No. 31
Affected by.....	No other pronouncements
Interpreted by	INT 20-01; INT 20-09; INT 22-01
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	2
SUMMARY CONCLUSION	2
Definitions.....	2
Embedded Derivative Instruments.....	6
Impairment.....	6
Derivative Premium	6
Recognition of Derivatives	7
Derivatives Used in Hedging Transactions.....	7
Hedge Designations	8
Fair Value Hedges.....	8
Cash Flow Hedges	10
Hedging Forecasted Transactions.....	10
Foreign Currency Hedges	12
Foreign Currency Fair Value Hedges	13
Foreign Currency Cash Flow Hedges	13
Hedges of the Foreign Currency Exposure of a Net Investment in a Foreign Operation	14
Hedge Effectiveness.....	15
Documentation Guidance.....	15
Derivatives Used in Income Generation Transactions.....	18
Written Fixed Income Covered Call Options	18
Written Covered Put Options.....	20
Written Fixed Income Caps and Floors	21
Derivatives Used in Replication (Synthetic Asset) Transactions.....	21
Disclosure Requirements	22
Relevant Literature.....	27
Effective Date and Transition	29
REFERENCES.....	30
Other	30
Relevant Issue Papers	30
EXHIBIT A – DISCUSSION OF HEDGE EFFECTIVENESS	31

EXHIBIT B – SPECIFIC HEDGE ACCOUNTING PROCEDURES FOR DERIVATIVES.....	44
EXHIBIT C – WEATHER DERIVATIVE ILLUSTRATION.....	55

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for derivative instruments and hedging, income generation, and replication (synthetic asset) transactions using selected concepts outlined in *FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities* (FAS 133).
2. This statement supersedes the provisions of *SSAP No. 31— Derivative Instruments*.

SUMMARY CONCLUSION

3. This statement addresses the recognition of derivatives and measurement of derivatives used in:
 - a. Hedging transactions;
 - b. Income generation transactions; and
 - c. Replication (synthetic asset) transactions.
 - d. Other Derivatives – (Derivatives that are not used in hedging, income generation or replication transactions.)

Definitions (for purposes of this statement)

4. “Derivative instrument” means an agreement, option, instrument or a series or combination thereof:
 - a. To make or take delivery of, or assume or relinquish, a specified amount of one or more underlying interests, or to make a cash settlement in lieu thereof; or
 - b. That has a price, performance, value or cash flow based primarily upon the actual or expected price, level, performance, value or cash flow of one or more underlying interests.
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.
 - a. “Caps” are option contracts in which the cap writer (seller), in return for a premium, agrees to limit, or cap, the cap holder’s (purchaser) risk associated with an increase in a reference rate or index. For example, in an interest rate cap, if rates go above a specified interest rate level (the strike price or the cap rate), the cap holder is entitled to receive cash payments equal to the excess of the market rate over the strike price multiplied by the notional principal amount. Because a cap is an option-based contract, the cap holder has the right but not the obligation to exercise the option. If rates move down, the cap holder has lost only the premium paid. A cap writer has virtually unlimited risk resulting from increases in interest rates above the cap rate.

- b. “Collar” means an agreement to receive payments as the buyer of an option, cap or floor and to make payments as the seller of a different option, cap or floor.
- c. “Floors” are option contracts in which the floor writer (seller), in return for a premium, agrees to limit the risk associated with a decline in a reference rate or index. For example, in an interest rate floor, if rates fall below an agreed rate, the floor holder (purchaser) will receive cash payments from the floor writer equal to the difference between the market rate and an agreed rate multiplied by the notional principal amount.
- d. “Forwards” are agreements (other than futures) between two parties that commit one party to purchase and the other to sell the instrument or commodity underlying the contract at a specified future date. Forward contracts fix the price, quantity, quality, and date of the purchase and sale. Some forward contracts involve the initial payment of cash and may be settled in cash instead of by physical delivery of the underlying instrument.
- e. “Futures” are standardized forward contracts traded on organized exchanges. Each exchange specifies the standard terms of futures contracts it sponsors. Futures contracts are available for a wide variety of underlying instruments, including insurance, agricultural commodities, minerals, debt instruments (such as U.S. Treasury bonds and bills), composite stock indices, and foreign currencies.
- f. “Options” are contracts that give the option holder (purchaser of the option rights) the right, but not the obligation, to enter into a transaction with the option writer (seller of the option rights) on terms specified in the contract. A call option allows the holder to buy the underlying instrument, while a put option allows the holder to sell the underlying instrument. Options are traded on exchanges and over the counter.
- g. “Structured Notes” in scope of this statement are instruments defined in *SSAP No. 26R—Bonds* (often in the form of debt instruments), in which the amount of principal repayment or return of original investment is contingent on an underlying variable/interest¹. Structured notes that are “mortgage-referenced securities” are captured in *SSAP No. 43R—Loan-Backed and Structured Securities*.
- h. “Swaps” are contracts to exchange, for a period of time, the investment performance of one underlying instrument for the investment performance of another underlying instrument, typically, but not always, without exchanging the instruments themselves. Swaps can be viewed as a series of forward contracts that settle in cash and, in some instances, physical delivery. Swaps generally are negotiated over-the-counter directly between the dealer and the end user. Interest rate swaps are the most common form of swap contract. However, foreign currency, commodity, and credit default swaps also are common.

¹ 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.

- i. “Swaptions” are contracts granting the owner the right, but not the obligation, to enter into an underlying swap. Although options can be traded on a variety of swaps, the term “swaption” typically refers to options on interest rate swaps. A swaption hedges the buyer against downside risk, as well as lets the buyer take advantage of any upside benefits. That is, it gives the buyer the benefit of the agreed-upon rate if it is more favorable than the current market rate, with the flexibility of being able to enter into the current market swap rate if it is preferable. Conversely, the seller of swaptions assumes the downside risk, but benefits from the amount paid for the swaption, regardless if it is exercised by the buyer and the swap is entered into.
 - j. “Warrants” are instruments that give the holder the right to purchase an underlying financial instrument at a given price and time or at a series of prices and times outlined in the warrant agreement. Warrants may be issued alone or in connection with the sale of other securities, for example, as part of a merger or recapitalization agreement, or to facilitate divestiture of the securities of another business entity. Publicly traded stock warrants are captured in scope of *SSAP No. 30R—Unaffiliated Common Stock* or *SSAP No. 32R—Preferred Stock*. All other warrants, including non-publicly traded stock warrants, shall be captured in scope of SSAP No. 86.
6. “Derivative Premium” is the cost to acquire or write a derivative contract. Derivative premium is not an “underlying” in a derivative contract and is not impacted by changes in an underlying interest of the derivative agreement. A derivative with contract terms that finance the derivative premium, so that the cost is paid or received throughout the derivative term or at derivative maturity, does not result with an “embedded derivative” addressed in paragraph 17.
7. “Firm commitment” is an agreement with an unrelated party, binding on both parties and expected to be legally enforceable, with the following characteristics:
- a. The agreement specifies all significant terms, including the quantity to be exchanged, the fixed price, and the timing of the transaction. The fixed price may be expressed as a specified amount of an entity’s functional currency or of a foreign currency. It may also be expressed as a specified interest rate or specified effective yield;
 - b. The agreement includes a disincentive for nonperformance that is sufficiently large to make performance probable; and
 - c. For investments in subsidiary, controlled, and affiliated entities (as defined by *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*) and investments in limited liability companies (as defined by *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*) it must be probable that acquisition will occur within a reasonable period of time.
8. A hedging transaction is defined as a derivative(s) transaction which is entered into and maintained to reduce:
- a. The risk of a change in the fair value or cash flow of assets and liabilities which the reporting entity has acquired or incurred or has a firm commitment to acquire or incur or for which the entity has forecasted acquisition or incurrence; or
 - b. The currency exchange rate risk or the degree of foreign currency exposure in assets and liabilities which a reporting entity has acquired or incurred or has a firm commitment to acquire or incur or for which the entity has forecasted acquisition or incurrence.

9. “Income generation transaction” is defined as derivatives written or sold to generate additional income or return to the reporting entity. They include covered options, caps, and floors (e.g., a reporting entity writes an equity call option on stock that it already owns).
10. “Replication (Synthetic Asset) transaction” is a derivative transaction entered into in conjunction with other investments in order to reproduce the investment characteristics of otherwise permissible investments. A derivative transaction entered into by an insurer as a hedging or income generation transaction shall not be considered a replication (synthetic asset) transaction.
11. “Forecasted transaction” is a transaction that is expected to occur for which there is no firm commitment. Because no transaction or event has yet occurred and the transaction or event when it occurs will be at the prevailing market price, a forecasted transaction does not give an entity any present rights to future benefits or a present obligation for future sacrifices.
12. An “underlying” is a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, or other variable (including the occurrence or nonoccurrence of a specified event such as a scheduled payment under contract). An underlying may be a price or rate of an asset or liability but is not the asset or liability itself.
13. “Benchmark Interest Rate” is a widely recognized and quoted rate in an active financial market that is broadly indicative of the overall level of interest rates attributable to high-credit-quality obligors in that market. It is a rate that is widely used in a given financial market as an underlying basis for determining the interest rates of individual financial instruments and commonly referenced in interest-rate-related transactions. In theory, the benchmark interest rate should be a risk-free rate (that is, has no risk of default). In some markets, government borrowing rates may serve as a benchmark. In other markets, the benchmark interest rate may be an interbank offered rate. In the United States, the interest rates on direct Treasury obligations of the U.S. government, the London Interbank Offered Rate (LIBOR) swap rate, the Fed Funds Effective Rate Overnight Index Swap Rate, the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate, and the Secured Overnight Financing Rate (SOFR) Overnight Index Swap Rate are considered to be benchmark interest rates.
14. “Weather derivatives” are defined as a forward-based or option-based contract for which settlement is based on a climatic or geological variable. One example of such a variable is the occurrence or nonoccurrence of a specified amount of snow at a specified location within a specified period of time. (See Exhibit C – Weather Derivative Illustration.)
15. “Notional amount” is defined² as the face value of a financial instrument in a derivatives transaction as of a reporting date which is used to calculate future payments in the reporting currency. Notional amount may also be referred to as notional value or notional principal amount. The notional amount reported should remain static over the life of a trade unless the instrument is partially unwound or has a contractually amortizing notional. The notional amount shall apply to derivative transactions as follows:
- a. For derivative instruments other than futures contracts (e.g., options, swaps, forwards), the notional amount is either the amount to which interest rates are applied in order to calculate periodic payment obligations or the amount of the contract value used to

² The definition in paragraph 15 is intended to be a principle for determining notional for all derivative instruments. To the extent a derivative type is not explicitly addressed in paragraph 15.a. through paragraph 15.c., notional should be reported in a manner consistent with this principle.

determine the cash obligations. Non-U.S. dollar contracts must be multiplied or divided by the appropriate inception foreign currency rate.

- b. For futures contracts, with a U.S. dollar-denominated contract size (e.g., Treasury note and bond contracts, Eurodollar futures) or underlying, the notional amount is the number of contracts at the reporting date multiplied by the contract size (value of one point multiplied by par value).
- c. For equity index and similar futures, the number of contracts at the reporting date is multiplied by the value of one point multiplied by the transaction price. Non-U.S. dollar contract prices must be multiplied or divided by the appropriate inception foreign currency rate.

16. “Variation Margin” reflects the daily change in market value of derivative contracts (e.g., daily gain/loss on a derivative contract due to market movements). Amounts received/paid to adjust variation margin on derivative contracts that are both cleared and settled on an exchange shall be recognized as an adjustment to the carrying value of the derivative contract (e.g., futures). Amounts received/paid to adjust variation margin on all other derivative contracts shall be recognized on the balance sheet as an asset or liability separate from the carrying value of the derivative instrument. This treatment shall occur under statutory accounting regardless if the counterparty/exchange considers amounts exchanged for variation margin to be legal settlement or collateral. Changes in variation margin shall not be treated as realized gains or adjustments to the basis of the hedged item until the derivative contract has been sold, matured or expired.

Embedded Derivative Instruments

17. Contracts that do not in their entirety meet the definition of a derivative instrument, such as bonds, insurance policies, and leases, may contain “embedded” derivative instruments—implicit or explicit terms that affect some or all of the cash flows or the value of other exchanges required by the contract in a manner similar to a derivative instrument. The effect of embedding a derivative instrument in another type of contract (“the host contract”) is that some or all of the cash flows or other exchanges that otherwise would be required by the contract, whether unconditional or contingent upon the occurrence of a specified event, will be modified based on one or more underlyings. An embedded derivative instrument shall not be separated from the host contract and accounted for separately as a derivative instrument.

Impairment

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

Derivative Premium

19. Derivative premium is the amount paid (acquired derivative) or received (written derivative) to enter into a derivative contract. At inception, the premium generally represents the fair value of the derivative. Derivative premium that is not paid or received at inception represents a liability or receivable for the reporting entity. Derivatives with premiums not remitted at acquisition are considered “financed derivatives.” Financed derivatives shall be reported in accordance with the following provisions:

- a. At acquisition and subsequently, the gross reported fair value of the derivative shall exclude the impact of financing premiums. Only market changes in the actual fair value of the derivative shall be reflected as unrealized gains or losses.

- b. At acquisition and subsequently, premiums payable (acquired derivative) and premiums receivable (written derivatives) shall be separately reported as “payable for securities” and “receivables for securities.”

Recognition of Derivatives

20. Derivative instruments represent rights or obligations that meet the definitions of assets (*SSAP No. 4—Assets and Nonadmitted Assets*) or liabilities (*SSAP No. 5R*) and shall be reported in financial statements. In addition, derivative instruments also meet the definition of financial instruments as defined in *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures*. Should the cost basis of the derivative instrument be undefined (i.e., no premium is paid), the instrument shall be disclosed in accordance with paragraphs ~~44-48~~46-50 of *SSAP No. 100R—Fair Value*. Derivative instruments used in hedging, income generation or replication (synthetic asset) transactions shall be recognized and measured in accordance with the specific provisions within this statement and are admitted assets to the extent they conform to the requirements of this statement.

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

Derivatives Used in Hedging Transactions

22. Derivative instruments used in hedging transactions that meet the criteria of a highly effective hedge shall be considered an effective hedge and are permitted to be valued and reported in a manner that is consistent with the hedged asset or liability (referred to as hedge accounting). For instance, assume an entity has a financial instrument on which it is currently receiving income at a variable rate but wishes to receive income at a fixed rate and thus enters into a swap agreement to exchange the cash flows. If the transaction qualifies as an effective hedge and a financial instrument on a statutory basis is valued and reported at amortized cost, then the swap would also be valued and reported at amortized cost. Derivative instruments used in hedging transactions that do not meet or no longer meet the criteria of an effective hedge, or that meet the required criteria but the entity has chosen not to apply hedge accounting, shall be accounted for at fair value and the changes in the fair value shall be recorded as unrealized gains or unrealized losses (referred to as fair value accounting)³.

23. Entities shall not bifurcate the effectiveness of derivatives. A derivative instrument is either classified as an effective hedge or an ineffective hedge. Entities must account for the derivative using fair value accounting if it is deemed to be ineffective or becomes ineffective. Derivative instruments classified as effective with excluded components in determining hedge effectiveness pursuant to Exhibit A, paragraph 8, shall account for the derivative and excluded components pursuant to the guidance in paragraph 40. Entities may redesignate a derivative in a hedging relationship even though the derivative was used in a previous hedging relationship that proved to be ineffective. A change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship would not, in and of itself, be considered a termination of the derivative instrument. An entity shall prospectively discontinue hedge accounting for an existing hedge if any one of the following occurs:

- a. Any criterion in paragraphs 26-38 is no longer met;

³ Pursuant to paragraph 19, the gross reported value of a derivative and the determination of unrealized gains or losses shall exclude the impact of financing premiums. Premiums payable or receivable from the acquisition or writing of a derivative shall not be reflected in the gross reporting of derivatives or in determining the fair value change in a derivative.

- b. The derivative expires or is sold, terminated, or exercised (the effect is recorded as realized gains or losses or, for effective hedges of firm commitments or forecasted transactions, in a manner that is consistent with the hedged transaction – see paragraph 24);
- c. The entity removes the designation of the hedge; or
- d. The derivative is deemed to be impaired in accordance with paragraph 18. A permanent decline in a counterparty's credit quality/rating is one example of impairment required by paragraph 18, for derivatives used in hedging transactions.

24. For those derivatives which qualify for hedge accounting, the change in the carrying value or cash flow of the derivative shall be recorded consistently with how the changes in the carrying value or cash flow of the hedged asset, liability, firm commitment or forecasted transaction are recorded. Upon termination of a derivative that qualified for hedge accounting, the gain or loss shall adjust the basis of the hedged item and be recognized in income in a manner that is consistent with the hedged item (alternatively, if the item being hedged is subject to Interest Maintenance Reserve (IMR), the gain or loss on the hedging derivative may be realized and shall be subject to IMR upon termination.) Entities who choose the alternative method shall apply it consistently thereafter.

Hedge Designations

25. An entity may designate a derivative instrument as hedging the exposure to:
- a. Changes in the fair value of an asset or a liability or an identified portion thereof that is attributable to a particular risk. This type of hedge can be utilized regardless of whether the hedged asset or liability is recorded in the financial statements at fair value;
 - b. Variability in expected future cash flows that are attributable to a particular risk. That exposure may be associated with an existing recognized asset or liability (such as all or certain future interest payments on variable-rate debt) or a forecasted transaction; or
 - c. Foreign currency exposure. Specific examples include a fair value or cash flow hedge of a foreign-currency-denominated firm commitment or financial instrument.

Fair Value Hedges

26. Fair value hedges qualify for hedge accounting if all of the following criteria are met:
- a. At inception of the hedge, the formal documentation requirements of paragraph 42 are met;
 - b. Both at inception of the hedge and on an ongoing basis, the hedging relationship must be highly effective in achieving offsetting changes in fair value attributable to the hedged risk during the period that the hedge is designated. An assessment of effectiveness is required whenever financial statements or earnings are reported, and at least every three months. All assessments of effectiveness shall be consistent with the risk management strategy documented for that particular hedging relationship;
 - 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;

- d. The hedged item is specifically identified as either all, a specific portion, or the partial term of a recognized asset, or all of a specific portion of a recognized liability or of an unrecognized firm commitment. The hedged item is a single asset or liability (or a specific portion or partial term thereof) or is a portfolio of similar assets or a portfolio of similar liabilities (or a specific portion thereof) or a closed portfolio of assets (pursuant to paragraph 26.f. and Exhibit A, paragraph 46) where assumed layer or layers is anticipated to be outstanding (or a specific portion thereof)⁴. For a partial term hedge of one or more consecutive selected contractual cash flows where the hedged item begins when the first hedge cash flow begins to accrue and ends at the end of the designation hedge period, the assumed maturity of the hedged item occurs at the end of the designated hedge period;
- e. If similar assets or similar liabilities are aggregated and hedged as a portfolio, the individual assets or individual liabilities must share the risk exposure for which they are designated as being hedged. The change in fair value attributable to the hedged risk for each individual item in a hedged portfolio must be expected to respond in a generally proportionate manner to the overall change in fair value of the aggregate portfolio attributable to the hedged risk;
- f. For a closed portfolio of financial assets or one or more beneficial interests secured by a portfolio of financial instruments, an entity may designate as the hedged item or items a hedged layer or layers (this designation is referred to throughout as the “portfolio layer method” detailed in Exhibit A); and
- g. If the hedged item is a financial asset or liability, a recognized loan servicing right, or a nonfinancial firm commitment with financial components, the designated risk being hedged is:
 - i. The risk of changes in the overall fair value of the entire hedged item;
 - ii. The risk of changes in its fair value attributable to changes in benchmark interest rate;
 - iii. The risk of changes in its fair value attributable to changes in the related foreign currency exchange rates; or
 - iv. The risk of changes in its fair value attributable to both changes in the obligor’s creditworthiness and changes in the spread over the benchmark interest rate with respect to the related financial asset’s or liability’s credit sector at inception of the hedge (referred to as credit risk).

If the risk designated as being hedged is not the risk in paragraph 26.g.i., two or more of the other risks (benchmark interest rate risk, foreign currency exchange risk, and credit risk) may simultaneously be designated as being hedged.

The benchmark interest rate being hedged in a hedge of interest rate risk must be specifically identified as part of the designation and documentation at the inception of the hedging relationship. In calculating the change in the hedged item's fair value attributable

⁴ For clarity, partial-term hedges and portfolio hedges addressed in paragraph 26.f. are limited to the situations in which the hedged item(s) is a recognized asset or a closed portfolio of financial assets. These hedging accounting methods are not permitted to hedge liabilities.

to changes in the benchmark interest rate, the estimated coupon cash flows used in calculating fair value shall be based on either the full contractual cash flows or the benchmark rate component of the contractual coupon cash flows of the hedged item determined at hedge inception. An entity may designate a fair value hedge of interest rate risk in which the hedged item is a prepayment instrument. The entity may consider only how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity (for example, an entity may consider only how change in the benchmark interest rate affect an obligor's decision to call a debt instrument when it has the right to do so). The entity need not consider other factors that would affect this decision (for example, credit risk) when assessing hedge effectiveness. An entity may not simply designate prepayment risk as the risk being hedged for a financial asset. However, it can designate the option component of a prepayable instrument as the hedged item in a fair value hedge of the entity's exposure to changes in the fair value of that "prepayment" option, perhaps thereby achieving the objective of its desire to hedge prepayment risk. The effect of an embedded derivative of the same risk class must be considered in designating a hedge of an individual risk. For example, the effect of an embedded prepayment option must be considered in designating a hedge of benchmark interest rate risk.

Cash Flow Hedges

27. Cash flow hedges qualify for hedge accounting if all of the following criteria are met:

- a. At inception of the hedge, the formal documentation requirements of paragraph 42 are met;
- b. Both at inception of the hedge and on an ongoing basis, the hedging relationship shall be highly effective in achieving offsetting cash flows attributable to the hedged risk during the term of the hedge. An assessment of effectiveness is required whenever financial statements or earnings are reported, and at least every three months. All assessments of effectiveness shall be consistent with the originally documented risk management strategy for that particular hedging relationship; and
- 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.

Hedging Forecasted Transactions

28. A forecasted transaction is eligible for designation as a hedged transaction in a cash flow hedge if all of the following additional criteria are met:

- a. The forecasted transaction is specifically identified as a single transaction or a group of individual transactions. If the hedged transaction is a group of individual transactions, those individual transactions must share the same risk exposure for which they are designated as being hedged. Thus, a forecasted purchase and a forecasted sale cannot both be included in the same group of individual transactions that constitute the hedged transaction.
- b. The occurrence of the forecasted transaction is probable. An assessment of the likelihood that a forecasted transaction will take place should not be based solely on management's

intent because intent is not verifiable. The transaction's probability should be supported by observable facts and the attendant circumstances. Consideration should be given to the following circumstances in assessing the likelihood that a transaction will occur:

- i. The frequency of similar past transactions;
- ii. The financial and operational ability of the entity to carry out the transaction;
- iii. Substantial commitments of resources to a particular activity (for example, a manufacturing facility that can be used in the short run only to process a particular type of commodity);
- iv. The extent of loss or disruption of operations that could result if the transaction does not occur; and
- v. The likelihood that transactions with substantially different characteristics might be used to achieve the same business purpose (for example, an entity that intends to raise cash may have several ways of doing so, ranging from a short-term bank loan to a common stock offering).

The term probable requires a significantly greater likelihood of occurrence than the phrase more likely than not. In addition, both the length of time until a forecasted transaction is projected to occur and the quantity of the forecasted transaction are considerations in determining probability. Other factors being equal, the more distant a forecasted transaction is, the less likely it is that the transaction would be considered probable and the stronger the evidence that would be needed to support an assertion that it is probable. For example, a transaction forecasted to occur in five years may be less likely than a transaction forecasted to occur in one year. However, forecasted interest payments for the next 20 years on variable-rate debt typically would be probable if supported by an existing contract. Additionally, other factors being equal, the greater the physical quantity or future value of a forecasted transaction, the less likely it is that the transaction would be considered probable and the stronger the evidence that would be required to support an assertion that it is probable. For example, less evidence generally would be needed to support forecasted investments of \$100,000 in a particular month than would be needed to support forecasted investments of \$950,000 in that month by an entity, even if its investments have averaged \$950,000 per month for the past 3 months.

A forecasted transaction that is expected to occur within 2 months of the original forecasted date (or time frame) may still be considered probable. If the transaction will not occur until greater than 2 months after the original forecasted date, it is no longer probable.

If a forecasted transaction is determined to no longer be probable, hedge accounting shall cease immediately and any deferred gains or losses on the derivative must be recognized in unrealized gains or losses. If an entity demonstrates a pattern of determining that hedged forecasted transactions probably will not occur, such action would call into question both the entity's ability to accurately predict forecasted transactions and the propriety of using hedge accounting in the future for similar forecasted transactions. Accordingly, hedge accounting for transactions forecasted by that entity will no longer be permitted.

- c. If the hedged transaction is the forecasted purchase or sale of a nonfinancial asset, the designated risk being hedged is (1) the risk of changes in the functional-currency-equivalent cash flows attributable to changes in the related foreign currency exchange

rates or (2) the risk of changes in the cash flows relating to all changes in the purchase price or sales price of the asset (reflecting its actual location if a physical asset), not the risk of changes in the cash flows relating to the purchase or sale of a similar asset in a different location or of a major ingredient.

- d. If the hedged transaction is the forecasted purchase or sale of a financial asset or liability or the variable cash inflow or outflow of an existing financial asset or liability, the designated risk being hedged is (1) the risk of changes in the cash flows of the entire asset or liability, such as those relating to all changes in the purchase price or sales price (regardless of whether that price and the related cash flows are stated in the entity's functional currency or a foreign currency), (2) the risk of changes in its cash flows attributable to changes in the designated benchmark interest rate, (3) the risk of changes in the functional-currency-equivalent cash flows attributable to changes in the related foreign currency exchange rates, or (4) the risk of changes in its cash flows attributable to default or changes in the obligor's creditworthiness, and changes in the spread over the benchmark interest rate with respect to the hedged item's credit sector at inception of the hedge. Two or more of the above risks may be designated simultaneously as being hedged. The benchmark interest rate being hedged in a hedge of interest rate risk must specifically be identified as part of the designation and documentation at the inception of the hedging relationship. An entity may not designate prepayment risk as the risk being hedged.

Foreign Currency Hedges

29. If the hedged item is denominated in a foreign currency, an entity may designate the following types of hedges of foreign currency exposure, as specified in paragraphs 26-28:

- a. A fair value hedge of an unrecognized firm commitment or a recognized asset or liability;
- b. A cash flow hedge of a forecasted transaction, an unrecognized firm commitment, the forecasted functional-currency-equivalent cash flows associated with a recognized asset or liability, or a forecasted intercompany transaction; or
- c. A hedge of a net investment in a foreign operation.

30. The recognition in earnings of the foreign currency transaction gain or loss on a foreign-currency-denominated asset or liability based on changes in the foreign currency spot rate is not considered to be the remeasurement of that asset or liability with changes in fair value attributable to foreign exchange risk recognized in earnings. Thus, those criteria are not impediments to either a foreign currency fair value or cash flow hedge of such a foreign-currency-denominated asset or liability or a foreign currency cash flow hedge of the forecasted acquisition or incurrence of a foreign-currency-denominated asset or liability whose carrying amount will be remeasured at spot exchange rates. A foreign currency derivative instrument that has been entered into with another member of a holding company can be a hedging instrument in a fair value hedge or in a cash flow hedge of a recognized foreign-currency-denominated asset or liability or in a net investment hedge only if that other member has entered into an offsetting contract with an unrelated third party to hedge the exposure it acquired from issuing the derivative instrument to the affiliate that initiated the hedge.

31. The provisions in paragraph 30 that permit a recognized foreign-currency-denominated asset or liability to be the hedged item in a fair value or cash flow hedge of foreign currency exposure also pertain to a recognized foreign-currency-denominated receivable or payable that results from a hedged forecasted foreign-currency-denominated sale or purchase on credit. An entity may choose to designate a single cash flow hedge that encompasses the variability of functional currency cash flows attributable to foreign exchange risk related to the settlement of a foreign-currency-denominated receivable or payable resulting

from a forecasted sale or purchase on credit. Alternatively, an entity may choose to designate a cash flow hedge of the variability of functional currency cash flows attributable to foreign exchange risk related to a forecasted foreign-currency-denominated sale or purchase on credit and then separately designate a foreign currency fair value hedge of the resulting recognized foreign-currency-denominated receivable or payable. In that case, the cash flow hedge would terminate (be dedesignated) when the hedged sale or purchase occurs and the foreign-currency-denominated receivable or payable is recognized. Although the use of the same foreign currency derivative instrument for both the cash flow hedge and the fair value hedge is not prohibited, some ineffectiveness may result.

Foreign Currency Fair Value Hedges

32. *Unrecognized firm commitment.* A derivative instrument or a nonderivative financial instrument that may give rise to a foreign currency transaction gain or loss can be designated as hedging changes in the fair value of an unrecognized firm commitment, or a specific portion thereof, attributable to foreign currency exchange rates. The designated hedging relationship qualifies for hedge accounting if all the fair value hedge criteria in paragraph 26 are met.

33. *Recognized asset or liability.* A nonderivative financial instrument shall not be designated as the hedging instrument in a fair value hedge of the foreign currency exposure of a recognized asset or liability. A derivative instrument can be designated as hedging the changes in the fair value of a recognized foreign-currency-denominated asset or liability (or a specific portion thereof) for which a foreign currency transaction gain or loss is recognized in earnings. All recognized foreign-currency-denominated assets or liabilities for which a foreign currency transaction gain or loss is recorded in earnings may qualify for hedge accounting if all the fair value hedge criteria in paragraph 26 are met.

34. *Securities carried at fair value.* A nonderivative financial instrument shall not be designated as the hedging instrument in a fair value hedge of the foreign currency exposure of security carried at fair value. A derivative instrument can be designated as hedging the changes in the fair values of an debt security carried at fair value (or a specific portion thereof) attributable to changes in foreign currency exchange rates. The designated hedging relationship qualifies for hedge accounting if all the fair value hedge criteria in paragraph 26 are met. An equity security carried at fair value can be hedged for changes in the fair value attributable to changes in foreign currency exchange rates and qualify for hedge accounting if all the fair value hedge criteria in paragraph 26 are met and the following two conditions are satisfied.

- a. The security is not traded on an exchange (or other established marketplace) on which trades are denominated in the investor's functional currency; and
- b. Dividends or other cash flows to holders of the security are all denominated in the same foreign currency as the currency expected to be received upon sale of the security.

35. Gain and losses on a qualifying foreign currency fair value hedge shall be accounted for as specified in paragraphs 22-24 and Exhibit B. The gain or loss on a nonderivative hedging instrument attributable to foreign currency risk is the foreign currency transaction gain or loss as determined under *SSAP No. 23—Foreign Currency Transactions and Translations*.

Foreign Currency Cash Flow Hedges

36. A nonderivative financial instrument shall not be designated as a hedging instrument in a foreign currency cash flow hedge. A derivative instrument designated as hedging the foreign currency exposure to variability in the functional-currency-equivalent cash flows associated with a forecasted transaction (for example, a forecasted sale to an unaffiliated entity with the price to be denominated in a foreign currency), a recognized asset or liability, an unrecognized firm commitment, or a forecasted intercompany

transaction (for example, a forecasted sale to a foreign subsidiary or a forecasted royalty from a foreign subsidiary) qualifies for hedge accounting if all the following criteria are met:

- a. The hedged transaction is denominated in a currency other than the hedging unit's functional currency.
- b. All of the criteria in paragraph 27 are met.
- c. If the hedged transaction is a group of individual forecasted foreign-currency-denominated transactions, a forecasted inflow of a foreign currency and a forecasted outflow of the foreign currency cannot both be included in the same group.
- d. If the hedged item is a recognized foreign-currency-denominated asset or liability, all the variability in the hedged item's functional-currency-equivalent cash flows must be eliminated by the effect of the hedge. (For example, with a variable-rate foreign-currency-denominated asset or liability a cash flow hedge cannot be used to hedge changes in exchange rates alone because the derivative would not eliminate all the variability in the functional currency cash flows.)
- e. If the hedged transaction is the forecasted purchase or sale of a financial asset or liability or the interest payments on that financial asset or liability or the variable cash inflow or outflow of an existing financial asset or liability, the designated risk being hedged is (1) the risk of overall change in the hedged cash flows related to the asset or liability, such as those relating to all changes in the purchase price or sales price (regardless of whether that price and the related cash flows are stated in the entity's functional currency or a foreign currency), (2) the risk of changes in its cash flows attributable to changes in the designated benchmark interest rate (referred to as interest rate risk), (3) the risk of changes in the functional-currency-equivalent cash flows attributable to changes in the related foreign currency exchange rates, or (4) the risk of changes in its cash flows attributable to default, changes in the obligor's creditworthiness, and changes in the spread over the benchmark interest rate with respect to the hedged item's credit sector at inception of the hedge (referred to as credit risk). Two or more of the above risks may be designated simultaneously as being hedged. An entity may not designate prepayment risk as the risk being hedged.

The benchmark interest rate being hedged in a hedge of interest rate risk must be specifically identified as part of the designation and documentation at the inception of the hedging relationship. In a cash flow hedge of a variable-rate financial asset or liability, either existing or forecasted, the designated risk being hedged cannot be the risk of changes in its cash flows attributable to changes in the specifically identified benchmark interest rate if the cash flows of the hedged transaction are explicitly based on a different index, for example, based on a specific bank's prime rate, which cannot qualify as the benchmark rate. However, the risk designated as being hedged could potentially be the risk of overall changes in the hedged cash flows related to the asset or liability, provided that the other criteria for a cash flow hedge have been met.

37. A qualifying foreign currency cash flow hedge shall be accounted for in accordance with paragraphs 22-24 and Exhibit B.

Hedges of the Foreign Currency Exposure of a Net Investment in a Foreign Operation

38. A derivative instrument or a nonderivative financial instrument that may give rise to a foreign currency transaction gain or loss under SSAP No. 23 can be designated as hedging the foreign currency exposure of a net investment in a foreign operation. The gain or loss on a hedging derivative instrument

(or the foreign currency transaction gain or loss on the nonderivative instrument) that is designated as, and is effective as, an economic hedge of the net investment in a foreign operation shall be reported in the same manner as a translation adjustment to the extent it is effective as a hedge. The hedged net investment shall be accounted for consistent with SSAP No. 23; the provisions of this statement for recognizing the gain or loss on assets designated as being hedged in a fair value hedge do not apply to the hedge of a net investment in a foreign operation.

Hedge Effectiveness

39. The measurement of hedge effectiveness for a particular hedging relationship shall be consistent with the entity's risk management strategy and the method of assessing hedge effectiveness that was documented at the inception of the hedging relationship, as discussed in paragraph 42.

40. The gain or loss on a derivative designated as a hedge and assessed to be effective is reported consistently with the hedged item. (Therefore, if the hedged item is reported at amortized cost, and the hedging instrument is consistent with that measurement method, fluctuations in fair value would not be recognized as unrealized gains or losses for either the hedging item nor hedging instrument.) If an entity's defined risk management strategy for a particular hedging relationship excludes a specific component of the gain or loss, or related cash flows, on the hedging derivative from the assessment of hedge effectiveness (as discussed in Exhibit A, paragraph 8), specific accounting treatment shall be followed for the excluded component:

- a. If the excluded component pertains to the difference between a foreign currency spot price and the forward or future price (e.g., a forward spot rate), then this premium/discount shall be amortized into income over the life of the contract or hedged program. (This guidance addresses the excluded component in Exhibit A, paragraph 8.d.)
- b. If the excluded component pertains to a foreign currency swap cross-currency basis spread, the impact of fair value changes shall be reflected as a component of the foreign currency swap's periodic interest accrual. (This guidance addresses the excluded component in Exhibit A, paragraph 8.e.)
- c. For all other excluded components, the excluded component shall be measured and reported at fair value, with changes in fair value recognized as unrealized gains or losses. (This guidance shall be applied to excluded components detailed in Exhibit A, paragraphs 8.a. through 8.c.)

41. Hedging instruments with excluded components shall be identified in the financial statement investment schedule (Schedule DB) and shall be disclosed pursuant to paragraph 43.g.

Documentation Guidance

42. At inception of the hedge, documentation must include:

- a. A formal documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge, including identification of the hedging instrument, the hedged item, the nature of the risk being hedged, and how the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or variability in cash flows attributable to the hedged risk will be assessed, including whether an entity will perform subsequent effectiveness assessments on a qualitative basis (per paragraph 46) and how it intends to carry out that qualitative assessment. There must be a reasonable basis for how the entity plans to assess the hedging instrument's effectiveness;

- b. An entity's defined risk management strategy for a particular hedging relationship may exclude certain components of a specific hedging derivative's change in fair value, such as time value, from the assessment of hedge effectiveness, as discussed in paragraph 40 and Exhibit A;
- c. Signature of approval, for each instrument, by person(s) authorized, either by the entity's board of directors or a committee authorized by the board, to approve such transactions; and
- d. A description of the reporting entity's methodology used to verify that opening transactions do not exceed limitations promulgated by the state of domicile.

43. At inception, if an entity is required to perform an initial prospective assessment of hedge effectiveness on a quantitative basis (using information applicable as of the date of hedge inception⁵), the assessment is considered to be performed concurrently at hedge inception if it is completed by the earliest of the following:

- a. The first quarterly hedge effectiveness assessment date;
- b. The date that financial statements that include the hedged transaction are available to be issued;
- c. The date that the hedging instrument and hedged item no longer qualify for hedge accounting;
- d. The date of expiration, sale, termination or exercise of the hedging instrument;
- e. The date of redesignation of the hedging relationship; or
- f. For a cash flow hedge of a forecasted transaction, the date that the forecasted transaction occurs.
- g. 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

⁵ Entities are required to perform an initial prospective assessment unless qualifying for an exception in accordance with ASU 2017-12, paragraph 815-20-25-3.

excluded forward points (e.g., forward spot rates), the aggregate amount owed at maturity, along with current year and remaining amortization.

44. For all derivatives terminated, expired, or exercised during the year:
- a. Signature of approval, for each instrument, by person(s) authorized, either by the entity's board of directors or a committee authorized by the board, to approve such transactions;
 - b. A description, for each instrument, of the nature of the transaction, including:
 - i. The date of the transaction;
 - ii. A complete and accurate description of the specific derivative, including description of the underlying securities, currencies, rates, indices, commodities, derivatives, or other financial market instruments;
 - iii. Number of contracts or notional amount;
 - iv. Date of maturity, expiry or settlement;
 - v. Strike price, rate or index (termination price for futures contracts);
 - vi. Counterparty, or exchange on which the transaction was traded; and
 - vii. Consideration paid or received, if any, on termination.
 - c. Description of the reporting entity's methodology to verify that derivatives were effective hedges; and
 - d. Identification of any derivatives that ceased to be effective as hedges.
45. For derivatives open at quarter-end:
- a. A description of the methodology used to verify the continued effectiveness of hedges, and whether the entity is using qualitative assessments pursuant to paragraph 46⁶;
 - b. An identification of any derivatives that have ceased to be effective as hedges;
 - c. A description of the reporting entity's methodology to determine fair values of derivatives;
 - d. Copy of Master Agreements, if any, where indicated on Schedule DB Part D.
46. An entity may subsequently qualitatively assess hedge effectiveness, on a hedge-by-hedge basis, if both the conditions in paragraphs 46.a. and 46.b. were initially met. When an entity performs subsequent qualitative assessments of hedge effectiveness, it shall verify and document whenever financial statements or earnings are reported and at least every three months that the facts and circumstances related to the hedging relationship have not changed such that it can assert qualitatively

⁶ For purposes of this requirement, this statement adopts the guidance for effectiveness assessment after initial designation reflected in ASU 2017-12, including the concepts and restrictions for use of the short-cut method and the critical terms match method.

that the hedging relationship was and continues to be highly effective. An entity may perform a quantitative assessment in any reporting period to validate whether qualitative assessments remain appropriate. When facts and circumstances change such that an entity no longer can assert qualitatively that the hedging relationship continues to be highly effective, then the entity shall begin performing quantitative assessments.

- a. An entity performs an initial quantitative test of hedge effectiveness on a prospective basis (that is, it is not assuming that the hedging relationship is perfectly effective at hedge inception) and the results of that quantitative test demonstrate highly effective offset.
- b. At hedge inception, an entity can reasonably support an expectation of high effectiveness on a qualitative basis in subsequent periods.

Derivatives Used in Income Generation Transactions

General

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

48. Because these transactions require writing derivatives, they expose the reporting entity to potential future liabilities for which the reporting entity receives a premium up front. Because of this risk, dollar limitations and additional constraints are imposed requiring that the transactions be "covered" (i.e., offsetting assets can be used to fulfill potential obligations). To this extent, the combination of the derivative and the covering asset works like a reverse hedge where an asset owned by the reporting entity in essence hedges the derivative risk.

49. As with derivatives in general, these instruments include a wide variety of terms regarding maturities, range of exercise periods and prices, counterparties, underlying instruments, etc.

50. The principal features of income generation transactions are:

- a. Premium received is initially recorded as a deferred liability.
- b. The accounting of the covering asset or underlying interest controls the accounting of the derivative. The covering asset/underlying interest is accounted at either fair value (e.g., common stocks) or (amortized) cost (e.g., bonds).
- c. The gain/loss on termination of the derivative is a capital item. For life insurance companies, it shall be subject to IMR treatment if interest rate related.
- d. For options that are exercised, the remaining premium shall adjust the proceeds (cost) associated with the exercise resulting in no explicit gain or loss reported for the derivative itself.

Written Fixed Income Covered Call Options

51. The principal features of written fixed income covered call options are:

- a. The general approach is to value at cost (i.e., consideration received) without amortization over the life of the contract if the original duration is less than one year, otherwise carry at amortized cost.

- b. An alternative to the general approach combines the accounting of the written option with the covering asset and then uses standard accounting for callable bonds (yield to worst amortization) on the adjusted asset. This method prevents the possibility of future loss recognition upon exercise while at the same time providing recognition of the income feature of the option over time. This approach would appear most relevant for longer-lived covered European call options, which are in substance like callable bonds.
- c. For life insurance companies, the gain or loss flows through the IMR if the covering asset or underlying interest is subject to the IMR using callable bond rules to determine the remaining life.
- d. Reporting entities are responsible for timely recognition of any probable losses that may occur as a result of the strategy. If the exercise price is below the covering asset's book value, the asset shall be evaluated for write down or disclosure treatment in accordance with SSAP No. 5R. All relevant factors such as whether the option is currently exercisable, the fair value of the bond relative to its exercise price, to what extent the statement value of the option premium offsets any loss on the asset, or how any IMR transaction on exercise would affect unassigned funds (surplus) and income shall be considered.

52. Written fixed income covered call options shall be accounted for as follows:

STATUS OF OPTION	COVERING ASSET VALUED AT AMORTIZED COST	COVERING ASSET VALUED AT FAIR VALUE
Open	Record premium as deferred liability. Carry at amortized value. (Alternatively carry at consideration received if original duration is less than 1 year to maturity.) Alternatively, attach premium to covering asset and amortize (under yield to worse scenario) using standard callable bond accounting.	Record premium as deferred liability. Changes in fair value recorded as unrealized adjustments to unassigned funds (surplus) – gain/loss.
Closed – Expired	Premium received recognized as realized capital gain. Gain from expiration to flow through IMR, if applicable. (1)	Premium received recognized as realized capital gain.
Closed – Exercised	Adjust disposition proceeds. (Include in capital gain/loss of disposed asset.) Gain or loss from disposition to flow through IMR, if applicable. (1)	Adjust disposition proceeds. (Include in capital gain/loss of disposed asset.)

STATUS OF OPTION	COVERING ASSET VALUED AT AMORTIZED COST	COVERING ASSET VALUED AT FAIR VALUE
Closed – Terminated	Recognize net amount as realized capital gain/loss. Gain or loss from disposition to flow through IMR, if applicable. (1)	Recognize net amount as realized capital gain/loss.

NOTE (1) If premium is attached to covering asset, the accounting treatment for the covering asset applies.

Written Covered Put Options

53. The principal features of written covered put options are:

- The accounting for the underlying interest instead of the covering asset governs the accounting of the written put while it is open. For example, if a reporting entity wrote a put requiring it to purchase a certain common stock (underlying interest) at a specific price, the reporting entity might cover that option by holding cash or cash equivalents (covering asset). The accounting for the common stock would govern the accounting of the option in this case.
- As with covered call writing for life insurance companies, gain/loss on termination may be subject to IMR over the remaining life of the underlying interest.
- As with covered call writing, entities writing put options for income generation purposes are responsible for timely recognition of any probable losses that may occur as a result of the strategy.

54. Written covered put options shall be accounted for as follows:

STATUS OF OPTION	UNDERLYING INTEREST VALUED AT AMORTIZED COST	UNDERLYING INTEREST VALUED AT FAIR VALUE
Open	Record premium as deferred liability. Carry at amortized value. (Alternatively carry at consideration received if original duration is less than 1 year to maturity.)	Record premium as deferred liability. Changes in fair value recorded as unrealized adjustments to unassigned funds (surplus) – gain/loss.
Closed – Expired	Premium received recognized as realized capital gain. Gain from expiration to flow through IMR, if applicable.	Premium received recognized as realized capital gain.
Closed – Exercised	Adjust acquisition cost by premium received.	Adjust acquisition cost by premium received.

STATUS OF OPTION	UNDERLYING INTEREST VALUED AT AMORTIZED COST	UNDERLYING INTEREST VALUED AT FAIR VALUE
Closed – Terminated	Recognize net amount as realized capital gain/loss. Gain or loss from disposition to flow through IMR, if applicable.	Recognize net amount as realized capital gain/loss.

Written Fixed Income Caps and Floors

55. The principal features of written fixed income caps and floors are:

- The value of the premium received shall be amortized into income over the life of the contract. For caps and floors, where the entity is selling off possible excess interest/income, the value of the covering asset is not relevant.
- Gain/loss may be subject to IMR. The expected maturity would be the derivative contract's maturity.

56. Written fixed income caps and floors shall be accounted for as follows:

STATUS OF OPTION	COVERING ASSET VALUED AT AMORTIZED COST	COVERING ASSET VALUED AT FAIR VALUE
Open	Record premium as deferred liability. Carry at amortized value. (Alternatively carry at consideration received if original duration is less than 1 year to maturity.) Amortize over life of contract to produce constant yield. Record any interest expense as “Other Investment Income” – negative value.	Record premium as deferred liability. Changes in fair value recorded as unrealized adjustments to unassigned funds (surplus) – gain/loss.
Closed – Matured	Would usually mature at zero amortized value. Any remaining unamortized value recognized as ordinary income through a final amortization adjustment.	Premium received recognized as realized capital gain.
Closed – Exercised	Not applicable.	Not applicable.
Closed – Terminated	Recognize net amount as realized capital gain/loss. Gain/loss on termination to flow through IMR, if applicable.	Recognize net amount as realized capital gain/loss.

Derivatives Used in Replication (Synthetic Asset) Transactions

57. Replication (Synthetic Asset) transaction means a derivative transaction entered into in conjunction with other investments in order to reproduce the investment characteristics of otherwise

permissible investments. A derivative transaction entered into by an insurer as a hedging or income generation transaction shall not be considered a replication (synthetic asset) transaction.

58. Any premium paid or received shall be carried as an asset or liability on the balance sheet (Derivative line on the Assets (or) Liabilities pages). Premiums paid or received on the replication (synthetic asset) derivative should be amortized into investment income or expense until the exercise, termination or maturity date of the derivative.

59. If the replication (synthetic asset) transaction would be carried at amortized cost and the cash instrument used is carried at amortized cost, then the derivative used should be carried at amortized cost. The derivative may be valued at fair value when both the replication (synthetic asset) and the cash instrument are valued at amortized cost. This is consistent with the alternative valuation methods available for hedges. If the replication (synthetic asset) transaction would be carried at fair value and/or the cash instrument used is carried at fair value, then the derivative used should be carried at fair value.

	(a)	(b)	(c)	(d)
	If the Replication (Synthetic Asset) is Valued at:	And Cash Instrument(s) Used is (are) Valued at:	The Derivative is Valued at:	Alternative Derivative Value Basis:
1.	Amortized Cost	Amortized Cost	Amortized Cost	Fair value
2.	Fair value	Fair value	Fair value	N/A
3.	Amortized Cost	Fair value	Fair value	N/A
4.	Fair value	Amortized Cost	Fair value	N/A

60. In the case of No. 3 in the chart above, the fair values for the cash instrument and derivative, when added together, shall not exceed the replication (synthetic asset) statement value. If this does occur, the excess shall reduce the fair value of the derivative and shall be recorded as an unrealized gain separate from the Asset Valuation Reserve (AVR).

61. If the replication (synthetic asset) transaction involves the exchange of interest related cash flows (default free assets), then the cash flows should be accrued as investment income. If the replication (synthetic asset) transaction involves the exchange of total return or change in index cash flows, then the cash flows should be segregated between interest income and fair value (equity) changes. The interest income portion should be accrued as investment income.

62. If the derivative is carried at fair value, the periodic change in the fair value should be recorded as an unrealized gain or loss adjustment to surplus until the transaction is terminated. If the replication (synthetic asset) transaction involves the exchange of total return or change in index cash flows, then the cash flows should be segregated between interest income and fair value (equity) changes. The fair value (equity) change should be recognized as a deferred asset/liability until the termination of the contract. Gains or losses on the derivative at termination or sale should be recognized as realized.

Disclosure Requirements

63. Reporting entities shall disclose the following for all derivative contracts used:

- a. General disclosures:

- i. A description of the reporting entity's objectives for using derivatives, i.e., hedging, income generation or replication;
 - ii. A description of the context needed to understand those objectives and its strategies for achieving those objectives;
 - iii. The description for hedging objectives shall identify the category, e.g., fair value hedges, cash flow hedges, or foreign currency hedges, and for all objectives, the type of instrument(s) used;
 - iv. A description of the accounting policies for derivatives including the policies for recognizing (or reasons for not recognizing) and measuring the derivatives used, and when recognized, where those instruments and related gains and losses are reported;
 - v. Identification of whether the reporting entity has derivative contracts with financing premiums. (For purposes of this term, this includes scenarios in which the premium cost is paid at the end of the derivative contract or throughout the derivative contract.);
 - vi. The net gain or loss recognized in unrealized gains or losses during the reporting period representing the component of the derivative instruments' gain or loss, if any, excluded from the assessment of hedge effectiveness; and
 - vii. The net gain or loss recognized in unrealized gains or losses during the reporting period resulting from derivatives that no longer qualify for hedge accounting. For portfolio layer method hedges, disclose circumstances that led to the breach.
- b. Disclosures by type of instrument outstanding, e.g., call options, floors, etc.:
- i. Notional or contract amounts;
 - ii. Carrying and fair values; and
 - iii. A discussion of the market risk, credit risk, and cash requirements of the derivatives.
- c. For derivatives held for other-than-hedging purposes in addition to paragraphs 63.a. and 63.b.:
- i. Average fair value of the derivatives during the reporting period together with the related end-of-period fair value distinguishing between assets and liabilities; and
 - ii. Net gains or losses detailed by class, business activity or other category that is consistent with the management of those activities and where the net gains or losses are reported.
- d. The financial statements shall disclose details of covered items and/or written transactions to allow evaluation of cash flow implications for all written covered options used for income generation.

- e. A seller⁷ of credit derivatives⁸ shall disclose information⁹ about its credit derivatives and hybrid instruments¹⁰ that have embedded credit derivatives to enable users of financial statements to assess their potential effect on its financial position, income and cash flows. The seller of a credit derivative shall disclose the following information for each credit derivative, or each group of credit derivatives, even if the likelihood of the seller's having to make any payments under the credit derivative is remote. With respect to hybrid instruments that have embedded credit derivatives, the seller of the embedded credit derivative shall disclose the required information for the entire hybrid instrument, not just the embedded credit derivative.
- i. The nature of the credit derivative, including the approximate term of the credit derivative, the reason(s) for entering into the credit derivative, the events or circumstances that would require the seller to perform under the credit derivative, and the current status (that is, as of the date of the statement of financial position) of the payment/performance risk of the credit derivative. For example, the current status of the payment/performance risk of a credit derivative could be based on either recently issued external credit ratings or current internal groupings used by the seller to manage its risk. An entity that uses internal groupings shall disclose how those groupings are determined and used for managing risk.
- ii. The maximum potential amount of future payments (undiscounted) the seller could be required to make under the credit derivative. That maximum potential amount of future payments shall not be reduced by the effect of any amounts that may possibly be recovered under recourse or collateralization provisions in the credit derivative (which are addressed under paragraph 63.e.iv.). If the terms of the credit derivative provide for no limitation to the maximum potential future payments under the contract, that fact shall be disclosed. If the seller is unable to develop an estimate of the maximum potential amount of future payments under the credit derivative, the seller shall disclose the reasons why it cannot estimate the maximum potential amount.

⁷ The term "seller" refers to the party that assumes credit risk, which could be a guarantor in a guarantee-type contract, and any party that provides the credit protection in an option-type contract, a credit default swap, or any other credit derivative contract. A seller is also sometimes referred to as a writer of the contract.

⁸ A credit derivative instrument is (1) in which one or more of its underlyings are related to the credit risk of a specified entity (or a group of entities) or an index based on the credit risk of a group of entities and (2) that exposes the seller to potential loss from credit-risk-related events specified in the contract. Examples of credit derivatives within the scope of this paragraph include, but are not limited to, credit default swaps, credit spread options, and credit index products. This also includes a hybrid instrument that has an embedded credit derivative (e.g., a credit-linked note). The disclosures required by this paragraph do not apply to an embedded derivative feature related to the transfer of credit risk that is only in the form of subordination of one financial instrument to another.

⁹ One way to present the information for groups of similar credit derivatives would be first to segregate the disclosures by major types of contracts (single-name credit default swaps, traded indexes, other portfolio products and swaptions) and then, for each major type, provide additional subgroups for major types of referenced/underlying asset classes (e.g., corporate debt, sovereign debt, and structured finance).

¹⁰ A hybrid instrument is considered a contract that includes the host contract and an embedded derivative. Unlike FAS 133, statutory accounting guidance in *SSAP No. 86—Accounting for Derivative Instruments and Hedging Activities* does not permit embedded derivatives to be separated from the host contract and accounted for separately as a derivative instrument. As noted in paragraph 63.e., the seller of the hybrid instrument shall disclose the required information for the entire hybrid instrument, not just the embedded credit derivative.

- iii. The fair value of the credit derivative as of the date of the statement of financial position.
 - iv. The nature of (1) any recourse provisions that would enable the seller to recover from third parties any of the amounts paid under the credit derivative and (2) any assets held either as collateral or by third parties that, upon the occurrence of any specified triggering event or condition under the credit derivative, the seller can obtain and liquidate to recover all or a portion of the amounts paid under the credit derivative. The seller shall indicate, if estimable, the approximate extent to which the proceeds from liquidation of those assets would be expected to cover the maximum potential amount of future payments under the credit derivative. In its estimate of potential recoveries, the seller of credit protection shall consider the effect of any purchased credit protection with identical underlying(s).
- f. A holder of a financial instrument with an embedded credit derivative¹¹ that exposes the holder to the possibility (however remote) of being required to make future payments (not merely receive reduced cash inflows) because the possibility of those future payments is not caused by subordination (such as the subordination of one beneficial interest to another tranche of a securitization, thereby redistributing credit risk) shall provide the following disclosures for the entire hybrid instrument, not just the embedded credit derivative:
- i. The nature of the embedded credit derivative, including the approximate term of the embedded credit derivative, the events or circumstances that would require the holder to perform under the embedded credit derivative, and the current status (that is, as of the date of the statement of financial position) of the payment/performance risk of the embedded credit derivative.
 - ii. The maximum potential amount of future payments (undiscounted) the holder could be required to make under the embedded credit derivative. That maximum potential amount of future payments shall not be reduced by the effect of any amounts that may possibly be recovered under recourse or collateralization provisions in the embedded credit derivative (which are addressed under paragraph 63.f.iv.). If the terms of the embedded credit derivative provide for no limitation to the maximum potential future payments under the contract, that fact shall be disclosed. If the holder is unable to develop an estimate of the maximum potential amount of future payments under the embedded credit derivative, the holder shall disclose the reasons why it cannot estimate the maximum potential amount.
 - iii. The fair value of the hybrid instrument containing the embedded credit derivative as of the date of the statement of financial position.
 - iv. The nature of (1) any recourse provisions that would enable the holder to recover from third parties any of the amounts paid under the embedded credit derivative and (2) any assets held either as collateral or by third parties that, upon the occurrence of any specified triggering event or condition under the embedded

¹¹ This disclosure is required even though the embedded credit derivative is not separated under statutory accounting and recognized as a derivative. These requirements are also applicable to hybrid instruments that are beneficial interests in securitized financial assets.

credit derivative, the holder can obtain and liquidate to recover all or a portion of the amounts paid under the credit derivative. The holder shall indicate, if estimable, the approximate extent to which the proceeds from liquidation of those assets would be expected to cover the maximum potential amount of future payments under the embedded credit derivative. In its estimate of potential recoveries, the holder of credit protection shall consider the effect of any purchased credit protection with identical underlying(s).

- g. For derivatives accounted for as cash flow hedges of a forecasted transaction, disclose:
 - i. The maximum length of time over which the entity is hedging its exposure to the variability in future cash flows for forecasted transactions excluding those forecasted transactions related to the payment of variable interest on existing financial instruments; and
 - ii. The amount of gains and losses classified in unrealized gains/losses related to cash flow hedges that have been discontinued because it was no longer probable that the original forecasted transactions would occur by the end of the originally specified time period or within 2 months of that date.
- h. For derivative contracts with financing premiums:
 - i. Disclose the aggregate, non-discounted total premium cost for these contracts and the premium cost due in each of the following four years, and thereafter. Also disclose the aggregate fair value of derivative instruments with financing premiums excluding the impact of the deferred or financing premiums.
 - ii. For each derivative contract with financing premiums:
 - (a) Whether premium cost is paid throughout the contract, or at derivative maturity;
 - (b) Next premium cost payment date;
 - (c) Total premium cost;
 - (d) Premium cost paid in prior years;
 - (e) Current year premium cost paid;
 - (f) Future unpaid premium cost;
- i. All derivatives are required to be shown gross on Schedule DB. However, derivatives may be reported net in the financial statements (pages 2 and 3 of the statutory financial statements) in accordance with *SSAP No. 64—Offsetting and Netting of Assets and Liabilities* when a valid right to offset exists. Derivatives offset in accordance with SSAP No. 64 and reported net in the financial statement shall follow the disclosure requirements in SSAP No. 64, paragraph 6. (Derivative Assets and Derivative Liabilities reported on the balance sheet shall agree to columns 5 and 6, respectively, after netting, on Schedule DB – Part D – Section 1.)
- j. The disclosure requirements of paragraphs 63.a., 63.b., and 63.g. shall be included in the annual statement. Refer to the Preamble for further discussion regarding interim disclosure requirements. The disclosure requirements of paragraphs 63.a. through 63.g. shall be included in the annual audited statutory financial reports. The disclosure

requirements in paragraph 63.h. shall be included in statutory financial statements (annual and quarterly). Paragraph 63 of the Preamble states that disclosures made within specific schedules or exhibits to the annual statement need not be duplicated in a separate note.

64. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

65. This statement adopts the framework established by FAS 133, *FASB Statement No. 137, Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133, An amendment of FASB Statement No. 133* (FAS 137) and *FASB Statement No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, An amendment of FASB Statement No. 133* (FAS 138), for fair value and cash flow hedges, including its technical guidance to the extent such guidance is consistent with the statutory accounting approach to derivatives utilized in this statement. This statement adopts the provisions of FAS 133 and 138 related to foreign currency hedges. With the exception of guidance specific to foreign currency hedges and amendments specific to refining the hedging of interest rate risk (under FAS 138, the risk of changes in the benchmark interest rate would be a hedged risk), this statement rejects FAS No. 137 and 138 as well as the various related Emerging Issues Task Force interpretations. This statement adopts paragraphs 4 and 25 of *FASB Statement No. 149: Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (FAS 149) regarding the definition of an underlying and guidance for assessing hedge effectiveness. (The adoption from FAS 149 on the assessment of hedge effectiveness is impacted by the adoption with modification of guidance from ASU 2017-12 as detailed in paragraph 66.b., with the guidance from ASU 2017-12 superseding the prior adoption to the extent applicable.) All other paragraphs in FAS 149 are rejected as not applicable for statutory accounting. This statement adopts FSP FAS 133-1 and FIN 45-5: *Disclosures about Credit Derivatives and Certain Guarantees, An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45 and Clarification of the Effective Date of FASB Statement No. 161* (FSP FAS 133-1 and FIN 45-4) and requires disclosures by sellers of credit derivatives. This statement rejects FSP FIN 39-1, *Amendments of FASB Interpretation No. 39*, and ASU 2014-03, *Derivatives and Hedging – Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps – Simplified Hedge Accounting Approach*.

66. This statement adopts, with modification, certain revisions to ASC 815-20 included in ASU 2017-12. Remaining provisions of ASU 2017-12 will be subsequently assessed for statutory accounting and shall not be considered adopted for statutory accounting until that assessment is complete.

- a. Revisions effective January 1, 2019, with early adoption permitted, are limited to specific provisions, and related transition guidance, pertaining to the documentation and assessment of hedge effectiveness and only includes: 1) provisions allowing more time to perform the initial quantitative hedge effectiveness assessment; 2) provisions allowing subsequent assessments of hedge effectiveness to be performed qualitatively if certain conditions are met; and 3) revisions regarding use of the critical terms and short-cut methods for assessing hedge effectiveness.
- b. Revisions effective January 1, 2023, with early adoption permitted, are limited to the criteria for initial and subsequent hedge effectiveness detailed in the FASB Accounting Standards Codification (ASC) paragraphs 815-20-25-72 through 815-20-35-20, as modified through the issuance of ASU 2017-12. This adoption reflects statutory modifications to specify that the accounting and reporting of hedging instruments, including excluded components of the instruments, shall follow statutory-specific guidance detailed in the statement. The intent of this guidance is to clarify that the determination of whether a hedging instrument qualifies as an effective hedge shall converge with U.S. GAAP, but that the measurement method shall continue to follow statutory-specific provisions. The adoption of the referenced ASC paragraphs only

extends to revisions incorporated through ASU 2017-12; therefore, any subsequent U.S. GAAP edits would require statutory accounting consideration before considered adopted.

- c. Revisions effective January 1, 2023, with early adoption permitted, are limited to the criteria for the portfolio layer method detailed in ASU 2022-01, criteria to only consider how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity date in 815-20-25-6B, adding option in calculating the change in the hedged item's fair value attributed to changes in the benchmark interest rate based on the benchmark rate components of the contractual cash flows detailed in FASB ASC 815-25-35-13, and the partial-term hedging method detailed in FASB ASC 815-25-35-13B. The adoption of the partial term hedging method reflects statutory modifications that limits its use only when the hedged item is a recognized asset. This is different than U.S. GAAP, which permits the partial term method for hedged liabilities. The statutory limitation is established to prevent interim basis adjustments to hedged liabilities that could present a reduction of reported liabilities on the financial statements when the actual liability has not been reduced. Reconsideration of this statutory limitation may occur after a broader project to consider how derivative basis adjustments to hedged liabilities shall be reflected in the financial statements.

67. This statement adopts with modification revisions to ASC 815 as reflected within *ASU 2016-05, Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships*. This guidance is modified to require prospective application, as such it is only applicable to future counterparty changes in derivative instruments, and this guidance cannot be used to adjust derivative transactions previously terminated. This statement adopts revisions to ASC 815-20-25-15 as reflected within *ASU 2010-08, Technical Corrections to Various Topics*. This statement adopts revisions to ASC 815-10-50-4K as reflected within *ASU 2010-11, Derivatives and Hedging (Topic 815), Scope Exception Related to Embedded Credit Derivatives*.

- a. This statement rejects all other GAAP revisions from ASU 2010-11 and *ASU 2014-16, Derivatives and Hedging, Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share is More Akin to Debt or to Equity* and *ASU 2016-06, Derivatives and Hedging, Contingent Put and Call Options in Debt Instruments*. These GAAP revisions are rejected as embedded derivatives are not separated from the host contract and recognized as derivatives under SSAP No. 86. Revisions are also incorporated to SSAP No. 86 to require disclosures on embedded credit derivatives that expose the holder of a financial instrument to the possibility of being required to make future payments. This disclosure is a modification to the GAAP disclosures specific to statutory accounting as embedded credit derivatives are not separately recognized under statutory accounting.
- b. This statement rejects *ASU 2017-11, Accounting for Certain Financial Instruments with Down Round Features; Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Noncontrolling Interests with a Scope Exception*.

68. It should be noted that the conclusions reached in this statement are not intended to usurp the rules and regulations put forth by states in their respective investment laws. The contents of this statement are intended to provide accounting guidance on the use of derivatives as allowed by an insurer's state of domicile. It is not intended to imply that insurers may use derivatives or cash instruments that the insurer's state of domicile does not allow under the state's insurance regulatory requirements, e.g., in replication transactions.

69. This statement adopts revisions to ASC 815-20 as reflected within *ASU 2013-10, Derivatives and Hedging, Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a*

benchmark interest rate for Hedge Accounting Purposes. These revisions define a benchmark interest rate, clarify what can be used in the U.S. for a benchmark interest rate, and eliminate the prior restriction on using different benchmark rates for similar hedges. This statement adopts revisions to the benchmark interest rates as reflected in *ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities* and *ASU 2018-16, Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as Benchmark Interest Rate for Hedge Accounting Purposes* to incorporate the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate, and the Secured Overnight Financing Rate (SOFR) Overnight Index Swap Rate.

70. This statement adopts U.S. GAAP guidance for determining whether short sales are considered a derivative instrument including the regular-way security trade exception. The adopted GAAP guidance includes ASC 815-10-55-57 through 59 and 815-10-15-15 through 17. As a result, short sales shall generally be accounted for in accordance with *SSAP No. 103R—Short Sales*. Contracts that may resemble “short sales” but do not meet the criteria may be in scope of SSAP No. 86 as forward contracts.

71. This statement adopts with modification *ASC Topic 815-45: Weather Derivatives*. Weather derivatives are within the scope of SSAP No. 86 and shall be accounted and reported as other derivatives. The guidance in this statement does not apply to contracts written by insurance entities that entitle the holder to be compensated only if, as a result of an insurable event, the holder incurs a liability or there is an adverse change in the value of a specific asset or liability for which the holder is at risk.

72. This statement rejects revisions to ASC 815-15, as reflected within *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts*. Pursuant to the ASU, market risk benefits are excluded from the U.S. GAAP embedded derivative bifurcation requirements. However, under SSAP No. 86, embedded derivatives shall not be separated from the host contract.

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. Effective December 31, 2023, this statement rejects ASU 2016-13 Financial Instruments—Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB’s issuance of ASU 2016-13 and other related ASUs.*

Effective Date and Transition

74. This statement is effective for derivative transaction entered into or modified on or after January 1, 2003. A modification is any revision or change in contractual terms of the derivative. SSAP No. 31 applies to derivative transaction prior to January 1, 2003. Alternatively, an insurer may choose to apply this statement to all derivatives to which the insurer is a party as of January 1, 2003. In either case, the insurer is to disclose the transition approach that is being used.

- a. Revisions adopted to paragraph 65 to reject FSP FIN 39-1 is effective January 1, 2013, for companies that have previously reported a position in the balance sheet that was net

of counterparty agreements. (Companies that have previously reported derivative instruments and/or related collateral gross shall not be impacted by these revisions.)

- b. Revisions adopted in paragraph 16 clarify the reporting for amounts received/paid to adjust variation margin until the derivative contract has ended and are effective January 1, 2018, on a prospective basis, for reporting entities that have previously considered these amounts to reflect settlement or realized gains/losses. (Companies that have previously reported variation margin changes in line with the revisions shall not be impacted by these revisions.)
- c. Revisions to incorporate limited provisions from ASU 2017-12 pertaining to the documentation of hedge effectiveness (detailed in paragraph 66) are effective January 1, 2019, with early adoption permitted for year-end 2018. However, if the reporting entity is a U.S. GAAP filer, the reporting entity may only elect early adoption if the entity has also elected early adoption of ASU 2017-12 for year-end 2018.
- d. Revisions adopted April 2019 to explicitly include structured notes in scope of this statement are effective December 31, 2019. Revisions adopted July 2020 to define “derivative premium,” require gross reporting of derivatives without the impact of financing premiums and require separate recognition of premiums payable and premiums receivable, are effective January 1, 2021.
- e. Revisions adopted August 2022 that adopt with modification the criteria for initial and subsequent hedge effectiveness detailed in the FASB ASC paragraphs 815-20-25-72 through 815-20-35-20, as modified through the issuance of ASU 2017-12 and that incorporate statutory accounting revisions for the accounting and reporting of excluded components are effective January 1, 2023, with early adoption permitted. These revisions shall be applied prospectively for all new and existing hedges. Entities shall detail the adoption of this guidance as a change in accounting principle pursuant to *SSAP No. 3—Accounting Changes and Corrections of Error*.
- f. Revisions adopted December 13, 2022, that adopt U.S. GAAP guidance for the portfolio layer method, U.S. GAAP guidance to only consider how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity, U.S. GAAP guidance adding option in calculating the change in the hedged item’s fair value attributed to changes in the benchmark interest rate based on the benchmark rate component of the contractual coupon cash flows, that and adopt with modification U.S. GAAP guidance for partial term hedging are effective January 1, 2023, with early adoption permitted. These revisions shall be applied prospectively to qualifying new hedges.

REFERENCES

Other

- *SSAP No. 31—Derivative Instruments*
- *Purposes and Procedures Manual of the NAIC Investment Analysis Office*

Relevant Issue Papers

- *Issue Paper No. 114—Accounting for Derivative Instruments and Hedging Activities*
- [*Issue Paper No. 167—Derivatives and Hedging*](#)

EXHIBIT A – DISCUSSION OF HEDGE EFFECTIVENESS

The guidance within this exhibit reflects the adoption, with modification, of *FASB Accounting Standards Codification (ASC) 815-20-25-72 through 815-20-35-20*, as revised through the issuance of *ASU 2017-12: Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities* (ASU 2017-12) (issued on August 28, 2017). This adoption captures the U.S. GAAP guidance for the assessment and determination of hedge effectiveness, with modification to require the accounting and reporting of hedging instruments, including excluded components of hedging instruments to follow specific statutory accounting guidance in SSAP No. 86. The intent of this guidance is to clarify that the determination of whether a hedging instrument and derivative transaction qualifies as an effective hedge shall converge with U.S. GAAP, but that the measurement and reporting of effective hedge transactions shall follow statutory specific provisions. The adoption only extends to revisions incorporated to the FASB ASC through ASU 2017-12, therefore any subsequent U.S. GAAP edits to the ASC would require statutory accounting adoption before application. The guidance within this exhibit reflects excerpts from the U.S. GAAP ASC, but do not reflect the full U.S. GAAP guidance referenced in the adopted language. The exclusion of cited guidance is to manage the extent of detail included within SSAP No. 86. Excerpts not duplicated within from the cited U.S. GAAP guidance are considered adopted unless subject to the specific accounting and reporting statutory exclusion. This exhibit intends to supplement the guidance in SSAP No. 86 on hedge effectiveness. In any event in which this exhibit could be interpreted as conflicting with the SSAP No. 86 guidance, the guidance in the body of SSAP No. 86 shall be followed.

Hedge Effectiveness Criteria Applicable to Both Fair Value Hedges and Cash Flow Hedges

1. This guidance addresses hedge effectiveness criteria applicable to both fair value hedges and cash flow hedges.
2. To qualify for hedge accounting, the hedging relationship, both at inception of the hedge and on an ongoing basis, shall be expected to be highly effective in achieving either of the following:
 - a. Offsetting changes in fair value attributable to the hedged risk during the period that the hedge is designated (if a fair value hedge)
 - b. Offsetting cash flows attributable to the hedged risk during the term of the hedge (if a cash flow hedge), unless the hedging instrument is used to modify the contractually specified interest receipts or payments associated with a recognized financial asset liability from one variable rate to another variable rate.
3. If the hedging instrument (such as an at-the-money option contract) provides only one-sided offset of the hedged risk, either of the following conditions shall be met:
 - a. The increases (or decreases) in the fair value of the hedging instrument are expected to be highly effective in offsetting the decreases (or increases) in the fair value of the hedged item (if a fair value hedge).
 - b. The cash inflows (outflows) from the hedging instrument are expected to be highly effective in offsetting the corresponding change in the cash outflows or inflows of the hedged transaction (if a cash flow hedge).
4. There would be a mismatch between the change in fair value or cash flows of the hedging instrument and the change in fair value or cash flows of the hedged item or hedged transaction in any of the following circumstances, among others:
 - a. A difference between the basis of the hedging instrument and the hedged item or hedged transaction, to the extent that those bases do not move in tandem.

- b. Differences in critical terms of the hedging instrument and hedged item or hedged transaction, such as differences in any of the following:
 - i. Notional amounts
 - ii. Maturities
 - iii. Quantity
 - iv. Location (not applicable for hedging relationships in which the variability in cash flows attributable to changes in a contractually specified component is designated as the hedged risk)
 - v. Delivery Dates
5. An entity shall consider hedge effectiveness in two different ways—in prospective considerations and in retrospective evaluations:
- a. Prospective considerations. The entity's expectation that the relationship will be highly effective over future periods in achieving offsetting changes in fair value or cash flows, which is forward looking, must be assessed on a quantitative basis at hedge inception unless one of the exceptions detailed in ASU 2017-12, paragraph 815-20-25-3(b)(2)(iv)(01)¹² is met. Prospective assessments shall be subsequently performed whenever financial statements or earnings are reported and at least every three months. The entity shall elect at hedge inception whether to perform subsequent retrospective and prospective hedge effectiveness assessments on a quantitative or qualitative basis. A quantitative assessment can be based on regression or other statistical analysis of past changes in fair values or cash flows as well as on other relevant information. The quantitative prospective assessment of hedge effectiveness shall consider all reasonably possible changes in fair value (if a fair value hedge) or in fair value or cash flows (if a cash flow hedge) of the derivative instrument and the hedged items for the period used to assess whether the requirement for expectation of highly effective offset is satisfied. The quantitative prospective assessment may not be limited only to the likely or expected changes in fair value (if a fair value hedge) or in fair value or cash flows (if a cash flow hedge) of the derivative instrument or the hedged items. Generally, the process of formulating an expectation regarding the effectiveness of a proposed hedging relationship involves a probability-weighted analysis of the possible changes in fair value (if a fair value hedge) or in fair value or cash flows (if a cash flow hedge) of the derivative instrument and the hedged items for the hedge period. Therefore, a probable future change in fair value will be more heavily weighted than a reasonably possible future change.
 - b. Retrospective evaluations. An assessment of effectiveness may be performed on a quantitative or qualitative basis on the basis of the entity's election at hedge inception. That assessment shall be performed whenever financial statements or earnings are reported, and at least every three months. At inception of the hedge, an entity electing a

¹² Reference to this ASU 2017-12 guidance is consistent with the guidance in SSAP No. 86, paragraph 43, footnote 5.

dollar-offset approach to perform retrospective evaluations on a quantitative basis may choose either a period-by-period approach or a cumulative approach in designating how effectiveness of a fair value hedge or of a cash flow hedge will be assessed retrospectively under that approach, depending on the nature of the hedge initially documented.

6. All assessments of effectiveness shall be consistent with the originally documented risk management strategy for that particular hedging relationship. An entity shall use the quantitative effectiveness assessment method defined at hedge inception consistently for the periods that the entity either elects or is required to assess hedge effectiveness on a quantitative basis.

7. This guidance does not specify a single method for assessing whether a hedge is expected to be highly effective. The method of assessing effectiveness shall be reasonable. The appropriateness of a given method of assessing hedge effectiveness depends on the nature of the risk being hedged and the type of hedging instrument used. Ordinarily, an entity shall assess effectiveness for similar hedges in a similar manner, including whether a component of the gain or loss on a derivative instrument is excluded in assessing effectiveness for similar hedges. Use of different methods for similar hedges shall be justified. The mechanics of isolating the change in time value of an option discussed beginning in paragraph 13 also shall be applied consistently.

8. In defining how hedge effectiveness will be assessed, an entity shall specify whether it will include in that assessment all of the gain or loss on a hedging instrument. An entity may exclude all or a part of the hedging instrument's time value from the assessment of hedge effectiveness, as follows:

- a. If the effectiveness of a hedge with an option is assessed based on changes in the option's intrinsic value, the change in the time value of the option would be excluded from the assessment of hedge effectiveness.
- b. If the effectiveness of a hedge with an option is assessed based on changes in the option's minimum value, that is, its intrinsic value plus the effect of discounting, the change in the volatility value of the contract shall be excluded from the assessment of hedge effectiveness.
- c. An entity may exclude any of the following components of the change in an option's time value from the assessment of hedge effectiveness:
 - i. The portion of the change in time value attributable to the passage of time (theta).
 - ii. The portion of the change in time value attributable to changes due to volatility (vega).
 - iii. The portion of the change in time value attributable to changes due to interest rates (rho).
- d. If the effectiveness of a hedge with a forward contract or futures contract is assessed based on changes in fair value attributable to changes in spot prices, the change in the fair value of the contract related to the changes in the difference between the spot price and the forward or futures price shall be excluded from the assessment of hedge effectiveness.
- e. An entity may exclude the portion of the change in fair value of a currency swap attributable to a cross-currency basis spread.

9. No other components of a gain or loss on the designated hedging instrument shall be excluded from the assessment of hedge effectiveness nor shall an entity exclude any aspect of a change in an option's value from the assessment of hedge effectiveness that is not one of the permissible components of the change in an option's time value. For example, an entity shall not exclude from the assessment of hedge effectiveness the portion of the change in time value attributable to changes in other market variables (that is, other than rho and vega).

10. If the critical terms of the hedging instrument and of the hedged item or hedged forecasted transaction are the same, the entity could conclude that changes in fair value or cash flows attributable to the risk being hedged are expected to completely offset at inception and on an ongoing basis. For example, an entity may assume that a hedge of a forecasted purchase of a commodity with a forward contract will be perfectly effective if all of the following criteria are met:

- a. The forward contract is for purchase of the same quantity of the same commodity at the same time and location as the hedged forecasted purchase. Location differences do not need to be considered if an entity designates the variability in cash flows attributable to changes in a contractually specified component as the hedged risk and the requirements in paragraphs 815-20-25-22A through 25-22B of the FASB Codification are met.
- b. The fair value of the forward contract at inception is zero.
- c. Either of the following criteria is met:
 - i. The change in the discount or premium on the forward contract is excluded from the assessment of effectiveness pursuant to paragraphs 7-9.
 - ii. The change in expected cash flows on the forecasted transaction is based on the forward price for the commodity.

11. In a cash flow hedge of a group of forecasted transactions in accordance with paragraph 28.a. of the SSAP guidance, an entity may assume that the timing in which the hedged transactions are expected to occur and the maturity date of the hedging instrument match in accordance with paragraph 10.a. if those forecasted transactions occur and the derivative matures within the same 31-day period or fiscal month.

12. If all of the criteria in paragraphs 10-11 are met, an entity shall still perform and document an assessment of hedge effectiveness at the inception of the hedging relationship and, on an ongoing basis throughout the hedge period. No quantitative effectiveness assessment is required at hedge inception if the criteria in paragraphs 10-11 are met.

Computing Changes in an Option's Time Value

13. In computing the changes in an option's time value that would be excluded from the assessment of hedge effectiveness, an entity shall use a technique that appropriately isolates those aspects of the change in time value. Generally, to allocate the total change in an option's time value to its different aspects—the passage of time and the market variables—the change in time value attributable to the first aspect to be isolated is determined by holding all other aspects constant as of the beginning of the period. Each remaining aspect of the change in time value is then determined in turn in a specified order based on the ending values of the previously isolated aspects.

14. Based on that general methodology, if only one aspect of the change in time value is excluded from the assessment of hedge effectiveness (for example, theta), that aspect shall be the first aspect for which the change in time value is computed and would be determined by holding all other parameters

constant for the period used for assessing hedge effectiveness. However, if more than one aspect of the change in time value is excluded from the assessment of hedge effectiveness (for example, theta and vega), an entity shall determine the amount of that change in time value by isolating each of those two aspects in turn in a prespecified order (one first, the other second). The second aspect to be isolated would be based on the ending value of the first isolated aspect and the beginning values of the remaining aspects. The portion of the change in time value that is included in the assessment of effectiveness shall be determined by deducting from the total change in time value the portion of the change in time value attributable to excluded components.

Assuming Perfect Hedge Effectiveness in a Hedge with an Interest Rate Swap

15. The conditions for the shortcut method do not determine which hedging relationships qualify for hedge accounting; rather, those conditions determine which hedging relationships qualify for a shortcut version of hedge accounting that assumes perfect hedge effectiveness. If all of the applicable conditions in the list in paragraph 17 are met, an entity may assume perfect effectiveness in a hedging relationship of interest rate risk involving a recognized interest-bearing asset or liability (or a firm commitment arising on the trade [pricing] date to purchase or issue an interest-bearing asset or liability) and an interest rate swap (or a compound hedging instrument composed of an interest rate swap and a mirror-image call or put option as discussed in paragraph 17.e.) provided that, in the case of a firm commitment, the trade date of the asset or liability differs from its settlement date due to generally established conventions in the marketplace in which the transaction is executed. The shortcut method's application shall be limited to hedging relationships that meet each and every applicable condition. That is, all the conditions applicable to fair value hedges shall be met to apply the shortcut method to a fair value hedge, and all the conditions applicable to cash flow hedges shall be met to apply the shortcut method to a cash flow hedge. A hedging relationship cannot qualify for application of the shortcut method based on an assumption of perfect effectiveness justified by applying other criteria. The verb *match* is used in the specified conditions in the list to mean *exactly the same* or *correspond exactly*.

16. Implicit in the conditions for the shortcut method is the requirement that a basis exist for concluding on an ongoing basis that the hedging relationship is expected to be highly effective in achieving offsetting changes in fair values or cash flows. In applying the shortcut method, an entity shall consider the likelihood of the counterparty's compliance with the contractual terms of the hedging derivative that require the counterparty to make payments to the entity.

17. All of the following conditions apply to both fair value hedges and cash flow hedges:

- a. The notional amount of the interest rate swap matches the principal amount of the interest-bearing asset or liability being hedged.
- b. If the hedging instrument is solely an interest rate swap, the fair value of that interest rate swap at the inception of the hedging relationship must be zero, with one exception. The fair value of the swap may be other than zero at the inception of the hedging relationship only if the swap was entered into at the relationship's inception, the transaction price of the swap was zero in the entity's principal market (or most advantageous market), and the difference between transaction price and fair value is attributable solely to differing prices within the bid-ask spread between the entry transaction and a hypothetical exit transaction. The guidance in the preceding sentence is applicable only to transactions considered *at market* (that is, transaction price is zero exclusive of commissions and other transaction costs). If the hedging instrument is solely an interest rate swap that at the inception of the hedging relationship has a positive or negative fair value, but does not meet the one exception specified in this paragraph, the shortcut method shall not be used even if all the other conditions are met.

- c. If the hedging instrument is a compound derivative composed of an interest rate swap and mirror-image call or put option as discussed in paragraph 17.e., the premium for the mirror-image call or put option shall be paid or received in the same manner as the premium on the call or put option embedded in the hedged item based on the following:
 - i. If the implicit premium for the call or put option embedded in the hedged item is being paid principally over the life of the hedged item (through an adjustment of the interest rate), the fair value of the hedging instrument at the inception of the hedging relationship shall be zero (except as discussed previously in paragraph 17.b. regarding differing prices due to the existence of a bid-ask spread).
 - ii. If the implicit premium for the call or put option embedded in the hedged item was principally paid at inception-acquisition (through an original issue discount or premium), the fair value of the hedging instrument at the inception of the hedging relationship shall be equal to the fair value of the mirror-image call or put option.
- d. The formula for computing net settlements under the interest rate swap is the same for each net settlement. That is, both of the following conditions are met:
 - i. The fixed rate is the same throughout the term.
 - ii. The variable rate is based on the same index and includes the same constant adjustment or no adjustment. The existence of a stub period and stub rate is not a violation of the criterion in paragraph 17.d. that would preclude application of the shortcut method if the stub rate is the variable rate that corresponds to the length of the stub period.
- e. The interest-bearing asset or liability is not prepayable, that is, able to be settled by either party before its scheduled maturity, or the assumed maturity date if the hedged item is measured as a partial-term hedge of interest rate risk in which the assumed maturity of the hedged items ends at the end of the designated hedge period, in accordance with paragraph 815-25-35-13B, with the following qualifications:
 - i. This criterion does not apply to an interest-bearing asset or liability that is prepayable solely due to an embedded call option (put option) if the hedging instrument is a compound derivative composed of an interest rate swap and a mirror-image call option (put option).
 - ii. The call option embedded in the interest rate swap is considered a mirror image of the call option embedded in the hedged item if all of the following conditions are met:
 - (a) The terms of the two call options match exactly, including all of the following:
 - (1) Maturities
 - (2) Strike price (that is, the actual amount for which the debt instrument could be called) and there is no termination payment equal to the deferred debt issuance costs that remain unamortized on the date the debt is called

- (3) Related notional amounts
 - (4) Timing and frequency of payments
 - (5) Dates on which the instruments may be called.
- (b) The entity is the writer of one call option and the holder (purchaser) of the other call option.
- f. Any other terms in the interest-bearing financial instruments or interest rate swaps meet both of the following conditions:
- i. The terms are typical of those instruments.
 - ii. The terms do not invalidate the assumption of perfect effectiveness.
18. All of the following incremental conditions apply to fair value hedges only:
- a. The expiration date of the interest rate swap matches the maturity date of the interest-bearing asset or liability or the assumed maturity date if the hedged item is measured as a partial-term hedge of interest rate risk in which the assumed maturity of the hedged items ends at the end of the designated hedge period.
 - b. There is no floor or cap on the variable interest rate of the interest rate swap.
 - c. The interval between repricings of the variable interest rate in the interest rate swap is frequent enough to justify an assumption that the variable payment or receipt is at a market rate (generally three to six months or less).
 - d. For fair value hedges of a proportion of the principal amount of the interest-bearing asset or liability, the notional amount of the interest rate swap designated as the hedging instrument matches the portion of the asset or liability being hedged.
 - e. For fair value hedges of portfolios (or proportions thereof) of similar interest-bearing assets or liabilities, both of the following criteria are met:
 - i. The notional amount of the interest rate swap designated as the hedging instrument matches the aggregate notional amount of the hedged item (whether it is all or a proportion of the total portfolio).
 - ii. The remaining criteria for the shortcut method are met with respect to the interest rate swap and the individual assets or liabilities in the portfolio.
 - f. The index on which the variable leg of the interest rate swap is based matches the benchmark interest rate designated as the interest rate risk being hedged for that hedging relationship.
19. All of the following incremental conditions apply to cash flow hedges only:
- a. All interest receipts or payments on the variable-rate asset or liability during the term of the interest rate swap are designated as hedged.
 - b. No interest payments beyond the term of the interest rate swap are designated as hedged.

- c. Either of the following conditions is met:
 - i. There is no floor or cap on the variable interest rate of the interest rate swap.
 - 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.
- d. The repricing dates of the variable-rate asset or liability and the hedging instrument must occur on the same dates and be calculated the same way (that is, both shall be either prospective or retrospective). If the repricing dates of the hedged item occur on the same dates as the repricing dates of the hedging instrument but the repricing calculation for the hedged item is prospective whereas the repricing calculation for the hedging instrument is retrospective, those repricing dates do not match.
- e. For cash flow hedges of the interest payments on only a portion of the principal amount of the interest-bearing asset or liability, the notional amount of the interest rate swap designated as the hedging instrument matches the principal amount of the portion of the asset or liability on which the hedged interest payments are based.
- f. For a cash flow hedge in which the hedged forecasted transaction is a group of individual transactions (as permitted by paragraph 28.a. of the SSAP guidance), if both of the following criteria are met:
 - i. The notional amount of the interest rate swap designated as the hedging instrument matches the notional amount of the aggregate group of hedged transactions.
 - ii. The remaining criteria for the shortcut method are met with respect to the interest rate swap and the individual transactions that make up the group. For example, the interest rate repricing dates for the variable-rate assets or liabilities whose interest payments are included in the group of forecasted transactions shall match (that is, be exactly the same as) the reset dates for the interest rate swap.
- g. The index on which the variable leg of the interest rate swap is based matches the contractually specified interest rate designated as the interest rate being hedged for that hedging relationship.

20. The shortcut method may be applied to a hedging relationship that involves the use of an interest rate swap-in-arrears provided all of the applicable conditions are met.

21. Any discount or premium in the hedged debt's carrying amount (including any related deferred issuance costs) is irrelevant to and has no direct impact on the determination of whether an interest rate swap contains a mirror-image call option under paragraph 17.e.i. Typically, the call price is greater than the par or face amount of the debt instrument. The carrying amount of the debt is economically unrelated to the amount the issuer would be required to pay to exercise the call embedded in the debt.

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~~.

23. Comparable credit risk at inception is not a condition for assuming perfect effectiveness even though actually achieving perfect offset would require that the same discount rate be used to determine the fair value of the swap and of the hedged item or hedged transaction. To justify using the same discount rate, the credit risk related to both parties to the swap as well as to the debtor on the hedged interest-bearing asset (in a fair value hedge) or the variable-rate asset on which the interest payments are hedged (in a cash flow hedge) would have to be the same. However, because that complication is caused by the interaction of interest rate risk and credit risk, which are not easily separable, comparable creditworthiness is not considered a necessary condition for assuming perfect effectiveness in a hedge of interest rate risk.

24. If a fair value hedge or cash flow hedge initially qualifies for hedge accounting, the entity would continue to assess whether the hedge meets the effectiveness test on either a quantitative basis (using either a dollar-offset test or a statistical method such as regression analysis) or a qualitative basis. If the hedge fails the effectiveness test at any time (that is, if the entity does not expect the hedge to be highly effective at achieving offsetting changes in fair values or cash flows), the hedge ceases to qualify for hedge accounting. At least quarterly, the hedging entity shall determine whether the hedging relationship has been highly effective in having achieved offsetting changes in fair value or cash flows through the date of the periodic assessment.

Effectiveness Assessment on a Qualitative Basis

25. An entity may qualitatively assess hedge effectiveness if both of the following criteria are met:

- a. An entity performs an initial quantitative test of hedge effectiveness on a prospective basis (that is, it is not assuming that the hedging relationship is perfectly effective at hedge inception), and the results of that quantitative test demonstrate highly effective offset.
- b. At hedge inception, an entity can reasonably support an expectation of high effectiveness on a qualitative basis in subsequent periods.

26. An entity may elect to qualitatively assess hedge effectiveness in accordance with paragraph 25 on a hedge-by-hedge basis. If an entity makes this qualitative assessment election, only the quantitative method specified in an entity's initial hedge documentation must comply with paragraph 7.

27. When an entity performs qualitative assessments of hedge effectiveness, it shall verify and document whenever financial statements or earnings are reported and at least every three months that the facts and circumstances related to the hedging relationship have not changed such that it can assert qualitatively that the hedging relationship was and continues to be highly effective. While not all-inclusive, the following is a list of indicators that may, individually or in the aggregate, allow an entity to continue to assert qualitatively that the hedging relationship is highly effective:

- a. An assessment of the factors that enabled the entity to reasonably support an expectation of high effectiveness on a qualitative basis has not changed such that the entity can continue to assert qualitatively that the hedging relationship was and continues to be highly effective.
- b. There have been no adverse developments regarding the risk of counterparty default.

28. If an entity elects to assess hedge effectiveness on a qualitative basis and then facts and circumstances change such that the entity no longer can assert qualitatively that the hedging relationship was and continues to be highly effective in achieving offsetting changes in fair values or cash flows, the entity shall assess effectiveness of that hedging relationship on a quantitative basis in subsequent periods. In addition, an entity may perform a quantitative assessment of hedge effectiveness in any reporting period to validate whether qualitative assessments of hedge effectiveness remain appropriate. In both cases, the entity shall apply the quantitative method that it identified in its initial hedge documentation.

29. When an entity determines that facts and circumstances have changed and it no longer can assert qualitatively that the hedging relationship was and continues to be highly effective, the entity shall begin performing subsequent quantitative assessments of hedge effectiveness as of the period that the facts and circumstances changed. If there is no identifiable event that led to the change in the facts and circumstances of the hedging relationship, the entity may begin performing quantitative assessments of effectiveness in the current period.

30. After performing a quantitative assessment of hedge effectiveness for one or more reporting periods as discussed in paragraphs 28-29, an entity may revert to qualitative assessments of hedge effectiveness if it can reasonably support an expectation of high effectiveness on a qualitative basis for subsequent periods.

Quantitative Hedge Effectiveness Assessments After Hedge Designation

31. Quantitative assessments can be based on regression or other statistical analysis of past changes in fair values or cash flows as well as on other relevant information.

32. If an entity elects at the inception of a hedging relationship to use the same regression analysis approach for both prospective considerations and retrospective evaluations of assessing effectiveness, then during the term of that hedging relationship both of the following conditions shall be met:

- a. Those regression analysis calculations shall generally incorporate the same number of data points.
- b. That entity must periodically update its regression analysis (or other statistical analysis).

33. Electing to use a regression or other statistical analysis approach instead of a dollar-offset approach to perform retrospective evaluations of assessing hedge effectiveness may affect whether an entity can apply hedge accounting for the current assessment period.

34. In periodically (that is, at least quarterly) assessing retrospectively the effectiveness of a fair value hedge (or a cash flow hedge) in having achieved offsetting changes in fair values (or cash flows) under a dollar-offset approach, an entity shall use either a period-by-period approach or a cumulative approach on individual fair value hedges (or cash flow hedges):

- a. Period-by-period approach. The period-by-period approach involves comparing the changes in the hedging instrument's fair values (or cash flows) that have occurred during the period being assessed to the changes in the hedged item's fair value (or hedged

transaction's cash flows) attributable to the risk hedged that have occurred during the same period. If an entity elects to base its comparison of changes in fair value (or cash flows) on a period-by-period approach, the period cannot exceed three months. Fair value (or cash flow) patterns of the hedging instrument or the hedged item (or hedged transaction) in periods before the period being assessed are not relevant.

- b. Cumulative approach. The cumulative approach involves comparing the cumulative changes (to date from inception of the hedge) in the hedging instrument's fair values (or cash flows) to the cumulative changes in the hedged item's fair value (or hedged transaction's cash flows) attributable to the risk hedged.

35. If an entity elects at inception of a hedging relationship to base its comparison of changes in fair value (or cash flows) on a cumulative approach, then that entity must abide by the results of that methodology as long as that hedging relationship remains designated. Electing to utilize a period-by-period approach instead of a cumulative approach (or vice versa) to perform retrospective evaluations of assessing hedge effectiveness under the dollar-offset method may affect whether an entity can apply hedge accounting for the current assessment period.

Assessing Effectiveness Based on Whether the Critical Terms of the Hedging Instrument and the Hedged Items Match

36. If, at inception, the critical terms of the hedging instrument and the hedged forecasted transaction are the same (see paragraphs 10-11), the entity can conclude that changes in cash flows attributable to the risk being hedged are expected to be completely offset by the hedging derivative. Therefore, subsequent assessments can be performed by verifying and documenting whether the critical terms of the hedging instrument and the forecasted transaction have changed during the period in review.

37. Because the assessment of hedge effectiveness in a cash flow hedge involves assessing the likelihood of the counterparty's compliance with the contractual terms of the derivative instrument designated as the hedging instrument, the entity must also assess whether there have been adverse developments regarding the risk of counterparty default, particularly if the entity planned to obtain its cash flows by liquidating the derivative instrument at its fair value.

38. If there are no such changes in the critical terms or adverse developments regarding counterparty default, the entity may conclude that the hedging relationship is perfectly effective. In that case, the change in fair value of the derivative instrument can be viewed as a proxy for the present value of the change in cash flows attributable to the risk being hedged.

39. However, the entity must assess whether the hedging relationship is expected to continue to be highly effective using a quantitative assessment method (either a dollar-offset test or a statistical method such as regression analysis) if any of the following conditions exist:

- a. The critical terms of the hedging instrument or the hedged forecasted transaction have changed.
- b. There have been adverse developments regarding the risk of counterparty default.

Possibility of Default by the Counterparty to Hedging Derivative

40. For an entity to conclude on an ongoing basis that the hedging relationship is expected to be highly effective in achieving offsetting changes in cash flows, the entity shall not ignore whether it will collect the payments it would be owed under the contractual provisions of the derivative instrument. In complying with the requirements of paragraph 2.b., the entity shall assess the possibility of whether the

counterparty to the derivative instrument will default by failing to make any contractually required payments to the entity as scheduled in the derivative instrument. In making that assessment, the entity shall also consider the effect of any related collateralization or financial guarantees. The entity shall be aware of the counterparty's creditworthiness (and changes therein) in determining the fair value of the derivative instrument. Although a change in the counterparty's creditworthiness would not necessarily indicate that the counterparty would default on its obligations, such a change shall warrant further evaluation.

41. If the likelihood that the counterparty will not default ceases to be probable, an entity would be unable to conclude that the hedging relationship in a cash flow hedge is expected to be highly effective in achieving offsetting cash flows.

42. In contrast, a change in the creditworthiness of the derivative instrument's counterparty in a fair value hedge would have an immediate effect because that change in creditworthiness would affect the change in the derivative instrument's fair value, which would immediately affect both of the following:

- a. The assessment of whether the relationship qualifies for hedge accounting
- b. The amount of mismatch between the change in the fair value of the hedging instrument and the hedged item attributable to the hedged risk recognized in earnings under fair value hedge accounting.

43. Paragraph 16 states that, in applying the shortcut method, an entity shall consider the likelihood of the counterparty's compliance with the contractual terms of the hedging derivative that require the counterparty to make payments to the entity. That paragraph explains that implicit in the criteria for the shortcut method is the requirement that a basis exist for concluding on an ongoing basis that the hedging relationship is expected to be highly effective in achieving offsetting changes in fair values or cash flows.

Change in Hedge Effectiveness Method When Hedge Effectiveness is Assessed on a Quantitative Basis

44. If the entity identifies an improved method of assessing hedge effectiveness in accordance with the guidance in paragraph 6 and wants to apply that method prospectively, it shall do both of the following:

- a. Discontinue the existing hedging relationship.
- b. Designate the relationship anew using the improved method.

45. The new method of assessing hedge effectiveness shall be applied prospectively and shall also be applied to similar hedges unless the use of a different method for similar hedges is justified. A change in the method of assessing hedge effectiveness by an entity shall not be considered a change in accounting principle as defined in *SSAP No. 3—Accounting Changes and Corrections of Errors*.

Portfolio Layer Method

46. For a closed portfolio of financial assets or one or more beneficial interests secured by a portfolio of financial instruments, an entity may designate as the hedged item or items a hedged layer or layers. (This designation is referred to throughout as the "portfolio layer method.")

- a. As part of the initial hedge documentation, an analysis is completed and documented to support the entity's expectation that the hedged item or items (that is, the hedged layer or layers in aggregate) is anticipated to be outstanding for the designated hedge period. That analysis shall incorporate the entity's current expectations of prepayments, defaults, and

other factors affecting the timing and amount of cash flows associated with the closed portfolio.

- b. For purposes of its analysis in paragraph 46.a., the entity assumes that as prepayments, defaults, and other factors affecting the timing and amount of cash flows occur, they first will be applied to the portion of the closed portfolio that is not hedged; and
- c. The entity applies the partial-term hedging guidance to the assets or beneficial interest used to support the entity's expectation in paragraph 46.a. An asset that matures on a hedged layer's assumed maturity date meets this requirement.

47. After a closed portfolio is established in accordance with paragraph 46, and entity may designate new hedging relationships associated with the closed portfolio without dedesignating any existing hedging relationships associated with the closed portfolio if the criteria of paragraph 46 are met for those newly designated hedging relationships.

48. For the portfolio layer method, if both of the following conditions exist, the quantitative test described for similar assets (shared risk exposure) may be performed qualitatively on a hedge-by-hedge basis and only at hedge inception:

- a. The hedged item is a hedged layer in a portfolio layer hedge and designated in accordance with paragraph 26.f. of SSAP No. 86.
- b. An entity measures the change in fair value of the hedged item based on the benchmark rate component of the contractual coupon cash flows.

Using the benchmark rate component of the contractual coupon cash flows when all assets have the same assumed maturity date and prepayment risk does not affect the measurement of the hedged item results in all hedged items having the same benchmark rate component coupon cash flows.

49. For one or more hedging relationships designated under the portfolio layer method, an entity shall discontinue (or partially discontinue) hedge accounting in the following circumstances:

- a. If the entity cannot support on a subsequent testing date that the hedged layer or layers are anticipated to be outstanding for the designated hedge (that is, a breach is anticipated), it shall discontinue (or partially discontinue) hedge accounting for one or more hedging relationships for the portion of the hedged item that is no longer anticipated to be outstanding for the designated hedge period.
- b. If on a subsequent testing date the outstanding amount of the closed portfolio of financial assets or one or more beneficial interests is less than the hedged layer or layers (that is, a breach has occurred), the entity shall discontinue (or partially discontinue) hedge accounting for one or more hedging relationships for the portion of the hedged item that is no longer outstanding.

50. In the event of either an anticipated breach (as described in paragraph 49.a.) or a breach that has occurred (as described in paragraph 49.b.) for portfolio layer method, if multiple hedged layers are associated with a closed portfolio, an entity shall determine which hedge or hedges to discontinue (or partially discontinue) in accordance with an accounting policy election. That accounting policy election shall specify a systematic and rational approach to determining which hedge or hedges to discontinue (or partially discontinue). An entity shall establish its accounting policy no later than when it first anticipates a breach or when a breach has occurred (whichever comes first). After an entity establishes its accounting policy, it shall consistently apply its accounting policy to all portfolio layer method breaches (anticipated and occurred).

EXHIBIT B – SPECIFIC HEDGE ACCOUNTING PROCEDURES FOR DERIVATIVES

Synopsis: Derivatives may be designated as hedges of changes in the fair value or variability in expected cash flows of assets, liabilities, forecasted transactions or firm commitments due to one or more of the following risks: interest rate, security price, commodity price, foreign exchange rate, index of prices or rates or other variables (excluding risks of identifiable insurable events such as death, disability, accident, illness, damage to property or damage or injury to an insured or third party). Derivatives used in hedging transactions that meet the criteria of a highly effective hedge shall be considered an effective hedge and valued and reported in a manner that is consistent with the hedged asset or liability (referred to as hedge accounting). Under hedge accounting the valuation method used for the derivative shall be consistent with the valuation method used for the hedged item: e.g., amortized cost or fair value. Changes in the carrying value (i.e., amortization or fair value changes) or cash flow of the derivative shall be recognized in the same period and in the same category of income or surplus as the amortization or fair value changes of the hedged item: e.g. net gain from operations, realized capital gains and losses on investments, unrealized capital gains and losses on investments, or unrealized foreign exchange capital gain or loss.

The effects of hedge accounting are reflected in a manner that does not change the reporting of the item being hedged, consistent with the financial statement category that would normally be required under statutory accounting principles. Generally, if the change in the item being hedged is reported as a component of net gain from operations, the change in the derivative shall be reported in its appropriate component of net gain from operations. For example, a change in the aggregate reserve liabilities is reflected in its appropriate annual statement line change in aggregate reserves. A change in the related derivatives that are hedging that item is reflected through other income.

In the case where a portion of the item being hedged is reported as a component of net gain from operations, with the remainder reported as an other change to surplus, then the change in the hedging derivative is bifurcated; a portion is reported as a component of net gain from operations, in the appropriate category and included in the net gain from operations with the remainder reported as an other change to surplus.

For example, in the hedge of a foreign currency denominated asset the change in the value of the asset due to fluctuations in foreign exchange rates is recorded as unrealized capital gains or losses until the asset is sold. A derivative instrument that is in an effective hedging relationship of that item, shall have its change in value associated with fluctuations in foreign currency exchange rates bifurcated and recorded in unrealized capital gains and losses with the remaining change in value recorded consistent with the item being hedged (amortized cost or fair value).

A common purpose of entering into derivatives such as interest rate swaps and forwards as hedges is to change the interest rate characteristics of hedged items. Consistent with this purpose and the hedge accounting concept of matched accounting between the hedging and hedged item, hedged items may be viewed as bearing the changed interest rate characteristics and the cost of the derivatives may therefore be combined with the hedged items. All derivatives shall be reported on Schedule DB. When one or more derivatives hedge more than one asset, liability, forecasted transaction or firm commitment (or a portfolio of hedged items), a company may allocate the total derivative(s) to hedged items individually or in the aggregate. If derivatives are allocated to hedged items, indicate on Schedule DB the nature of the items hedged and the schedule or exhibit where they are presented.

An open derivative hedging a forecasted transaction or firm commitment shall be recorded at cost until the hedged transaction occurs. When the hedged forecasted transaction or firm commitment occurs, an open derivative shall be accounted for in a manner consistent with the hedged item (i.e., amortized cost or fair value).

Upon termination of a derivative that qualified for hedge accounting of an existing asset or liability or a forecasted transaction or firm commitment, the resulting gain or loss shall be recognized in income in a

manner that is consistent with the hedged item. If the hedged item is recorded at amortized cost, the gain or loss shall adjust, individually or in the aggregate, the basis of the hedged item subject to amortization. Alternatively, if the item being hedged is subject to IMR, the gain or loss on the terminated hedging derivative may be realized and shall be subject to IMR upon termination. For terminated derivatives, indicate on Schedule DB, Section 2, Parts A and B the nature of the assets or liabilities so adjusted and the schedule or exhibit where they are presented.

Derivative instruments used in hedging transactions that (i) do not meet or no longer meet the criteria of an effective hedge or (ii) meet the required hedge criteria but the entity has chosen not to apply hedge accounting shall be accounted for at fair value and the changes in the fair value shall be recorded in surplus as unrealized gains or unrealized losses (referred to as fair value accounting). Hedge accounting may not be applied upon inception, redesignation or termination of a derivative designated in a hedging relationship if documentation is not maintained in accordance with SSAP No. 86, paragraphs 42-46.

Specific hedge accounting procedures for derivative instruments are outlined below.

1. Call and Put Options, Warrants, Caps, and Floors:

- a. Accounting at Date of Acquisition (purchase) or Issuance (written): The premium paid or received for purchasing or writing a call option, put option, warrant, cap or floor shall either be (i) recorded as an asset (purchase) or liability (written) on the Derivative line on the Assets (or) Liabilities pages or (ii) combined with the hedged item(s) individually or in the aggregate;
- b. Statement Value:
 - i. Open derivatives hedging items recorded at amortized cost:
 - (a) Options, warrants, caps, and floors purchased or written shall be valued at amortized cost in a manner consistent with the hedged item. (Components of a hedging instrument excluded from the determination of hedge effectiveness shall be recognized at fair value, with changes in fair value recognized as unrealized gains/losses throughout the duration of the hedging instrument. These components are not captured within the guidance for effective hedges detailed within this section.)
 - (b) The amortization period and methods used shall result in a constant effective yield over the life of the hedged item or program. (For floating rate hedged items, the estimated effective yield shall be based on the current rate so the changes in yields attributable to changes in interest rates will be recognized in the period of change.) Specific treatment includes:
 - (1) Holdings in derivatives purchased or written within a year of maturity or expiry need not be amortized;
 - (2) For hedges of forecasted transactions or firm commitments, the derivative may be recorded at cost until the hedged transaction occurs or it is determined that the hedge was not effective (see (d) in this section 1.b.i.);
 - (3) For other derivatives, the amortization period is usually from date of acquisition (issuance) of the derivative to maturity of the hedged item or program.

- (c) For hedges where the cost of the derivative is combined with the hedged item, the statement value is zero. The fair value of the derivative and hedged item shall be determined and reported separately, either individually or in the aggregate;
 - (d) For hedges of forecasted transactions or firm commitments, the derivative shall be recorded at cost until (1) the hedged transaction occurs or (2) it is determined that the hedge was not effective (when the derivative is valued in accordance with (e) in this section);
 - (e) If during the life of the derivative it or a designated portion of the derivative is no longer effective as a hedge, valuation at amortized cost ceases and the derivative or the designated portion of the derivative shall be valued at its current fair value with gains and losses recognized in unrealized gains or unrealized losses to the extent it ceased to be an effective hedge.
- ii. Open derivatives hedging items recorded at fair value (where gains and losses on the hedged item are recognized as adjustments to unassigned funds (surplus)):
 - (a) Options, warrants, caps, or floors purchased or written shall be valued at current fair value with changes in fair value recognized currently consistent with the hedged item; this will result in unrealized gain/loss treatment with adjustment to unassigned funds (surplus).
 - (b) For hedges where the cost of the derivative is combined with the hedged item, the fair value of the derivative and hedged item will be determined and reported separately, either individually or in the aggregate. The cost (book value) basis used to figure unrealized gain/loss on the derivative on Schedule DB is zero.
 - (c) For hedges of forecasted transactions or firm commitments, the derivative shall be recorded at cost until the hedged transaction occurs or it is determined that the hedge was not effective (when fair value accounting is applied as described in the Introduction above).
- iii. Open derivatives hedging items recorded at fair value, where gains and losses on the hedged item are recognized currently in earnings: options, warrants, caps, or floors purchased or written shall be valued at current fair value with changes in fair value recognized currently in earnings together with the gains and losses on the hedged item.
 - (a) For hedges of forecasted transactions or firm commitments, the derivative shall be recorded at cost until (1) the hedged transaction occurs or (2) it is determined that the hedge was not effective (when fair value accounting is applied as described in (b) of this section).
 - (b) If during the life of the derivative it or a designated portion of the derivative is no longer effective as a hedge, recognition of changes in fair value through earnings ceases. The derivative or the designated portion of the derivative shall continue to be valued at its current fair value, but thereafter gains or losses shall be recognized in unrealized gains or unrealized losses to the extent it ceased to be an effective hedge.

- c. Cash Flows and Income
- i. Where the cost of the derivative is not combined with the hedged item:
 - (a) Amortization of premium or discount on derivatives is an adjustment to net investment income or another appropriate caption within operating income consistent with the reporting of the hedged item;
 - (b) Periodic cash flows and accruals of income/expense shall be reported in a manner consistent with the hedged item, such as net investment income or interest and adjustments on policy or deposit-type contract funds (operating income) or net realized capital gains.
 - ii. Where the cost of the derivative is combined with the hedged item, the cash flows and income of the derivative on Schedule DB will be zero. All related amortization and cash flow accounting shall be reported with the hedged item instead of with the derivative.
- d. Gain/Loss on Termination of an option, warrant, cap or floor accounted for under hedge accounting (includes closing, exercise, maturity, and expiry):
- i. Exercise of an Option: The remaining book value of the derivative shall become an adjustment to the cost or proceeds of the hedged item(s) received or disposed of individually or in aggregate;
 - ii. Sale, maturity, expiry, or other closing transaction of a derivative which is an effective hedge—Any gain or loss on the transaction, except for excluded components, will adjust the basis (or proceeds) of the hedged item(s) individually or in aggregate. Alternatively, if the item being hedged is subject to IMR, the gain or loss on the terminated hedging derivative may be realized and shall be subject to IMR upon termination. For hedging instruments with excluded components in determining hedge effectiveness, the unrealized gain/loss from the change in fair value of the excluded component shall be realized upon the closing transaction. This gain/loss shall not be used to adjust the basis or proceeds of the hedged item.
 - iii. Gain/loss on termination of derivatives will be recognized currently in net income (realized gain/loss) to the extent they ceased to be effective hedges.
 - iv. Upon the redesignation of a derivative from a currently effective hedging relationship:
 - (a) with an item(s) carried at amortized cost to another effective hedging relationship with an item(s) carried at amortized cost, the derivative shall continue to be recorded at amortized cost and no gain or loss on the derivative shall be recognized.
 - (b) with an item(s) carried at amortized cost or fair value to an effective relationship with an item(s) carried at fair value, the accounting for the derivative shall be consistent with (ii) above.
 - (c) with an item(s) carried at fair value to an effective relationship with an item(s) carried at amortized cost, the accounting for the derivative shall be consistent with (ii) above.

2. Swaps, Collars, and Forwards (see also discussion in Introduction above):

a. Accounting at Date of Opening Position:

- i. Any premium paid or received at date of opening shall either be (a) recorded on the Derivative line on the Assets (or) Liabilities pages or (b) combined with the hedged item(s), individually or in the aggregate;

b. Statement Value:

i. Open derivatives hedging items recorded at amortized cost:

- (a) Swaps, collars, and forwards shall be valued at amortized cost in a manner consistent with hedged item. (Components of a hedging instrument excluded from the determination of hedge effectiveness not addressed in paragraph 2.b.iii. shall be recognized at fair value, with changes in fair value of the excluded component recognized as unrealized gains/losses throughout the duration of the hedging instrument. These components are not captured within the guidance for effective hedges detailed within this section.)
- (b) The amortization period and methods used shall result in a constant effective yield over the life of the hedged item or program. (For floating rate hedged items the estimated effective yield shall be based on the current rate so the changes in yields attributable to changes in interest rates will be recognized in the period of change.) Specific treatment includes:
- (1) Holdings in derivatives purchased or written within a year of maturity or expiry need not be amortized;
- (2) For hedges of forecasted transactions or firm commitments, the derivative shall be recorded at cost until (a) the hedged transaction occurs or (b) it is determined that the hedge was not effective (see (5) in this section 2.b.i.);
- (3) For other derivatives the amortization period is usually from date of acquisition (issuance) of the derivative to maturity of the hedged item or program;
- (4) For hedges where the cost of the derivative is combined with the hedged item, the statement value is zero. The fair value of the derivative and hedged item shall be determined and reported separately, either individually or in the aggregate;
- (5) If during the life of the derivative it or a designated portion of the derivative is no longer effective as a hedge, valuation at amortized cost ceases and the derivative or a designated portion of the derivative shall be valued at its current fair value with gains and losses recorded in unrealized gains or unrealized losses to the extent that it ceased to be an effective hedge. Upon redesignation into an effective hedging relationship, the derivative's mark to fair value through unrealized gain or loss shall be reversed.

- ii. Open derivatives hedging items recorded at fair value (where gains and losses on the hedged item are recognized as adjustments to unassigned funds (surplus)):
 - (a) Swaps, collars, or forwards shall be valued at current fair value with changes in fair value recognized currently consistent with the hedged item; this will result in unrealized gain/loss treatment with adjustment to unassigned funds (surplus);
 - (b) For hedges where the derivative is combined with the hedged item, the fair value of the derivative and hedge item shall be determined and reported separately, either individually or in the aggregate. The cost (book value) basis used to figure gain/loss on the derivative is zero.
- iii. Open foreign currency swap and forward contracts hedging foreign currency exposure on items denominated in a foreign currency and translated into U.S. dollars where fair value accounting is not being used:
 - (a) The foreign exchange premium (discount) is defined as the foreign currency (notional) amount to be received (paid) times the net of the forward rate minus the spot rate at the time the contract was opened. For forward contracts, an excluded component representing a foreign exchange premium (discount) (forward points) on the currency contract shall be amortized into income over the life of the contract or hedge program. Amortization is not required if the contract was entered into within a year of maturity. For foreign currency swaps, an excluded component representing a cross-currency basis spread, is recognized into income through the foreign currency swap's periodic interest accruals;
 - (b) A foreign currency translation adjustment shall be reflected as an unrealized gain/loss (unassigned funds (surplus) adjustment) using the same procedures as done to translate the hedged item;
 - (c) The unrealized gain/loss for the period equals the foreign currency (notional) amount to be received (paid) times the net of the current spot rate minus the prior period end spot rate.
 - (d) The statement value of the derivative equals the amortized cost plus:
 - (1) For forward contracts, the amortized (premium) discount plus the cumulative unrealized gain/(loss) on the contract;
 - (2) For foreign currency swaps, the cumulative unrealized gain/(loss) on the contract. The cross-currency basis spread is recorded through the Investment Income Due and Accrued or Other Liabilities, as a component of the foreign currency swap's periodic interest accrual.

The cumulative unrealized gain/loss equals the foreign currency (notional) amount to be received (paid) times the net of the current spot rate minus the spot rate at the time the contract was opened.

- (e) Recognition of unrealized gains/losses and amortization of foreign exchange premium/discount on derivatives hedging forecasted transactions or firm commitments shall be deferred until the hedged

transaction occurs. These deferred gains/losses will adjust the basis or proceeds of the hedged transaction when it occurs;

- (f) For hedges where the cost of the foreign currency contract is combined with the hedged item, the statement value on Schedule DB is zero. The fair value of the derivative and hedged item shall be determined and reported separately, either individually or in the aggregate.
- (g) The derivative shall be recorded at fair value and a cumulative unrealized gain/loss (surplus adjustment) shall be recognized equal to the difference between the carrying value of the derivative on the balance sheet and the fair value of the derivative if either of the following occur:
 - (1) During the life of the currency contract, it or a designated portion of the currency contract is not effective as a hedge;
 - (2) The entity decides to terminate the derivative in advance of scheduled maturity.
- iv. Open derivatives hedging items recorded at fair value, where gains and losses on the hedged item are recognized currently in earnings: swaps, collars and forwards shall be valued at current fair value with changes in fair value recognized currently in earnings together with the gains and losses on the hedged item:
 - (a) If during the life of the derivative it or a designated portion of the derivative is no longer effective as a hedge, recognition of changes in fair value through earnings ceases. The derivative shall continue to be valued at its current fair value, but thereafter gains or losses shall be recognized in unrealized gains or unrealized losses to the extent it ceased to be an effective hedge.
- c. Cash Flows and Income:
 - i. Where the cost of the derivative is not combined with the hedged item:
 - (a) Amortization of premium paid or received on derivatives is an adjustment to net investment income or another appropriate caption within operating income consistent with the reporting of the hedged item;
 - (b) Periodic cash flows and accruals of income/expense are to be reported in a manner consistent with the hedged item, usually as net investment income or another appropriate caption within operating income.
 - ii. Where the cost of the derivative is combined with the hedged item, the cash flows and income of the derivative on Schedule DB is zero. All related amortization and cash flow accounting shall be reported with the hedged item instead of with the derivative.
- d. Gain/Loss on Termination of a swap, collar or forward accounted for under hedge accounting (includes closing, exercise, maturity, and expiry):
 - i. Exercise – The remaining book value of the derivative shall become an adjustment to the cost or proceeds of the hedged item(s) received or disposed of individually or in aggregate;

- ii. Sale, maturity, expiry, or other closing transaction of a derivative which is an effective hedge – Any gain or loss on the transaction, except for excluded components, will adjust the basis (or proceeds) of the hedged item(s) individually or in aggregate. If a portfolio layer method hedging relationship is discontinued (or partially discontinued) in a voluntary dedesignation or in anticipation of a breach, the basis adjustment associated with the dedesignated amount as of the discontinuation date shall be allocated to the remaining individual assets in the closed portfolio that supported the dedesignated hedged layer using a systematic and rational method. Alternatively, if the item being hedged is subject to IMR, the gain or loss on the terminated hedging derivative may be realized and shall be subject to IMR upon termination;
 - iii. Gain/loss on termination of derivatives will be recognized currently in net income (realized gain/loss) to the extent they ceased to be effective hedges;
 - iv. Upon the redesignation of a derivative from a currently effective hedging relationship:
 - (a) With an item(s) carried at amortized cost to another effective hedging relationship with an item(s) carried at amortized cost, the derivative shall continue to be recorded at amortized cost and no gain or loss on the derivative shall be recognized;
 - (b) With an item(s) carried at amortized cost or fair value to an effective relationship with an item(s) carried at fair value, the accounting for the derivative shall be consistent with (ii) above;
 - (c) With an item(s) carried at fair value to an effective relationship with an item(s) carried at amortized cost, the accounting for the derivative shall be consistent with (ii) above.
3. Futures (see also discussion in Introduction above):
- a. Accounting at Date of Acquisition:
 - i. Positions in futures contracts shall be initially valued at the amount of cash deposits (i.e., basis or book value of the contract), if any, placed with a broker and either be (a) recorded as an asset (paid) or liability (received) on the Derivative line on the Assets (or) Liabilities pages or (b) combined with the hedged item. Subsequent additions (reductions) in cash deposits plus changes in contract value from date of contract opening (i.e., variation margin) paid (received) will increase (decrease) the book value of the futures contract (hedge accounting).
 - b. Statement Value:
 - i. Hedges of Items Recorded at Amortized Cost:
 - (a) Futures shall be valued at book value;
 - (b) Book value of open futures contracts need not be amortized;
 - (c) For hedges where the variation margin portion of the cost of the futures contract is combined with the hedged item, the statement value of the futures contract would be equal to cash deposits outstanding, if any. The

fair value of the futures contract and the hedged item will be determined and reported separately, either individually or in the aggregate. Fair value on futures contracts is limited to the value of the cash deposits outstanding;

- (d) For hedges of forecasted transactions or firm commitments, the derivative shall be recorded at cost (with the variation margin deferred) until (1) the hedged transaction occurs or (2) it is determined that the hedge was not effective (see (e) in this section);
 - (e) If during the life of the futures contract it or a designated portion of the futures contract is no longer effective as a hedge, hedge accounting for the variation margin ceases. A gain/(loss) equal to the variation margin received (paid) shall be recognized in unrealized gains or unrealized losses (surplus adjustment) to the extent it or a designated portion of the variation margin ceased to be an effective hedge. Statement value will be limited to the cash deposits outstanding, if any, and subsequent changes in the variation margin will be recognized in unrealized gains or unrealized losses (surplus adjustment).
- ii. Hedges of Items Recorded at Fair Value (where gains and losses on the hedged item are recognized as adjustments to unassigned funds (surplus)):
- (a) Changes in futures contract value from date of contract opening (i.e., variation margin) shall be recognized currently consistent with the hedged item. Statement value will be limited to the cash deposits outstanding, if any;
 - (b) This will result in unrealized gain/loss treatment with adjustment to unassigned funds (surplus);
 - (c) For hedges where the variation margin of the futures contract is combined with the hedged item, the fair value of the futures contract and the hedged item will be determined and reported separately, either individually or in the aggregate.
- iii. Open foreign currency futures contracts hedging foreign currency exposure on item(s) denominated in a foreign currency and translated into U.S. dollars (where fair value accounting is not being used):
- (a) The foreign exchange premium (discount) on the currency contract will be amortized into net investment income over the life of the contract or hedge program. The foreign exchange premium (discount) is defined as the foreign currency (notional) amount to be received (paid) times the net of the forward rate minus the spot rate at the time the contract was opened.

Amortization is not required if the contract was entered into within a year of maturity;
 - (b) A foreign currency translation adjustment shall be reflected as an unrealized gain/loss (unassigned funds (surplus) adjustment) using the same procedures as is done to translate the hedged item. The cumulative unrealized gain/(loss) which equals the foreign currency (notional) amount to be received (paid) times the net of the current spot rate minus

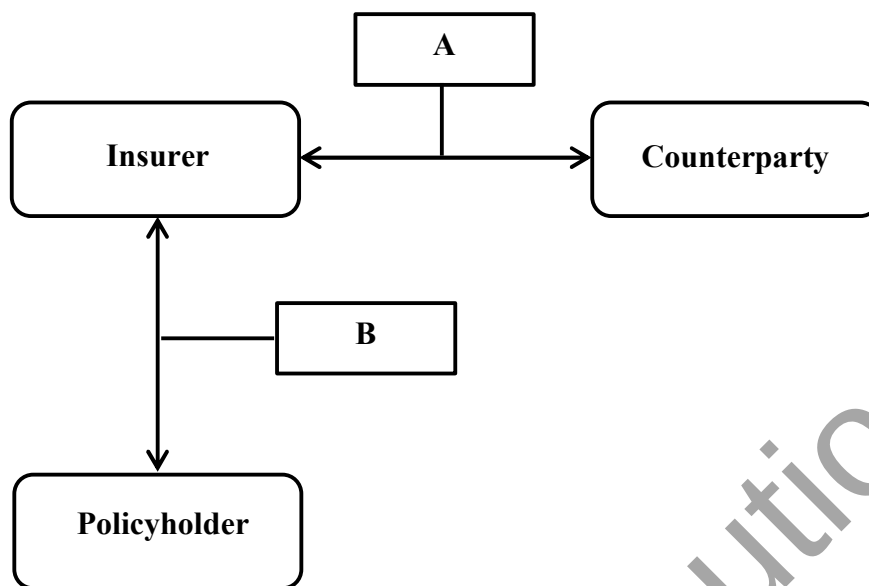
the spot rate at the time the contract was opened shall be reported as recognized variation margin;

- (c) The statement value of the currency futures contract is book value, including any cash deposits outstanding and increase (decrease) for amortization of foreign exchange (premium) discount plus the foreign exchange translation gain/(loss), which is reported as deferred variation margin;
 - (d) Recognition of unrealized gains/losses and amortization of foreign exchange premium/discount on derivatives hedging forecasted transactions or firm commitments shall be deferred until the hedged transaction occurs. These deferred gains/losses will adjust the basis or proceeds of the hedged transaction when it occurs;
 - (e) For hedges where the variation margin of the foreign currency contract is combined with the hedged item, the statement value of the foreign currency contract would equal the cash deposits outstanding, if any. The fair value of the derivative and the hedged item will be determined and reported separately, either individually or in the aggregate. Fair value on futures contracts is limited to the value of the cash deposits outstanding;
 - (f) If during the life of the currency contract it or a designated portion of the currency contract is not effective as a hedge, valuation at amortized cost ceases. To the extent it ceases to be an effective hedge, an unrealized gain/loss will be recognized equal to the notional amount or a designated portion of the notional amount times the difference between the forward rate available for the remaining maturity of the contract (i.e., the forward rate as of the balance sheet date) and the forward rate at the time it ceased to be an effective hedge.
- iv. Open futures hedging items recorded at fair value, where gains and losses on the hedging item are recognized currently in earnings shall be valued at current fair value with changes in fair value recognized currently in earnings:
- (a) If during the life of the futures contract it or a designated portion of the futures contract is no longer effective as a hedge, current recognition in earnings of changes in fair value ceases. Prospective changes in the variation margin shall be recognized in unrealized gains or unrealized losses (surplus adjustment) to the extent it or a designated portion of the variation margin ceased to be an effective hedge. Statement value of the derivative will thereafter be limited to the cash deposits outstanding, if any.
- c. Gain/Loss on Termination of a futures contract accounted for under hedge accounting:
- i. Settlement at maturity of a futures contract—The remaining variation margin of the futures contract shall become an adjustment to the cost or proceeds of the hedged item(s) received, disposed of or held, individually or in aggregate;
 - ii. Sale, or other closing transaction of a futures contract which is an effective hedge—Any gain or loss on the transaction will adjust the basis (or proceeds) of the hedged item(s) individually or in aggregate. Alternatively, if the item being

hedged is subject to IMR, the gain or loss on the terminated hedging derivative may be realized and shall be subject to IMR upon termination;

- iii Gain/loss on termination of futures contracts will be recognized currently in net income (realized gain/loss) to the extent they ceased to be effective hedges;
- iv. Upon the redesignation of a derivative from a currently effective hedging relationship:
 - (a) with an item(s) carried at amortized cost to another effective hedging relationship with an item(s) carried at amortized cost, the derivative shall continue to be recorded at amortized cost and no gain or loss on the derivative shall be recognized;
 - (b) with an item(s) carried at amortized cost or fair value to an effective relationship with an item(s) carried at fair value, the accounting for the derivative shall be consistent with (ii) above;
 - (c) with an item(s) carried at fair value to an effective relationship with an item(s) carried at amortized cost, the accounting for the derivative shall be consistent with (ii) above.

Not for Distribution

EXHIBIT C – WEATHER DERIVATIVE ILLUSTRATION

- A:** Security issued directly (or through a broker), in which settlement is based on a climatic or geological variable (i.e., earthquake). This security would meet the definition of a weather derivative (incorporated into SSAP No. 86) and shall be accounted for and reported consistent with other derivatives in SSAP No. 86.
- B:** A policy issued directly from the insurer to the policyholder in which coverage (and payment of claims) is based on a climatic or geological variable (i.e., earthquake coverage). This would be classified as insurance contract and be subject to the scope exclusion in ASC 815-45-15-2 that is also included in SSAP No. 86.

Statement of Statutory Accounting Principles No. 90

Impairment or Disposal of Real Estate Investments

STATUS

Type of Issue.....	Common Area
Issued	June 13, 2005
Effective Date	January 1, 2006
Affects.....	Supersedes paragraphs 11, 12 and 25 of SSAP No. 40R
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	2
Recognition and Measurement of an Impairment Loss	2
Long-Lived Assets Categories for Real Estate Investments.....	4
Long-Lived Assets to Be Disposed of Other Than By Sale.....	4
Long-Lived Assets to Be Abandoned	5
Long-Lived Assets to Be Exchanged or to Be Distributed to Owners in a Spinoff.....	5
Long-Lived Assets to Be Disposed Of By Sale.....	5
Reporting Long-Lived Assets and Disposal Groups to Be Disposed Of.....	7
Disclosures.....	7
Relevant Literature.....	8
Effective Date and Transition	10
REFERENCES.....	10
Other	10
Relevant Issue Papers	10

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for the impairment or disposal of real estate investments and the treatment of long-lived assets associated with discontinued operations including nonadmitted intangible assets other than goodwill, such as trade names (referred to collectively as long-lived assets). This statement is not intended to conflict with guidance concerning operating results associated with discontinued operations, which is contained in *SSAP No. 24—Discontinued Operations and Unusual or Infrequent Items*.
2. This statement supersedes *SSAP No. 40R—Real Estate Investments*, paragraphs 11, 12 and 25.
3. This statement does not apply to (a) goodwill, (b) servicing assets, (c) financial instruments, including investments in equity securities accounted for under the cost or equity method, (d) deferred policy acquisition costs, and (e) deferred tax assets. This statement also does not apply to long-lived assets for which the accounting is prescribed by *FASB Codification 985-20 – Costs of Software to be*

Sold, Leased or Marketed (ASC 985-20) as adopted with modification to preclude the capitalization of software development costs in *SSAP No. 16R—Electronic Data Processing Equipment and Software*. For a discussion on software development costs, see the guidance also in *SSAP No. 16R*. Statutory guidance on goodwill is in *SSAP No. 68—Business Combinations and Goodwill*.

SUMMARY CONCLUSION

Recognition and Measurement of an Impairment Loss

4. An impairment loss shall be recognized only if the carrying amount of a long-lived asset is not recoverable and exceeds its fair value. The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. That assessment shall be based on the carrying amount of the asset at the date it is tested for recoverability, whether in use or under development. An impairment loss shall be measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value as discussed in paragraph 16.

When to Test a Long-Lived Asset for Recoverability

5. A long-lived asset shall be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. The following are examples of such events or changes in circumstances:

- a. A significant decrease in the fair value of a long-lived asset
- b. A significant adverse change in the extent or manner in which a long-lived asset is being used or in its physical condition
- c. A significant adverse change in legal factors or in the business climate that could affect the value of a long-lived asset, including an adverse action or assessment by a regulator
- d. An accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of a long-lived asset
- e. A current-period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset
- f. A current expectation that, more likely than not, a long-lived asset will be sold or otherwise disposed of significantly before the end of its previously estimated useful life.

6. Real estate investment properties occupied by the company (per *SSAP No. 40R*) shall not be subject to recoverability testing under paragraphs 4 and 5 of this statement. However, if any of the following conditions are present, the reporting entity's property occupied by the company on a property by property basis shall be subject to immediate recoverability testing, by determining the fair value of the property using the criteria in *SSAP No. 40R*, paragraph 13:

- a. The financial condition of the reporting entity is in question as described in paragraph 7 of this statement.
- b. The property occupied by the company is held for sale as defined in paragraph 21 of this statement.
- c. A significant adverse change in the physical condition of the property occupied by the company has occurred.

- d. The management of the reporting entity has voluntarily determined a need for recoverability testing.

7. The following, while not meant to be an all-inclusive listing, are factors, which would indicate that the financial condition of the reporting entity is in question:

- a. Entity is subject to regulatory action such as administrative supervision, corrective order based on hazard to policyholders, or substantially similar proceeding, whether voluntary or involuntary;
- b. Entity is at any action or control level under Risk Based Capital;
- c. Grounds exist for conservation, receivership, rehabilitation or liquidation;
- d. Independent certified public accounting report issues a going concern opinion, adverse opinion or disclaimer of opinion.

8. When a long-lived asset is tested for recoverability, it also may be necessary to review depreciation estimates and methods as required by *SSAP No. 3—Accounting Changes and Corrections of Errors*. Any revision to the remaining useful life of a long-lived asset resulting from that review also shall be considered in developing estimates of future cash flows used to test the asset for recoverability. However, any change in the accounting method for the asset resulting from that review shall be made only after applying this statement.

New Cost Basis

9. If an impairment loss is recognized, the adjusted carrying amount of a long-lived asset shall be its new cost basis. For a depreciable long-lived asset, the new cost basis shall be depreciated (amortized) over the remaining useful life of that asset. Restoration of a previously recognized impairment loss is prohibited.

Estimates of Future Cash Flows Used to Test a Long-Lived Asset for Recoverability

10. Estimates of future cash flows used to test the recoverability of a long-lived asset shall include only the future cash flows (cash inflows less associated cash outflows) that are directly associated with, and that are expected to arise as a direct result of, the use and eventual disposition of the asset, however properties occupied by company are exempt from this requirement and should follow the guidance in paragraphs 6 and 7 of this statement. Those estimates shall exclude interest charges that will be recognized as an expense when incurred.

11. Estimates of future cash flows used to test the recoverability of a long-lived asset shall incorporate the entity's own assumptions about its use of the asset and shall consider all available evidence. The assumptions used in developing those estimates shall be reasonable in relation to the assumptions used in developing other information used by the entity for comparable periods, such as internal budgets and projections, accruals related to incentive compensation plans, or information communicated to others. However, if alternative courses of action to recover the carrying amount of a long-lived asset are under consideration or if a range is estimated for the amount of possible future cash flows associated with the likely course of action, reporting entities shall use their best estimate in testing the recoverability of a long-lived asset.

12. Estimates of future cash flows used to test the recoverability of a long-lived asset shall be made for the remaining useful life of the asset to the entity.

13. Estimates of future cash flows used to test the recoverability of a long-lived asset that is in use, including a long-lived asset for which development is substantially complete, shall be based on the existing service potential of the asset at the date it is tested. The service potential of a long-lived asset encompasses its remaining useful life, cash-flow-generating capacity, and for tangible assets, physical output capacity. Those estimates shall include cash flows associated with future expenditures necessary to maintain the existing service potential of a long-lived asset, including those that replace the service potential of component parts of a long-lived asset (for example, the roof of a building). Those estimates shall exclude cash flows associated with future capital expenditures that would increase the service potential of a long-lived asset.

14. Estimates of future cash flows used to test the recoverability of a long-lived asset that is under development shall be based on the expected service potential of the asset when development is substantially complete. Those estimates shall include cash flows associated with all future expenditures necessary to develop a long-lived asset, including interest payments that will be capitalized as part of the cost of the asset.

15. If a long-lived asset that is under development is in use, estimates of future cash flows used to test the recoverability of that asset shall include the cash flows associated with future expenditures necessary to maintain the existing service potential of the asset as well as the cash flows associated with all future expenditures necessary to substantially complete the asset that is under development.

Fair Value

16. A discussion of fair value is contained in *SSAP No. 100R—Fair Value*. This statement requires real estate investment properties occupied by the company (per SSAP No. 40R), that are determined to be subject to recoverability testing as discussed in paragraphs 6 and 7, to follow the guidance in SSAP No. 40R, paragraph 13.

Long-Lived Assets Categories for Real Estate Investments

17. SSAP No. 40R states that real estate investments shall be reported in the balance sheet categories of properties occupied by the company, properties held for the production of income, and properties held for sale. Accounting guidance in *FASB Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets* (FAS 144) distinguishes between long-lived assets to be held and used and long-lived assets to be disposed of. For statutory accounting purposes, long-lived assets to be held and used encompass real estate investments classified under SSAP No. 40R as properties occupied by the company and properties held for the production of income. Further, FAS 144 bifurcates the category of long-lived assets to be disposed of into long-lived assets to be disposed of other than by sale and long-lived assets to be disposed of by sale. Long-lived real estate investments to be disposed of other than by sale shall be classified either as properties occupied by the company or as properties held for the production of income. Long-lived real estate investments to be disposed of by sale shall be classified as properties held for sale.

Long-Lived Assets to Be Disposed of Other Than By Sale

18. A long-lived asset to be disposed of other than by sale (for example, by abandonment, in an exchange measured based on the recorded amount of the nonmonetary asset relinquished, or in a distribution to owners in a spinoff) shall continue to be classified as held and used until disposal. Paragraphs 4-17, and 31-34 shall apply while the asset is classified as held and used. If a long-lived asset is to be abandoned or distributed to owners in a spinoff together with other assets (and liabilities) as a group and that disposal group is a segment, paragraphs 31-34 shall apply to the disposal group at the date of disposal.

Long-Lived Assets to Be Abandoned

19. For purposes of this statement, a long-lived asset to be abandoned is disposed of when it ceases to be used. If an entity commits to a plan to abandon a long-lived asset before the end of its previously estimated useful life, depreciation estimates shall be revised in accordance with SSAP No. 3 to reflect the use of the asset over its shortened useful life. A long-lived asset that has been temporarily idled shall not be accounted for as if abandoned.

Long-Lived Assets to Be Exchanged or to Be Distributed to Owners in a Spinoff

20. For purposes of this statement, a long-lived asset to be disposed of in an exchange measured based on the recorded amount of the nonmonetary asset relinquished or to be distributed to owners in a spinoff is disposed of when it is exchanged or distributed. If the asset is tested for recoverability while it is classified as held and used, the estimates of future cash flows used in that test shall be based on the use of the asset for its remaining useful life, assuming that the disposal transaction will not occur. In addition to any impairment losses required to be recognized while the asset is classified as held and used, an impairment loss, if any, shall be recognized when the asset is disposed of if the carrying amount of the asset exceeds its fair value¹.

Long-Lived Assets to Be Disposed Of By Sale

Recognition

21. Real estate investment properties classified as held for sale or a long-lived asset to be sold shall be classified as held for sale in the period in which all of the following criteria are met:

- a. Management, having the authority to approve the action, commits to a plan to sell the asset.
- b. The asset is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets.
- c. An active program to locate a buyer and other actions required to complete the plan to sell the asset have been initiated.
- d. The sale of the asset is probable, and transfer of the asset is expected to qualify for recognition as a completed sale, within one year, except as permitted by paragraph 22.
- e. The asset is being actively marketed for sale at a price that is reasonable in relation to its current fair value.
- f. Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

If at any time the criteria in this paragraph are no longer met (except as permitted by paragraph 22), a long-lived asset classified as held for sale shall be reclassified as held and used in accordance with paragraphs 29 and 30.

22. Events or circumstances beyond an entity's control may extend the period required to complete the sale of a long-lived asset beyond one year. An exception to the one-year requirement in paragraph 21.d. shall apply in the following situations in which such events or circumstances arise:

¹ The provisions of this paragraph apply to nonmonetary exchanges that are not recorded at fair value under the provisions of SSAP No. 95—*Nonmonetary Transactions*.

- a. If at the date an entity commits to a plan to sell a long-lived asset the entity reasonably expects that others (not a buyer) will impose conditions on the transfer of the asset that will extend the period required to complete the sale and (1) actions necessary to respond to those conditions cannot be initiated until after a firm purchase commitment is obtained and (2) a firm purchase commitment is probable within one year.
 - b. If an entity obtains a firm purchase commitment and, as a result, a buyer or others unexpectedly impose conditions on the transfer of a long-lived asset previously classified as held for sale that will extend the period required to complete the sale and (1) actions necessary to respond to the conditions have been or will be initiated in a timely manner and (2) a favorable resolution of the delaying factors is expected.
 - c. If during the initial one-year period, circumstances arise that previously were considered unlikely and, as a result, a long-lived asset previously classified as held for sale is not sold by the end of that period and (1) during the initial one-year period the entity initiated actions necessary to respond to the change in circumstances, (2) the asset is being actively marketed at a price that is reasonable given the change in circumstances, and (3) the criteria in paragraph 21 are met.
23. A long-lived asset that is newly acquired and that will be sold rather than held and used shall be classified as held for sale at the acquisition date only if the one-year requirement in paragraph 21.d. is met (except as permitted by paragraph 22) and any other criteria in paragraph 21 that are not met at that date are probable of being met within a short period following the acquisition (usually within three months).
24. If the criteria in paragraph 21 are met after the balance sheet date but before issuance of the financial statements, a long-lived asset shall continue to be classified as held and used in those financial statements when issued. The information required by paragraph 36 shall be disclosed in the notes to the financial statements. If the asset is tested for recoverability (on a held-and-used basis) as of the balance sheet date, the estimates of future cash flows used in that test shall consider the likelihood of possible outcomes that existed at the balance sheet date, including the assessment of the likelihood of the future sale of the asset. That assessment made as of the balance sheet date shall not be revised for a decision to sell the asset after the balance sheet date. An impairment loss, if any, to be recognized shall be measured as the amount by which the carrying amount of the asset exceeds its fair value at the balance sheet date.

Measurement

25. Real estate investment properties classified as held for sale or a long-lived asset to be sold shall be measured at the lower of its carrying amount or fair value less encumbrances and estimated costs to sell the property. If the asset is newly acquired, the carrying amount of the asset shall be established based on its fair value less encumbrances and estimated costs to sell the property at the acquisition date. A long-lived asset shall not be depreciated (amortized) while it is classified as held for sale. Interest and other expenses attributable to the liabilities of a disposal classified as held for sale shall continue to be accrued.
26. Costs to sell are the incremental direct costs to transact a sale, that is, the costs that result directly from and are essential to a sale transaction and that would not have been incurred by the entity had the decision to sell not been made. Those costs include broker commissions, legal and title transfer fees, and closing costs that must be incurred before legal title can be transferred.
27. The carrying amounts of any assets that are not covered by this statement that are included in a disposal classified as held for sale shall be adjusted in accordance with other applicable statements of statutory accounting principles prior to measurement.
28. A realized loss shall be recognized in the summary of operations for any initial or subsequent write-down to fair value less cost to sell. A gain shall not be recognized for any subsequent increase in

fair value less cost to sell until the asset is sold. The loss shall adjust only the carrying amount of a long-lived asset, whether classified as held for sale individually or as part of a disposal group. A gain or loss not previously recognized that results from the sale of a long-lived asset shall be recognized at the date of sale.

Changes to a Plan of Sale

29. If circumstances arise that previously were considered unlikely and, as a result, an entity decides not to sell a long-lived asset previously classified as held for sale, the asset shall be reclassified as held and used. A long-lived asset that is reclassified shall be measured individually at the lower of its (a) carrying amount before the asset was classified as held for sale, adjusted for any depreciation (amortization) expense that would have been recognized had the asset been continuously classified as held and used, or (b) fair value at the date of the subsequent decision not to sell.

30. Any required adjustment to the carrying amount of a long-lived asset that is reclassified as held and used shall be included in income from continuing operations in the period of the subsequent decision not to sell. That adjustment shall be reported in the same income statement caption used to report a loss, if any, recognized in accordance with paragraph 31.

Reporting Long-Lived Assets and Disposal Groups to Be Disposed Of

Reporting Disposal Gains or Losses in Operations

31. Any disposal gain or loss recognized for long-lived assets shall be included as a net realized gain or loss in the summary of operations.

Reporting a Long-Lived Asset or Disposal Group Classified as Held for Sale

32. The results of operations of a segment that either has been disposed of or is classified as held for sale shall be reported consistently with the entity's reporting of continuing operations.

33. A long-lived asset classified as held for sale shall be presented separately in the balance sheet. The assets and liabilities of a disposal classified as held for sale shall be presented separately in the asset and liability sections, respectively, of the balance sheet. Those assets and liabilities shall not be offset and presented as a single amount. The major classes of assets and liabilities classified as held for sale, in the case of real estate shall be separately disclosed either on the face of the balance sheet or in the notes to financial statements (paragraph 36).

Reporting Impairment Losses

34. Any impairment loss recognized on long-lived assets shall be recorded in the summary of operations as a realized loss.

Disclosures

35. The following information shall be disclosed in the notes to the financial statements that include the period in which an impairment loss is recognized:

- a. A description of the impaired assets and the facts and circumstances leading to the impairment;
- b. The amount of the impairment loss and how fair value was determined; and
- c. The caption in the summary of operations which includes the impairment loss.

36. The following information shall be disclosed in the notes to the financial statements that cover the period in which a long-lived asset either has been sold or is classified as held for sale:

- a. A description of the facts and circumstances leading to the expected disposal, the expected manner and timing of that disposal.
- b. If applicable, the gain or loss recognized and if not separately presented on the face of the summary of operations, the caption in the summary of operations that includes that gain or loss.

37. If paragraph 29 applies, a description of the facts and circumstances leading to the decision to change the plan to sell the asset; and its effect on the results of operations for the period and any prior periods presented shall be disclosed in the notes to financial statements that include the period of that decision.

Relevant Literature

38. FAS 144 supersedes *FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* (FAS 121) and in part *Accounting Principles Board Opinion No. 30, Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. FAS 144 retains the requirements of FAS 121 to (a) recognize an impairment loss only if the carrying amount of a long-lived asset is not recoverable from its undiscounted cash flows and (b) measure an impairment loss as the difference between the carrying amount and fair value of the asset. FAS 144 requires that a long-lived asset to be abandoned, exchanged for a similar productive asset, or distributed to owners in a spinoff be considered held and used until it is disposed of. FAS 144 also sets forth that the accounting model for long-lived assets to be disposed of by sale is used for all long-lived assets, whether previously held and used or newly acquired. FAS 144 also resolves implementation issues that came about in the application of existing guidance. This statement adopts with modification *FAS 153, Exchanges of Nonmonetary Assets, An Amendment of APB Opinion No. 29* (FAS 153) for the accounting guidance of long-lived assets to be disposed of other than by sale addressed in paragraphs 18-20.

39. This statement adopts FAS 144 with modification to paragraphs 9, 17, 18, 19, 21, 25, 28, 35, 36, 37, 41, 42, 44, 45 and 47. Further, this statement rejects paragraphs 10-14, paragraphs 22-24, 26.d., and 43 of FAS 144. Refer to paragraph 40 of this statement for additional information with regard to these paragraphs.

40. The modifications to FAS 144 were made in order to maintain consistency with current statutory accounting principles and the Statement of Concepts:

- a. Paragraph 9 is amended to require that changes in depreciation estimates and methods and amortization periods found as a result of a test for recoverability should be accounted for in accordance with SSAP No. 3;
- b. Paragraphs 10-14, which address the grouping of assets, are rejected, as reporting entities should apply the guidance in this statement to each of its assets on an individual basis;
- c. Paragraphs 17, 18, 19 and 21 discuss estimates of future cash flows used to test the recoverability of a long-lived asset, and states that a probability-weighted approach may be useful in considering the likelihood of those possible outcomes. For statutory accounting purposes, reporting entities shall use their best estimate in testing the recoverability of a long-lived asset;

- d. Paragraphs 22-24, which discuss fair value, are rejected. The definition of fair value is in *SSAP No. 100R—Fair Value*.
- e. Paragraph 25 is amended to require that an impairment loss on properties occupied by the company and properties held for the production of income shall be recorded in the summary of operations as a realized loss;
- f. Paragraph 28 is amended to require that changes in depreciation estimates shall be accounted for in accordance with SSAP No. 3;
- g. If the sale is expected to occur beyond one year, paragraph 35 allows the cost to sell to be discounted. For statutory accounting purposes, the cost to sell shall not be discounted;
- h. Paragraph 35 allows for expected future losses associated with the operations of a long-lived asset (disposal group) while it is held for sale to be excluded from the costs to sell. For statutory accounting purposes, the cost to sell shall be calculated in accordance with SSAP No. 24, paragraphs 5 and 6.
- i. Paragraph 36 is amended to remove the reference to goodwill, as FAS 144 does not include goodwill within its scope unless such goodwill is included in an asset group that is or includes a reporting unit; paragraph 40.n. of this statement does not recognize a reporting unit. Paragraph 36 is further amended to require reporting entities to adjust all assets in accordance with other applicable statements of statutory accounting principles prior to measurement;
- j. Paragraph 37 is amended to clarify that losses recognized as a result of adjustments to fair value less cost to sell shall be recorded in the summary of operations as a realized gain/loss. Paragraph 37 is also modified to disallow the recognition of any gain for subsequent increases in fair value less cost to sell until the asset is sold. This is consistent with the concept of conservatism found in the Statement of Concepts;
- k. Paragraph 42 is amended to state that the results of operations of a discontinued operation shall be reported consistently with the entity's reporting of continuing operations. This is consistent with the guidance found in paragraph 7 of SSAP No. 24;
- l. Paragraph 44 is amended to state that adjustments to amounts previously reported related to continuing operations shall be reported consistently with the entity's reporting of continuing operations. This is consistent with the guidance found in paragraph 7 of SSAP No. 24. In addition, paragraphs 44.a. through 44.c. are adopted into paragraph 7 of SSAP No. 24;
- m. Paragraph 45 is amended to state that a gain or loss on an asset classified as held for sale that has been disposed of shall be included in the summary of operations as a realized gain or loss;
- n. The disclosures in paragraphs 47.a. and 47.b. are adopted with respect to properties held for sale, except for the disclosures related to major classes of assets, as grouping has been rejected in this statement. Paragraphs 47.c. and 47.d. are rejected as such paragraphs relate to discontinued operations and segment reporting. The disclosures included in paragraphs 11-15 of SSAP No. 24 are more appropriate given the differences between statutory and generally accepted accounting principles reporting of discontinued operations;

- o. Paragraph 26.d. requires the disclosure of the segment in which an impaired asset is reported. This paragraph is rejected, as statutory accounting requires accounting and reporting at the legal entity level. Further, any additional references to segments, reporting units, or disposal groups found in FAS 144 are also rejected, except with regard to a segment within the context of discontinued operations; and
- p. Paragraph 43 is rejected and the guidance related to the recognition of losses/income expected between the measurement date and the expected disposal date included in paragraphs 5 and 6 of SSAP No. 24 is retained, as such guidance is consistent with the concept of conservatism in the Statement of Concepts.

41. *FASB Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets* (FAS 144) supersedes FAS 121, but specifically scopes out the concept of goodwill. Paragraphs 12-14 of FAS 121 address the impairment of goodwill and paragraphs 12, 14.a. and 14.b. of FAS 121 were adopted in SSAP No. 68. However, paragraph 12 of FAS 121 was superseded by *FASB Statement No. 142, Goodwill and Other Intangible Assets* (FAS 142), which was rejected in SSAP No. 68. Given the applicability of the guidance found in paragraph 12 of FAS 121 to statutory accounting principles, the impairment guidance found in FAS 121, paragraph 12 is retained. Paragraph 12 of FAS 121 has been excerpted in *Issue Paper No. 68—Business Combinations and Goodwill*, paragraph 31. This statement rejects *ASU 2017-04, Simplifying the Test for Goodwill Impairment*, *ASU 2014-02, Accounting for Goodwill (a consensus of the private Company Council)*, *ASU 2012-02, Testing Indefinite-Lived Intangible Assets for Impairment*, *ASU 2011-08, Testing Goodwill for Impairment* and *ASU 2010-28, When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts*.

Effective Date and Transition

42. The provisions of this statement shall be applied to all assets on the books of the reporting entity within the scope of this statement for reporting periods beginning on and after January 1, 2006. The guidance within paragraphs 18-20 was originally amended with the adoption of SSAP No. 95, included in that statement, and effective for fiscal periods beginning after January 1, 2007. The original guidance included in this SSAP with tracked changes showing the amendments from SSAP No. 95 are retained for historical purposes within Issue Paper No. 127.

REFERENCES

Other

- *Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy*
- *SSAP No. 3—Accounting Changes and Corrections of Errors*
- *SSAP No. 24—Discontinued Operations and Unusual or Infrequent Items*
- *SSAP No. 40R—Real Estate Investments*

Relevant Issue Papers

- *Issue Paper No. 121—Accounting for the Impairment or Disposal of Real Estate Investments*
- *Issue Paper No. 127—Exchanges of Nonmonetary Assets, A Replacement of SSAP No. 28—Nonmonetary Transactions*

Statement of Statutory Accounting Principles No. 92

Postretirement Benefits Other Than Pensions

STATUS

Type of Issue.....	Common Area
Issued	Finalized March 3, 2012
Effective Date	January 1, 2013
Affects.....	Supersedes SSAP No. 14; Nullifies INT 99-26, INT 01-16 and INT 13-03
Affected by.....	No other pronouncements
Interpreted by	INT 04-17
Relevant Appendix A Guidance	None

STATUS.....	1

SCOPE OF STATEMENT.....	2

SUMMARY CONCLUSION	2

Single-Employer Defined Benefit Postretirement Plans.....	2
Elements of Accounting for Postretirement Benefits.....	3
Measurement of Cost and Obligations.....	4
Recognition of Liabilities and Assets	8
Recognition of Net Periodic Postretirement Benefit Cost	9
Measurement of Plan Assets	11
Annuity Contracts	12
Measurement Date	13
Disclosures - Single-Employer Defined Postretirement Plans.....	14
Employers with Two or More Plans	17
Disclosures – Employers with Two or More Defined Benefit Plans	17
Interim Financial Disclosures – Defined Benefit Plans	18
Multiemployer Plans.....	18
Disclosures - Multiemployer Plans	18
Multiple-Employer Plans.....	19
Postretirement Benefit Plans Outside the United States	19
Business Combinations	19
Accounting for Settlement of a Postretirement Benefit Obligation	20
Accounting for a Plan Curtailment	21
Measurement of the Effects of Termination Benefits.....	22
Defined Contribution Plans.....	22
Disclosures - Defined Contribution Plans.....	22
Consolidated/Holding Company Plans	22
Relevant Literature.....	23
Effective Date and Transition	25
REFERENCES.....	28
Other	28
Relevant Issue Papers	28

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles and related reporting for employers' postretirement plans other than pensions.

2. This statement applies to all postretirement benefits expected to be provided by an employer to current and former employees (including retirees, disabled employees, and other former employees who are expected to receive postretirement benefits), their beneficiaries, and covered dependents, pursuant to the terms of an employer's undertaking to provide those benefits. Other postretirement benefits include, but are not limited to, postretirement health care; life insurance provided outside a pension plan to retirees; and other welfare benefits such as tuition assistance, day care, legal services, and housing subsidies provided after retirement. Often those benefits are in the form of a reimbursement to plan participants or direct payment to providers for the cost of specified services as the need for those services arises, but they may also include benefits payable as a lump sum, such as death benefits. Much of the guidance in this statement focuses on postretirement health care plans. Nevertheless, this statement applies equally to all postretirement benefits other than pensions. A postretirement benefit plan may be part of a larger plan or arrangement that provides benefits currently to active employees as well as to retirees. In those circumstances, the promise to provide benefits to present and future retirees under the plan shall be segregated from the promise to provide benefits currently to active employees and shall be accounted for in accordance with the provisions of this statement. Absent evidence to the contrary, it shall be presumed that an employer that has provided postretirement benefits in the past or is currently promising those benefits to employees will continue to provide those future benefits. This statement supersedes the guidance in *SSAP No. 14—Postretirement Plans Other Than Pensions*, nullifies and incorporates the guidance in *INT 99-26: Offsetting Pension Assets and Liabilities* and nullifies *INT 01-16: Measurement Date for SSAP No. 8 Actuarial Valuations*.

SUMMARY CONCLUSION

Single-Employer Defined Benefit Postretirement Plans

3. A defined benefit postretirement plan is one that defines the postretirement benefits in terms of (a) monetary amounts or (b) benefit coverage to be provided. In some cases, an employer may limit its obligation through an individual or an aggregate "cap" on the employer's cost or benefit obligation. Plans of that nature are considered to be defined benefit postretirement plans. (Hybrid postretirement plans or "cash-balance" plans are considered defined benefit plans for purposes of applying this statement.) For defined benefit plans, reporting entities shall adopt *FAS 158: Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, an amendment of *FASB Statements No. 87, 88, 106 and 132 (R)* (FAS 158) and *FASB Staff Position FAS 136(R)-1, Employers' Disclosures about Postretirement Benefit Plan Assets* (FSP FAS 136(R)-1) with modifications as discussed in paragraph 102.

4. A postretirement benefit is part of the compensation paid to an employee for services rendered. In a defined benefit plan, the employer promises to provide, in addition to current wages and benefits, future benefits during retirement. Generally, the amount of those benefits depends on the benefit formula (which may include factors such as the number of years of service rendered or the employee's compensation before retirement or termination), the longevity of the retiree and any beneficiaries and covered dependents, and the incidence of events requiring benefit payments (for example, illnesses affecting the amount of health care required). In most cases, services are rendered over a number of years before an employee retires and begins to receive benefits or is entitled to receive benefits as a need arises. Even though the services rendered by the employee are complete and the employee has retired, the total amount of benefits the employer has promised and the cost to the employer of the services rendered are not precisely determinable but can be estimated using the plan's benefit formula and estimates of the effects of relevant future events.

Elements of Accounting for Postretirement Benefits

5. Any method of accounting that recognizes the cost of postretirement benefits over employee service periods (before the payment of benefits to retirees) must deal with two factors that stem from the nature of the arrangement. First, estimates or assumptions must be made about the future events that will determine the amount and timing of the benefit payments. Second, an attribution approach that assigns benefits and the cost of those benefits to individual years of service must be selected.

6. The expected postretirement benefit obligation for an employee is the actuarial present value as of a particular date of the postretirement benefits expected to be paid by the employer's plan to or for the employee, the employee's beneficiaries, and any covered dependents pursuant to the terms of the plan. Measurement of the expected postretirement benefit obligation is based on the expected amount and timing of future benefits, taking into consideration the expected future cost of providing the benefits and the extent to which those costs are shared by the employer, the employee (including consideration of contributions required during the employee's active service period and following retirement, deductibles, coinsurance provisions, and so forth), or others (such as through governmental programs).

7. The accumulated postretirement benefit obligation as of a particular date is the actuarial present value of all future benefits attributed to an employee's service rendered to that date pursuant to paragraphs 30-31 and 42-45, assuming the plan continues in effect and that all assumptions about future events are fulfilled. Prior to the date on which an employee attains full eligibility for the benefits that employee is expected to earn under the terms of the postretirement benefit plan (the full eligibility date), the accumulated postretirement benefit obligation for an employee is a portion of the expected postretirement benefit obligation. On and after the full eligibility date, the accumulated postretirement benefit obligation and the expected postretirement benefit obligation for an employee are the same. Determination of the full eligibility date is affected by plan terms that provide incremental benefits expected to be received by or on behalf of an employee for additional years of service, unless those incremental benefits are trivial. Determination of the full eligibility date is not affected by plan terms that define when benefit payments commence or by an employee's current dependency status.

8. Net periodic postretirement benefit cost comprises several components that reflect different aspects of the employer's financial arrangements. The service cost component of net periodic postretirement benefit cost is the actuarial present value of benefits attributed to services rendered by employees during the period (the portion of the expected postretirement benefit obligation attributed to service in the period). The service cost component is the same for an unfunded plan, a plan with minimal funding, and a well-funded plan. The other components of net periodic postretirement benefit cost are interest cost (interest on the accumulated postretirement benefit obligation, which is a discounted amount), actual return on plan assets¹, amortization of any prior service cost or credit included in unassigned funds (surplus), amortization of the transition obligation or transition asset, and the gain or loss component which includes, to the extent recognized, amortization of the net gain or loss included in unassigned funds (surplus) (refer to paragraph 49).

¹ To address a question on how the expected return on plan assets affects the determination of net periodic benefit cost if the actual return on plan assets for a period is a component of net periodic benefit cost, it is noted that the expected return on plan assets generally will be different from the actual return on plan assets for the year. This statement provides for recognition of that difference (a net gain or loss) in unassigned funds in the period it arises. The amount recognized in unassigned funds is also a component of net periodic benefit cost for the current period. Thus, the amount recognized in unassigned funds and the actual return on plan assets, when aggregated, equal the expected return on plan assets. The amount recognized in unassigned funds affects future net periodic benefit cost through subsequent amortization, if any, of the net gain or loss. (This footnote reflects guidance included in E12 of FSP FAS 158-1.)

Measurement of Cost and Obligations²

Accounting for the Substantive Plan

9. An objective of this statement is that the accounting reflects the terms of the exchange transaction that takes place between an employer that provides postretirement benefits and the employees who render services in exchange for those benefits, as those terms are understood by both parties to the transaction. Generally, the extant written plan provides the best evidence of the terms of that exchange transaction. However, in some situations, an employer's cost-sharing policy, as evidenced by past practice or by communication of intended changes to a plan's cost-sharing provisions, or a past practice of regular increases in certain monetary benefits may indicate that the substantive plan—the plan as understood by the parties to the exchange transaction—differs from the extant written plan. The substantive plan shall be the basis for the accounting.

10. Except as provided in paragraph 11, an employer's cost-sharing policy, as evidenced by the following past practice or communication, shall constitute the cost-sharing provisions of the substantive plan if either of the following conditions exist. Otherwise, the extant written plan shall be considered to be the substantive plan.

- a. The employer has a past practice of (1) maintaining a consistent level of cost sharing between the employer and its retirees through changes in deductibles, coinsurance provisions, retiree contributions, or some combination of those changes or (2) consistently increasing or reducing the employer's share of the cost of the covered benefits through changes in retired or active plan participants' contributions toward their retiree health care benefits, deductibles, coinsurance provisions, out-of-pocket limitations, and so forth, in accordance with the employer's established cost-sharing policy.
- b. The employer has the ability, and has communicated to affected plan participants its intent, to institute different cost-sharing provisions at a specified time or when certain conditions exist (for example, when health care cost increases exceed a certain level).

11. An employer's past practice of maintaining a consistent level of cost sharing with its retirees or consistently increasing or reducing its share of the cost of providing the covered benefits shall not constitute provisions of the substantive plan if accompanied by identifiable offsetting changes in other benefits or compensation or if the employer incurred significant costs, such as work stoppages, to effect that cost-sharing policy. Similarly, an employer's communication of its intent to institute cost-sharing provisions that differ from the extant written plan or the past cost-sharing practice shall not constitute provisions of the substantive plan (a) if the plan participants would be unwilling to accept the change without adverse consequences to the employer's operations or (b) if other modifications of the plan, such as the level of benefit coverage, or providing offsetting changes in other benefits, such as pension benefits, would be required to gain plan participants' acceptance of the change to the cost-sharing arrangement.

12. A past practice of regular increases in postretirement benefits defined in terms of monetary amounts may indicate that the employer has a present commitment to make future improvements to the

² In addition to a properly weighted average rate, an entity may elect to measure the service cost and interest cost components of net periodic benefit cost by using individual spot rates derived from an acceptable high-quality corporate bond yield curve and matched with separate cash flows for each future year (also known as the spot rate approach). If the election is made to switch from a weighted-average approach to the spot rate approach, this approach shall be consistently applied to all defined benefit plans and to the measurement of both service and interest cost. This change shall be reflected as a change in estimate as prescribed in *SSAP No. 3—Accounting Changes and Corrections of Errors* and once changed; the company should not revert back to the weighted-average discount rate in future periods. This change in estimate shall be appropriately disclosed in accordance with this statement, SSAP No. 3 and the Preamble.

plan and that the plan will provide monetary benefits attributable to prior service that are greater than the monetary benefits defined by the extant written plan. In those situations, the substantive commitment to increase those benefits shall be the basis for the accounting. Changes in the benefits, other than benefits defined in terms of monetary amounts, covered by a postretirement health care plan or by other postretirement benefit plans shall not be anticipated.

13. Contributions expected to be received from active employees toward the cost of their postretirement benefits and from retired plan participants are treated similarly for purposes of measuring an employer's expected postretirement benefit obligation. That obligation is measured as the actuarial present value of the benefits expected to be provided under the plan, reduced by the actuarial present value of contributions expected to be received from the plan participants during their remaining active service and postretirement periods. In determining the amount of the contributions expected to be received from those participants toward the cost of their postretirement benefits, consideration is given to any related substantive plan provisions, such as an employer's past practice of consistently increasing or reducing the contribution rates as described in paragraphs 10-11. An obligation to return contributions received from employees who do not attain eligibility for postretirement benefits and, if applicable, any interest accrued on those contributions shall be recognized as a component of an employer's postretirement benefit obligation.

14. Automatic benefit changes specified by the plan that are expected to occur shall be included in measurements of the expected and accumulated postretirement benefit obligations and the service cost component of net periodic postretirement benefit cost. Also, plan amendments shall be included in the computation of the expected and accumulated postretirement benefit obligations once they have been contractually agreed to, even if some provisions take effect only in future periods. For example, if a plan amendment grants a different benefit level for employees retiring after a future date, that increased or reduced benefit level shall be included in current-period measurements for employees expected to retire after that date.

15. Measuring the net periodic postretirement benefit cost and accumulated postretirement benefit obligation based on best estimates is superior to implying, by a failure to accrue, that no cost or obligation exists prior to the payment of benefits. This statement requires the use of explicit assumptions, each of which individually represents the best estimate of a particular future event, to measure the expected postretirement benefit obligation. A portion of that expected postretirement benefit obligation is attributed to each period of an employee's service associated with earning the postretirement benefits, and that amount is accrued as service cost for that period.

16. The service cost component of postretirement benefit cost, any prior service cost, and the accumulated postretirement benefit obligation are measured using actuarial assumptions and present value techniques to calculate the actuarial present value of the expected future benefits attributed to periods of employee service. Each assumption used shall reflect the best estimate solely with respect to that individual assumption. All assumptions shall presume that the plan will continue in effect in the absence of evidence that it will not continue. Principal actuarial assumptions include the time value of money (discount rates); participation rates (for contributory plans); retirement age; factors affecting the amount and timing of future benefit payments, which for postretirement health care benefits consider past and present per capita claims cost by age, health care cost trend rates, Medicare reimbursement rates, and so forth; salary progression (for pay-related plans); and the probability of payment (turnover, dependency status, mortality, and so forth).

17. Assumed discount rates shall reflect the time value of money as of the measurement date in determining the present value of future cash outflows currently expected to be required to satisfy the postretirement benefit obligation. In making that assumption, employers shall look to rates of return on high-quality fixed-income investments currently available whose cash flows match the timing and amount of expected benefit payments. If settlement of the obligation with third-party insurers is possible (for example, the purchase of nonparticipating life insurance contracts to provide death benefits), the interest

rates inherent in the amount at which the postretirement benefit obligation could be settled are relevant in determining the assumed discount rates. Assumed discount rates are used in measurements of the expected and accumulated postretirement benefit obligations and the service cost and interest cost components of net periodic postretirement benefit cost.

18. Pursuant to paragraph 17, an employer shall look to rates of return on high-quality fixed-income investments in determining assumed discount rates. The objective of selecting assumed discount rates using that method is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash flows to pay the postretirement benefits when due. Notionally, that single amount, the accumulated postretirement benefit obligation, would equal the current fair value of a portfolio of high-quality zero coupon bonds whose maturity dates and amounts would be the same as the timing and amount of the expected future benefit payments. Because cash inflows would equal cash outflows in timing and amount, there would be no reinvestment risk in the yields to maturity of the portfolio. However, in other than a zero coupon portfolio, such as a portfolio of long-term debt instruments that pay semiannual interest payments or whose maturities do not extend far enough into the future to meet expected benefit payments, the assumed discount rates (the yield to maturity) need to incorporate expected reinvestment rates available in the future. Those rates shall be extrapolated from the existing yield curve at the measurement date. The determination of the assumed discount rate is separate from the determination of the expected rate of return on plan assets whenever the actual portfolio differs from the hypothetical portfolio described above. Assumed discount rates shall be reevaluated at each measurement date. If the general level of interest rates rises or declines, the assumed discount rates shall change in a similar manner.

19. The expected long-term rate of return on plan assets shall reflect the average rate of earnings expected on the existing assets that qualify as plan assets and contributions to the plan expected to be made during the period. In estimating that rate, appropriate consideration should be given to the returns being earned on the plan assets currently invested and the rates of return expected to be available for reinvestment. If the return on plan assets is taxable to the trust or other fund under the plan, the expected long-term rate of return shall be reduced to reflect the related income taxes expected to be paid under existing law. There is no assumption of an expected long-term rate of return on plan assets for plans that are unfunded or that have no assets that qualify as plan assets pursuant to this statement.

20. The service cost component of net periodic postretirement benefit cost and the expected and accumulated postretirement benefit obligations shall reflect future compensation levels to the extent the postretirement benefit formula defines the benefits wholly or partially as a function of future compensation levels. For pay-related plans, assumed compensation levels shall reflect the best estimate of the actual future compensation levels of the individual employees involved, including future changes attributed to general price levels, productivity, seniority, promotion, and other factors. All assumptions shall be consistent to the extent that each reflects expectations about the same future economic conditions, such as future rates of inflation. Measuring service cost and the expected and accumulated postretirement benefit obligations based on estimated future compensation levels entails considering any indirect effects, such as benefit limitations, that would affect benefits provided by the plan.

Assumptions Unique to the Postretirement Health Care Benefits

21. Measurement of an employer's postretirement health care obligation requires the use of several assumptions unique to health care benefits. Most significantly, it includes several assumptions about factors that will affect the amount and timing of future benefit payments for postretirement health care. Those factors include consideration of historical per capita claims cost by age, health care cost trend rates (for plans that provide a benefit in kind), and medical coverage to be paid by governmental authorities and other providers of health care benefits.

22. In principle, an employer's share of the expected future postretirement health care cost for a plan participant is developed by reducing the assumed per capita claims cost at each age at which the plan

participant is expected to receive benefits under the plan by (a) the effects of coverage by Medicare^(INT 04-17) and other providers of health care benefits, and (b) the effects of the cost-sharing provisions of the plan (deductibles, copayment provisions, out-of-pocket limitations, caps on the limits of the employer-provided payments, and retiree contributions). The resulting amount represents the assumed net incurred claims cost at each age at which the plan participant is expected to receive benefits under the plan. If contributions are required to be paid by active plan participants toward their postretirement health care benefits, the actuarial present value of the plan participants' future contributions reduces the actuarial present value of the aggregate assumed net incurred claims costs.

23. The assumed per capita claims cost by age is the annual per capita cost, for periods after the measurement date, of providing the postretirement health care benefits covered by the plan from the earliest age at which an individual could begin to receive benefits under the plan through the remainder of the individual's life or the covered period, if shorter. The assumed per capita claims cost shall be the best estimate of the expected future cost of the benefits covered by the plan. It may be appropriate to consider other factors in addition to age, such as sex and geographical location, in developing the assumed per capita claims cost.

24. Past and present claims data for the plan, such as a historical pattern of gross claims by age (claims curve), should be used in developing the current per capita claims cost to the extent that those data are considered to be indicative of the current cost of providing the benefits covered by the plan. Those current claims data shall be adjusted by the assumed health care cost trend rate. The resulting assumed per capita claims cost by age, together with the plan demographics, determines the amount and timing of expected future gross eligible charges.

25. In the absence of sufficiently reliable plan data about the current cost of the benefits covered by the plan, the current per capita claims cost should be based, entirely or in part, on the claims information of other employers to the extent those costs are indicative of the current cost of providing the benefits covered by the plan. For example, the current per capita claims cost may be based on the claims experience of other employers derived from information in data files developed by insurance companies, actuarial firms, or employee benefits consulting firms. The current per capita claims cost developed on those bases shall be adjusted to best reflect the terms of the employer's plan and the plan demographics. For example, the information should be adjusted, as necessary, for differing demographics, such as the age and sex of plan participants, health care utilization patterns by men and women at various ages, and the expected geographical location of retirees and their dependents, and for significant differences between the nature and types of benefits covered by the employer's plan and those encompassed by the underlying data.

26. The assumption about health care cost trend rates represents the expected annual rates of change in the cost of health care benefits currently provided by the postretirement benefit plan, due to factors other than changes in the demographics of the plan participants, for each year from the measurement date until the end of the period in which benefits are expected to be paid. Past and current health care cost trends shall be used in developing an employer's assumed health care cost trend rates, which implicitly consider estimates of health care inflation, changes in health care utilization or delivery patterns, technological advances, and changes in the health status of plan participants. Differing services, such as hospital care and dental care, may require the use of different health care cost trend rates. It is appropriate for that assumption to reflect changes in health care cost trend rates over time. For example, the health care cost trend rates may be assumed to continue at the present level for the near term, or increase for a period of time, and then grade down over time to an estimated health care cost trend rate ultimately expected to prevail.

27. Certain medical claims may be covered by governmental programs under existing law or by other providers of health care benefits. Benefit coverage by those governmental programs shall be assumed to continue as provided by the present law and by other providers pursuant to their present plans. Presently enacted changes in the law or amendments of the plans of other health care providers that take effect in

future periods and that will affect the future level of their benefit coverage shall be considered in current-period measurements for benefits expected to be provided in those future periods. Future changes in laws concerning medical costs covered by governmental programs and future changes in the plans of other providers shall not be anticipated.

28. In some cases, determining the assumed per capita claims cost by age as described in paragraphs 23-25 may not be practical because credible historical information about the gross per capita cost of covered benefits may not be available or determinable to satisfy the stated measurement approach. However, credible historical information about incurred claims costs may be available. In those cases, an alternative method of developing the assumed per capita claims cost may be used provided the method results in a measure that is the best estimate of the expected future cost of the benefits covered by the plan. For example, the assumed health care cost trend rates may be determined by adjusting the expected change in the employer's share of per capita incurred claims cost by age by a factor that reflects the effects of the plan's cost-sharing provisions. However, an approach that projects net incurred claims costs using unadjusted assumed health care cost trend rates would implicitly assume changes in the plan's cost-sharing provisions at those assumed rates and, therefore, is not acceptable unless the plan's cost-sharing provisions are indexed in that manner or the substantive plan operates in that manner.

29. Assumed discount rates include an inflationary element that reflects the expected general rate of inflation. Assumed compensation levels include consideration of future changes attributable to general price levels. Similarly, assumed health care cost trend rates include an element that reflects expected general rates of inflation for the economy overall and an element that reflects price changes of health care costs in particular. To the extent that those assumptions consider similar inflationary effects, the assumptions about those effects shall be consistent.

Attribution

30. An equal amount of the expected postretirement benefit obligation for an employee generally shall be attributed to each year of service in the attribution period (a benefit/years-of-service approach). However, some plans may have benefit formulas that attribute a disproportionate share of the expected postretirement benefit obligation to employees' early years of service. For that type of plan, the expected postretirement benefit obligation shall be attributed in accordance with the plan's benefit formula.

31. The beginning of the attribution period generally shall be the date of hire. However, if the plan's benefit formula grants credit only for service from a later date and that credited service period is not nominal in relation to employees' total years of service prior to their full eligibility dates, the expected postretirement benefit obligation shall be attributed from the beginning of that credited service period. In all cases, the end of the attribution period shall be the full eligibility date.

Recognition of Liabilities and Assets

32. An employer that sponsors one or more single-employer defined benefit postretirement plans other than pensions shall recognize in its statement of financial position the funded statuses of those plans. The status for each plan shall be measured as the difference between the fair value of plan assets and the accumulated postretirement benefit obligation (considering both vested and nonvested employees) as it is defined in this statement.

33. The employer shall aggregate the statuses of all overfunded plans and recognize that amount as a nonadmitted asset in its statement of financial position. It also shall aggregate the statuses of all underfunded plans and recognize that amount as a liability in its statement of financial position. It is not acceptable statutory accounting practice to offset pension or postretirement benefits other than pensions liability generated by one plan against the prepaid assets of another plan.

Recognition of Net Periodic Postretirement Benefit Cost

34. As with other forms of deferred compensation, the cost of providing postretirement benefits shall be attributed to the periods of employee service rendered in exchange for those future benefits pursuant to the terms of the plan. That cost notionally represents the change in the unfunded accumulated postretirement benefit obligation for the period, ignoring employer contributions to the plan, plan settlements, and payments made by the employer directly to retirees. However, changes in that unfunded obligation that arise from experience gains and losses and the effects of changes in assumptions may be recognized as a component of net periodic postretirement benefit cost on a delayed basis. In addition, the effects of a plan initiation or amendment generally are recognized on a delayed basis.

35. The following components shall be included in the net postretirement benefit cost recognized for a period by an employer sponsoring a defined benefit postretirement plan: a) Service cost; b) Interest cost; c) Actual return on plan assets, if any; d) Amortization of any prior service cost or credit included in unassigned funds (surplus) to the extent required by paragraphs 40-45; e) Gain or loss (including the effects of changes in assumptions) to the extent recognized; and f) Amortization of any obligation or asset existing at the date of initial application of this statement, hereinafter referred to as the transition obligation or transition asset remaining in unassigned funds (surplus).

Service Cost

36. The service cost component recognized in a period shall be determined as the portion of the expected postretirement benefit obligation attributed to employee service during that period. The measurement of the service cost component requires identification of the substantive plan and the use of assumptions and an attribution method, which are discussed in paragraphs 9-31.

37. The prior service cost for nonvested employees not previously recognized³ is not required to be included in net postretirement benefit cost entirely in the year this standard is adopted. Unrecognized prior service cost for nonvested employees shall be amortized as a component of the net postretirement benefit cost by assigning an equal amount to each expected future period of service before vesting occurs for nonvested employees active at the date of the amendment. Unassigned funds (surplus) is adjusted each period as prior service cost is amortized (refer to paragraphs 105-108 for transition guidance related to the recognition of the prior service cost for nonvested employees through unassigned surplus).

Interest Cost

38. The interest cost component recognized in a period shall be determined as the increase in the accumulated postretirement benefit obligation to recognize the effects of the passage of time. Measuring the accumulated postretirement benefit obligation as a present value requires accrual of an interest cost at rates equal to the assumed discount rates.

Actual Return on Plan Assets

39. For a funded plan, the actual return on plan assets shall be determined based on the fair value of plan assets at the beginning and end of the period, adjusted for contributions and benefit payments. If the fund holding the plan assets is a taxable entity, the actual return on plan assets shall reflect the tax expense or benefit for the period determined in accordance with generally accepted accounting principles. Otherwise, no provision for taxes shall be included in the actual return on plan assets.

³ The previous statutory accounting guidance in *SSAP No. 14—Postretirement Benefits Other Than Pensions* excluded nonvested employees from the service cost calculation. This exclusion has been eliminated with the issuance of this SSAP.

Prior Service Cost

40. Plan amendments (including initiation of a plan) may include provisions that attribute the increase or reduction in benefits to employee service rendered in prior periods or only to employee service to be rendered in future periods. For purposes of measuring the accumulated postretirement benefit obligation, the effect of a plan amendment on a plan participant's expected postretirement benefit obligation shall be attributed to each year of service in that plan participant's attribution period, including years of service already rendered by that plan participant, in accordance with the attribution of the expected postretirement benefit obligation to years of service as discussed in paragraphs 30-31. If a plan is initiated that grants benefits solely in exchange for employee service after the date of the plan initiation or a future date, no portion of the expected postretirement benefit obligation is attributed to prior service periods because, in that case, the credited service period for the current employees who are expected to receive benefits under the plan begins at the date of the plan initiation or the future date.

41. Plan amendments that improve benefits are granted with the expectation that the employer will realize economic benefits in future periods. Consequently, except as discussed in paragraph 44, this statement does not permit the cost of benefit improvements (that is, prior service cost) to be included in net periodic postretirement benefit cost entirely in the year of the amendment. Rather, paragraph 42 provides for recognition of prior service cost arising from benefit improvements during the remaining years of service to the full eligibility dates of those plan participants active at the date of the plan amendment.

42. A plan amendment that retroactively increases benefits (including benefits that are granted to fully eligible plan participants) increases the accumulated postretirement benefit obligation. The cost of the benefit improvement shall be recognized as a charge to unassigned funds (surplus) at the date of the amendment. Except as specified in the next sentence and in paragraphs 43-44, that prior service cost shall be amortized as a component of net periodic postretirement benefit cost by assigning an equal amount to each remaining year of service to the full eligibility date of each plan participant active at the date of the amendment who was not yet fully eligible for benefits at that date. If all or almost all of a plan's participants are fully eligible for benefits, the prior service cost shall be amortized based on the remaining life expectancy of those plan participants rather than on the remaining years of service to the full eligibility dates of the active plan participants. Unassigned funds (surplus) is adjusted as a result of amortizing prior service cost.

43. To reduce the complexity and detail of the computations required, consistent use of an alternative approach that more rapidly amortizes the prior service cost recognized in unassigned funds (surplus) is permitted. For example, a straight-line amortization of the cost over the average remaining years of service to full eligibility for benefits of the active plan participants is acceptable.

44. In some situations, a history of regular plan amendments and other evidence may indicate that the period during which the employer expects to realize economic benefits from an amendment that grants increased benefits is shorter than the remaining years of service to full eligibility for benefits of the active plan participants. Identification of those situations requires an assessment of the individual circumstances of the particular plan. In those circumstances, the amortization of prior service cost shall be accelerated to reflect the more rapid expiration of the employer's economic benefits and to recognize the cost in the periods benefited.

45. A plan amendment that retroactively reduces, rather than increases, benefits decreases the accumulated postretirement benefit obligation. The reduction in benefits shall be recognized as a corresponding credit (prior service credit) to unassigned funds (surplus) that shall be used first to reduce any remaining prior service cost included in unassigned funds (surplus), then to reduce any transition obligation remaining in unassigned funds (surplus). The excess, if any, shall be amortized as a component of net periodic postretirement benefit cost on the same basis as specified in paragraph 42 for prior service cost. Immediate recognition of the excess is not permitted.

Gains and Losses

46. Gains and losses are changes in the amount of either the accumulated postretirement benefit obligation or plan assets resulting from experience different from that assumed or from changes in assumptions. This statement generally does not distinguish between those sources of gains and losses. Gains and losses include amounts that have been realized as well as amounts that are unrealized. Because gains and losses may reflect refinements in estimates as well as real changes in economic values and because some gains in one period may be offset by losses in another or vice versa, this statement does not require recognition of gains and losses as components of net postretirement benefit cost in the period in which they arise, except as described in paragraph 51. Gains and losses that are not recognized immediately as a component of net periodic postretirement benefit cost shall be recognized as increases or decreases in unassigned funds (surplus) as they arise.

47. The expected return on plan assets shall be determined based on the expected long-term rate of return on plan assets and the fair value of plan assets.

48. Plan asset gains and losses are differences between the actual return on plan assets during a period and the expected return on plan assets for that period. Plan asset gains and losses include changes reflected in the fair value of plan assets.

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.

50. Any systematic method of amortizing gains and losses included in unassigned funds (surplus) may be used in place of the minimum amortization specified in paragraph 49 provided that (a) the minimum amortization is recognized in any period in which it is greater (reduces the net gain or loss balance by more) than the amount that would be recognized under the method used, (b) the method is applied consistently, (c) the method is applied similarly to both gains and losses, and (d) the method used is disclosed. If an enterprise uses a method of consistently recognizing gains and losses immediately, any gain that does not offset a loss previously recognized in income pursuant to this paragraph shall first offset any transition obligation remaining in unassigned funds (surplus); any loss that does not offset a gain previously recognized in income pursuant to this paragraph shall first offset any transition asset remaining in unassigned funds (surplus).

51. In some situations, an employer may forgive a retrospective adjustment of the current or past years' cost-sharing provisions of the plan as they relate to benefit costs already incurred by retirees or may otherwise deviate from the provisions of the substantive plan to increase or decrease the employer's share of the benefit costs incurred in the current or past periods. The effect of a decision to temporarily deviate from the substantive plan shall be immediately recognized as a loss or gain.

52. The gain or loss component of net periodic postretirement benefit cost shall consist of (a) the difference between the actual return on plan assets and the expected return on plan assets, (b) any gain or loss immediately recognized or the amortization of the net gain or loss included in unassigned funds (surplus), and (c) any amount immediately recognized as a gain or loss pursuant to paragraph 51.

Measurement of Plan Assets

53. Plan assets are assets—usually stocks, bonds, and other investments (except certain insurance ~~contracts~~ annuities as noted in paragraph 57)—that have been segregated and restricted (usually in a trust)

to be used for postretirement benefits. The amount of plan assets includes amounts contributed by the employer, and by plan participants for a contributory plan, and amounts earned from investing the contributions, less benefits, income taxes, and other expenses incurred. Plan assets ordinarily cannot be withdrawn by the employer except under certain circumstances when a plan has assets in excess of obligations and the employer has taken certain steps to satisfy existing obligations. Securities of the employer held by the plan are includable in plan assets provided they are transferable.

54. Assets not segregated in a trust, or otherwise effectively restricted, so that they cannot be used by the employer for other purposes are not plan assets for purposes of this statement, even though the employer may intend that those assets be used to provide postretirement benefits. Those assets shall be accounted for in the same manner as other employer assets of a similar nature and with similar restrictions. Amounts accrued by the employer but not yet paid to the plan are not plan assets for purposes of this statement.

55. Plan investments, whether equity or debt securities, real estate, or other, shall be measured at their fair value as of the measurement date.

56. Plan assets used in plan operations (for example, buildings, equipment, furniture and fixtures, and leasehold improvements) shall be measured at cost less accumulated depreciation or amortization for all purposes.

Insurance Annuity Contracts

57. For purposes of this statement, an **insurance annuity** contract is defined as a contract in which an insurance company unconditionally undertakes a legal obligation to provide specified benefits to specific individuals in return for a fixed consideration or premium; an **insurance annuity** contract is irrevocable and involves the transfer of significant risk from the employer (or the plan) to the insurance company. Benefits covered by **insurance annuity** contracts shall be excluded from the accumulated postretirement benefit obligation. **Insurance Annuity** contracts shall be excluded from plan assets.

58. Some **insurance annuity** contracts include participation rights (participating **insurance annuity** contracts), which provide that the purchaser (either the plan or the employer) may participate in the experience of the insurance company. Under those contracts, the insurance company ordinarily pays dividends to the purchaser, the effect of which is to reduce the cost of the plan. If the participating **insurance annuity** contract causes the employer to remain subject to all or most of the risks and rewards associated with the benefit obligation covered or the assets transferred to the insurance company, that contract is not an **insurance annuity** contract for purposes of this statement, and the purchase of that contract does not constitute a settlement pursuant to paragraphs 83-88. Endorsement split-dollar life **insurance annuity** contracts⁴ do not settle a liability for a postretirement benefit obligation. For these contracts and other **insurance annuity** contracts that do not constitute settlement, reporting entities shall accrue a liability for the postretirement benefit arrangement in accordance with this statement.

59. The purchase price of a participating **insurance annuity** contract ordinarily is higher than the price of an equivalent contract without a participation right. The difference is the cost of the participation right.

⁴ An endorsement split-dollar life insurance arrangement is a split-dollar life insurance arrangement in which the entity owns and controls the insurance policy. The employer enters into a separate agreement that splits the policy benefits between the employer and the employee. The employer owns the policy, controls all rights of ownership, and may terminate the insurance policy (and, in turn, the policy benefits promised to the employee). To effect the split-dollar arrangement, the employer endorses a portion of the death benefits to the employee (the employee designates a beneficiary for this portion of the death benefits). Upon the death of the employee, the employee's beneficiary typically receives the designated portion of the death benefits directly from the insurance entity and the employer receives the remainder of the death benefits. SSAP No. 21R, paragraph 8, provides guidance for amounts reporting entities can realize when they are owner and beneficiary, or otherwise have obtained rights to control insurance policies.

The cost of the participation right shall be recognized at the date of purchase as a nonadmitted asset. In subsequent periods, the participation right shall be nonadmitted and measured at its fair value if the contract is such that fair value is reasonably estimable. Otherwise, the participation right shall be measured at its amortized cost (not in excess of its net realizable value), and the cost shall be amortized systematically over the expected dividend period under the contract.

60. To the extent that ~~insurance~~annuity contracts are purchased during the period to cover postretirement benefits attributed to service in the current period (such as life insurance benefits), the cost of those benefits shall be the cost of purchasing the coverage under the contracts, except as provided in paragraph 59 for the cost of a participation right. If all the postretirement benefits attributed to service in the current period are covered by nonparticipating ~~insurance~~annuity contracts purchased during that period, the cost of the contracts determines the service cost component of net postretirement benefit cost for that period. Benefits attributed to current service in excess of benefits provided by nonparticipating ~~insurance~~annuity contracts purchased during the current period shall be accounted for according to the provisions of this statement applicable to plans not involving ~~insurance~~annuity contracts.

61. Other contracts with insurance companies may not meet the definition of an ~~insurance~~annuity contract because the insurance company does not unconditionally undertake a legal obligation to provide specified benefits to specified individuals. Those contracts shall be accounted for as investments and measured at fair value. If a contract has a determinable cash surrender value or conversion value, that is presumed to be its fair value. For some contracts, the best available estimate of fair value may be contract value.

Measurement Date

62. The measurements of plan assets and benefit obligations required by this statement shall be as of the date of the employer's fiscal year-end statement of financial position. Even though the postretirement benefit measurements are required as of a particular date, all procedures are not required to be performed after that date. As with other financial statement items requiring estimates, much of the information can be prepared as of an earlier date and projected forward to account for ~~subsequent events~~ occurring between the most recent valuation date and the plan's year end (for example, employee service and benefit payments).

63. Measurements of net periodic postretirement benefit cost for both interim and annual financial statements generally shall be based on the assumptions at the beginning of the year (assumptions used for the previous year-end measurements of plan assets and obligations) unless more recent measurements of both plan assets and the accumulated postretirement benefit obligation are available. For example, if a significant event occurs, such as a plan amendment, settlement, or curtailment, that ordinarily would call for remeasurement, the assumptions used for those later measurements shall be used to remeasure net periodic postretirement benefit cost from the date of the event to the year-end measurement date. Unless an employer remeasures both its plan assets and benefit obligations during the fiscal year, the funded status it reports in its interim-period statement of financial position shall be the same asset or liability recognized in the previous year-end statement of financial position adjusted for (a) subsequent accruals of net periodic postretirement benefit cost that exclude the amortization of amounts previously recognized in unassigned funds (surplus) (for example, subsequent accruals of service cost, interest cost, and return on plan assets) and (b) contributions to a funded plan, or benefit payments. Upon remeasurement, a business entity shall adjust its statement of financial position in a subsequent interim period to reflect the overfunded or underfunded status of the plan consistent with that measurement date.

64. If a significant event caused by the employer (such as a plan amendment, settlement, or curtailment) that requires an employer to re-measure both plan assets and benefit obligations does not coincide with a month-end, the employer may elect to re-measure plan assets and benefit obligations using the month-end that is closest to the date of the significant event. This re-measurement would not

eliminate the requirement for a year-end measurement of plan assets and benefit obligations required in paragraph 62.

65. If an employer re-measures plan assets and benefit obligations during the fiscal year in accordance with paragraph 64, the employer shall adjust the fair value of plan assets and the actuarial present value of benefit obligations for any effects of the significant event that may or may not be captured in the month-end measurement (for example, if the closest month-end is before the date of a partial settlement, then the measurement of plan assets may include assets that are no longer part of the plan). An employer shall not adjust the fair value of plan assets and the actuarial present value of benefit obligations for other events occurring between the month-end date used to re-measure plan assets and benefit obligations and the employer's fiscal year-end that may be significant to the measurement of defined benefit plan assets and obligations, but are not caused by the employer (for example, changes in market prices or interest rates).

Disclosures - Single-Employer Defined Postretirement Plans

66. An employer that sponsors one or more other defined benefit postretirement plans shall provide the following information for postretirement benefit plans other than pensions. Amounts related to the employer's results of operations shall be disclosed for each period for which a statement of income is presented. Amounts related to the employer's statement of financial position, shall be disclosed as of the date of each statement of financial position presented.

- a. A reconciliation of beginning and ending balances of the benefit obligation showing separately, if applicable, the effects during the period attributable to each of the following: service cost, interest cost, contributions by plan participants, actuarial gains and losses, foreign currency exchange rate changes, benefits paid, plan amendments, business combinations, divestitures, curtailments, settlements, and special termination benefits.
- b. A reconciliation of beginning and ending balances of the fair value of plan assets showing separately, if applicable, the effects during the period attributable to each of the following: actual return on plan assets, foreign currency exchange rate changes, contributions by the employer, contributions by plan participants, benefits paid, business combinations, divestitures, and settlements.
- c. The funded status of the plans and the amounts recognized in the statement of financial position, showing separately the assets (nonadmitted) and liabilities recognized.
- d. The objectives of the disclosures about postretirement benefit plan assets are to provide users of financial statements with an understanding of:
 - i. How investment allocation decisions are made, including the factors that are pertinent to an understanding of investment policies and strategies;
 - ii. The classes of plan assets;
 - iii. The inputs and valuation techniques used to measure the fair value of plan assets;
 - iv. The effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets for the period;
 - v. Significant concentrations of risk within plan assets.

An employer shall consider those overall objectives in providing the following information about plan assets:

- (a) A narrative description of investment policies and strategies, including target allocation percentages or range of percentages considering the classes of plan assets disclosed pursuant to (b) below, as of the latest statement of financial position presented (on a weighted-average basis for employers with more than one plan), and other factors that are pertinent to an understanding of those policies and strategies such as investment goals, risk management practices, permitted and prohibited investments including the use of derivatives, diversification, and the relationship between plan assets and benefit obligations. For investment funds disclosed as classes as described in (b) below, a description of the significant investment strategies of those funds shall be provided.
- (b) The fair value of each class of plan assets as of each date for which a statement of financial position is presented. Asset classes shall be based on the nature and risks of assets in an employer's plan(s). Examples of classes of assets include, but are not limited to, the following: cash and cash equivalents; equity securities, (segregated by industry type, company size, or investment objective); debt securities, issued by national, state, and local governments; corporate debt securities; asset-backed securities; structured debt; derivatives on a gross basis (segregated by type of underlying risk in the contract, for example, interest rate contracts, foreign exchange contracts, equity contracts, commodity contracts, credit contracts, and other contracts); investment funds (segregated by type of fund); and real estate. Those examples are not meant to be all inclusive. An employer should consider the overall objectives in paragraph 66.d. in determining whether additional classes of plan assets or further disaggregation of classes should be disclosed.
- (c) A narrative description of the basis used to determine the overall expected long-term rate-of-return-on-assets assumption, such as the general approach used, the extent to which the overall rate-of-return-on-assets assumption was based on historical returns, the extent to which adjustments were made to those historical returns in order to reflect expectations of future returns, and how those adjustments were determined. The description should consider the classes of assets described in (b) above, as appropriate.
- (d) Information that enables users of financial statements to assess the inputs and valuation techniques used to develop fair value measurements of plan assets at the reporting date. For fair value measurements using significant unobservable inputs, an employer shall disclose the effect of the measurements on changes in plan assets for the period. To meet those objectives, the employer shall disclose the following information for each class of plan assets disclosed pursuant to (b) above for each annual period:

- (1) The level within the fair value hierarchy in which the fair value measurements in their entirety fall,⁵ segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3)
 - (2) Information about the valuation technique(s) and inputs used to measure fair value and a discussion of changes in valuation techniques and inputs, if any, during the period.
- e. The benefits (as of the date of the latest statement of financial position presented) expected to be paid in each of the next five fiscal years, and in the aggregate for the five fiscal years thereafter. The expected benefits should be estimated based on the same assumptions used to measure the company's benefit obligation at the end of the year and should include benefits attributable to estimated future employee service.
- f. The employer's best estimate, as soon as it can reasonably be determined, of contributions expected to be paid to the plan during the next fiscal year beginning after the date of the latest statement of financial position presented. Estimated contributions may be presented in the aggregate combining (1) contributions required by funding regulations or laws, (2) discretionary contributions, and (3) noncash contributions.
- g. The amount of net periodic benefit cost recognized, showing separately the service cost component, the interest cost component, the expected return on plan assets for the period, the gain or loss component, the prior service cost or credit component, the transition asset or obligation component, and the gain or loss recognized due to settlements or curtailments.
- h. Separately the net gain or loss and net prior service cost or credit recognized in unassigned funds (surplus) for the period pursuant to paragraphs 42 and 46, and reclassification adjustments of unassigned funds (surplus) for the period, as those amounts, including amortization of the net transition asset or obligation, are recognized as components of net periodic benefit cost.
- i. The amounts in unassigned funds (surplus) that have not yet been recognized as components of net periodic benefit cost, showing separately the net gain or loss, net prior service cost or credit, and net transition asset or obligation.
- j. On a weighted-average basis, the following assumptions used in the accounting for the plans: discount rates, rates of compensation increase (for pay-related plans), expected long-term rates of return on plan assets specifying, in a tabular format, the assumptions used to determine the benefit obligation and the assumptions used to determine net benefit cost, and interest crediting rates (for cash balance plans and other plans with promised interest crediting rates).
- k. The assumed health care cost trend rate(s) for the next year used to measure the expected cost of benefits covered by the plan (gross eligible charges), and a general description of

⁵ In some cases, the inputs used to measure fair value might fall in different levels of the fair value hierarchy. The level in the fair value hierarchy within which the fair value measurement in its entirety falls shall be determined based on the lowest level input that is significant to the fair value measurement in its entirety. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability.

the direction and pattern of change in the assumed trend rates thereafter, together with the ultimate trend rate(s) and when that rate is expected to be achieved.

- l. If applicable, the amounts and types of securities of the employer and related parties included in plan assets.
- m. If applicable, any alternative method used to amortize prior service amounts or net gains and losses pursuant to paragraphs 43 and 50.
- n. If applicable, any substantive commitment, such as past practice or a history of regular benefit increases, used as the basis for accounting for the benefit obligation.
- o. If applicable, the cost of providing special or contractual termination benefits recognized during the period and a description of the nature of the event.
- p. An explanation of the following information:
 - i. The reasons for significant gains and losses related to changes in the defined benefit obligation for the period.
 - ii. Any other significant change in the benefit obligation or plan assets not otherwise apparent in the other required disclosures in this statement.

Employers with Two or More Plans

67. Postretirement benefits offered by an employer may vary in nature and may be provided to different groups of employees. As discussed in paragraph 68, in some cases an employer may aggregate data from unfunded plans for measurement purposes in lieu of performing separate measurements for each unfunded plan (including plans whose designated assets are not appropriately segregated and restricted and thus have no plan assets as that term is used in this statement). Net periodic postretirement benefit cost, the accumulated postretirement benefit obligation, and plan assets shall be determined for each separately measured plan or aggregation of plans by applying the provisions of this statement to each such plan or aggregation of plans.

68. The data from all unfunded postretirement health care plans may be aggregated for measurement purposes if (a) those plans provide different benefits to the same group of employees or (b) those plans provide the same benefits to different groups of employees. Data from other unfunded postretirement welfare benefit plans may be aggregated for measurement purposes in similar circumstances, such as when an employer has a variety of welfare benefit plans that provide benefits to the same group of employees. However, a plan that has plan assets (as defined herein) shall not be aggregated with other plans but shall be measured separately.

Disclosures – Employers with Two or More Defined Benefit Plans

69. The disclosures required by this statement shall be aggregated for all of an employer's other defined benefit postretirement plans unless disaggregating in groups is considered to provide useful information or is otherwise required by this paragraph and paragraph 70 of this statement. Disclosures shall be as of the date of each statement of financial position presented. If aggregate disclosures are presented, an employer shall disclose, as of the date of each statement of financial position presented:

- a. The accumulated benefit obligation and fair value of plan assets for plans with accumulated benefit obligations in excess of plan assets.

70. A U.S. reporting entity may combine disclosures about pension plans or other postretirement benefit plans outside the United States with those for U.S. plans unless the benefit obligations of the plans outside the United States are significant relative to the total benefit obligation and those plans use significantly different assumptions.

Interim Financial Disclosures – Defined Benefit Plans

71. The following shall be disclosed within interim financial statements that include a statement of income:

- a. The amount of net periodic benefit cost recognized, for each period for which a statement of income is presented, showing separately the service cost component, the interest cost component, the expected return on plan assets for the period, the gain or loss component, the amount prior service cost or credit component, the transition asset or obligation component, and the gain or loss recognized due to a settlement or curtailment.
- b. The total amount of the employer's contributions paid, and expected to be paid, during the current fiscal year, if significantly different from amounts previously disclosed pursuant to paragraph 66.f. of this statement. Estimated contributions may be presented in the aggregate combining, (1) contributions required by funding regulations or laws, (2) discretionary contributions, and (3) noncash contributions.

Multiemployer Plans

72. For purposes of this statement, a multiemployer plan is a postretirement benefit plan to which two or more unrelated employers contribute, usually pursuant to one or more collective-bargaining agreements. A characteristic of multiemployer plans is that assets contributed by one participating employer may be used to provide benefits to employees of other participating employers since assets contributed by an employer are not segregated in a separate account or restricted to provide benefits only to employees of that employer.

73. An employer participating in a multiemployer plan shall recognize as net postretirement benefit cost the required contribution for the period, which shall include both cash and the fair value of noncash contributions, and shall recognize as a liability any unpaid contributions required for the period.

74. In some situations, withdrawal from a multiemployer plan may result in an employer having an obligation to the plan for a portion of the plan's unfunded accumulated postretirement benefit obligation. If it is either probable or reasonably possible that (a) an employer would withdraw from the plan under circumstances that would give rise to an obligation or (b) an employer's contribution to the fund would be increased during the remainder of the contract period to make up a shortfall in the funds necessary to maintain the negotiated level of benefit coverage (a "maintenance of benefits" clause), the employer shall apply the provisions *SSAP No. 5R—Liabilities, Contingencies, and Impairments of Assets*.

Disclosures - Multiemployer Plans

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.

76. In addition to the requirements of paragraph 75, the following information shall be disclosed:
- Whether a funding improvement plan or rehabilitation plan had been implemented or is pending.
 - Whether the reporting entity paid a surcharge to the plan.
 - A description of minimum contributions required for future periods, if applicable.
 - A qualitative description of the extent to which the employer could be responsible for the obligations of the plan, including benefits earned by employees during employment with another employer.
77. Pursuant to paragraph 74, if withdrawal under circumstances that would give rise to an obligation is either probable or reasonably possible, the provisions and disclosures of SSAP No. 5R, shall apply.

Multiple-Employer Plans

78. Some postretirement benefit plans to which two or more unrelated employers contribute are not multiemployer plans. Rather, those multiple-employer plans are in substance aggregations of single-employer plans, combined to allow participating employers to pool plan assets for investment purposes or to reduce the costs of plan administration. Those plans ordinarily do not involve collective-bargaining agreements. They may also have features that allow participating employers to have different benefit formulas, with the employer's contributions to the plan based on the benefit formula selected by the employer. Those plans shall be considered single-employer plans rather than multiemployer plans for purposes of this statement, and each employer's accounting shall be based on its respective interest in the plan.

Postretirement Benefit Plans Outside the United States

79. This statement includes no special provisions applicable to postretirement benefit arrangements outside the United States. Those arrangements are subject to the provisions of this statement. The applicability of this statement to those arrangements is determined by the nature of the obligation and by the terms or conditions that define the amount of benefits to be paid, not by whether or how a plan is funded, whether benefits are payable at intervals or as a single amount, or whether the benefits are required by law or custom or are provided under a plan the employer has elected to sponsor.

Business Combinations

80. When an employer is acquired in a business combination and that employer sponsors a single-employer defined benefit postretirement plan, the assignment of the purchase price to individual assets acquired and liabilities assumed shall include a liability for the accumulated postretirement benefit obligation in excess of the fair value of the plan assets or an asset for the fair value of the plan assets in excess of the accumulated postretirement benefit obligation. The accumulated postretirement benefit obligation assumed shall be measured based on the benefits attributed by the acquired entity to employee service prior to the date the business combination is consummated, adjusted to reflect (a) any changes in assumptions based on the purchaser's assessment of relevant future events (as discussed in paragraphs 9-29) and (b) the terms of the substantive plan (as discussed in paragraphs 9-14) to be provided by the purchaser to the extent they differ from the terms of the acquired entity's substantive plan.

81. If the postretirement benefit plan of the acquired entity is amended as a condition of the business combination (for example, if the change is required by the seller as part of the consummation of the acquisition), the effects of any improvements attributed to services rendered by the participants of the acquired entity's plan prior to the date of the business combination shall be accounted for as part of the accumulated postretirement benefit obligation of the acquired entity. Otherwise, if improvements to the

postretirement benefit plan of the acquired entity are not a condition of the business combination, credit granted for prior service shall be recognized as a plan amendment as discussed in paragraphs 40-45. If it is expected that the plan will be terminated or curtailed, the effects of those actions shall be considered in measuring the accumulated postretirement benefit obligation. Otherwise, no future changes to the plan shall be anticipated.

82. As a result of applying the provisions of paragraphs 80-81, any previously existing net gain or loss, prior service cost or credit, or transition obligation or transition asset remaining in unassigned funds (surplus) is eliminated for the acquired employer's plan.

Accounting for Settlement of a Postretirement Benefit Obligation

83. For purposes of this statement, a settlement is defined as a transaction that (a) is an irrevocable action, (b) relieves the employer (or the plan) of primary responsibility for a postretirement benefit obligation, and (c) eliminates significant risks related to the obligation and the assets used to effect the settlement. Examples of transactions that constitute a settlement include making lump-sum cash payments to plan participants in exchange for their rights to receive specified postretirement benefits and purchasing long-term nonparticipating ~~insurance~~annuity contracts for the accumulated postretirement benefit obligation for some or all of the plan participants.

84. A transaction that does not meet the three criteria of paragraph 83 does not constitute a settlement for purposes of this statement. For example, investing in a portfolio of high-quality fixed-income securities with principal and interest payment dates similar to the estimated payment dates of benefits may avoid or minimize certain risks. However, that investment decision does not constitute a settlement because that decision can be reversed, and investing in that portfolio does not relieve the employer (or the plan) of primary responsibility for a postretirement benefit obligation nor does it eliminate significant risks related to that obligation.

85. For purposes of this statement, the maximum gain or loss subject to recognition in income when a postretirement benefit obligation is settled is the net gain or loss included in unassigned funds (surplus) defined in paragraphs 46-50 plus any transition asset remaining in unassigned funds (surplus). That maximum gain or loss includes any gain or loss resulting from remeasurements of plan assets and the accumulated postretirement benefit obligation at the time of settlement.

86. If the entire accumulated postretirement benefit obligation is settled and the maximum amount subject to recognition is a gain, the settlement gain shall first reduce any transition obligation remaining in unassigned funds (surplus); any excess gain shall be recognized in income. If the entire accumulated postretirement benefit obligation is settled and the maximum amount subject to recognition is a loss, the maximum settlement loss shall be recognized in income. If only part of the accumulated postretirement benefit obligation is settled, the employer shall recognize in income the excess of the pro rata portion (equal to the percentage reduction in the accumulated postretirement benefit obligation) of the maximum settlement gain over any remaining transition obligation or a pro rata portion of the maximum settlement loss.

87. If the purchase of a participating ~~insurance~~annuity contract constitutes a settlement, the maximum gain (but not the maximum loss) shall be reduced by the cost of the participation right before determining the amount to be recognized in income. As detailed in paragraph 58, the purchase of an endorsement split-dollar life ~~insurance~~annuity contract does not settle a liability for a postretirement benefit obligation.

88. If the cost of all settlements in a year is less than or equal to the sum of the service cost and interest cost components of net postretirement benefit cost for the plan for the year, gain or loss recognition is permitted but not required for those settlements. However, the accounting policy adopted shall be applied consistently from year to year.

Accounting for a Plan Curtailment

89. For purposes of this statement, a curtailment is an event that significantly reduces the expected years of future service of active plan participants or eliminates the accrual of defined benefits for some or all of the future services of a significant number of active plan participants. Curtailments include:

- a. Termination of employees' services earlier than expected, which may or may not involve closing a facility or discontinuing a component of an entity.
- b. Termination or suspension of a plan so that employees do not earn additional benefits for future service. In the latter situation, future service may be counted toward eligibility for benefits accumulated based on past service.

90. The prior service cost included in unassigned funds (surplus) associated with the portion of the future years of service that had been expected to be rendered, but as a result of a curtailment are no longer expected to be rendered, is a loss. For purposes of measuring the effect of a curtailment, prior service cost includes the cost of plan amendments and any remaining transition obligation. For example, a curtailment may result from the termination of a significant number of employees who were plan participants at the date of a prior plan amendment. The loss associated with that curtailment is measured as the portion of the remaining prior service cost included in unassigned funds (surplus) related to that (and any prior) plan amendment attributable to the previously expected remaining future years of service of the employees who were terminated and the portion of the remaining transition obligation attributable to the previously expected remaining future years of service of the terminated employees who were plan participants at the date of transition.

91. The accumulated postretirement benefit obligation may be decreased (a gain) or increased (a loss) by a curtailment. That (gain) loss shall reduce any net loss (gain) included in unassigned funds (surplus).

- a. To the extent that such a gain exceeds any net loss included in unassigned funds (surplus) (or the entire gain, if a net gain exists), it is a curtailment gain.
- b. To the extent that such a loss exceeds any net gain included in unassigned funds (surplus) (or the entire loss, if a net loss exists), it is a curtailment loss.

For purposes of applying the provisions of this paragraph, any transition asset remaining in unassigned funds (surplus) shall be treated as a net gain and shall be combined with the unrecognized net gain or loss arising subsequent to transition to this statement.

92. If the sum of the effects identified in paragraphs 90-91 is a net loss, it shall be recognized in income when it is probable that a curtailment will occur and the net effect is reasonably estimable. If the sum of those effects is a net gain, it shall be recognized in income when the related employees terminate or the plan suspension or amendment is adopted.

93. A settlement and a curtailment may occur separately or together. If benefits expected to be paid in future periods are eliminated for some plan participants (for example, because a significant portion of the work force is dismissed or a plant is closed) but the plan remains in existence and continues to pay benefits, to invest assets, and to receive contributions, a curtailment has occurred but not a settlement. If an employer purchases nonparticipating ~~insurance~~ annuity contracts for the accumulated postretirement benefit obligation and continues to provide defined benefits for future service, either in the same plan or in a successor plan, a settlement has occurred but not a curtailment. If a plan termination occurs (that is, the obligation is settled and the plan ceases to exist) and the plan is not replaced by a successor defined benefit plan, both a settlement and a curtailment have occurred (whether or not the employees continue to work for the employer).

Measurement of the Effects of Termination Benefits

94. An employer that offers special or contractual termination benefits to employees shall recognize a liability and a loss when the employees accept the offer and the amount can be reasonably estimated. An employer that provides contractual termination benefits shall recognize a liability and a loss when it is probable that employees will be entitled to benefits and the amount can be reasonably estimated. A situation involving special or contractual termination benefits may also result in a curtailment to be accounted for under paragraphs 89-92.

95. The liability and loss recognized for employees who accept an offer of special termination benefits to be provided by a postretirement benefit plan shall be the difference between (a) the accumulated postretirement benefit obligation for those employees, assuming that those employees (active plan participants) not yet fully eligible for benefits would terminate at their full eligibility date and that fully eligible plan participants would retire immediately, without considering any special termination benefits and (b) the accumulated postretirement benefit obligation as measured in (a) adjusted to reflect the special termination benefits.

Defined Contribution Plans

96. For purposes of this statement, a defined contribution postretirement plan is a plan that provides postretirement benefits in return for services rendered, provides an individual account for each participant, and has terms that specify how contributions to the individual's account are to be determined rather than the amount of postretirement benefits the individual is to receive. Under a defined contribution plan, the postretirement benefits a plan participant will receive are limited to the amount contributed to the plan participant's account, the returns earned on investments of those contributions, and forfeitures of other plan participants' benefits that may be allocated to the plan participant's account.

97. To the extent a plan's defined contributions to an individual's account are to be made for periods in which that individual renders services, the net postretirement benefit cost for a period shall be the contribution called for in that period. If a plan calls for contributions for periods after an individual retires or terminates, the estimated cost shall be accrued during the employee's service period.

98. A postretirement benefit plan having characteristics of both a defined benefit plan and a defined contribution plan requires careful analysis. If the substance of the plan is to provide a defined benefit, as may be the case with some "target benefit" plans, the accounting requirements shall be determined in accordance with the provisions of this statement applicable to a defined benefit plan and the disclosure requirements within paragraph 66 shall be followed.

Disclosures - Defined Contribution Plans

99. An employer shall disclose the amount of cost recognized for defined contribution postretirement benefit plans for all periods presented separately from the amount of cost recognized for defined benefit plans. The disclosures shall include a description of the nature and effect of any significant changes during the period affecting comparability, such as a change in the rate of employer contributions, a business combination, or a divestiture.

Consolidated/Holding Company Plans

100. The employees of many reporting entities are eligible for certain postretirement benefits other than pensions provided by a parent company or holding company. A reporting entity with employees who are eligible for those benefits and is not directly liable for those related obligations shall recognize an expense equal to its allocation of the benefits earned during the period. A liability shall be established for any such amounts due but not yet paid.

101. The reporting entity shall disclose in the financial statements that its employees participate in a plan sponsored by the holding company for which the reporting entity has no legal obligation. The amount of the postretirement benefit expense incurred and the allocation methodology utilized by the provider of such benefits shall also be disclosed. If the reporting entity is directly liable for postretirement benefits other than pensions, then the requirements outlined in paragraphs 1-99 and paragraphs 102-116 of this statement shall be applied.

Relevant Literature

102. This statement adopts with modification paragraphs 1-7 and 16-18 as well as Appendix D – Amendments to Statement 106 and Appendix E – Amendments to Statement 132(R) of *FASB Statement No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)* (FAS 158). Paragraphs 8-10 and D2.u providing specific guidance for not-for-profit organizations are rejected. Paragraphs 11-15 regarding the effective dates for FAS 158 are rejected and paragraph 19 providing an alternative method for remeasuring plan assets and benefits obligations as of the fiscal year the measurement date provisions are applied is also rejected. The disclosure included within FAS 132 (R), as amended by FAS 158, pertaining specifically to pensions (paragraph 5.e.) has been rejected for inclusion within this standard. This statement adopts the revisions to paragraph 5.d. of FAS 132(R) as amended by *FASB Staff Position FAS 132(R)-1, Employers' Disclosures about Postretirement Benefit Plan Assets* (FSP FAS 132(R)-1) and *ASU 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements* (ASU 2010-06). Other revisions to disclosure requirements as amended by FSP FAS 132(R)-1 relate to nonpublic entities and are rejected. This statement adopts *EITF 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*. This statement adopts by reference revisions to ASC 715-80 as detailed in *ASU 2011-09, Compensation – Retirement Benefits – Multiemployer Plans* with limited additional disclosures required within statutory financial statements. This statement adopts by reference *FSP FAS 158-1, Conforming Amendments to the Illustrations in FASB Statements No. 87, No. 88, and No. 106 and to the Related Staff Implementation Guides* (FSP FAS 158-1) to the extent that the examples and related implementation guides comply with the adopted GAAP guidance previously identified within this statement, as modified for statutory accounting. The statement adopts with modification the disclosure revisions reflected in *ASU 2018-14, Changes to the Disclosure Requirements for Defined Benefit Plans*, consistent with the modifications from the adoption of FAS 158 and FAS 106. The following modifications from the adopted paragraphs of FAS 158 and FAS 106 have been incorporated within this standard:

- a. All references to “other comprehensive income” or “accumulated other comprehensive income” within FAS 158 have been revised to reflect “unassigned funds (surplus).”
- b. Any prepaid asset resulting from the excess of the fair value of plan assets over the accumulated postretirement benefit obligation shall be nonadmitted. Furthermore, any asset recognized from the cost of a “participation right” of an annuity contract per paragraph 59 shall also be nonadmitted.
- c. Provisions within paragraph 57 and 58 of FAS 106, as amended by FAS 158, permitting a calculated market-related value of plan assets has been eliminated with only the fair value measurement method for plan assets retained.
- d. The reduced disclosure requirements for nonpublic entities described in paragraph 8 of FAS 132(R), as amended by FAS 158, are rejected. All reporting entities shall follow the disclosure requirements within this statement which have been adopted from paragraph 5 of FAS 132(R), as amended by FAS 158.

- e. Clarification has been included within this standard to ensure both vested and nonvested employees are included within the recognition of net postretirement benefit cost and in the accumulated postretirement benefit obligation. Although this is consistent with GAAP, this is a change from previous statutory accounting. As nonvested employees were excluded from statutory accounting under SSAP No. 14, guidance has been included to indicate that the unrecognized prior service cost attributed to nonvested individuals is not required to be included in net postretirement benefit cost entirely in the year this standard is adopted. The unrecognized prior service cost for nonvested employees shall be amortized as a component of net postretirement benefit cost by assigning an equal amount to each expected future period of service before vesting occurs for nonvested employees active at the date of the amendment. Unassigned funds (surplus) is then adjusted each period as prior service cost is amortized. (Guidance is included within the transition related to the recognition of the prior service cost for nonvested employees through unassigned surplus.)
- f. Conclusion of *Interpretation 99-26: Offsetting Pension Assets and Liabilities* prohibiting the offset of defined benefit liabilities of one plan with prepaid assets of another plan has been incorporated within paragraph 33 of this statement.
- g. Provisions within paragraph 44B of FAS 106, as amended by FAS 158, regarding the classification of underfunded liabilities as current or noncurrent liabilities and the classification of assets from overfunded plans as noncurrent assets has been rejected as inconsistent with statutory accounting.
- h. Provisions within paragraph 65 of FAS 106, as amended by FAS 158, defining the fair value of investments have been rejected. Fair value definitions and measurement for investments shall be determined in accordance with statutory accounting guidance.
- i. Provisions within paragraph 72 of FAS 106, as amended by FAS 158, regarding the plan assets measurement date for consolidating subsidiaries or entities utilizing the equity method under APB Opinion No. 18 has been rejected. For statutory accounting, all entities shall follow the measurement date guidance within paragraph 62 of this statement.
- j. The disclosure requirement included within paragraph 5.e. of FAS 132(R) has been rejected for this statement as it specifically pertains to pensions.
- k. Transition under FAS 158 is different from the requirements of this statement. FAS 158 requires publicly traded equity securities to initially apply the requirement to recognize the funded status of a postretirement benefit plan; the gains/losses, prior service costs/credits and transition obligations/assets that have not yet been included in net periodic benefit cost; and the disclosure requirements as of the end of the fiscal year ending after December 15, 2006. Transition guidelines for statutory accounting are defined in paragraphs 105-116 of this statement.
- l. FAS 158 provided two approaches for an employer to transition to a fiscal year-end measurement date. For purposes of statutory accounting, the second approach permitting reporting entities to use earlier measurements determined for year-end reporting as of the fiscal year immediately preceding the year that the measurement date provisions is rejected. For consistency purposes, all reporting entities shall follow the first approach and remeasure plan assets and benefit obligations as of the beginning of the fiscal year that the measurement date provisions are applied.

103. This statement adopts the revisions to ASC 715-60 as it relates to interim re-measurement due to a *significant* event as detailed in *ASU 2015-04, Practical Expedient for the Measurement Date of An Employer's Defined Benefit Obligation and Plan Assets*. Other revisions are rejected as statutory accounting requires the annual measurement of benefit obligations and plan assets to be measured as of a year-end measurement date.

104. This statement rejects *ASU 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. Existing statutory disclosures on the components of benefit costs shall be completed.

Effective Date and Transition

105. Reporting entities are required to disclose the accumulated postretirement benefit obligation and the fair value of plan assets for defined postretirement benefit plans in the first reporting period after the effective date of this standard and in each subsequent reporting period. This disclosure shall specifically note the funded/underfunded status of the postretirement benefit plan. Reporting entities shall also specifically note the surplus impact necessary, at each reporting date, to reflect the full benefit obligation within the financial statements.

106. This statement is effective for quarterly and annual reporting periods beginning on or after January 1, 2013 (transition date) with early adoption permitted. Any unfunded defined benefit amounts, as determined when the accumulated benefit obligation exceeds the fair value of plan assets, is a liability under SSAP No. 5R and shall be reported in the first quarter statutory financial statements after the transition date with a corresponding entry to unassigned funds (surplus). If the fair value of plan assets exceeds the accumulated benefit obligation, the asset shall be considered a nonadmitted asset. Net periodic benefit cost shall include a component for unrecognized prior service cost for nonvested employees beginning in 2013.

~~107. Gains or losses, prior service costs or credits (including prior service costs for non-vested participants pursuant to paragraph 37), and remaining transition assets or obligations (collectively referred to as "unrecognized items") from prior application of SSAP No. 14 that have not yet been included in net periodic benefit cost as of December 31, 2012⁶ shall be recognized as components of the ending balance of unassigned funds (surplus), net of tax, as of January 1, 2013 (provided that alternative transition is not elected per paragraph 108.b.). The offset to unassigned funds is reported separately as an "Aggregate Write-In for Other Than Invested Assets" or as an "Aggregate Write-In for Other Liabilities." After recognition, the full unfunded or overfunded status of the plan shall be reflected within the financial statements. Any prepaid asset resulting from an overfunded plan shall be nonadmitted.~~

~~108. Due to the potential impact to surplus as a result of immediately applying the accounting guidance in paragraph 107, reporting entities may elect one of the following two methods, on an individual plan basis, to recognize the transition surplus impact:~~

- ~~a. Reporting entities may elect to recognize the entire transition surplus impact calculated from applying paragraph 107, on an individual plan basis, as of January 1, 2013.~~
- ~~b. Alternatively, reporting entities may elect to recognize the entire surplus impact from applying paragraph 07, on an individual plan basis, over a period not to exceed ten (10) years. The surplus impact initially recognized as of January 1, 2013, under this transition option, and subsequently over the transition period, shall be the greater of:~~

⁶ ~~The intent of the guidance is to recognize the unrecognized amounts as of December 31, 2012, annual statements, even if new actuarial projections (expected postretirement benefit obligations) are calculated as of January 1, 2013. (These projections would be considered in the recognition of the 2013 pension cost.)~~

- ~~i. Ten percent of the calculated surplus impact as of the transition date; and~~
- ~~ii. Amortization⁷ of the “unrecognized items” (defined in paragraph 107) into net periodic benefit cost, including any accelerated amortization of these items from curtailments or settlements that occur after the transition date. (If the amortization cannot be determined at transition, at a minimum, the amount amortized for “unrecognized items” during the prior year shall be utilized for this component of the calculation. If the amount recognized for transition (greater of both components in paragraph 108.b.) is subsequently determined to be less than what is amortized for the year (paragraph 108.b.ii.), the difference between what was recognized for transition, and what is amortized must immediately be recognized as an adjustment to the transition impact to unassigned funds—surplus.)~~

~~109. If the surplus deferral (paragraph 108.b.) is elected at the transition date, subsequently, starting with the 2014 year-end financial statement, the reporting entity shall annually recognize the remaining surplus impact (collectively referred to as the “transition liability”⁸) on a systematic basis over a period not to exceed nine years. The minimum amount recognized each subsequent year shall be an amount that reflects the conditions within paragraph 108.b. Reporting entities that elect the transition option in paragraph 108.b. are permitted to recognize the remaining transition liability, or an amount in excess of the minimum requirement, at any time after the transition date.~~

~~110. Reporting entities that elect the transition option in paragraph 108.b. must recognize any remaining transition liability to the extent that the plan reflects a prepaid benefit cost. (For example, if changes in circumstances have resulted with the plan reflecting an overfunded status, the remaining transition liability must be recognized to the extent that the plan is overfunded.) The transition guidance in paragraph 108.b. is not intended (on a net basis for each plan) to result in more favorable subsequent surplus OPEB positions when there are remaining unrecognized liabilities as a result of the reporting entity’s initial election for surplus deferral. Therefore, if there is a plan curtailment, settlement, or other plan amendment resulting in a reduction of benefit obligations, or net benefit obligation gains due to revisions in assumptions (e.g., discount rates) or plan experience differing from assumptions, or plan asset gains due to the actual return on plan assets exceeding the expected return on plan assets, a corresponding amount of unrecognized liability from the surplus deferral shall be recognized. For this purpose, net gains, if any, are the net aggregation of all gains and losses (excluding plan amendments that increase benefit obligations) from factors such as those listed above, determined as of a measurement or remeasurement date. This shall occur regardless if the impact from the change results with the plan being in an overfunded state, or whether the gain is recognized in earnings. The transition guidance was to provide surplus relief from the immediate surplus impact from adopting this statement, but in no instance should changes (on a net basis for each plan) attributed to OPEB plans result in more favorable, subsequent surplus positions when there are unrecognized liabilities remaining as a result of the reporting entity’s initial election for surplus deferral. (The guidance in this paragraph was originally contained within *INT 13-03: Clarification of Surplus Deferral in SSAP No. 92 & SSAP No. 102* and was effective December 15, 2013.)~~

⁷ ~~Unless otherwise impacted from the provisions within this statement or in accordance with changes to the benefit plan, the amortization of the unrecognized items into net periodic benefit cost shall continue to follow the existing amortization schedules in effect on the transition date.~~

⁸ ~~If the surplus deferral from paragraph 108.b. is elected, the deferred liability, although comprised of the previous “unrecognized items” shall be collectively referred to as the “transition liability.” Although reporting entities will need to continue to track the unrecognized items for amortization into net periodic cost (offset through unassigned funds), reporting entities shall not allocate the recognized surplus impact from transition to these categories. As noted in paragraph 108.b.ii., the minimum amount of liability recognized under the deferral option must cover the annual amortization of the “unrecognized items” into net periodic benefit cost to prevent a surplus benefit.~~

~~111. — The transition guidance in paragraphs 107-110 is specific to the transition surplus impact from initially applying this statement on January 1, 2013. Thus, this transition guidance does not apply to additional liability calculated from subsequent comparison of the fair value of plan assets to the accumulated benefit obligation, or the impact of subsequent plan amendments.~~

~~112. — Reporting entities electing to apply the transition guidance in paragraph 108.b. must disclose the full transition surplus impact calculated from applying paragraph 107 in the first quarter statutory financial statements after the transition date and each reporting period thereafter. This disclosure shall include the initial “transition liability” calculated under paragraph 107 and the annual amortization amount of the “unrecognized items” into net periodic benefit cost. This disclosure shall include a schedule of the entity’s anticipated recognition of the remaining surplus impact over the transition period.~~

~~113. — The requirement to measure plan assets and benefit obligations as of the date of the reporting entity’s financial statement year end is effective for financial statement years beginning January 1, 2014. (The measurement date change will be initially reflected in the December 31, 2014, financial statements.)~~

~~114. — In order to transition to a fiscal year-end measurement date, the reporting entity shall remeasure plan assets and benefit obligations as of the beginning of the fiscal year that the measurement date provisions are applied. The reporting entity shall use those new measurements to determine the effects of the measurement date change as of the beginning of the fiscal year that the measurement date provisions are applied.~~

~~115. — The reporting entity shall measure plan assets and benefit obligations as of the beginning of the fiscal year that the measurement date provisions are applied. This would result with the following:~~

- ~~a. — Net periodic benefit cost for the period between the measurement date that is used for the immediately preceding fiscal year end and the beginning of the fiscal year that the measurement date provisions are applied, exclusive of any curtailment or settlement gain or loss, shall be recognized, net of tax, as a separate adjustment of the opening balance of unassigned funds (surplus). That is, the pretax amount recognized as an adjustment to unassigned funds (surplus) is the net periodic benefit cost that without a change in measurement date otherwise would have been recognized on a delayed basis during the first interim period for the fiscal year that the measurement date provisions are applied.~~
- ~~b. — Any gain or loss arising from a curtailment or settlement between the measurement date that is used for the immediately preceding fiscal year end and the beginning of the fiscal year that the measurement date provisions are applied shall be recognized in earnings in that period and not as an adjustment to unassigned funds (surplus). This provision prohibits a reporting entity from early application of the measurement date provisions when the reporting entity has issued financial statements for the prior year without recognition of such a settlement or curtailment.~~
- ~~c. — Other changes in the fair value of plan assets and the benefit obligations (for example, gains or losses) for the period between the measurement date that is used for the immediately preceding fiscal year end and the beginning of the fiscal year that the measurement date provisions are applied shall be recognized, net of tax, as a separate adjustment of the opening balance of unassigned funds (surplus) for the fiscal year that the measurement date provisions are applied.~~

~~116. — Earlier application of the recognition or measurement date provisions is encouraged, however, early applications must be for all of the reporting entity’s benefit plans. If early application is elected, the transition date shall reflect the January 1st of the year in which this standard is initially applied. Retrospective application is not permitted.~~

REFERENCES**Other**

- *Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy*
- *SSAP No. 14—Employers' Accounting for Postretirement Benefits Other Than Pensions*

Relevant Issue Papers

- *Issue Paper No. 133—Accounting for Postretirement Benefits Other Than Pensions, A Replacement of SSAP No. 14*

Not for Distribution

Statements of Statutory Accounting Principles No. 93

Low-Income Housing Tax Credit Property Investments

STATUS

Type of Issue..... Common Area
Issued June 13, 2005
Effective Date January 1, 2006
Affects..... No other pronouncements
Affected by..... No other pronouncements
Interpreted by..... INT 06-07
Relevant Appendix A Guidance None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	2
Accounting.....	2
Impairment.....	3
Audited Financial Statements	4
Disclosures.....	4
Relevant Literature.....	5
Effective Date and Transition	7
REFERENCES.....	7
Relevant Issue Papers	7
EXHIBIT A – LOW-INCOME HOUSING TAX CREDIT PROPERTY INVESTMENTS.....	8

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for investments in federal and certain state sponsored Low-Income Housing Tax Credit (LIHTC) properties owned through limited liability entities that are flow-through entities for tax purposes. State sponsored LIHTC programs that have the following characteristics are within the scope of and shall be accounted for in accordance with this statement:

- a. The program is based upon Internal Revenue Code (IRC) section 42.
- b. The investment requires an ongoing interest in a limited liability entity, which is a flow-through entity, and cannot be transferred apart from this interest.
- c. Resale value of the investment is not based upon the fair value of the underlying real estate.
- d. Fair value of the investment is directly tied to the remaining stream of tax credits and deductible losses available to investors.

- e. The critical element of value is known with a high degree of certainty before being marketed to investors.
- f. The proportional amortization method (as modified by this statement) is more indicative of liquidation value than the equity method.

State sponsored LIHTC programs requiring ownership in a partnership or limited liability entity that do not have the foregoing characteristics shall continue to be accounted for in accordance with the requirements of *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*.

2. Some states have enacted laws that create programs by which transferable and non-transferable state tax credits are granted to entities under certain specified conditions (e.g., an entity makes an investment in a particular industry). Investments in transferable and non-transferable state tax credits are not within the scope of this statement. See *SSAP No. 94R—Transferable and Non-Transferable State Tax Credits*.

SUMMARY CONCLUSION

3. LIHTC investments held by reporting entities meet the definition of an asset as specified in *SSAP No. 4—Assets and Nonadmitted Assets* and are admissible assets to the extent that they comply with the requirements of this statement.

4. Resale valuation of these investments is based on the present value of the future stream of tax credits and deductible losses, and not the fair value of the underlying real estate.

5. Investors in entities that manage or invest in low-income housing projects receive tax benefits in the form of tax deductions from operating losses and tax credits. The tax credits are allowable on the tax return each year over a 10-year period as a result of renting a sufficient number of units to qualifying tenants and are subject to restrictions on gross rentals paid by those tenants. These credits are subject to recapture over a 15-year period starting with the first year tax credits are earned. Corporate investors generally purchase an interest in a limited liability entity that manages or invests in the low-income housing projects.

Accounting

6. LIHTC investments shall be initially recorded at cost and carried at proportional amortized cost as specified in this statement unless considered impaired as discussed in paragraphs 16-19. An illustration has been provided in Exhibit A of this statement.

7. A reporting entity investor using the proportional amortized cost method shall amortize any excess of the carrying amount of the investment over its estimated residual value during the periods in which tax benefits are allocated to the investor. The estimated residual value used in determining the amount to be amortized is the estimated residual value at the end of the last period in which tax benefits are allocated to the investor and should not reflect anticipated inflation. Annual amortization shall be based on the proportion of tax benefits received in the current year to total estimated tax benefits to be allocated to the investor. The amortization amount shall be calculated as follows:

- a. The initial investment balance less any expected residual value of the investment, multiplied by,
- b. The percentage of actual tax credits and other tax benefits allocated to the reporting entity in the current period divided by the total estimated tax credits and other tax benefits expected to be received by the reporting entity over the life of the investment.

8. Under the proportional amortized cost method, the amortization of the investment in the limited liability entity is recognized in the income statement as a component of net investment income/expense. The current tax credit (or benefit) shall be accounted for as a component of income tax expense.

9. Federal tax credits shall be recognized in the income statement as an offset to federal taxes in the tax reporting year in which the tax credit is utilized in accordance with *SSAP No. 101—Income Taxes*. State tax credits shall be recognized 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. Tax benefits received, other than tax credits, shall be accounted for pursuant to SSAP No. 101.

10. At the time of initial investment, immediate recognition of the entire benefit of the tax credits to be received during the term of an investment in a low-income housing project is not appropriate. (That is, low-income housing tax credits shall not be recognized in the financial statements before their inclusion in the investor's tax return.)

11. Many LIHTC investments require future equity contributions by the investor (equity contributions), that may be contingent on a variety of conditions, such as receiving representations, contract performance, meeting occupancy requirements, etc. If the commitment by the investor to provide equity contributions meets the definition of a liability as defined in *SSAP No. 5R—Liabilities Contingencies and Impairments of Assets*, a liability shall be recorded.

12. If the commitment to provide equity contributions does not meet the definition of a liability, the contingent commitment shall be disclosed in the notes to the financial statements with other contingent commitments. A liability shall also be recognized for equity contributions that are contingent on a future event when that contingent event becomes probable.

13. Additional funding that does not result in additional tax credits for the reporting entity (investor) shall be expensed as a component of net investment income. In the event a reporting entity obtains additional tax credits for a LIHTC investment, the following shall be applied:

- a. If additional tax credits are allocated without additional funding, the additional tax credits shall not be afforded any value; rather, the tax benefit is only recognized when realized.
- b. If additional funding directly related to the additional tax credits is required, the provisions of this statement shall be followed as if the additional funding were a new investment in LIHTC property.

14. An investment amortized to residual value in accordance with paragraph 7 of this statement shall not be revalued under any other method during or subsequent to the amortization period, other than as discussed in this statement.

15. Changes in estimated losses shall be accounted for in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors* as a change in estimate and included as a component of net investment income.

Impairment

16. Reporting entities with investments in LIHTC properties shall complete and document an impairment analysis at each reporting period. If it is determined that an impairment exists, the book value of the LIHTC investment shall be compared to the present value of future tax benefits discounted at a risk free rate of return, i.e., the rate on U.S. Treasury obligations of a similar duration, and the investment shall be written-down if the book value is higher. This will result in a new cost basis 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.

17. Among other things, an other-than-temporary impairment^(INT 06-07) shall be considered to have occurred if it is probable that future tax benefits will not be received as expected. For example, for LIHTC properties based on state tax credits, if the reporting entity intends to decrease premium volume in that state, it may affect whether or not the tax credits in that state are realizable. The best available information about market share or premiums by state and premiums by line of business generally should be used to estimate the amount of future tax credits that are realizable. For purposes of determining impairment, future tax benefits consist of both estimated tax losses and anticipated tax credits. Loan default or a reasonable probability of credit recapture would signify that tax benefits would not be received as expected.

18. In a multi-tiered partnership, whereby one limited partnership exists only to hold interests in other limited partnerships that are each invested in different developments, the impairment should be determined at the lowest tier. The partnership that holds the assets in which the impairment is determined to exist will be adjusted to a new cost basis representing the lower of book value or the present value of future tax benefits discounted at a risk-free rate of interest. This new cost basis and related realized loss shall be recognized by the holder of a LIHTC investment.

19. It should be noted that a foreclosure of a single property within an LIHTC investment fund only affects the loss of tax credits on a proportional basis. For example, a foreclosure of one property in a six-property fund generating equal levels of credits would only eliminate 1/6 of the credits, thereby, only affecting 1/6 of the LIHTC investment fund value to the individual investors.

Audited Financial Statements

20. The reporting entity's return and book value of an LIHTC investment is reliant upon maintaining tax credit eligibility and not its share of the equity as reported on a financial statement. As such, a reporting entity shall monitor the tax credit eligibility of an LIHTC investment through requiring either audited GAAP or audited tax basis financial statements. In the event an audited GAAP or audited tax basis financial statement is not obtained, the asset shall be nonadmitted.

Disclosures

21. Disclose the number of remaining years of unexpired tax credits and the required holding period for the LIHTC investments.

22. Disclose the amount of low-income housing tax credits and other tax benefits recognized during the years presented.

23. Disclose the balance of the investment recognized in the statement of financial position for the reporting period(s) presented.

24. Disclose if the LIHTC property is currently subject to any regulatory reviews and the status of such review. (Example investigations by the housing authority.)

25. Any commitment or contingent commitment (e.g., guarantees or commitments to provide additional capital contributions) including the amount of equity contributions that are contingent commitments related to LIHTC properties investments and the year(s) that contingent commitments are expected to be paid shall be disclosed.

26. The significance of an investment to the reporting entity's financial position and results of operations shall be considered in evaluating the extent of disclosures of the financial position and results of operations of an investment in a LIHTC. If in the aggregate the LIHTC investments exceed 10% of the total admitted assets of the reporting entity the following disclosures shall be made:

- a. (i) The name of each partnership or limited liability entity and percentage of ownership, (ii) the accounting policies of the reporting entity with respect to investments in partnerships and limited liability entities (iii) the difference, if any, between the amount at which the investment is carried and the amount of underlying equity in net assets (i.e., nonadmitted goodwill or other nonadmitted assets) and (iv) the accounting treatment of the difference;
 - b. For partnerships, and limited liability entities for which a quoted fair value is available, the aggregate value of each partnership, or limited liability entity investment based on the quoted fair value; and
 - c. Summarized information as to assets, liabilities and results of operations for partnerships, and limited liability entities, either individually or in groups.
27. A reporting entity that recognizes an impairment loss shall disclose the following in the financial statements that include the period of the impairment write-down:
- a. A description of the impaired assets and the facts and circumstances leading to the impairment; and
 - b. The amount of the impairment and how fair value was determined.
28. Disclose the amount and nature of the write-downs or reclassifications made during the year resulting from the forfeiture or ineligibility of tax credits, etc. These write-downs may be based on actual property level foreclosure, loss of qualification due to occupancy levels, compliance issues with tax code provisions within an LIHTC investment, or other issues.
29. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

30. This statement adopts with modification *ASU 2014-01, Investments—Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects*. The modifications include:
- a. ASU 2014-01 allows the election of using the proportional amortization method if an affordable housing project investment meets several criteria, including the lack of significant influence. This statement requires the proportional amortization method, with modifications as discussed in this statement, for all investments within its scope. Although the terminology is updated, the balance sheet amount and timing of amortization should be the same under this statement and the proportional amortization method in ASU 2014-01.
 - b. The proportional amortization method in ASU 2014-01 utilizes a net presentation in the income statement by including the amortized initial cost of the investment and the tax credits and benefits received within income tax expense. This statement requires a gross presentation on the income statement, with proportional amortization of the initial cost of the investment in investment income and the tax credits and benefits included in income tax expense.
 - c. Paragraphs 323-740-50-2c and 323-740-50-2d related to disclosures of the optionality of the method used and net reporting, are rejected as not applicable to statutory accounting.
 - d. Disclosures should be followed as indicated in the disclosures section in this statement.

31. This statement adopts with modification *EITF 94-1: Accounting for Tax Benefits from Investments in Affordable Housing Projects* as applicable to statutory accounting to the extent it is not modified by ASU 2014-01. In 2006, this statement modified *Issue Paper No. 99—Nonapplicable GAAP Pronouncements* to remove the reference to EITF 94-1.

32. ASU 2014-01 and EITF 94-1 are modified for the following statutory concepts:

- a. The elective effective yield method and the net income statement reporting in EITF 94-1 are rejected. The elective proportional amortization method in ASU 2014-01, which replaced the effective yield method, is required for only the balance sheet calculation reflecting the timing and amount of amortization. The proportional amortization method net income statement reporting in ASU 2014-01 is rejected for statutory accounting.
- b. Investments that meet the criteria of this statement are required to use a proportional amortization method as prescribed in this statement. This method requires the tax credits and benefits to be recognized in proportion to the percentage of actual tax credits and other tax benefits allocated to the reporting entity in the current period divided by the total estimated tax credits and other tax benefits expected to be received by the reporting entity over the life of the investment. This statement requires a gross presentation on the financial statements, with amortization in investment income.
- c. Federal tax credits shall be recognized in the income statement as an offset to federal income taxes in the tax reporting year in which the tax credit is utilized in accordance with *SSAP No. 101—Income Taxes*. State tax credits shall be recognized 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.
- d. Tax benefits received, other than tax credits, shall be accounted for pursuant to *SSAP No. 101*. Amortization shall be reported as a component of net investment income.
- e. Reporting entities shall follow the guidance in paragraphs 11 and 12 regarding the application of the definition of a liability and contingent commitments from *SSAP No. 5R—Liabilities Contingencies and Impairments of Assets* to equity contributions.
- f. *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* shall be utilized to account for investments that qualify as subsidiary, controlled or affiliated entities.
- g. The impairment guidance contained in this statement shall be followed.
- h. For statutory accounting purposes, deferred taxes are not reported as a component of income from continuing operations in the income statement; rather deferred taxes are recognized as a separate component of gains and losses in unassigned funds (surplus).

33. *AICPA Statement of Position 78-9, Accounting for Investments in Real Estate Ventures* (SOP 78-9) is rejected for purposes of statutory accounting in *SSAP No. 48*. This statement does not intend to establish SOP 78-9 as applicable to statutory accounting.

34. *FASB Interpretation No. 46, Consolidation of Variable Interest Entities* (FIN 46) is rejected for purposes of statutory accounting in *SSAP No. 3*. This statement does not intend to establish FIN 46 as applicable to statutory accounting.

35. *EITF 85-16: Leveraged Leases* (EITF 85-16) is adopted for purposes of statutory accounting in *SSAP No. 22R—Leases*. This statement does not intend to readdress the conclusions reached in *SSAP No. 22R*.

Effective Date and Transition

36. This statement is effective for reporting periods beginning on or after January 1, 2006. Early adoption is permitted. 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. The guidance previously in paragraph 3 of this statement superseded paragraph 1 of SSAP No. 48. In 2011, this guidance was moved to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* and deleted from this statement. The original guidance included in this standard is retained for historical purposes in Issue Paper No. 125. The guidance from ASU 2014-01 is effective for reporting periods beginning on or after January 1, 2015, with early adoption permitted.

REFERENCES**Relevant Issue Papers**

- *Issue Paper No. 125—Accounting for Low-Income Housing Tax Credit Property Investments*

Not for Distribution

EXHIBIT A – LOW-INCOME HOUSING TAX CREDIT PROPERTY INVESTMENTS

A Limited Partnership Investment in an Affordable Housing Project Accounted for Using the Amortized Cost Method (modified to include tax benefits and record amortization as a component of net investment income):

This exhibit is based on ASU 2014-01, paragraph 323-740-55-7 of the Accounting Standards Codification. The amount and timing of amortization in the proportional amortization method is consistent with the statutory modifications; therefore, the table incorporated in this exhibit is based on the proportional amortization table. The statutory income statement requires a gross presentation on the income statement, with proportional amortization of the initial cost of the investment in investment income and the tax credits and benefits included in income tax expense.

Terms:

Date of Investment: January 1, 20X1

Purchase Price of Investment: \$100,000

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~~.
7. For simplicity, the project will operate with break-even pretax cash flows including debt service during the first 15 years of operations.
8. The project's taxable loss will be equal to depreciation expense. The cumulative book loss (and thus the cumulative depreciation expense) recognized by the investor is limited to the \$100,000 investment.
9. It is assumed that all requirements are met to retain allocable tax credits so there will be no recapture of tax credits.
10. The investor expects that the estimated residual value of the investment will be zero.

Proportional Amortization Method with Statutory Modifications

Year	Net Investment (1)	Amortization of Investment (2)	Tax Credits (3)	Net Losses/Tax Depreciation (4)	Other Tax Benefits from Tax Depreciation (5)	Tax Credits and Other Tax Benefits (6)
	100,000					
1	90,909	9,091	8,000	7,273	2,909	10,909
2	81,818	9,091	8,000	7,273	2,909	10,909
3	72,727	9,091	8,000	7,273	2,909	10,909
4	63,636	9,091	8,000	7,273	2,909	10,909
5	54,545	9,091	8,000	7,273	2,909	10,909
6	45,454	9,091	8,000	7,273	2,909	10,909
7	36,363	9,091	8,000	7,273	2,909	10,909
8	27,272	9,091	8,000	7,273	2,909	10,909
9	18,181	9,091	8,000	7,273	2,909	10,909
10	9,090	9,091	8,000	7,273	2,909	10,909
11	6,666	2,424		7,273	2,909	2,909
12	4,242	2,424		7,273	2,909	2,909
13	1,818	2,424		7,273	2,909	2,909
14	0	1,818		5,451	2,183	2,183
15	0					0
Total		100,000	80,000	100,000	40,000	120,000

- (1) End-of-year investment for a ~~5%—percent~~ limited liability interest in the project net of amortization in Column (2).
- (2) Initial investment of \$100,000 x (total tax benefits received during the year in Column (6)/total anticipated tax benefits over the life of the investment of \$120,000).
- (3) ~~Four percent~~ A 4% tax credit on \$200,000 tax basis of the underlying assets.
- (4) Depreciation (on \$200,000 tax basis of the underlying assets) using the straight-line method over 27.5 years up to the amount of the initial investment of \$100,000.
- (5) Column (4) x 40% tax rate.
- (6) Column (3) + Column (5).

Statements of Statutory Accounting Principles No. 94 – Revised

Transferable and Non-Transferable State Tax Credits

STATUS

Type of Issue.....	Common Area
Issued	June 12, 2006; Substantively revised December 7, 2011
Effective Date	December 31, 2006; Substantive revisions detailed in Issue Paper No. 145 effective December 31, 2011
Affects.....	No other pronouncements
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	2
Transferable State Tax Credits.....	2
Non-Transferable State Tax Credits	2
Acquisition.....	3
Balance Sheet Treatment	3
Income Statement Treatment	3
Impairment.....	3
Disclosures.....	3
Effective Date and Transition	4
REFERENCES.....	4
Relevant Issue Papers	4
EXHIBIT A – ACCOUNTING FOR TRANSFERABLE STATE TAX CREDITS.....	5
EXHIBIT B – ACCOUNTING FOR NON-TRANSFERABLE STATE TAX CREDITS.....	6

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for transferable and non-transferable state tax credits that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).
2. Investments in Low-Income Housing Tax Credits as discussed in *SSAP No. 93—Low-Income Housing Tax Credit Property Investments*, which involve an investment by a reporting entity in a limited liability company or similar entity that earns tax credits as a consequence of its operating activities involving low-income housing developments and passes those tax credits to its investors, are not within the scope of this statement.
3. Investments in a CAPCO (Certified Capital Company), organized as a partnership or an LLC, which is a company, authorized by state statute that borrows from investors (insurance companies), in

order to make venture capital investments in “qualified” businesses, are not within the scope of this statement. Although associated with tax credits, the insurance company is paid principal and interest on its investment with the CAPCO. Depending upon the terms of the CAPCO offering, principal and interest payments to the insurance company will come from the CAPCO and/or the state. The CAPCO will make cash payments directly to the insurance company while the state will make payments in the form of premium or income tax credits.

SUMMARY CONCLUSION

4. The criteria in paragraphs 5 and 6 are for transferable state tax credits (i.e., credits which may be sold or assigned). The criteria in paragraphs 7 and 8 are for non-transferable state tax credits (i.e., those which cannot be sold or assigned to other parties).

Transferable State Tax Credits

5. Some states have enacted laws that create programs by which transferable state tax credits are granted to entities under certain specified conditions (e.g., an entity makes an investment in a particular industry). The terms of these state tax credits vary from state to state and, within a state, from program to program. However, many of these transferable state tax credit programs share the following four characteristics:

- a. The tax credit is nonrefundable;
- b. The holder of the transferable state tax credit may sell or otherwise transfer the transferable state tax credit to another entity, which can likewise resell or transfer the credit;
- c. The transferable state tax credit will expire if not used by a predetermined date; and
- d. The transferable state tax credit can be applied against either state income tax or state premium tax.

6. For purposes of this statement, such programs will be referred to as “transferable state tax credits.” The criteria in paragraphs 5.b., 5.c. and 5.d. must be present in order for the transferable state tax credit to receive the accounting treatment described in this statement. When a reporting entity purchases a transferable state tax credit from another entity, the transaction does not result in a continuing investment in a business entity (i.e. limited partnership).

Non-Transferable State Tax Credits

7. If the original or subsequent holder of the transferable tax credit is not able to transfer the tax credit, then the admissibility criteria in paragraph 8 for non-transferable tax credits apply. These non-transferable state tax credits share the following characteristics:

- a. The tax credit is nonrefundable;
- b. The successive holder of a state tax credit must redeem the credit by April 15 of the subsequent year to the entity’s acquisition of the state tax credit and is not permitted to carry-over, carry-back, obtain a refund, sell or assign the credit;
- c. The non-transferable state tax credit will expire if not used by the predetermined date; and
- d. The non-transferable state tax credit can be applied against either state income tax or state premium tax.

8. The criteria in paragraphs 7.b., 7.c. and 7.d. must be present in order for the non-transferable state tax credit to receive the accounting treatment described in this statement.

9. Transferable and non-transferable state tax credits as defined within this SSAP held by reporting entities meet the definition of assets as specified in *SSAP No. 4—Assets and Nonadmitted Assets* and are admissible assets to the extent that they comply with the requirements of this statement. If the criteria in paragraphs 6 or 8 are not met, the tax credits are nonadmitted.

Acquisition

10. Transferable and non-transferable state tax credits are recorded at cost at the date of acquisition.

Balance Sheet Treatment

11. Transferable and non-transferable state tax credits expected to be realized are initially recorded at cost.

12. Transferable and non-transferable state tax credits shall be established gross of any related state tax liabilities and reported in the category of other-than-invested assets (not reported net).

13. As transferable and non-transferable state tax credits are redeemed, the carrying value of the tax credits is reduced dollar for dollar by the amount of state tax credits applied toward the reporting entity's applicable state tax liability.

Income Statement Treatment

14. Gains on transferable and non-transferable state tax credits are deferred until the value of the state tax credits utilized exceeds the cost of the state tax credits or until the state tax credits are sold to other entities and the payment received is greater than the book value.

15. Losses on transferable and non-transferable state tax credits are recognized when known.

16. Gains and losses on transferable and non-transferable state tax credits are reflected in other income.

Impairment

17. An impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to recover the carrying amount of the transferable or non-transferable state tax credits. State tax credits should be evaluated for impairment at each reporting date.

18. When there is a decline in the realizability of a transferable or non-transferable state tax credit owned by the reporting entity that is other than temporary, the asset shall be written down to the expected realizable amount and the amount of the write down shall be accounted for as a realized loss. The expected realizable value is the new cost basis.

19. The new cost basis shall not be changed for subsequent recoveries in realizability.

Disclosures

20. The following disclosures shall be made in the financial statements. For purposes of this disclosure, total unused transferable and non-transferable state tax credits represent the entire transferable and non-transferable state tax credits available:

- a. Carrying value of transferable and non-transferable state tax credits gross of any related state tax liabilities by state and in total,

- b. Total unused transferable and non-transferable state tax credits by state;
- c. Method of estimating utilization of remaining transferable and non-transferable state tax credits or other projected recovery of the current carrying value.
- d. Impairment amount recognized in the reporting period, if any.
- e. Identify state tax credits by transferable and non-transferable classifications, and identify the admitted and Nonadmitted portions of each classification.

Effective Date and Transition

21. This statement is effective for reporting periods ending on or after December 31, 2006. Early adoption is permitted. 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. Substantive revisions to 1) revising the title; 2) incorporating the criteria for non-transferable state tax credits as described in paragraphs 7 and 8; 3) adding a disclosure; and 4) updating terminology throughout the document as appropriate, are effective for reporting periods ending on or after December 31, 2011.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 126—Accounting for Transferable State Tax Credits*
- *Issue Paper No. 145—Accounting for Transferable and Non-Transferable State Tax Credits*

EXHIBIT A – ACCOUNTING FOR TRANSFERABLE STATE TAX CREDITS

On 1/1/X1 SAM Insurance Company purchased transferable state tax credits for a cost of \$100,000. The transferable state tax credits are redeemable for \$160,000 and expire at the end of 12/31/X4. SAM initially expects to utilize the tax credits before expiration in their state of domicile in the amount of \$40,000 per year. In year X4, SAM sells the remaining \$30,000 in transferable state tax credits for \$20,000

1/1/x1	Transferable state tax credits	100,000	
	Cash		100,000
	<i>To record the purchase of the tax credits</i>		
6/30/x1	Premium tax expense	40,000	
	Premium taxes payable to domiciliary state		40,000
	<i>To record premium tax expense and accrue the liability in Year 1.</i>		
10/1/x1	Premium tax payable	40,000	
	Transferable state tax credits		40,000
	<i>To record the use of tax credits in Year 1. The reporting entity expects to be able to utilize remaining tax credits before expiration.</i>		
6/30/x2	Premium tax expense	60,000	
	Premium taxes payable to domiciliary state		60,000
	<i>To record premium tax expense and accrue the liability in Year 2.</i>		
9/30/x2	Premium tax payable	60,000	
	Transferable state tax credits		60,000
	<i>To record the use of taxes credits in Year 2. The reporting entity expects to be able to utilize remaining tax credits before expiration.</i>		
6/30/x3	Premium tax expense	30,000	
	Premium taxes payable to domiciliary state		30,000
	<i>To record premium tax expense and accrue the liability in Year 3.</i>		
9/30/x3	Premium tax payable	30,000	
	Other income		30,000
	<i>To record the use of premium tax credits in excess of cost and recognize a gain on premium tax credits in other income. The Company intends to sell the remaining tax credits in year 4.</i>		
6/30/x4	Cash	20,000	
	Other income		20,000
	<i>To record the sale of the remaining tax credits.</i>		

EXHIBIT B – ACCOUNTING FOR NON-TRANSFERABLE STATE TAX CREDITS

On 7/1/X1 LJW Insurance Company purchased non-transferable state tax credits for a cost of \$100,000. The state tax credits are redeemable for \$110,000, are not transferable and expire on, April 15, 20x2. LJW expects to utilize the tax credits before expiration in their state of domicile in the amount of \$110,000.

7/1/x1	State tax credits	100,000	
	Cash		100,000
	<i>To record the purchase of the tax credits</i>		
9/30/x1	Premium tax expense	200,000	
	Premium taxes payable to domiciliary state		200,000
	<i>To record premium tax expense and accrue the liability.</i>		
3/15/x2	Premium tax payable	110,000	
	Other Income		10,000
	State tax credits		100,000
	<i>To record the use of premium tax credits in excess of cost and recognize a gain on premium tax credits in other income. (The additional \$90,000 of premium taxes payable would still be due.)</i>		

Statements of Statutory Accounting Principles No. 95

Nonmonetary Transactions

STATUS

Type of Issue.....	Common Area
Issued	September 11, 2006
Effective Date	January 1, 2007
Affects.....	Supersedes SSAP No. 28; Nullifies and incorporates INT 00-29, INT 02-19 and INT 03-16; Nullifies INT 99-21
Affected by.....	No other pronouncements
Interpreted by	INT 00-26; INT 06-13; INT 08-05
Relevant Appendix A Guidance	None

STATUS	1
SUMMARY CONCLUSION	1
Definitions.....	1
Basic Principle	2
Modifications of the Basic Principle.....	3
Commercial Substance.....	3
Additional Guidance	3
Applying the Basic Principle	4
Accounting for a Convertible Instrument Granted or Issued to a Nonemployee for Goods or Services, or Services and Cash (in Combination or Individually), or as Consideration Payable to a Customer	5
Disclosures.....	6
Relevant Literature.....	6
Effective Date and Transition.....	7
REFERENCES.....	8
Relevant Issue Papers	8

SCOPE OF STATEMENT

1. The statement establishes statutory accounting principles for nonmonetary transactions. Specific statutory requirements for certain types of nonmonetary transactions are addressed in other statements.
2. This statement supersedes the conclusions reached in *SSAP No. 28—Nonmonetary Transactions* by updating conclusions reached in SSAP No. 28 related to APB 29 with those included in FAS 153. Consequently, this statement adopts with modification FAS 153 to change GAAP references to those applicable to statutory accounting. In addition, references made to APB 29 within SSAP No. 28 will be replaced with the actual amended guidance resulting from FAS 153.

SUMMARY CONCLUSION

Definitions

3. The definitions of certain terms used in this statement are:

- a. **Monetary assets and liabilities** are assets and liabilities whose amounts are fixed in terms of units of currency by contract or otherwise. Examples are cash; amounts due from agents, brokers, and intermediaries; policy loans; accounts payable; and other amounts receivable or payable in cash;
 - b. **Nonmonetary assets and liabilities** are assets and liabilities other than monetary ones. Examples are common stocks; furniture, fixtures, and equipment; real estate and liabilities for rent collected in advance;
 - c. **Exchange (or exchange transaction)** is a reciprocal transfer between a reporting entity and another entity that results in the reporting entity acquiring assets or services or satisfying liabilities by surrendering other assets or services or incurring other obligations. A reciprocal transfer of a nonmonetary asset shall be deemed an exchange only if the transferor has no substantial continuing involvement in the transferred asset such that the usual risks and rewards of ownership of the asset are transferred;
 - d. **Nonreciprocal transfer** is a transfer of assets or services in one direction, either from a reporting entity to its owners (whether or not in exchange for their ownership interests) or another entity, or from owners or another entity, to the reporting entity. An insurance company's reacquisition of its outstanding stock is an example of a nonreciprocal transfer.
4. Nonmonetary transactions shall be accounted for in accordance with this statement, except as addressed by other statements or interpretations including but not limited to *SSAP No. 12—Employee Stock Ownership Plans*, *SSAP No. 25—Affiliates and Other Related Parties*, *SSAP No. 68—Business Combinations and Goodwill*, *SSAP No. 72—Surplus and Quasi-Reorganizations*, *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, *SSAP No. 104R—Share-Based Payments*, and *INT 00-26: EITF 98-3: Determining Whether a Nonmonetary Transactions Involves Receipt of Productive Assets or of a Business*.

Basic Principle

5. Accounting for nonmonetary transactions shall generally be based on the fair values of the assets (or services) involved, as defined in paragraph 13, which is the same basis as that used in monetary transactions. Thus, the cost of a nonmonetary asset acquired in exchange for another nonmonetary asset (reciprocal transactions) is the fair value of the asset surrendered to obtain it, and a gain or loss should be recognized on the exchange. The fair value of the asset received should be used to measure the cost if it is more clearly evident than the fair value of the asset surrendered. Similarly, a nonmonetary asset received in a nonreciprocal transfer should be recorded at the fair value of the asset received as defined in paragraph 6. A transfer of a nonmonetary asset to a stockholder or to another entity in a nonreciprocal transfer should be recorded at the fair value of the asset transferred, and a gain or loss should be recognized on the disposition of the asset. The fair value of a reporting entity's own stock reacquired may be a more clearly evident measure of the fair value of the asset distributed in a nonreciprocal transfer if the transaction involves distribution of a nonmonetary asset to eliminate a disproportionate part of owners' interests (that is, to acquire stock for the treasury or for retirement).
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 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.

Modifications of the Basic Principle

7. A nonmonetary exchange shall be measured based on the recorded amount (after reduction, if appropriate, for an indicated impairment of value) of the nonmonetary asset(s) relinquished, and not on the fair values of the exchanged assets, if any of the following conditions apply:

- a. *Fair Value Not Determinable.* The fair value of neither the asset(s) received nor the asset(s) relinquished is determinable within reasonable limits (paragraph 14).
- b. *Exchange Transaction to Facilitate Sales to Customers.* The transaction is an exchange of a product or property held for sale in the ordinary course of business for a product or property to be sold in the same line of business to facilitate sales to customers other than the parties to the exchange.
- c. *Exchange Transaction That Lacks Commercial Substance.* The transaction lacks commercial substance (paragraph 8).

Commercial Substance

8. A nonmonetary exchange has commercial substance if the entity's future cash flows are expected to significantly change as a result of the exchange. The entity's future cash flows are expected to significantly change if either of the following criteria is met:

- a. The configuration (risk, timing, and amount)¹ of the future cash flows of the asset(s) received differs significantly from the configuration of the future cash flows of the asset(s) transferred.
- b. The entity-specific value² of the asset(s) received differs from the entity-specific value of the asset(s) transferred, and the difference is significant in relation to the fair values of the assets exchanged.

A qualitative assessment will, in some cases, be conclusive in determining that the estimated cash flows of the entity are expected to significantly change as a result of the exchange.

9. In the United States and some other tax jurisdictions, a transaction is not given effect for tax purposes unless it serves a legitimate business purpose other than tax avoidance. In assessing the commercial substance of an exchange, tax cash flows that arise solely because the tax business purpose is based on achieving a specified financial reporting result shall not be considered.

Additional Guidance

10. Stock received in the form of a stock dividend or stock split shall not result in the recognition of income. The cost basis of stock held shall be reallocated ratably to the total shares held after receipt of the stock dividend or stock split.

¹ The configuration of future cash flows is composed of the risk, timing, and amount of the cash flows. A change in any one of those elements would be a change in configuration.

² An entity-specific value (referred to as an entity-specific measurement in Concepts Statement 7) is different from a fair value measurement. As described in paragraph 24.b. of Concepts Statement 7, an entity-specific value attempts to capture the value of an asset or liability in the context of a particular entity. For example, an entity computing an entity-specific value of an asset would use its expectations about its use of that asset rather than the use assumed by marketplace participants. If it is determined that the transaction has commercial substance, the exchange would be measured at fair value, rather than at the entity-specific value.

11. The exchanges of nonmonetary assets that would otherwise be based on recorded amounts (paragraphs 7 and 8) may include an amount of monetary consideration. The recipient of the monetary consideration has realized gain on the exchange to the extent that the amount of the monetary receipt exceeds a proportionate share of the recorded amount of the asset surrendered. The portion of the cost applicable to the realized amount should be based on the ratio of the monetary consideration to the total consideration received (monetary consideration plus the estimated fair value of the nonmonetary asset received) or, if more clearly evident, the fair value of the nonmonetary asset transferred. However, the entity paying the monetary consideration should not recognize any gain on a transaction covered in paragraphs 7 and 8, but should record the asset received at the amount of the monetary consideration paid plus the recorded amount of the nonmonetary asset surrendered. If a loss is indicated by the terms of a transaction described in this paragraph or in paragraphs 7 and 8, the entire indicated loss on the exchange should be recognized.

12. *Nonreciprocal Transfers to Owners.* Accounting for the distribution of nonmonetary assets to owners of an enterprise in a spin-off^(INT 06-13 and INT 08-05) or other form of reorganization or liquidation or in a plan that is in substance the rescission of a prior business combination should be based on the recorded amount (after reduction, if appropriate, for an indicated impairment of value) (An indicated impairment of value of a long-lived asset covered by SSAP No. 90 shall be determined in accordance with paragraph 4 of SSAP No. 90) of the nonmonetary assets distributed. A pro rata distribution to owners of an enterprise of shares of a subsidiary or other investee company that has been or is being controlled or that has been or is being accounted for under the equity method is to be considered to be equivalent to a spin-off. Other nonreciprocal transfers of nonmonetary assets to owners should be accounted for at fair value if the fair value of the nonmonetary asset distributed is objectively measurable and would be clearly realizable to the distributing entity in an outright sale at or near the time of the distribution

Applying the Basic Principle

13. Fair value of a nonmonetary asset transferred to or from a reporting entity in a nonmonetary transaction should be determined in accordance with *SSAP No. 100R—Fair Value*. If one of the parties in a nonmonetary transaction could have elected to receive cash instead of the nonmonetary asset, the amount of cash that could have been received may be evidence of the fair value of the nonmonetary assets exchanged.

14. Fair value should be regarded as not determinable within reasonable limits if major uncertainties exist about the realizability of the value that would be assigned to an asset received in a nonmonetary transaction accounted for at fair value. An exchange involving parties with essentially opposing interests is not considered a prerequisite to determining a fair value of a nonmonetary asset transferred; nor does an exchange insure that a fair value for accounting purposes can be ascertained within reasonable limits. If neither the fair value of a nonmonetary asset transferred nor the fair value of a nonmonetary asset received in exchange is determinable within reasonable limits, the book adjusted carrying value of the nonmonetary asset transferred from the enterprise may be the only available measure of the transaction.

15. A difference between the amount of gain or loss recognized for tax purposes and that recognized for accounting purposes may constitute a temporary difference to be accounted for according to *SSAP No. 101—Income Taxes*.

16. Involuntary conversions of nonmonetary assets to monetary assets (for example, as a result of total or partial destruction, theft, seizure, or condemnation) are monetary transactions for which gain or loss shall be recognized even though a reporting entity reinvests or is obligated to reinvest the monetary assets in replacement nonmonetary assets. In some cases, a nonmonetary asset may be destroyed or damaged in one accounting period, and the amount of monetary assets to be received is not determinable until a subsequent accounting period. In those cases, gain or loss shall be recognized in accordance with the conclusions in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*. Gain or loss resulting from an involuntary conversion of a nonmonetary asset to monetary assets shall be reported

consistently with the reporting entity's reporting of continuing operations and disclosed in the notes to financial statements in accordance with *SSAP No. 24—Discontinued Operations and Unusual or Infrequent Items*.

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.

18. Once an instrument is considered "issued" for accounting purposes, pursuant to SSAP No. 104R, distributions paid or payable should be characterized as financing costs (that is, as interest or dividends). Before that time, distributions paid or payable under the instrument should be characterized as a cost of the underlying goods or services. If the convertible instrument is issued for cash proceeds that indicate that the instrument includes a beneficial conversion feature and the purchaser of the instrument also provides (receives) goods or services to (from) the issuer that are the subject of a separate contract, the convertible instrument shall be recognized with a corresponding increase or decrease in the purchase or sales price of the goods or services.

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.

20. The requirements of this statement shall then be applied such that the fair value determined pursuant to SSAP No. 104R is considered the proceeds from issuing the instrument for purposes of determining whether a beneficial conversion option exists. The measurement of the intrinsic value, if any, of the conversion option (for separate recognition as additional paid-in capital) shall then be computed by comparing the proceeds received for the instrument (the instrument's fair value under SSAP No. 104R) to the fair value of the common stock that the grantee would receive upon exercising the conversion option. For purposes of determining whether a convertible instrument contains a beneficial conversion feature for separate recognition as additional paid-in capital, an entity shall use the effective conversion price based on the proceeds allocated to the convertible instrument to compute the intrinsic value, if any, of the embedded conversion option.

21. SSAP No. 104R shall be used to measure the fair value of the convertible instrument and to measure the intrinsic value, if any, of the conversion option as of the date the convertible instrument granted as part of the share-based payment award becomes fully vested. That is, in measuring the intrinsic value of the conversion option for separate recognition as additional paid-in capital, the fair value of the issuer's equity securities into which the instrument can be converted shall be determined as of the date the convertible instrument granted as part of a share-based payment award becomes fully vested, and not on the commitment date. Both of the following guidelines for determining the fair value of convertible instruments shall be used:

- a. Recent issuances of similar convertible instruments for cash to parties that only have an investor relationship with the issuer may provide the best evidence of fair value of the convertible instrument.
- b. If reliable information about paragraph 21.a. is not available, the fair value of the convertible instrument should be deemed to be no less than the fair value of the equity shares into which it can be converted.

22. In cases where a reporting entity issues a convertible instrument for cash proceeds that indicate that the instrument includes a beneficial conversion option, and the purchaser of the instrument provides (receives) goods or services to (from) the issuer that are the subject of a separate contract, the terms of both the agreement for goods or services and the convertible instrument shall be evaluated to determine whether their separately stated pricing is equal to the fair value of the goods or services and convertible instrument. If that is not the situation, the terms of the respective transactions should be adjusted by measuring the convertible instrument initially at its fair value with a corresponding increase or decrease in the purchase or sales price of the goods or services. It may be difficult to evaluate whether the separately stated pricing of a convertible instrument is equal to its fair value. If an instrument issued to a goods or services provider (or purchaser) is part of a larger issuance, a substantive investment in the issuance by unrelated investors (who are not also providers or purchasers of goods or services) may provide evidence that the price charged to the goods or services provider represents the fair value of the convertible instrument.

Disclosures

23. A reporting entity that engages in a nonmonetary transaction during a period shall disclose the following in the financial statements:

- a. The nature of the transaction;
- b. The basis of accounting for the assets transferred; and
- c. Gains or losses recognized on transfers.

24. Refer to the Preamble for further discussion regarding disclosure requirements. The disclosure in paragraph 23 shall be included in the annual audited statutory financial reports only.

25. Entities shall disclose the amount of revenue and expense recognized from advertising barter transactions for each income statement period presented. In addition, if an entity engages in advertising barter transactions for which the fair value is not determinable within the limits of this Issue, information regarding the volume and type of advertising surrendered and received (such as the number of equivalent pages, the number of minutes, or the overall percentage of advertising volume) shall be disclosed for each income statement period presented.

Relevant Literature

26. Although not meant to be all inclusive, accounting for specific nonmonetary transactions and unique circumstances is addressed in the following statements of statutory accounting principles:

- *SSAP No. 12—Employee Stock Ownership Plans*
- *SSAP No. 25—Affiliates and Other Related Parties*
- *SSAP No. 68—Business Combinations and Goodwill*
- *SSAP No. 72—Surplus and Quasi-Reorganizations*
- *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
- *SSAP No. 104R—Share-Based Payments*
- *INT 00-26; EITF 98-3: Determining Whether a Nonmonetary Transactions Involves Receipt of Productive Assets or of a Business*

27. This statement updates general statutory guidance for accounting for nonmonetary transactions not specifically addressed in the statements of statutory accounting principles noted above and carries forward current statutory guidance for stock dividends and stock splits received, other types of nonmonetary transactions and involuntary conversions of nonmonetary assets to monetary assets. The guidance in this statement remains consistent with the guidance provided in SSAP No. 30R, which addresses cash dividends and requires that dividends on common stock be recorded as investment income when declared with a corresponding receivable to be extinguished upon receipt of cash. This statement carries forward the disclosure requirements related to nonmonetary transactions from SSAP No. 28.

28. This statement adopts *Accounting Principles Board Opinion No. 29, Accounting for Nonmonetary Transactions* (APB 29) as modified by *FASB No. 153: Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29* (FAS 153).

29. This statement adopts FAS 153 with modifications for references to statements of statutory accounting principles.

30. This statement continues the adoption of *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins* (ARB 43), Chapter 7, Section B, *Stock Dividends and Stock Split-ups* paragraphs 1-9 as such relates to the receipt of stock in the form of a stock dividend or stock split. This conclusion is consistent with the recognition concept included in the Statement of Concepts, which states, "Revenue should be recognized only as the earnings process of the underlying underwriting or investment business is completed".

31. This statement continues the adoption of *FASB Interpretation No. 30, Accounting for Involuntary Conversions of Nonmonetary Assets to Monetary Assets* (FIN 30) with modification to provide that gain or loss contingencies be recognized in accordance with the conclusion in SSAP No. 5R and that gain or loss resulting from an involuntary conversion of nonmonetary assets to monetary assets be accounted for in continuing operations and disclosed in accordance with SSAP No. 24.

32. This statement continues the adoption of *FASB Emerging Issues Task Force Issue No. 86-29: Nonmonetary Transactions: Magnitude of Boot and the Exceptions to the Use of Fair Value* (EITF 86-29) and *FASB Emerging Issues Task Force Issue No. 93-11: Accounting for Barter Transactions Involving Barter Credits* (EITF 93-11) consistent with the general rule discussed in paragraph 27 of this statement. This statement also adopts with modification *FASB Emerging Issues Task Force Issue No. 99-17, Accounting for Advertising Barter Transactions*.

33. This statement nullifies *INT 99-21: EITF No. 98-7, Accounting for Exchanges of Similar Equity Method Investments*.

34. This statement continues the rejection of paragraph 16 of *Accounting Principles Board Opinion No. 6, Status of Accounting Research Bulletins and Emerging Issues Task Force No. 96-4, Accounting for Reorganizations Involving a Non-Pro Rata Split-off of Certain Nonmonetary Assets to Owners*.

35. This statement adopts 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*.

Effective Date and Transition

~~35.~~36. The provisions of this statement shall be effective for nonmonetary asset exchanges occurring in fiscal periods beginning after January 1, 2007. Earlier application is permitted for nonmonetary asset exchanges occurring in fiscal periods beginning after the date this statement is issued. The provisions of this statement shall be applied prospectively. The guidance in paragraph 21 related to long-lived assets to be disposed of other than by sale was previously included within *SSAP No. 90—Impairment or Disposal of Real Estate Investments*. In 2012, the guidance from SSAP No. 95 was incorporated within SSAP No.

90, with those paragraphs in SSAP No. 95 being nullified. The original guidance included in this statement, as well as the original guidance adopted in SSAP No. 90 for long-lived assets to be disposed of other than by sale, are retained for historical purposes in Issue Paper No. 127.

~~36~~³⁷. This statement adopts the consensus positions of *EITF 01-1: Accounting for a Convertible Instrument Granted or Issued to a Nonemployee for Goods or Services or a Combination of Goods or Services and Cash* with certain modifications to incorporate guidance in EITF 96-18 regarding the measurement date. EITF 96-18 was previously rejected by the working group in *INT 99-13: EITF 96-18: Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services* in the context of *SSAP No. 13—Stock Options and Stock Purchase Plans*; however, the measurement guidance included in Issue 1 of EITF 96-18 is adopted in this statement. The reference in paragraph 4 to *INT 03-16: Contribution of Stock*, was deleted as guidance was incorporated into SSAP No. 25 and SSAP No. 68. The guidance in paragraph 25 of this statement was originally contained within *INT 00-29: EITF 99-17: Accounting for Advertising Barter Transactions* and was effective June 12, 2000. The guidance in paragraphs 21-22 was originally contained within *INT 02-19: EITF 01-1: Accounting for a Convertible Instrument Granted or Issued to a Nonemployee for Goods or Services or a Combination of Goods or Services and Cash* and was effective December 8, 2002.

REFERENCES

Relevant Issue Papers

- Issue Paper No. 127—Exchanges of Nonmonetary Assets, A Replacement of SSAP No. 28—Nonmonetary Transactions

Statement of Statutory Accounting Principles No. 97

Investments in Subsidiary, Controlled and Affiliated Entities

STATUS

Type of Issue.....	Common Area
Issued	December 2, 2007
Effective Date	December 31, 2007
Affects.....	Supersedes SSAP No. 88; Nullifies and incorporates INT 01-07, INT 03-03, INT 04-10 and INT 08-03
Affected by	No other pronouncements
Interpreted by	INT 00-24, INT 06-07
Relevant Appendix A Guidance	A-820

STATUS.....	1
SCOPE OF STATEMENT.....	2
SUMMARY CONCLUSION	2
Definitions	2
Applying the Market Valuation, Audited Statutory Equity and Audited GAAP Equity Methods	3
Investment in Parent-Issued Surplus Notes	10
Qualified Versus Unqualified Opinions.....	11
Valuation of Investments in Downstream Holding Companies.....	12
Admissibility Requirements of Investments in Downstream Holding Companies.....	12
Limited Exceptions to the Audit Requirements for Downstream Noninsurance Holding Companies.....	13
Investment in Preferred Stock or Surplus Notes of a Subsidiary, Controlled and Affiliated Entity.....	14
Impairment.....	15
Consolidation	15
Disclosures.....	15
Relevant Literature.....	18
Effective Date and Transition	19
REFERENCES.....	19
Other	19
Relevant Issue Papers	19
EXHIBIT A – SCA REPORTING PROCESS	20
Initial Reporting of SCA Investments.....	20
Subsequent Reporting of SCA Investments.....	20
Consistency in Application of Chosen Valuation Method.....	21
Assessment and Review of Sub 1 Form.....	21
Assessment and Review of Sub 2 Form.....	22
Additional Reporting Instructions.....	23
EXHIBIT B – ILLUSTRATIONS.....	25
Accounting for SCAs	25
Illustrated Balance Sheets	27
EXHIBIT C – IMPLEMENTATION QUESTIONS AND ANSWERS.....	30

EXHIBIT D – DETERMINING THE VALUATION METHOD UNDER SSAP NO. 97	35
EXHIBIT E – SLIDING SCALE DISCOUNTING OF SCA ENTITIES USING THE MARKET VALUATION APPROACH	36
EXHIBIT F – ILLUSTRATION OF THE APPLICATION OF INT 00-24.....	37

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for investments in subsidiaries, controlled and affiliated entities, hereinafter referred to as SCA entities.
2. This statement supersedes the conclusions reached in *SSAP No. 88—Investments in Subsidiary, Controlled, and Affiliated Entities*.

SUMMARY CONCLUSION

Definitions

3. Parent and subsidiary are defined as follows:
 - a. Parent—An entity that directly or indirectly owns and controls the reporting entity;
 - b. Subsidiary—An entity that is, directly or indirectly, owned and controlled by the reporting entity.
4. An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies as defined in *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*. Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity method for all such investments.
5. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by common management, or (d) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity¹.

¹ Investments in an exchange traded fund (ETF), a mutual fund (as defined by the SEC) or a foreign open-end investment fund governed and authorized in accordance with regulation established by the applicable foreign jurisdiction does not reflect ownership in an underlying entity, regardless of the ownership percentage the reporting entity (or the holding company group) has of the ETF, mutual fund or foreign open-end investment fund unless ownership of the fund actually results in “control” with the power to direct or cause the direction of management of an underlying company. ETFs, mutual funds and foreign open-end investment funds are comprised of portfolios of securities subject to the regulatory requirements of the federal securities laws or the applicable foreign jurisdictions laws. ETFs, mutual funds and foreign open-end investment funds held by a reporting entity shall be reported as common stock, unless the fund qualifies for bond or preferred stock treatment per the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. Reporting entities are not required to verify that SCAs (subject to SSAP No. 97) are represented in the portfolio of securities held in ETFs, mutual funds or foreign open-end investment funds or to adjust the value of SCAs as a result of investments in ETFs, mutual funds or foreign open-end investment funds.

6. Control as defined in paragraph 5 shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13% and therefore each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment based on the criteria in *FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18*. The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting securities of an investee. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. An investment in an SCA entity may fall below the level of ownership described in paragraph 5, in which case, the reporting entity would discontinue the use of the equity method, as prescribed in paragraph 13.g. Additionally, through an increase in the level of ownership, a reporting entity may become qualified to use the equity method of accounting (paragraph 8.b.), in which case, the reporting entity shall add the cost of acquiring additional interest to the current basis of the previously held interest and shall apply the equity method prospectively, as of the date the investment becomes qualified for equity method accounting. Examples of situations where the presumption of control may be in doubt include the following:

- a. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.
- b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.
- c. An entity where the insurer has given up participating rights² as a shareholder to the investee.

7. Investments in SCA entities 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.

Applying the Market Valuation, Audited Statutory Equity and Audited GAAP Equity Methods

8. The admitted investments in SCA entities shall be valued using either the market valuation approach (as described in paragraph 8.a.), or one of the equity methods (as described in paragraph 8.b.) adjusted as appropriate in accordance with the guidance in *SSAP No. 25—Affiliates and Other Related Parties*, paragraph 18.d.

- a. In order to use the market valuation approach for SCA entities, the following requirements apply:
 - i. The subsidiary must be traded on one of the following major exchanges: (1) the New York Stock Exchange, (2) the NASDAQ, or (3) the Japan Exchange Group;
 - ii. The reporting entity must submit subsidiary information to the NAIC SCA analysts for calculation of the subsidiary's market value. Such calculation could result in further discounts in market value above the established base discounts based on ownership percentages detailed below;

² The term "participating rights" refers to the type of rights that allows an investor to effectively participate in significant decisions related to an investee's ordinary course of business and is distinguished from the more limited type of rights referred to as "protective rights". Refer to the sections entitled: "Protective Rights" and "Substantive Participating Rights" in *EITF 96-16, Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights*. The term "participating rights" shall be used consistent with the discussion of substantive participating rights in this EITF.

- iii. Ownership percentages for determining the discount rate shall be measured at the holding company level;
 - iv. If an investment in a SCA results in an ownership percentage between 10% and 50%, a base discount percentage between 0% and 20% on a sliding scale basis is required;
 - v. If an investment in a SCA results in an ownership percentage greater than 50% up to and including 80%, a base discount percentage between 20% and 30% on a sliding scale basis is required;
 - vi. If an investment in a SCA results in an ownership percentage greater than 80% up to and including 85%, a minimum base discount percentage of 30% is required.
 - vii. Further, the SCA must have at least two million shares outstanding, with a total market value of at least \$50 million in the public's control; and
 - viii. Any ownership percentages exceeding 85% will result in the SCA being recorded on an equity method.
- b. If a SCA investment does not meet the requirements for the market valuation approach in paragraph 8.a. or, if the requirements are met, but a reporting entity elects not to use that approach, the reporting entity's proportionate share of its investments in SCAs shall be recorded as follows:
- i. Investments in U.S. insurance SCA entities shall be recorded based on either 1) the underlying audited statutory equity of the respective entity's financial statements, adjusted for any unamortized goodwill as provided for in *SSAP No. 68—Business Combinations and Goodwill*³ or 2) the underlying audited statutory equity of the respective entity's financial statements, adjusted for any unamortized goodwill, modified to remove the impact of any permitted or prescribed accounting practices that depart from the NAIC *Accounting Practices and Procedures Manual*. Reporting entities shall record investments in U.S. insurance SCA entities on at least a quarterly basis, and shall base the investment value on the most recent quarterly information available from the SCA. Entities may recognize their investment in U.S. insurance SCA entities based on the unaudited statutory equity in the SCAs year-end annual statement if the annual SCA audited financial statements are not complete as of the filing deadline. The recorded statutory equity shall be adjusted for audit adjustments, if any, as soon as the annual audited financial statements have been completed. Annual consolidated or combined audits are allowed if completed in accordance with the Model Regulation Requiring Annual Audited Financial Reports as adopted by the SCA's domiciliary state;
 - ii. Investments in both U.S. and foreign noninsurance SCA entities that are engaged in the following transactions or activities:

³ If the insurance SCA employs accounting practices that depart from the NAIC accounting practices and procedures, and the reporting insurance entity has not adjusted the valuation of the insurance SCA to be consistent with the NAIC accounting practices and procedures, (i.e., retains the effect of the permitted or prescribed practice in its valuation), disclosure about those accounting practices that affect the insurance SCA's net income and surplus shall be made pursuant to paragraph 37. If the reporting entity has adjusted the investment in the insurance SCA with the resulting valuation being consistent with the accounting principles of the AP&P Manual, the disclosures in paragraph 37 are not required.

- (a) Collection of balances as described in *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*
- (b) Sale/lease or rental of EDP Equipment and Software as described in *SSAP No. 16R—Electronic Data Processing Equipment and Software*
- (c) Sale/lease or rental of furniture, fixtures, equipment or leasehold improvements as described in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements*
- (d) Loans to employees, agents, brokers, representatives of the reporting entity or SCA as described in *SSAP No. 20—Nonadmitted Assets*
- (e) Sale/lease or rental of automobiles, airplanes and other vehicles as described in *SSAP No. 20—Nonadmitted Assets*
- (f) Providing insurance services on behalf of the reporting entity including but not limited to accounting, actuarial, auditing, data processing, underwriting, collection of premiums, payment of claims and benefits, policyowner services
- (g) Acting as an insurance or administrative agent or an agent for a government instrumentality performing an insurance function (e.g. processing of state workers compensations plans, managing assigned risk plans, Medicaid processing etc).
- (h) Purchase or securitization of acquisition costs

and if 20% or more of the SCA's revenue is generated from the reporting entity and its affiliates, then the underlying equity of the respective entity's audited U.S. Generally Accepted Accounting Principles (GAAP) financial statements shall be adjusted to a limited statutory basis of accounting in accordance with paragraph 9. For purposes of this section, revenue means GAAP revenue reported in the audited U.S. GAAP financial statements excluding realized and unrealized capital gains/losses. Foreign SCA entities are defined as those entities incorporated or otherwise legally formed under the laws of a foreign country. Paragraphs 22-27 provide guidance for investments in holding companies;

- iii. Investments in both U.S. and foreign noninsurance SCA entities that do not qualify under paragraph 8.b.ii., shall be recorded based on the audited U.S. GAAP equity of the investee. Foreign SCA entities are defined as those entities incorporated or otherwise legally formed under the laws of a foreign country. Additional guidance on investments in downstream holding companies is included in paragraphs 22-27. Additional guidance on the use of audited foreign GAAP basis financial statements for the U.S. GAAP equity valuation amount is included in paragraph 23.b.
- iv. Investments in foreign insurance SCA entities shall be recorded based on the underlying U.S. GAAP equity from the audited U.S. GAAP basis financial statements, adjusted to a limited statutory basis of accounting in accordance with paragraph 9, if available. If the audited U.S. GAAP basis financial statements are not available, the investment can be recorded on the audited foreign statutory basis financial statements of the respective entity adjusted to a limited statutory basis of accounting in accordance with paragraph 9 and adjusted for reserves of the foreign

insurance SCA with respect to the business it assumes directly and indirectly from a U.S. insurer using the statutory accounting principles promulgated by the NAIC in the *Accounting Practices and Procedures Manual*. The audited foreign statutory basis financial statements must include an audited footnote that reconciles net income and equity on the foreign statutory basis of accounting to the U.S. GAAP basis. Foreign insurance SCA entities are defined as alien insurers formed according to the legal requirements of a foreign country.

- c. The following provides guidance regarding the audits for entities covered under paragraph 8.b.:
- i. The investment in the SCA shall be nonadmitted if the audited financial statements include substantial doubt about the entity's ability to continue as a going concern. Additionally, the investment shall be nonadmitted on the basis/contents of the audit opinion as detailed in paragraph 21.
 - ii. The recorded GAAP equity shall be adjusted for any audit adjustments resulting from either the annual audited GAAP financial statements of the respective entity or, if the entity is a member of a consolidated or combined group of insurers, the annual audited GAAP financial statements of the consolidated or combined group of companies, as soon as determined. GAAP is defined as those pronouncements included in the FASB codification.
 - iii. Annual consolidated or combined audits are allowed for the valuation of U.S. insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA's domiciliary state.
 - iv. Consolidated or combined financial statements are allowed for the valuation of downstream SCA entities, including downstream SCA entities, that directly or indirectly own U.S. insurance entities, provided that the statutory financial statements of such U.S. insurance entities are audited. The audited financial statements of the downstream SCA entities shall include, as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities, non-SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet of the downstream SCA entities shall then be adjusted for GAAP to SAP differences of the insurance entities and paragraph 8.b.ii. and 8.b.iv. entities owned directly and indirectly by the downstream SCA entities.
 - v. Investments in foreign SCA entities shall follow the guidance in paragraphs 8.b.ii., 8.b.iii. and 8.b.iv. based upon the nature of the SCA as described in the respective paragraphs. To fulfill the requirement for audited U.S. GAAP basis financial statements, the value of foreign SCA investments may be based on the GAAP equity from audited financial statements prepared on a foreign GAAP basis. The audited foreign GAAP basis financial statements must include an audited footnote that reconciles net income and equity on the foreign GAAP basis of accounting to the U.S. GAAP basis. The statutory carrying value of foreign insurance SCA entities (i.e., paragraph 8.b.iv. entities) and foreign noninsurance paragraph 8.b.ii. SCA entities shall include the additional adjustments as described in paragraph 9.

9. The limited statutory basis of accounting for investments in noninsurance SCA entities, subject to paragraph 8.b.ii. and foreign insurance SCA entities, subject to paragraph 8.b.iv., shall be adjusted for the following:

- a. Nonadmit assets pursuant to the following statutory accounting principles as promulgated by the NAIC in the *Accounting Practices and Procedures Manual*;
 - i. *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*
 - ii. *SSAP No. 16R—Electronic Data Processing Equipment and Software*
 - iii. *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements*
 - iv. *SSAP No. 20—Nonadmitted Assets*
 - v. *SSAP No. 21R—Other Admitted Assets* (e.g., collateral loans secured by assets that do not qualify as investments are nonadmitted under SAP)
 - vi. *SSAP No. 29—Prepaid Expenses*
 - vii. *SSAP No. 105R—Working Capital Finance Investments*
- b. Expense costs that are capitalized in accordance with GAAP but are expensed pursuant to statutory accounting as promulgated by the NAIC in the *Accounting Practices and Procedures Manual* (e.g., deferred policy acquisition costs, preoperating, development and research costs, etc.);
- c. Adjust depreciation for certain assets in accordance with the following statutory accounting principles:
 - i. *SSAP No. 16R—Electronic Data Processing Equipment and Software*
 - ii. *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements*
 - iii. *SSAP No. 68—Business Combinations and Goodwill*
- d. Nonadmit the amount of goodwill of the SCA in excess of 10% of the audited U.S. GAAP equity of the SCA's last audited financial statements.
- e. Nonadmit amount of the net deferred tax assets (DTAs) of the SCA in excess of 10% of the audited U.S. GAAP equity of the SCA's last audited financial statements.
- f. Nonadmit any surplus notes held by the SCA issued by the reporting entity.
- g. Adjust the U.S. GAAP annuity account value reserves of a foreign insurance SCA, with respect to the business it wrote directly, using the commissioners' annuity reserve valuation method (CARVM) as defined in paragraphs 14 and 15 of Appendix A-820 (including the reserving provisions in the various Actuarial Guidelines which support CARVM). The valuation interest rate and mortality tables to be used in applying CARVM should be that prescribed by the foreign insurance SCA's country of domicile. If the Foreign SCA's country of domicile does not prescribe the necessary tables and/or rates, no reserve adjustment shall be made.

Note that the outcome of these adjustments can result in a negative equity valuation of the investment for all paragraph 8.b.ii. entities. For a paragraph 8.b.iv. entity, the application of these adjustments will stop at zero, and will not result in negative equity valuation unless the paragraph 8.b.iv. entity provides services to the reporting entity or its affiliates or holds assets on behalf of the reporting entity. If such services, including reinsurance transactions, are occurring, the adjustments required in this paragraph can result in a

negative equity valuation. (See additional equity method application guidance in paragraph 13.e. regarding guarantees and financial support.)

10. For investments in entities recorded on an equity method (paragraph 8.b.i. through 8.b.iv.), the amount to be recorded at acquisition shall be defined as the initial investment in an investee at cost as defined in SSAP No. 68, paragraph 3, adjusted to exclude any investments in an investee's preferred stock and/or surplus notes⁴. This guidance shall be followed for initial investments as well as subsequent investments in the investee.

11. For investments in entities recorded on an equity method (paragraph 8.b.i. through 8.b.iv.) after the date of acquisition, the investment amount shall be 1) adjusted for the amortization of statutory goodwill as defined in SSAP No. 68, and 2) adjusted, with a corresponding unrealized gain or loss, for the reporting entity's share of undistributed earnings and losses of the investee (net of dividends declared⁵). (This results in a reduction of the investment amount when dividends declared are in excess of the undistributed accumulated earnings attributable to the investee.) The following additional adjustment, based on the equity method applied for the investment, shall also be made:

- a. For investments in scope of paragraph 8.b.i. (based on audited statutory equity) the investment amount shall be adjusted for the reporting entity's share of the change in special surplus funds, other than special surplus funds and unassigned funds (surplus), as defined in *SSAP No. 72—Surplus and Quasi-Reorganizations*. Additionally, the investment amount shall be adjusted, with a corresponding unrealized gain or loss, for the reporting entity's share of other changes in the investee's surplus (e.g., the change in the investee's nonadmitted assets);
- b. For investments in scope of paragraphs 8.b.ii., 8.b.iii. and 8.b.iv. (underlying audited GAAP equity), the investment amount shall be adjusted for the reporting entity's share of adjustments recorded directly to the investee's stockholder's equity under GAAP, with a corresponding entry to unrealized gain or loss. For investments in scope of paragraphs 8.b.ii. and 8.b.iv. (underlying audited GAAP with limited statutory adjustments), the investment amount shall also be adjusted in accordance with paragraph 9.

12. If the reporting entity uses the market valuation approach outlined in paragraph 8.a., changes in that valuation after initial acquisition shall be included in unrealized gains and losses

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

- a. A difference between the cost of an investment and the underlying equity in the statutory or GAAP book value, as applicable, of the acquired company at the date of acquisition shall be accounted for in accordance with SSAP No. 68 however, positive goodwill for noninsurance SCA entities subject to paragraph 8.b.ii. and foreign insurance SCA entities subject to paragraph 8.b.iv. shall be subject to the admissibility criteria in paragraph 9.d. rather than the admissibility criteria of paragraph 7 of SSAP No. 68.
- b. A transaction of an investee of a capital nature that affects the reporting entity's share of stockholders' equity of the investee shall be reflected as an unrealized gain or loss (e.g., where the investee issues additional stock or a new class of stock that impacts the reporting

⁴ The guidance in paragraphs 28-32 shall be applied for the separate reporting of preferred stock and surplus notes.

⁵ Dividends are recognized in investment income when declared.

entity's equity ownership in the investee, the reporting entity's recorded investment shall be adjusted to reflect the transaction);

- c. Realized gains or losses on the sale of an investment in a SCA entity shall be recorded in an amount equal to the difference at the time of sale between the selling price and carrying amount of the investment plus any previously recorded unrealized gain or loss;
- d. If financial statements of an investee are not sufficiently timely for the reporting entity to apply an equity method to the investee's current results of operations, the reporting entity shall record its share of the earnings or losses of an investee from the most recent available financial statements. A lag in reporting shall be consistent from period to period. This paragraph does not apply to a SCA valued under paragraph 8.b.i.;
- e. For entities subject to paragraphs 8.b.i., 8.b.ii., 8.b.iii. and 8.b.iv., a reporting entity's share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by an equity method plus advances made by the investor. The reporting entity shall discontinue applying an equity method when the investment (including advances) is reduced to zero⁶ and shall not provide for additional losses, while still continuing to track the amount of unreported equity method losses, until any future equity method income can be reported. If the reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee, the provisions of *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* shall be followed. As the entire equity method loss (subject to the financial guarantee/commitment) shall be recognized under SSAP No. 5R, it does not also need to be recognized under SSAP No. 97. If the investee subsequently reports net income, the reporting entity shall resume applying an equity method only after its share of that net income equals the share of net losses not recognized during the period that an equity method was suspended;
- f. When an investee has outstanding cumulative preferred stock, the reporting entity shall compute its share of earnings (losses) after deducting the investee's preferred dividends, whether or not such dividends are declared;
- g. An investment in a SCA entity may fall below the level of ownership described in paragraph 5 from the sale of a portion of an investment by the reporting entity, the sale of additional interests by an investee, or other transactions. The reporting entity shall discontinue accruing its share of the earnings or losses of the investee for an investment that no longer qualifies for an equity method. The earnings or losses that relate to the investment interests retained by the reporting entity and that were previously accrued shall remain as a part of the carrying amount of the investment. The investment account shall not be adjusted retroactively under the conditions described in this subparagraph. However, dividends received by the investor in subsequent periods which exceed the reporting entity's share of earnings for such periods shall be applied as a reduction of the carrying amount of the investment.

14. Once the reporting entity elects to use a valuation approach for a particular subsidiary, the reporting entity may not change the valuation method to another method without the approval of the domiciliary commissioner. For instance, if an entity selects the market valuation method, it may not change to an equity

⁶ Although the SCA is reported at zero in the investment schedule, a guarantee liability (either contingent or noncontingent) may be required to be reported under SSAP No. 5R. Additionally, refer to the guidance related to discontinuance of an equity method in paragraphs 15-17 and *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee* and *EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses*. As detailed in INT 00-24, a reporting entity's share of losses in an SCA shall be applied to other investments held in the SCA once the SCA (common stock) investment has been reduced to zero.

method or vice versa without approval from the domiciliary commissioner. Further, in order for an entity to transfer from a paragraph 8.a. or 8.b.ii. valuation to a paragraph 8.b.iii. valuation, the SCA shall not exceed the 20% threshold (as defined in paragraph 8.b.ii.) for three consecutive years prior to making the change. When an investment qualifies for use of another method of accounting, the reporting entity shall adopt the new method of accounting and the investment shall be adjusted to reflect the reporting entity's equity interest in the SCA entity under the new method. A corresponding amount shall be recorded as an unrealized gain or loss.

15. If an additional investment, in whole or in part, represents, in substance, the funding of prior losses, the entity should recognize previously suspended losses only up to the amount of the additional investment determined to represent the funding of prior losses. Whether the investment represents the funding of prior losses depends on the facts and circumstances.

16. Judgment is required in determining whether prior losses are being funded and that all available information should be considered in performing the related analysis. The following are certain factors to consider in that regard. However, no one factor should be considered presumptive or determinative.

- a. Whether the additional investment is acquired from a third party or directly from the investee. When the additional investment is purchased from a third party and the investee does not obtain additional funds either from the investor or the third party, it is unlikely that, in the absence of other factors, prior losses are being funded.
- b. The fair value of the consideration received in relation to the value of the consideration paid for the additional investment. For example, if the fair value of the consideration received is less than the fair value of the consideration paid, it may indicate that prior losses are being funded to the extent that there is disparity in the value of the exchange.
- c. Whether the additional investment results in an increase in ownership percentage of the investee. In instances in which the investment is made directly with the investee, the investor should consider the form of the investment and whether other investors are making simultaneous investments proportionate to their interests. Investments made without a corresponding increase in ownership or other interests, or a pro rata equity investment made by all existing investors, may indicate that prior losses are being funded.
- d. The seniority of the additional investment relative to existing equity of the investee. An investment in an instrument that is subordinate to other equity of the investee may indicate that prior losses are being funded.

17. Upon making the additional investment, the investor should evaluate whether it has become otherwise committed to provide financial support to the investee.

18. A reporting entity that owns an interest in itself via direct ownership of shares of an upstream intermediate or ultimate parent shall reduce the value of such shares for the reciprocal ownership. If the shares of the parent are owned indirectly by a reporting entity, via a downstream SCA entity, the directly held entity, which owns the parent's shares, shall have its value reduced for the reciprocal ownership.

19. Any parent reporting entity that owns an interest in itself via either direct or indirect ownership of a down-stream affiliate, which in turn owns shares of the parent reporting entity, shall eliminate its interest in these shares from the valuation of such affiliate.

Investment in Parent-Issued Surplus Notes

20. Any parent reporting entity that has issued a surplus note, which has been acquired by an SCA (held directly or indirectly) shall adjust the investment in the SCA to eliminate the issued surplus note to prevent double counting of the surplus note at the parent reporting entity. Without adjustment, the issued

surplus note would be reported both as an increase in surplus by the parent reporting entity, as well as an admitted asset of the parent through the “investment in an SCA.” The surplus note shall also be eliminated for instances in which the SCA acquires any portion of outstanding surplus notes issued by the parent through any means (e.g., directly acquired from the parent, acquired through a third-party broker, or via the market).

Qualified Versus Unqualified Opinions

21. Various opinions can be issued in which an entity can record certain investments under the GAAP Equity method of accounting. The reporting entity shall record investments that require audited GAAP equity in the manner described below when the audit opinion on the GAAP financial statements contains the following language:

- a. The investment shall be nonadmitted if the audit opinion contains a disclaimer of opinion for the most recent statement of financial position presented in the financial statements.
- b. The investment shall be nonadmitted if the audit opinion contains a qualified opinion due to a scope limitation that impacts the most recent statement of financial position presented in the financial statements and the impact of the scope limitation cannot be quantified. However, if the impact of the scope limitation is quantified in the audited financial statements or the audit opinion, the investment shall be admitted and the reporting entity’s valuation of the investment shall be determined based on the GAAP equity of the investee, adjusted to exclude the impact of the quantified scope limitation.
- c. The investment shall be nonadmitted if the audit opinion contains a qualified opinion due to a departure from GAAP that impacts the most recent statement of financial position presented in the financial statements and the impact of such departure is not quantified in either the auditor’s report or the footnotes to the financial statements (see quantification exception related to the valuation of a U.S. insurance entity on the basis of U.S. statutory accounting principles discussed below). However, if the impact of the departure from GAAP is quantified in the audited financial statements or the audit opinion, the investment shall be admitted and the reporting entity’s valuation of the investment shall be determined based on the GAAP equity of the investee, adjusted to exclude the impact of the quantified departure from GAAP. EXCEPTION: There is no need to quantify the impact of a departure from GAAP in either the auditor’s report or the footnotes to the financial statements if a qualified audit opinion is issued due to a departure from GAAP and the departure is related to the valuation of an U.S. insurance entity on the basis of U.S. statutory accounting principles. In such cases, the investment shall be admitted without quantifying the departure.
- d. The investment shall be nonadmitted if the audit opinion contains an adverse opinion due to a departure from GAAP that impacts the most recent statement of financial position presented in the financial statements and the impact of such departure is not quantified in either the auditor’s report or the footnotes to the financial statements (see quantification exception related to the valuation of a U.S. insurance entity on the basis of U.S. statutory accounting principles discussed below). However, if the impact of the departure from GAAP is quantified in the audited financial statements or the audit opinion, the investment shall be admitted and the reporting entity’s valuation of the investment shall be determined based on the GAAP equity of the investee, adjusted to exclude the impact of the quantified departure from GAAP. EXCEPTION: There is no need to quantify the impact of a departure from GAAP in either the auditor’s report or the footnotes to the financial statements if an adverse audit opinion is issued due to a departure from GAAP and the departure is related to the valuation of an U.S. insurance entity on the basis of U.S. statutory

accounting principles. In such cases, the investment shall be admitted without quantifying the departure.

- e. The investment shall be nonadmitted if the audit report or accompanying financial statements/notes contains explanatory language indicating there is an unalleviated substantial doubt about the investee's ability to continue as a going concern.

Valuation of Investments in Downstream Holding Companies

22. SSAP No. 48 requires the financial statements of joint ventures, partnerships, and/or limited liability companies in which the downstream noninsurance holding company has a minor ownership interest or otherwise lacks control, i.e., ownership interest is less than 10% (hereinafter referred to as "non-SCA SSAP No. 48 entities"), to be valued using U.S. GAAP basis financial statements. Valuation of a downstream holding company, including its investments in SCA entities, depends upon the nature of the SCA entities and non-SCA SSAP No. 48 entities it holds in accordance with paragraph 8 of this statement. All liabilities, commitments, contingencies, guarantees or obligations of the downstream noninsurance holding company, which are required to be recorded under applicable statutory accounting guidance, shall be reflected in the parent insurance reporting entity's determination of the carrying value of the investment in the downstream noninsurance holding company, if not already recorded in the financial statements of the downstream noninsurance holding company. If an SCA investment of the downstream holding company does not meet the provisions of paragraph 8.a. or if it elects not to use the guidance in paragraph 8.a., and instead uses the guidance in paragraph 8.b., the downstream holding company would be valued as the sum of the following (if applicable):

- a. Investments by a downstream holding company in U.S. insurance SCA entities are recorded based upon the guidance in paragraph 8.b.i.;
- b. Investments by a downstream holding company in noninsurance SCA entities that are engaged in transactions or activities described in paragraph 8.b.ii., are recorded based upon the guidance in paragraph 8.b.ii.;
- c. Investments by a downstream holding company in noninsurance SCA entities that do not qualify under paragraph 22.b. shall be recorded based upon the guidance in paragraph 8.b.iii.;
- d. Investments by a downstream holding company in foreign insurance SCA entities shall be recorded based upon the guidance in paragraph 8.b.iv.; and
- e. Any other assets and/or liabilities of the downstream holding company (not addressed in paragraphs 22.a. through 22.d.) shall be valued in accordance with the applicable SSAP.

For purposes of applying paragraphs 22-27 of this statement, a downstream holding company shall be considered to be the parent reporting entity's investment in a SCA entity. See paragraphs 26 and 27 for a limited exception to the audited financial statements requirement for downstream noninsurance holding companies which meet specified conditions.

Admissibility Requirements of Investments in Downstream Holding Companies

23. To meet the admissibility requirements of this statement, unless the limited exception to the audited financial statements requirement discussed in paragraphs 26 and 27 applies, an annual audit of the financial statements of SCA entities, including the downstream holding company valued under paragraphs 8.b.i through 8.b.iv. must be obtained. The requirement for audited financial statements may be met by utilizing any one of the following methods:

- a. Audited US GAAP financial statements of the downstream SCA holding company. (Consolidated or combined financial statements are allowed encompassing one or more downstream holding companies, including such holding companies that directly own U.S. insurance entities, provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA's domiciliary state.) The audited financial statements of the downstream holding company shall include as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities and non-SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet schedule shall separately present those entities owned directly by the downstream holding company. The consolidating or combining balance sheet shall then be adjusted for GAAP to SAP differences for paragraph 8.b.i., 8.b.ii. and 8.b.iv. entities owned directly or indirectly by the downstream holding company. The adjusted amount would then be the reported value of the investment in the downstream holding company at the higher-level reporting entity; or
- b. Audited foreign GAAP-basis financial statements of the downstream SCA holding company. (Consolidated or combined financial statements are allowed encompassing one or more downstream holding companies, including such holding companies that directly own U.S. insurance entities, provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA's domiciliary state.) The audited foreign GAAP basis financial statements shall include an audited footnote disclosure within the financial statements that reconciles each consolidated entity's net income and equity on a foreign basis of accounting to a U.S. GAAP basis. The audited financial statements of the downstream holding company shall include as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities non-SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet schedule shall separately present those entities owned directly by the downstream holding company. The consolidating or combining balance sheet shall then be adjusted for GAAP to SAP differences of the insurance entities and paragraph 8.b.ii. and paragraph 8.b.iv. entities owned directly or indirectly by the downstream holding company. The adjusted amount would then be the reported value of the investment in the downstream holding company at the higher-level reporting entity; or
- c. Individual audits of the downstream holding company and the downstream holding company's investments in individual SCA entities.

24. If the downstream noninsurance holding company does not meet the requirements of paragraph 26, audited GAAP financial statements, as described in paragraph 23, are required for the downstream noninsurance holding company and its SCA and non-SCA investments in order for the investment in the downstream noninsurance holding company to be classified as an admitted asset.

25. A purchased downstream holding company is valued in accordance with the provisions of paragraphs 22-25 and the provisions of SSAP No. 68.

Limited Exceptions to the Audit Requirements for Downstream Noninsurance Holding Companies

26. This statement requires that investments in SCA entities be recorded using one of the valuation methods described in paragraph 8 in order to be admitted assets. Each of the paragraph 8.b. valuation methods require the financial statements of SCA entities, including downstream noninsurance holding

companies, to be audited in order for the investments in SCA entities to be admitted assets. Likewise, SSAP No. 48 requires the financial statements of joint ventures, partnerships, and/or limited liability companies in which the downstream noninsurance holding company has a minor ownership interest or otherwise lacks control, i.e., ownership interest is less than 10% to be audited (U.S. GAAP) in order to be admitted assets. There is a limited exception to the requirement to have audited financial statements of a downstream noninsurance holding company, provided that the entities owned by the downstream noninsurance holding company (paragraph 8.b.iii. entity) have audited financial statements as described in paragraphs 26 and 27.

27. The process of admitting audited investments in entities owned by an unaudited downstream noninsurance holding company SCA entity will be known as a “look through.” In order to admit the investments in audited SCAs or the audited non-SCA SSAP No. 48 entities owned by an unaudited downstream noninsurance holding company, a reporting entity may apply the look through approach, provided all of the following conditions are met:

- a. The downstream noninsurance holding company is an 8.b.iii entity, and
- b. The downstream noninsurance holding company does not own any other assets which are material to the downstream holding company other than the audited SCA entities and/or audited non-SCA SSAP No. 48 entities, and
- c. The downstream noninsurance holding company is not subject to liabilities, commitments, contingencies, guarantees or obligations which are material to the downstream noninsurance holding company.

If an investment in a downstream noninsurance holding company meets the requirements set forth above, the reporting entity can admit the individual audited SCA entities and/or audited non-SCA SSAP No. 48 entities; however, unaudited immaterial assets of the downstream noninsurance holding company are to be carried at the lesser of the paragraph 8 valuation or nonadmitted (e.g. some equity method investments are required to be carried at a negative value due to either statutory adjustments or to parental obligations to keep funding the subsidiary). If a holding company structure has more than one downstream non-insurance holding company, each downstream non-insurance holding company may be looked through, provided each downstream non-insurance holding company meets all of the conditions in paragraph 27.

Investment in Preferred Stock or Surplus Notes of a Subsidiary, Controlled and Affiliated Entity

28. Investments in common stock, preferred stock and surplus notes are reported separately. Care should be taken to avoid double counting of the separate investments. When the SCA investee has issued multiple equity components such as common stock, preferred stock and/or surplus note(s) the total reported equity of the SCA investee must be separated into the respective components in order to determine the equity attributable to each class.

29. In order to establish the equity value of the common stock investment in an SCA, the reporting entity reduces the total equity of the SCA by the SCA's (issuer's) value of the preferred stock and/or surplus notes on the issuer's balance sheet (not the reporting entity's book/adjusted carrying value for the SCA's preferred stock and/or surplus notes held).

30. Investments in the preferred stock of an SCA shall be accounted for and reported in accordance with the provisions of *SSAP No. 32R—Preferred Stock*.

31. Investments in the surplus notes of an SCA shall be accounted for and reported in accordance with the provisions of *SSAP No. 41R—Surplus Notes*.

32. The following example is provided to illustrate the accounting and reporting. The reporting entity holds 100% of the preferred stock. The SCA issued the preferred stock for \$50,000. The investment in the SCA, measured in accordance with this statement is \$250,000 including the preferred stock of the SCA.

The investment in the SCA is \$200,000 (\$250,000-50,000) and the preferred stock is measured and reported in accordance with SSAP No. 32R.

Impairment

33. For any decline in the fair value of an investment in a SCA entity that is other than temporary^(INT 06-07), the investment shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. The write down shall first be considered as an adjustment to any portion of the investment that is nonadmitted (e.g., goodwill). The new cost basis shall not be changed for subsequent recoveries in fair value. Future declines in fair value, which are determined to be other than temporary shall be recorded as realized losses. An impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to recover the carrying amount of the investment or there is evidence indicating inability of the investee to sustain earnings, which would justify the carrying amount of the investment. A fair value of an investment that is below the carrying amount based on the statutory equity method or the existence of investee operating losses may indicate a loss in value, however, they are not necessarily indicative of a loss in value that is other than temporary.

Consolidation

34. Majority-owned subsidiaries shall not be consolidated for individual entity statutory reporting. This does not exempt certain reporting entities that are members of an affiliated group from the requirement to issue consolidated or combined annual statements as supplemental information in accordance with NAIC guidelines.

Disclosures

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

- a. For all periods presented, a reporting entity whose shares of losses in an SCA exceeds its investment in the SCA shall disclose its share of losses. (This is required regardless of a guarantee or commitment of future financial support to the SCA.) This disclosure shall include the following:
 - i. The reporting entity's accumulated share of the SCA losses not recognized during the period that the equity method was suspended;
 - ii. The reporting entity's share of the SCA's equity, including negative equity;
 - iii. Whether a guaranteed obligation or commitment for financial support exists; and
 - iv. The amount of the recognized guarantee under SSAP No. 5R.

This disclosure shall apply beginning in the period the SCA's equity initially falls below zero and shall continue to be disclosed as long as the SCA investment is in a deficit position. Additionally, the reporting entity shall detail in a narrative disclosure whether losses in the SCA have impacted other investments as required by *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor*

for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee and EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses.

36. The significance of an investment to the reporting entity's financial position and results of operations shall be considered in evaluating the extent of disclosures of the financial position and results of operations of an investee. The following disclosures shall be made for all investments in SCA entities that exceed 10% of the total admitted assets of the reporting entity:

- a. Financial statements of a reporting entity shall disclose (i) the name of each SCA entity and percentage of ownership of common stock, (ii) the accounting policies of the reporting entity with respect to investments in SCA entities, and (iii) the difference, if any, between the amount at which the investment is carried and the amount of underlying equity in net assets (i.e., goodwill, other nonadmitted assets, fair value or discounted fair value adjustments, adjustments pursuant to SSAP No. 25, paragraph 19.d.) and the accounting treatment of the difference;
- b. For those SCA entities for which a quoted market price is available, the aggregate value of each SCA investment based on the quoted price and the difference, if any, between the amount at which the investment is carried and the quoted price shall be disclosed;
- c. Summarized information as to assets, liabilities and results of operations shall be presented for SCA entities, either individually or in groups;
- d. Conversion of outstanding convertible securities, exercise of outstanding options and warrants and other contingent issuances of an investee may have a significant effect on an investor's share of reported earnings or losses. Accordingly, material effects of possible conversions, exercises or contingent issuances shall be disclosed in notes to the financial statements of the reporting entity; and
- e. For those SCA entities in which the reporting entity elected, or was required, to change its valuation method as described in paragraph 14, a description of the reason for the change and the amount of adjustment recorded as unrealized gains or losses shall be disclosed. The entity shall also disclose whether commissioner approval was obtained in accordance with paragraph 14.

37. A reporting entity that reports an investment in an insurance SCA (per paragraph 8.b.i.) for which the audited statutory equity reflects a departure from the NAIC statutory accounting practices and procedures (e.g., permitted or prescribed practices) shall disclose the following:

- a. A description of the accounting practice, with a statement that the practice differs from the NAIC statutory accounting practices and procedures.
- b. The monetary effect on net income and surplus reflected by the insurance SCA as a result of using an accounting practice that differed from NAIC statutory accounting practices and procedures.
- c. Whether the RBC of the insurance SCA would have triggered a regulatory event had it not used a prescribed or permitted practice.
- d. The reported entity's investment in the insurance SCA per the audited statutory equity, and the investment in the insurance SCA the reporting entity would have reported if the insurance SCA had completed statutory financial statements in accordance with the NAIC statutory accounting practices and procedures.

38. A reporting entity that calculates its investment in a foreign insurance subsidiary by adjusting annuity GAAP account value reserves using CARVM and the related Actuarial Guidelines shall disclose the interest rates and mortality assumptions used in the calculation as prescribed by the insurance department of the foreign country.

39. Any commitment or contingent commitment to a SCA entity shall be disclosed (e.g., guarantees or commitments to provide additional capital contributions).

40. A reporting entity that recognizes an impairment loss shall disclose the following in the financial statements that include the period of the impairment write down:

- a. A description of the impaired assets and the facts and circumstances leading to the impairment; and
- b. The amount of the impairment and how fair value was determined.

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

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

- a. The name of the downstream noninsurance holding company;
- b. The carrying value of the investment in the downstream non insurance holding company;
- c. The fact that the financial statements of the downstream noninsurance company are not audited;
- d. The fact that the reporting entity has limited the value of its investment in the downstream noninsurance holding company to the value contained in the audited financial statements, including adjustments required by this statement, of SCA entities and/or non-SCA SSAP No. 48 entities owned by the downstream noninsurance holding company and valued in accordance with paragraphs 22-25;
- e. The fact that all liabilities, commitments, contingencies, guarantees or obligations of the downstream noninsurance holding company, which are required to be recorded as liabilities, commitments, contingencies, guarantees or obligations under applicable accounting guidance, are reflected in the reporting entity's determination of the carrying value of the investment in the downstream noninsurance holding company, if not already recorded in the financial statements of the downstream noninsurance holding company.

43. Investments reported using an equity method from paragraph 8.b.ii. through 8.b.iv. may have fiscal year ends, not calendar year ends. To recognize a change to the reporting year-end of an equity method investee, including changes in, or the elimination of, previously existing differences (lag period) due to the reporting entity's ability to obtain financial results from a reporting period that is more consistent with, or the same as, that of the reporting entity, the guidance included in *FASB Emerging Issues Task Force 06-9*:

Reporting a Change in (or the elimination of) a Previously Existing Difference between the fiscal Year-End of a Parent Company and That of a Consolidated Entity or between the Reporting Period of an Investor and That of an Equity Method Investee that defines such reporting period changes as a change in accounting principle in accordance with SSAP No. 3—*Accounting Changes and Corrections of Errors* shall be followed. For instances in which this change in accounting principle occurs, disclosure requirements of SSAP No. 3 shall be followed.

44. Refer to the Preamble for further discussion regarding disclosure requirements. The disclosures in paragraph 36.d. shall be included in the annual audited statutory financial reports only.

Relevant Literature

45. This statement adopts the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*.

46. This statement adopts *ASU 2016-07, Investments—Equity and Joint Ventures*, modified to reflect statutory terms, including the definition of control and statutory reporting concepts. This statement adopts *FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18* as guidance to be considered in determining the existence of control.

47. This statement adopts with modification EITF 06-9 to include:

- a. Adopt the guidance that defines such reporting period changes as a change in accounting principle in accordance with SSAP No. 3, modified to apply only to equity method investments. For instances in which this change in accounting principle occurs, disclosure requirements of SSAP No. 3 shall be followed.
- b. The consolidation guidance in EITF 06-9 is rejected.
- c. Changes affecting companies reporting investments in SCA entities using the equity method: Investments in paragraph 8.b.i. entities are required to be calendar year-end. Investments in paragraphs 8.b.ii. through 8.b.iv. entities may have other fiscal year ends, thus this issue could apply to equity method investments under paragraphs 8.b.ii. through 8.b.iv. or under equity method valued investments that fall within the scope of SSAP No. 48.

48. This statement rejects *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 2019-06, Intangibles—Goodwill and Other Business Combinations, and Non-for-Profit Entities, ASU 2011-10, Derecognition of in Substance Real Estate, APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock, AICPA Accounting Interpretations APB 18, The Equity Method of Accounting for Investments in Common Stock: Accounting Interpretations of APB Opinion No. 18, FASB Technical Bulletin No. 79-19, Investor's Accounting for Unrealized Losses on Marketable Securities Owned by an Equity Method Investee, FASB Emerging Issues Task Force No. 87-21, Change of Accounting Basis in Master Limited Partnership Transactions, FASB Emerging Issues Task Force No. 96-16, Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights, FASB Emerging Issues Task Force No. 98-2: Accounting by a Subsidiary or Joint Venture for an Investment in the stock of Its Parent Company or Joint Venture Partner and FASB Staff Position No. APB 18-1, Accounting by an Investor for Its Proportionate Share of Accumulated Other Comprehensive Income of an Investee Accounted for under the Equity Method in Accordance with APB Opinion No. 18 upon a Loss of Significant Influence.*

Effective Date and Transition

49. This statement is effective for reporting periods ending on and after December 31, 2007. 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*. Detail of 2011 amendments that relocated guidance from this statement to SSAP No. 32R and SSAP No. 68 is provided in those statements respectively. Guidance reflected in paragraph 21, incorporated from INT 03-03: *Admissibility of Investments Recorded Based on the Audited GAAP Equity of the Investee when a Qualified Opinion is Provided* was originally effective December 7, 2003. Guidance reflected in paragraphs 15-17 incorporated from INT 04-10: *Accounting for Subsequent Investments in an Investee after Suspension of Equity Method Loss Recognition* was originally effective December 5, 2004. Guidance in paragraph 43 was previously included within INT 08-03: *EITF 06-9: Reporting a Change in (or the elimination of) a Previously Existing Difference between the fiscal Year-End of a Parent Company and That of a Consolidated Entity or between the Reporting Period of an Investor and That of an Equity Method Investee* and was effective for periods beginning May 31, 2008.

REFERENCES**Other**

Purposes and Procedures Manual of the NAIC Investment Analysis Office

Relevant Issue Papers

Issue Paper No. 118—Investments in Subsidiary, Controlled and Affiliated Entities, A Replacement of SSAP No. 46

EXHIBIT A – SCA REPORTING PROCESS

50. SCA entities, except for domestic SCA insurance company investments accounted for under paragraph 8.b.i of this statement, in which the reporting entity has an equity interest (common or preferred stock), are required to be filed with the NAIC. Nonadmitted assets are not required to be filed in a Sub 2 as long as they were nonadmitted, or had a zero value, for the full reporting period (all interim and annual reporting). Immaterial asset SCAs do not have an automatic exclusion from filing, as immateriality of an SCA will be ascertained by the state of domicile of the insurance reporting entity, but companies are allowed to request an exemption from the domiciliary state to not file an SCA on the basis that it is immaterial. The filing process does not include investments within the scope of SSAP No. 48.

51. Except for domestic SCA insurance company investments accounted for under paragraph 8.b.i., all SCA investments within the scope of this statement, purchased during any one calendar year, shall be reported to the NAIC on a Sub 1 form within 90 days of the acquisition or formation of the investment; this includes nonadmitted, zero-valued and immaterial SCAs. The NAIC will process that filing in the same year but will not at that time approve or disapprove a value for the SCA investment. By August 31 of each year, the insurance company shall submit a Sub 2 filing for the previously purchased SCA investment reported on a Sub 1 form and later that year, the NAIC will approve a value for the transaction. For SCAs that routinely receive their audit reports after the August 31 deadline, a filing deadline of one month after the audit date shall be applied. Filers must provide previous years' audit reports to verify an audit report dated after August 31 in order to not be charged a late fee for a Sub 2 filing that is filed after the August 31 deadline. The value approved by the NAIC at the conclusion of the Sub 2 form filing is reported by the insurance company on its financial statement blank. If the insurance company has reported a value for the SCA investment on its financial statement blank that differs from the value approved by the NAIC, the insurer is required to adjust the reported value in its next quarterly financial statement blank unless otherwise directed by the insurer's state of domicile.

52. Insurance companies shall use one of the valuation methods described in paragraph 8 to calculate the value of their investments in insurance and non-insurance SCA companies. An insurance company shall calculate the value of its investments in foreign insurance and all non-insurance company SCA entities and report the value to the NAIC no later than August 31, or one month after the audit report date for SCAs that routinely receive their audits after August 31 for existing SCA investments, and within 90 days of the acquisition or formation of a new SCA investment.

Initial Reporting of SCA Investments

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

54. The purpose of a Sub 1 filing is to gather basic information about the SCA. If the NAIC determines that the reported transaction meets the tests specified, it will complete the filing in the VISION database. If the NAIC determines that the transaction does not meet the tests specified, it will not complete the filing in the VISION database and instead shall notify the reporting insurance company and the state of domicile in writing of its determination.

Subsequent Reporting of SCA Investments

55. By August 31 or one month after the audit report date of each year and subsequent to the reporting of an SCA investment on the Sub 1 form, the insurance company shall submit a Sub 2 form filing, with all supporting documentation for foreign SCAs provided in English, for the same SCA investment.

Additionally, by August 31 or one month after the audit report date of each year, any insurance company that has made a Sub 2 form filing in a previous year must update the information by filing an updated Sub 2 form filing.

56. Each year the NAIC shall compile a list of all SCA investments (excluding insurance company SCAs (paragraph 8.b.i.) nonadmitted and zero-value SCAs) reported as Sub 1 form filings for which a Sub 2 form filing has not yet been received. For these transactions, the NAIC will notify the responsible reporting insurance company and its state of domicile that it has not received a Sub 2 filing for the SCA investment.

57. The purpose of the Sub 2 filing is to determine whether the value calculated by the reporting insurance company for the SCA investment is appropriate and to approve that or some other value for reporting on the insurer's financial statement blank.

58. An insurance company that concludes an SCA transaction at year-end may be unable to file a Sub 1 form prior to the time it would be required to file a Sub 2 form. Where this is the case, the NAIC is authorized to accept and review a Sub 1 filing from such an insurance company and to accept and review the Sub 2 filing after the Sub 1 filing review has been completed.

59. No filing of an investment in a domestic SCA insurance company valued under paragraph 8.b.i. shall be required to be made with the NAIC.

Consistency in Application of Chosen Valuation Method

60. The valuation method used for a specific SCA company shall be determined by the guidance in paragraph 8. If a reporting insurance company previously selected the Market Valuation Method and wished to change to an Equity Method (or vice versa), they may only do so with the approval of the domiciliary commissioner. Once the approval of the domiciliary commissioner has been obtained, the reporting insurance company shall provide the NAIC with evidence of that approval as part of the Sub 1 or Sub 2 filing.

61. For reporting insurance companies that use the Market Valuation Method, the reporting insurance company shall obtain the discount rate to be applied from the NAIC. The discounts identified in Exhibit E are minimum discounts. The NAIC calculation may result in discounts in market value higher than those shown in Exhibit E.

Assessment and Review of Sub 1 Form

62. Upon receipt of the reporting insurance company's Sub 1 filing, the NAIC shall conduct an assessment in the following manner:

- a. If the NAIC is aware of any broad regulatory concerns or issues affecting the reporting insurance company or the reported SCA investment, it shall determine whether such concerns or issues are relevant to valuation of the SCA investment. If so, the NAIC shall take such action as seems appropriate under the circumstances.
- b. The NAIC shall ensure that the value reported by the insurance company on a Sub 1 form has been arrived at by application of one of the permitted valuation methods described in paragraph 8. If a reporting insurance company submits a Sub 1 form filing that reports a value calculated under an inappropriate method, the NAIC shall contact the insurer to resolve the discrepancy or it shall recalculate the value of the SCA investment under the most appropriate valuation method and notify the reporting insurance company of such action.

- c. The NAIC shall review the factual, business and economic context of the transaction to determine whether, (i) the SCA investment appears to be an arms-length business arrangement with a reasonable economic value to the reporting insurance company, (ii) the valuation method chosen is reasonable in view of the factual, business and economic context of the transaction, (iii) the transaction is reasonable in the context of all the known facts surrounding the insurance company and its operations, and (iv) the value reported appropriately reflects economic value to the insurance company. The NAIC may consider other factors that appear relevant from the context of the transaction including:
 - i. The specific tax, accounting or other regulatory treatment sought.
 - ii. Whether the transaction effects a legally effective, binding and permanent transfer of the risks and rewards of ownership.
 - iii. The effect of the SCA valuation on the solvency of the insurer.
 - iv. The degree of affiliation between the insurer and the party from whom such company was acquired, the form of the consideration (cash, property or the exchange of stock), evidence of ability to recover cost and whether the acquisition price represented the result of arms-length dealing between economic equals.
 - v. The right to dividends or other payments from the SCA and any limitations thereto.
 - vi. The nature, extent and demonstrable financial value of the business operations of the SCA.
 - vii. The value of the assets owned by the SCA.

If the NAIC determines that the transaction does not seem to present economic value to the insurance company, or that the transaction tends to obscure issues that might be relevant to an NAIC member or that the information provided is insufficient or unreliable as a basis upon which to make a determination, then the NAIC shall notify the reporting insurance company and the NAIC member of the reporting insurance company's state of domicile and request guidance.
- d. The NAIC shall review whether the reporting insurance company has correctly applied the correct valuation guidance under paragraph 8 and made adjustments, if applicable, under paragraph 9.

63. If the SCA investment reported on the Sub 1 form filing is deemed to meet the assessment and reviews described in paragraph 62, the NAIC shall complete the filing in the VISION database. A completed filing will be a Sub 1 filing where the reported SCA investment meets the tests described above. The completed filing will be revised to a value if and when the filer submits a Sub 2 form on the same transaction and the NAIC approves a final value based on the information provided. (Assignment of completion to an SCA investment does not mean, and shall not be interpreted to mean, that the NAIC is expressing an opinion as to the value claimed by the reporting insurance company for the reported SCA investment. The completion implies only that, based on the information provided, the NAIC has determined that the SCA investment meets the tests described in paragraph 62.)

Assessment and Review of Sub 2 Form

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 Two 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.

65. Upon completion of the procedures described above, the NAIC will determine whether the value reported by the insurance company on the current SCA filing was calculated in accordance with the instructions for the valuation method chosen and verify that the filed value reflects the adjustments required by paragraph 9.

66. Upon approval of a value (including making necessary adjustments), the NAIC will complete the Sub 2 filing with the approved value in the status field of the VISION database.

67. The NAIC shall report its determination to the insurance company. If a significant discrepancy exists between the value claimed by the reporting insurance company and the value approved by the NAIC, the NAIC shall communicate the discrepancy with the company. If the NAIC cannot come to a conclusion based on the support provided, the filing can be rejected in VISION, and written notification will be provided to the reporting insurance company and the company's state of domicile of this action. This correspondence will be sent to the domiciliary state. Filers are able to download their review information from the NAIC filing system.

Additional Reporting Instructions

68. A reporting entity that has direct ownership of shares of an upstream intermediate or ultimate parent owns an interest in itself and is required to reduce the value of those shares from the value of the reporting entity. This is referred to as elimination of reciprocal ownership.

69. If the shares of the parent are owned indirectly by a reporting entity, for example, because the reporting entity owns a downstream SCA entity that directly owns shares in the parent, the entity that owns the parent's shares must reduce its value by the value of the shares in the parent. This is referred to as elimination of the reciprocal ownership.

70. Any parent reporting entity that owns an interest in itself via either direct or indirect ownership of a down-stream affiliate, which in turn owns shares of the parent reporting entity, shall eliminate its proportionate interest in these shares from the valuation of such affiliate.

71. Pursuant to paragraph 22, in lieu of separate GAAP audits of SCA entities of the downstream holding company, the insurer can choose to have a GAAP audit performed at the holding company level with a consolidating balance sheet showing GAAP equity of all the SCA entities. The consolidating balance

sheet shall then be adjusted for GAAP to SAP differences of the insurance entities as described in this statement. This adjusted amount would then be the reported value of the investment in downstream holding company at the higher-level insurance company.

72. Investments in the surplus notes of an SCA shall be accounted for in accordance with the provisions of SSAP No. 41R. If the reporting entity also holds an investment in preferred stock or surplus notes, refer to paragraphs 28-32 of this statement.

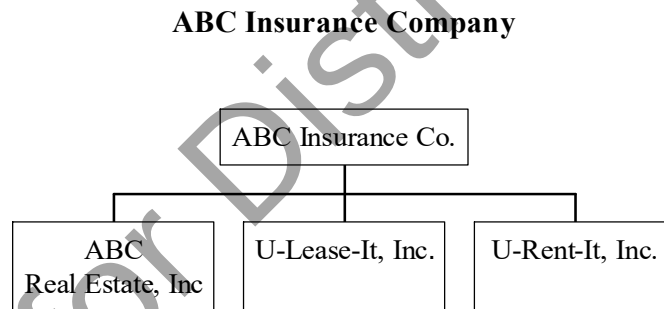
Not for Distribution

EXHIBIT B – ILLUSTRATIONS**Accounting for SCAs**

This illustration is intended to provide an example of the application of paragraphs 8.b.ii. and 8.b.iii. of this statement. Where an SCA meets the criteria of paragraph 8.b.ii., the illustration further demonstrates the necessary adjustments described in paragraph 9. While not all inclusive, the illustration is representative of the process and adjustments necessary to comply with this statement. That is, the reporting entity must, first, determine which sub-section of paragraph 8 applies with respect to each SCA. Secondly, where the reporting entity has determined that an SCA meets the criteria of paragraph 8.b.ii. or 8.b.iv., then the carrying amount is adjusted in accordance with the sub-section, which includes adjustments contained in the provisions of paragraph 9.

The ABC Insurance Company owns 100% of three subsidiaries:

1. ABC Real Estate, Inc. – owns and manages real estate properties and has no inter-company transactions
2. U-Lease-It, Inc. – leases furniture and equipment to local businesses including the insurance company. Lease fees received from ABC were \$10 million each in 20x2 and 20x1.
3. U-Rent-It, Inc. – leases EDP equipment to local businesses including the insurance company. Lease fees received from ABC were \$2 million each in 20x2 and 20x1.



Determination and application of adjustments to audited GAAP equity methods (paragraph 8.b. of this statement)

ABC Real Estate, Inc. – the company is not engaged in any activities described in paragraph 8.b.ii. No adjustments are made, and ABC Insurance Company records its investment based upon audited GAAP equity in accordance with 8b.iii.

U-Lease-It, Inc. – the company is engaged in activities described in paragraph 8.b.ii., leasing furniture and equipment. The fees paid by ABC and reflected in income of U-Lease-It, Inc. exceed 20% of GAAP revenue calculated as follows:

U-Lease-It, Inc.	(Millions)	
	<u>20x1</u>	<u>20x2</u>
GAAP revenue	46.5	46.4
Less:		
Realized capital gains/(losses)	<u>6</u>	<u>(.2)</u>
Adjusted GAAP revenue	45.9	46.6
Lease fees from ABC	10.0	10.0
Fees/adjusted GAAP revenue	21.8%	21.5%

U-Rent-It, Inc. – the company is engaged in activities described in paragraph 8.b.ii., leasing EDP equipment. The fees paid by ABC and reflected in income of U-Rent-It, Inc. do not exceed 20% of GAAP revenue. No adjustments are made, and ABC Insurance Company records its investment based upon audited GAAP equity in accordance with 8b.iii. The calculation test is as follows:

U-Rent-It, Inc.	(Millions)	
	<u>20x2</u>	<u>20x1</u>
GAAP revenue	32.6	30.5
Lease fees from ABC	2.0	2.0
Fees/GAAP revenue	6.1%	6.6%

Adjustments to audited GAAP equity for U-Lease-It, Inc.

	(Millions)	
	<u>20x2</u>	<u>20x1</u>
Audited GAAP equity	129	130
Nonadmit furniture & equipment	(250)	(260)
Nonadmit excess goodwill *	(2)	(2)
Adjusted GAAP equity	(123)	(132)

*Goodwill adjustment - 20x2=\$15- (10% x \$130[20x1 GAAP equity] and 20x1=\$15-(10% x \$129.9 [20x0 GAAP equity])

Note: No DTA adjustment since the amount is less than 10% of GAAP equity

Schedule D Affiliated Common Stocks for ABC Insurance Company

	(Millions)	
	<u>20x2</u>	<u>20x1</u>
ABC Real Estate Inc.	223	219
U-Lease-It, Inc.	(123)	(132)
U-Rent-It, Inc.	<u>30</u>	<u>27</u>
Total	130	114

Note: The change in carrying value between years of \$16 million is reported as an unrealized gain in 20x2.

Illustrated Balance Sheets

ABC Insurance Company

	<u>20x2</u>	<u>20x1</u>		<u>20x2</u>	<u>20x1</u>
<u>Net Admitted Assets</u>			<u>Liabilities</u>		
Bonds	11,210	11,150	Policy reserves	12,516	12,394
Common stock (unaffiliated)	325	315	Contract claims	30	29
Common Stock (affiliated)	130	114			
Real estate	120	125	Expenses due and accrued	14	13
Mortgage loans	1,685	1,640	Misc. liabilities	<u>250</u>	<u>245</u>
Cash	<u>10</u>	<u>7</u>	Total liabilities	12,810	12,681
Sub-total	13,480	13,351	Common stock	100	100
Other assets	<u>20</u>	<u>14</u>	Unassigned funds	<u>590</u>	<u>584</u>
Total	13,500	13,365	Total equity	<u>690</u>	<u>684</u>
			Total	13,500	13,365

ABC Real Estate, Inc.

	<u>20x2</u>	<u>20x1</u>		<u>20x2</u>	<u>20x1</u>
<u>Assets</u>			<u>Liabilities</u>		
Cash	10	7	Notes payable	260	220
Bonds (available for sale)	110	103	Misc. liabilities	<u>17</u>	<u>11</u>
Real estate investments	330	280	Total liabilities	277	231
Other assets	<u>50</u>	<u>60</u>			
Total	500	450	Common stock	15	15
			Retained earnings	<u>208</u>	<u>204</u>
			Total equity	<u>223</u>	<u>219</u>
			Total	500	450

U-Lease-It, Inc.

	<u>20x2</u>	<u>20x1</u>		<u>20x2</u>	<u>20x1</u>
<u>Assets</u>			<u>Liabilities</u>		
Cash	5	7	Accounts payable	15	12
Bonds (available for sale)	20	18	Notes payable	<u>183</u>	<u>190</u>
Furniture & equipment	250	260	Total liabilities	198	202
Investments in subs (15.0 mil. Goodwill)	45	42	Common stock	15	15
Federal tax recoverable (DTA)	<u>7</u>	<u>5</u>	Retained earnings	<u>114</u>	<u>115</u>
Total	327	332	Total equity	<u>129</u>	<u>130</u>
			Total	327	332
<u>Summary of Operations</u>					
	<u>20x2</u>	<u>20x1</u>			
Revenues:					
Interest income	8.1	9.0			
Realized capital gains/(losses)	0.6	(0.2)			
Investment in sub	3.0	2.6			
Lease fees	<u>34.8</u>	<u>35.0</u>			
Total	46.5	46.4			
Expenses:					
General Administration	6.4	6.2			
Depreciation	<u>42.4</u>	<u>41.0</u>			
Total	48.8	47.2			
Net income before taxes	(2.3)	(0.8)			
Federal income tax benefit	<u>0.8</u>	<u>0.3</u>			
Net income	(1.5)	(0.5)			
Unrealized capital gains/losses	0.4	0.6			

U-Rent-It, Inc.

	<u>20x2</u>	<u>20x1</u>		<u>20x2</u>	<u>20x1</u>
<u>Assets</u>			<u>Liabilities</u>		
Cash	6	6	Accounts payable	3	4
Bonds (available for sale)	5	4	Notes payable	<u>202</u>	<u>199</u>
EDP equipment	220	216	Total liabilities	205	203
Other assets	<u>4</u>	<u>4</u>	Common stock	10	10
Total	235	230	Retained earnings	<u>20</u>	<u>17</u>
			Total equity	<u>30</u>	<u>27</u>
			Total	235	230
<u>Summary of Operations</u>					
	<u>20x2</u>	<u>20x1</u>			
Revenues:					
Interest income	0.5	0.4			
Lease fees	<u>32.1</u>	<u>30.1</u>			
Total	32.6	30.5			
Expenses:					
General					
Administration	3.0	3.0			
Depreciation	<u>25.7</u>	<u>24.5</u>			
Total	28.7	27.5			
Net income before taxes	3.9	3.0			
Federal income tax	<u>(1.3)</u>	<u>(1.0)</u>			
Net income	2.6	2.0			
Unrealized capital gains/losses	0.4	0.6			

EXHIBIT C – IMPLEMENTATION QUESTIONS AND ANSWERS

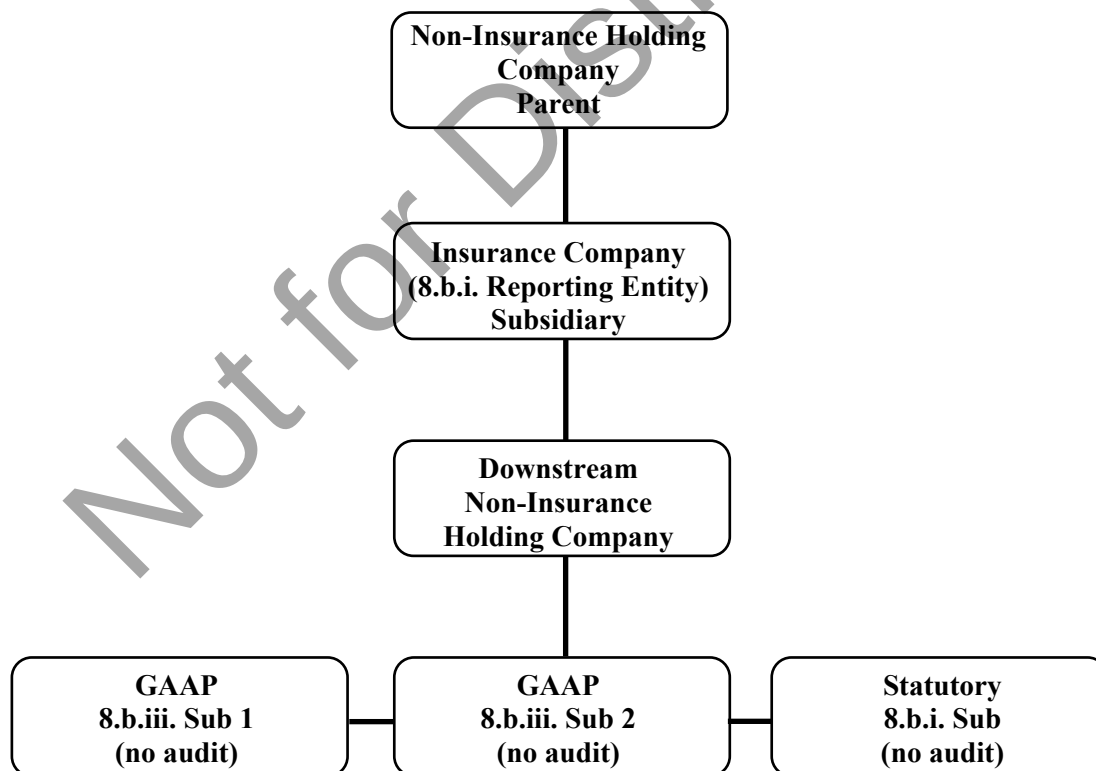
1. **Q – Is the list of activities listed in paragraph 8.b.ii.(f) of SSAP No. 97 meant to be all-inclusive? The guidance is as follows:**

8.b.ii.(f) Providing insurance services on behalf of the reporting entity including but not limited to accounting, actuarial, auditing, data processing, underwriting, collection of premiums, payment of claims and benefits, policyowner services

1.1 **A –** No, the Working Group did not intend for this list to be all-inclusive, but rather to be used as examples of the types of functions that can be performed by non-insurance companies. The purpose of the list is to set forth examples of activities that are often performed by an insurer directly that can result in less conservative values if performed by an entity that is not required to utilize statutory accounting as defined within the NAIC *Accounting Practices and Procedures Manual*. Therefore, the reporting entity, the auditor, and the regulator should consider whether the purpose of having the subsidiary is to avoid statutory accounting principles as discussed in *SSAP No. 25—Affiliates and Other Related Parties*, paragraph 18.d., and adjust the value of the SCA as appropriate. SSAP No. 25, paragraph 19.d. reads as follows:

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

2. **Q – As illustrated below, would an audit of the upstream holding company with consolidating balance sheets of the insurance company meet the requirements for auditing the subsidiaries under SSAP No. 97?**



2.1 **A –** No, SSAP No. 97 is specific in that it only allows audited GAAP financial statements of the downstream holding company level (See paragraph 23).

2.2 So, in the example provided above, the reporting entity cannot use an audit of the upstream holding company as the basis for complying with the audit requirements of SSAP No. 97. The primary purpose of the audit is to provide assurance that the valuation of the entity being considered is not materially misstated. Although assurance of this type would be provided for within an unqualified opinion of an upstream holding company, it would only be provided for in the context of the entity being audited. Since the materiality level for an upstream holding company is likely to be set at a higher level, the potential for material misstatement for the reporting entity's subsidiary(ies) could still exist within that unqualified opinion. It should also be noted, however, that individual state insurance holding company laws would still require an audit of the ultimate controlling entity.

3. **Q – Are consolidated, consolidating or combined audited financial statements allowed to meet the requirements for SSAP No. 97? Definitions of these types of audited financial statements are presented below:**

- Consolidated Audited Financial Statements (*ARB 51: Consolidated Financial Statements*, paragraph 1)

1. The purpose of consolidated statements is to present, primarily for the benefit of the shareholders and creditors of the parent company, the results of operations and the financial position of a parent company and its subsidiaries essentially as if the group were a single company with one or more branches or divisions. There is a presumption that consolidated statements are more meaningful than separate statements and that they are usually necessary for a fair presentation when one of the companies in the group directly or indirectly has a controlling financial interest in the other companies.

- Consolidating Audited Financial Statements (*ARB 51: Consolidated Financial Statements*, paragraph 24)

24. In some cases, parent-company statements may be needed, in addition to consolidated statements, to indicate adequately the position of bondholders and other creditors or preferred stockholders of the parent. Consolidating statements, in which one column is used for the parent company and other columns for particular subsidiaries or groups of subsidiaries, often are an effective means of presenting the pertinent information.

- Combined Audited Financial Statements (*ARB 51: Consolidated Financial Statements*, paragraphs 22 and 23)

23. To justify the preparation of consolidated statements, the controlling financial interest should rest directly or indirectly in one of the companies included in the consolidation. There are circumstances, however, where combined financial statements (as distinguished from consolidated statements) of commonly controlled companies are likely to be more meaningful than their separate statements. For example, combined financial statements would be useful where one individual owns a controlling interest in several corporations which are related in their operations. Combined statements would also be used to present the financial position and the results of operations of a group of unconsolidated subsidiaries. They might also be used to combine the financial statements of companies under common management.

24. Where combined statements are prepared for a group of related companies, such as a group of unconsolidated subsidiaries or a group of commonly controlled companies, intercompany transactions and profits or losses should be eliminated, and if there are problems in connection with such matters as minority interests, foreign operations, different fiscal periods, or income taxes, they should be treated in the same manner as in consolidated statements.

3.1 **A –** In this example, only consolidating and combined financial statements are allowed under SSAP No. 97. Combined audited financial statements are used to present the financial position and results of operations of a group of unconsolidated commonly controlled enterprises. Although U.S. Generally Accepted Auditing Standards requirements for combined statements are similar to those

required for consolidated financial statements, combined statements are allowed for purposes of meeting the requirements of this statement. (Consolidated or combined financial statements are allowed encompassing one or more downstream SCA entities, including downstream SCA entities that directly or indirectly own U.S. insurance entities provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA's domiciliary state.)

4. Q – Does a balance sheet audit meet the admissibility test within SSAP No. 97, or would a full audit be required?

4.1 A – The Working Group intended for a full financial statement audit to be performed, rather than a limited reporting engagement, in accordance with AU Section 508, paragraph 33 which states:

Limited reporting engagements. The auditor may be asked to report on one basic financial statement and not on the others. For example, he or she may be asked to report on the balance sheet and not on the statements of income, retained earnings or cash flows. These engagements do not involve scope limitations if the auditor's access to information underlying the basic financial statements is not limited and if the auditor applies all the procedures he considers necessary in the circumstances; rather, such engagements involve limited reporting objectives. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

4.2 In addition, within SSAP No. 97, paragraph 8.c.ii. (line 1), there is a reference to the “annual GAAP audit,” which indicates a full audit. A limited engagement audit was not the intent when SSAP No. 97 or its predecessors, were developed.

4.3 Therefore, SSAP No. 97 requires the presentation of the balance sheet, income statement, statement of surplus and cash flows of each admitted entity to be presented, along with the corresponding notes to the financial statements (which can be accomplished as a whole).

5. Q – Does the audit opinion provided on the subsidiaries financial statements have to be clean or unqualified in order for the SCA investment to be admitted?

5.1 A – Paragraph 21 addresses various opinions that can be issued in which an entity can record certain investments under the GAAP Equity method of accounting. In certain cases, such as when the audit opinion is a disclaimer of opinion or there is indication that there is substantial doubt about the entity's ability to continue as a going concern, the guidance states the investment shall be nonadmitted. In instances where there is an unalleviated substantial doubt about the entity's ability to continue as a going concern listed in any part of the audit report or accompanying financial statements/notes, the investment shall be nonadmitted. In addition, if there is a qualified opinion due to a departure from GAAP (or an adverse opinion) or due to a scope limitation, the investment shall be nonadmitted unless the impact of the departure is quantified within the audit opinion (see quantification exception related to the valuation of a U.S. insurance entity on the basis of U.S. statutory accounting principles discussed below). In cases where the departure is quantified, the reporting entity would admit the amount after adjusting for the quantified departure from GAAP. An audit report that contains a qualified or adverse opinion for any other reason than for what is stated within paragraph 21 would result in the nonadmissibility of the investment within that subsidiary. There is no need to quantify the impact of a departure from GAAP in either the auditor's report or the footnotes to the financial statements if a qualified audit opinion is issued due to a departure from GAAP and the departure is related to the valuation of an U.S. insurance entity on the basis of U.S. statutory accounting principles. In such cases, the investment shall be admitted without quantifying the departure.

6. Q – Do GAAP audits for non-insurance entities need to be completed before the annual statement or audited financial statements are filed? They are required to be completed annually, but should there be clarification on when the audits are due?

6.1 A – Paragraph 13.d. of SSAP No. 97 allows for a lag time if the audits of the investees are not completed as of the reporting date, as long as the lag is on a consistent annual basis and the SCA is not valued under paragraph 8.b.i. The following is an excerpt from paragraph 13.d. (bolded for emphasis). The SCA entity is still required to be audited annually.

13.d. If financial statements of an investee are not sufficiently timely for the reporting entity to apply an equity method to the investee's current results of operations, the reporting entity shall record its share of the earnings or losses of an investee from the **most recent available financial statements. A lag in reporting shall be consistent from period to period.** This paragraph does not apply to a SCA valued under paragraph 8.b.i.

7. Q – Is it possible for an SCA investment valued using an equity method to be reported as a negative value?

7.1 A – Yes, the equity method noninsurance SCA could have a negative equity. For example, SSAP No. 97, paragraph 8.b.ii., relating to noninsurance SCA entities may require some assets to be reported as a negative value (nonadmitted) in paragraph 9. In this example, a paragraph 8.b.ii. SCA subsidiary that is only holding furniture, which is nonadmitted, would be reflected with negative equity to the extent the value of the nonadmitted asset(s) exceed(s) reported equity. It should be noted that although SSAP No. 97, paragraph 13.e., discusses some situations in which the equity method should be discontinued, this does not apply to SCA entities, which meet the requirements of paragraph 8.b.ii. In addition, SSAP No. 97, paragraph 13.e., lists some situations where the equity method for paragraph 8.b.ii. and paragraph 8.b.iv. entities would result in a valuation that is less than zero.

8. Q – Paragraph 13.e. of SSAP No. 97 lists some situations where the equity method should be discontinued. If the equity method is discontinued, does the reporting entity cease tracking equity losses?

8.1 A – No, the reporting entity does not cease tracking losses related to the investment in the SCA if an equity method is discontinued. If the equity method is discontinued, follow the guidance in paragraphs 15-17 and INT 00-24: *EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee and EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses.*

8.2 INT 00-24 lists situations that might require the reporting entity to write down other investments in the SCA subsidiary, such as loans, because of continuing losses in the SCA investment. Paragraphs 15-17 provides guidance to assist in determining whether prior losses are being funded if the reporting entity purchases additional stock, etc. after suspending the equity method. Paragraphs 15-17 in INT 00-24 note that even if the equity method is not being applied, the investment should be tracked to determine if additional losses have to be applied to other items and to determine if the investment in the SCA has a future recovery.

9. Q – SSAP No. 97, paragraphs 28-32, provides guidance on segregating the equity from common stock from the equity in the form of preferred stock and surplus notes. This guidance is required for reporting reasons and to prevent double counting of these items in the SCA equity. This section indicates that preferred stock is deducted from the total equity. The guidance notes that reporting entities report their investments in preferred stock in accordance with SSAP No. 32R—Preferred Stock, which requires reporting at book value, fair value, or the lower of book value or fair value. When deducting the preferred stock from the equity of the SCA, which measure of preferred stock is to be utilized; the investor's reporting valuation or the Issuer's value in the equity section of their balance sheet?

9.1 A – In order to establish the equity value of the common stock investment in an SCA, the reporting entity reduces the total equity of the SCA by the SCA's (Issuer's) value of the preferred stock on the issuer's balance sheet (not the reporting entity's Book/Adjusted Carrying Value for the SCA's preferred stock held). Continuing from the example in paragraph 32, if the reporting entity's Book/Adjusted Carrying Value for the SCA preferred stock is currently \$40,000, the SCA's issuing value of the preferred stock (\$50,000) would still be used to calculate the total equity of the SCA ($\$250,000 - \$50,000 = \$200,000$). It should be noted this calculation does not affect the preferred stock valuation of \$40,000 on the books of the investor.

10. Q – If a parent reporting entity owns another insurance company that has obtained a permitted practice, or exemption or waiver from its state of domicile from the annual statutory audit requirement, would the parent be automatically allowed to admit the investment in the unaudited subsidiary?

10.1 A – No, the parent would need to obtain a permitted practice allowing the parent reporting entity to admit the non-audited insurance company due to the admissibility requirements of SSAP No. 97.

Not for Distribution

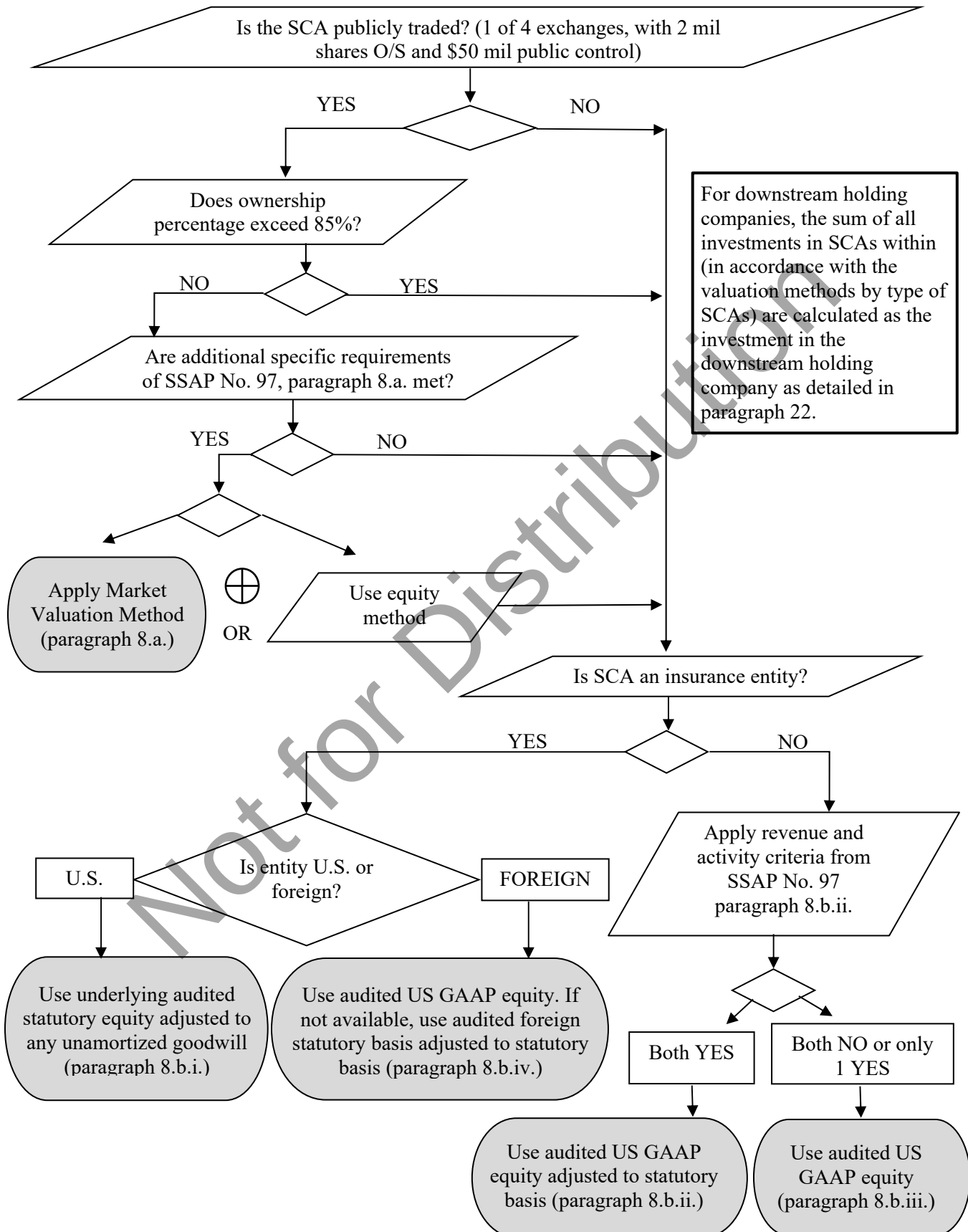
EXHIBIT D – DETERMINING THE VALUATION METHOD UNDER SSAP NO. 97

EXHIBIT E – SLIDING SCALE DISCOUNTING OF SCA ENTITIES USING THE MARKET VALUATION APPROACH

This chart illustrates the sliding scale discounting by ownership percentage that is described in paragraphs 8.a.iv., 8.a.v. and 8.a.vi. of this statement for investments in subsidiary controlled or affiliated entities which are carried using the market valuation approach.

Ownership Percentage	Discount Percentage	Ownership Percentage	Discount Percentage
10%	0.00%	48%	19.00%
11%	0.50%	49%	19.50%
12%	1.00%	50%	20.00%
13%	1.50%	51%	20.33%
14%	2.00%	52%	20.67%
15%	2.50%	53%	21.00%
16%	3.00%	54%	21.33%
17%	3.50%	55%	21.67%
18%	4.00%	56%	22.00%
19%	4.50%	57%	22.33%
20%	5.00%	58%	22.67%
21%	5.50%	59%	23.00%
22%	6.00%	60%	23.33%
23%	6.50%	61%	23.67%
24%	7.00%	62%	24.00%
25%	7.50%	63%	24.33%
26%	8.00%	64%	24.67%
27%	8.50%	65%	25.00%
28%	9.00%	66%	25.33%
29%	9.50%	67%	25.67%
30%	10.00%	68%	26.00%
31%	10.50%	69%	26.33%
32%	11.00%	70%	26.67%
33%	11.50%	71%	27.00%
34%	12.00%	72%	27.33%
35%	12.50%	73%	27.67%
36%	13.00%	74%	28.00%
37%	13.50%	75%	28.33%
38%	14.00%	76%	28.67%
39%	14.50%	77%	29.00%
40%	15.00%	78%	29.33%
41%	15.50%	79%	29.67%
42%	16.00%	80%	30.00%
43%	16.50%	81%	30.00%
44%	17.00%	82%	30.00%
45%	17.50%	83%	30.00%
46%	18.00%	84%	30.00%
47%	18.50%	85%	30.00%

EXHIBIT F – ILLUSTRATION OF THE APPLICATION OF INT 00-24**XYZ Investment in ABC Company**

1. ABC Company is a life insurance company, formed January 2, 20X1, to sell health insurance in the state of New York. On January 2, 20X1, XYZ Insurance Company invested \$500,000 in ABC, and purchased 100,000 shares of common stock at par, and 40,000 shares of preferred stock at par. ABC Preferred stock is non-voting, 5% cumulative.
2. XYZ determined it has obtained a controlling interest in ABC as XYZ owns 50% of the voting interests of ABC. XYZ accounted for its investment in ABC Insurance Company under the statutory equity method of accounting. The following table is selected information from the financial statements of ABC Insurance Company.

20X1 – 20X4					
	1/2/20X1	12/31/20X1	12/31/20X2	12/31/20X3	12/31/20X4
Capital and Surplus:					
Common stock, \$1 par, 200,000 shares issued and outstanding	\$200,000	\$200,000	\$200,000	\$200,000	\$200,000
Preferred stock, \$10 par, 100,000 shares issued and outstanding	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000
Surplus Notes			\$500,000	\$500,000	\$500,000
Unassigned Funds (Surplus)		\$130,000	(\$180,000)	(\$630,000)	(\$1,430,000)
Total Capital and Surplus	\$1,200,000	\$1,330,000	\$1,520,000	\$1,070,000	\$270,000
20X5 – 20X9					
	12/31/20X5	12/31/20X6	12/31/20X7	12/31/20X8	12/31/20X9
Capital and Surplus:					
Common stock, \$1 par, 200,000 shares issued and outstanding	\$200,000	\$200,000	\$200,000	\$200,000	\$200,000
Preferred stock, \$10 par, 100,000 shares issued and outstanding	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000
Surplus Notes	\$500,000	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000
Unassigned Funds (Surplus)	(\$1,980,000)	(\$1,830,000)	(\$1,280,000)	(\$430,000)	\$820,000
Total Capital and Surplus	(\$280,000)	\$370,000	\$920,000	\$1,770,000	\$3,020,000

3. At 1/2/20X1, XYZ recorded the following entry to record its investment in ABC:

Investment in ABC Common stock	\$100,000	
Investment in ABC Preferred stock	\$400,000	
Cash		\$500,000

To record initial investment in ABC Insurance Company

4. During the year ended 12/31/20X1, ABC had statutory net income before dividends of \$200,000. At 12/31/20X1, ABC declared and paid a 5% preferred dividend, and a common stock dividend of \$.10 per share. XYZ recorded the following entries:

Cash	\$20,000	
Dividend Income		\$20,000

To record preferred dividend income from ABC Insurance Company for 20X1.

Investment in ABC Common stock	\$75,000	
Unrealized Gain/Loss		\$75,000

To record 20X1 unrealized gain on investment in ABC Common. $((\$200,000 - \$50,000) * 50\%)$

Cash	\$10,000	
Unrealized Gain/Loss	\$10,000	
Dividend Income		\$10,000
Investment in ABC Common stock		\$10,000

To record 20X1 dividend on ABC Common. $(100,000 \text{ shares} * \$0.10)$

5. During the year ended 12/31/20X2, ABC issued an 8% surplus note of \$500,000. XYZ purchased 100% of the surplus note. During that same year, ABC incurred a statutory net loss before dividends of \$250,000. At 12/31/20X2, ABC declared and paid a 5% preferred dividend, and a common stock dividend of \$.05 per share. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Investment in ABC Surplus Notes	\$500,000	
Cash		\$500,000

To record investment in ABC Insurance Company surplus notes.

Cash	\$20,000	
Dividend Income		\$20,000

To record preferred dividend income from ABC Insurance Company for 20X2.

Unrealized Gain/Loss	\$150,000	
Investment in ABC Common stock		\$150,000

To record 20X2 unrealized loss on investment in ABC Common. $((\$-250,000 - \$50,000) * 50\%)$

Cash	\$5,000	
Unrealized Gain/Loss	\$5,000	
Dividend Income		\$5,000
Investment in ABC Common stock		\$5,000

To record 20X2 dividend on ABC Common. $(100,000 \text{ shares} * \$0.05)$

6. During the year ended 12/31/20X3, ABC Insurance Company incurred a statutory net loss before dividends of \$400,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Dividends Receivable	\$20,000	
Dividend Income		\$20,000

To record preferred dividend income from ABC Insurance Company for 20X3.

Unrealized Gain/Loss	\$182,000	
Investment in ABC Preferred stock		\$172,000
Investment in ABC Common stock		\$10,000

To record 20X3 unrealized loss on investment in ABC Common and Preferred.

Total net loss and preferred stock dividend (\$450,000).

Common stock component reduces the Investment in ABC Common stock component to \$0. $(20,000 * 50\%)$

Total net loss and preferred dividend $(-\$400,000 - \$50,000)$	\$450,000
Less amount used to reduce common stock investment to \$0	<u>20,000</u>
Amount remaining to be allocated to investment in preferred	430,000
XYZ ownership % of preferred	<u>40%</u>
XYZ reduction in investment in preferred	<u>\$172,000</u>

7. During the year ended 12/31/20X4, ABC Insurance Company incurred a statutory net loss before dividends of \$750,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Dividends Receivable	\$20,000	
Dividend Income		\$20,000

To record preferred dividend income from ABC Insurance Company for 20X4.

Unrealized Gain/Loss	\$458,000	
Investment in ABC Preferred stock		\$228,000
Investment in ABC Surplus note		\$230,000

To record 20X4 unrealized loss on investment in ABC Preferred and Surplus Notes.

Total net loss and preferred stock dividend (\$800,000).

Common stock component reduces the Investment in ABC Preferred stock component to \$0. ($570,000 \times 40\%$)

Preferred stock component calculated as:

Total net loss and preferred dividend ($-\$750,000 - \$50,000$)	\$800,000
Less amount used to reduce preferred stock investment to \$0	<u>570,000</u>
Amount remaining to be allocated to investment in surplus note	230,000
XYZ ownership % of surplus note	<u>100%</u>
XYZ reduction in investment in ABC Surplus Notes	<u>\$230,000</u>

8. During the year ended 12/31/20X5, ABC Insurance Company incurred a statutory net loss before dividends of \$500,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Dividends Receivable	\$20,000	
Dividend Income		\$20,000

To record preferred dividend income from ABC Insurance Company for 20X5.

Unrealized Gain/Loss	\$270,000	
Investment in ABC Surplus note		\$270,000

To record 20X5 unrealized loss on investment in ABC Surplus Notes.

Total ABC net loss and preferred stock dividend ($-\$500,000 - \$50,000$).

Surplus Note component calculated as:

Total net loss and preferred dividend ($-\$500,000 - \$50,000$)	\$550,000
XYZ ownership % of ABC Surplus Note	<u>100%</u>
	\$550,000
Amount of unrealized loss recognized in 20X5	<u>\$270,000</u>
Amount of unrealized loss suspended	<u>\$280,000</u>

9. Since XYZ had not guaranteed any liabilities of ABC, the reduction they would recognize is limited to their remaining investment in ABC Surplus Notes. Therefore, they would only recognize a 20X5 unrealized loss on their investment in ABC of \$270,000.

10. During the year ended 12/31/20X6, ABC Insurance Company realigned their marketing efforts and modified the products they were selling. ABC also issued an additional 8% surplus note of \$500,000. This surplus note was purchased by an unaffiliated third party. During the year ended 12/31/X6, ABC Insurance

Company had statutory net income before dividends of \$200,000. ABC Insurance Company did not declare any dividends on common stock but declared and paid current and dividends in arrears on preferred. XYZ recorded the following entries:

Cash	\$80,000	
Dividends Receivable		\$60,000
Dividend Income		\$20,000

To record preferred dividend income from ABC Insurance Company for 20X6, and receipt of preferred dividends receivable for 20X3, 20X4 and 20X5.

11. XYZ did not record any change in their investment in ABC Surplus Notes, ABC Preferred or ABC Common, since ABCs' net income after preferred dividends did not exceed the losses accumulated during the period that XYZ suspended recording unrealized losses.

12. The following amounts were tracked:

Total ABC net income and preferred stock dividend (\$200,000 - \$50,000).

Surplus Note component calculated as:

Total net income and preferred dividend (\$200,000 - \$50,000)	\$150,000
XYZ ownership % of ABC Surplus Note	<u>50%</u>
	\$75,000
Amount of unrealized loss suspended in 20X5	<u>\$280,000</u>
Remaining amount of unrealized loss suspended	<u>\$205,000</u>

13. During the year ended 12/31/20X7, ABC Insurance Company had statutory net income before dividends of \$600,000. At 12/31/20X7, ABC declared and paid a 5% preferred dividend. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Cash	\$20,000	
Dividend Income		\$20,000

To record preferred dividend income from ABC Insurance Company for 20X7.

Investment in ABC Surplus Notes	\$70,000	
Unrealized Gain/Loss		\$70,000

To record 20X7 unrealized gain on investment in ABC Surplus Notes.

Total ABC net income and preferred stock dividend (\$600,000 - \$50,000).

Surplus Note component calculated as:

Total net income and preferred dividend (\$600,000 - \$50,000)	\$550,000
XYZ ownership % of ABC Surplus Note	<u>50%</u>
	\$275,000
Remaining amount of unrealized loss suspended in 20X5	<u>\$205,000</u>
20X7 amount of unrealized gain on investment in ABC Surplus Note	<u>\$ 70,000</u>

14. During the year ended 12/31/20X8, ABC Insurance Company had statutory net income before dividends of \$900,000. At 12/31/20X8, ABC declared and paid a 5% preferred dividend. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Cash	\$20,000	
Dividend Income		\$20,000

To record preferred dividend income from ABC Insurance Company for 20X8.

Total ABC net income and preferred stock dividend (\$900,000 - \$50,000).

Surplus Note component calculated as:

Total net income and preferred dividend (\$900,000 - \$50,000)	\$850,000
XYZ ownership % of ABC Surplus Note	<u>50%</u>
20X8 amount of unrealized gain on investment in ABC Surplus Note	<u>\$425,000</u>
Investment in ABC Surplus Notes	\$425,000
Unrealized Gain/Loss	\$ 425,000

To record 20X8 unrealized gain on investment in ABC Surplus Notes.

15. During the year ended 12/31/20X9, ABC Insurance Company had statutory net income, before interest on surplus notes and dividends, of \$1,400,000. The commissioner approved one year's interest payment on the surplus notes. At 12/31/20X9, ABC declared and paid a 5% preferred dividend, and a \$.10 dividend per share on Common stock. XYZ recorded the following entries:

Cash	\$ 20,000	
Dividend Income		\$ 20,000

To record preferred dividend income from ABC Insurance Company for 20X9.

Cash	\$ 40,000	
Interest Income		\$ 40,000

To record surplus notes interest income from ABC Insurance Company for 20X9. (\$500,000 * 8%)

Investment in ABC Surplus Notes	\$	5,000	
Investment in ABC Preferred Stock	\$	400,000	
Investment in ABC Common Stock	\$	130,000	
Unrealized Gain/Loss			\$ 535,000

To record 20X9 unrealized gain on investment in ABC Common, Preferred and Surplus Notes. Components computed as follows:

Total Net Income net of preferred stock dividend and interest on surplus notes (\$1,400,000 - \$50,000 - \$80,000)	\$	1,270,000	
Less amount needed to restore investment in surplus notes		<u>(\$ 10,000)</u>	
Amount available for preferred stock and common stock investment restoration	\$	1,260,000	
Amount needed to restore preferred stock component		<u>(\$ 1,000,000)</u>	
Amount available to restore common stock component		<u>\$ 260,000</u>	
Surplus Notes Component (\$10,000 * 50%)	\$	5,000	
Preferred Stock Component (\$1,000,000 * 40%)	\$	400,000	
Common Stock Component (\$260,000 * 50%)	\$	130,000	
Cash	\$	10,000	
Unrealized Gain/Loss	\$	10,000	
Dividend Income			\$ 10,000
Investment in ABC Common Stock			\$ 10,000

To record 20X9 dividend on ABC Common. (100,000 shares * \$.10)

Statement of Statutory Accounting Principles No. 100 – Revised

Fair Value

STATUS

Type of Issue.....	Common Area
Issued	December 5, 2009; Substantively revised November 6, 2017
Effective Date	December 31, 2010; Substantive revisions detailed in Issue Paper No. 157 effective January 1, 2018
Affects.....	Nullifies INT 09-04
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Definition of Fair Value	2
Components of the Fair Value Definition.....	2
Fair Value at Initial Recognition.....	4
Valuation Techniques	5
Inputs to Valuation Techniques	6
Fair Value Hierarchy.....	7
Utilizing Net Asset Value Per Share as a Practical Expedient to Fair Value.....	11
Disclosures.....	13
Disclosures about Fair Value of Financial Instruments	15
Relevant Literature.....	16
Effective Date and Transition.....	18
REFERENCES.....	18
Relevant Issue Papers	18

SCOPE OF STATEMENT

1. This statement defines fair value, establishes a framework for measuring fair value and establishes disclosure requirements about fair value.

SUMMARY CONCLUSION

2. This standard applies under other accounting pronouncements that require or permit fair value measurements, but this standard does not require any new fair value amendments. However, the application of this standard may change current practice. This standard does not eliminate the practicability exceptions to fair value measurements in accounting pronouncements within the scope of this standard.

3. This standard applies under other statutory accounting pronouncements that require or permit fair value measurements, except as follows:

- a. This standard does not eliminate the practicality exceptions to fair value measurements in accounting pronouncements within the scope of this standard.
- b. This standard does not apply under *SSAP No. 22R—Leases* and other accounting pronouncements that address fair value measurements for purposes of lease classification to measurement under SSAP No. 22R. This scope exception does not apply to assets acquired or liabilities assumed in a business combination that are required to be measured at fair value under *SSAP No. 68—Business Combinations and Goodwill*, regardless of whether those assets and liabilities are related to leases. This standard does not apply to share-based payment transactions captured within *SSAP No. 104R—Share-Based Payments*.

Definition of Fair Value

4. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Components of the Fair Value Definition

5. **Asset/Liability** – A fair value measurement is for a particular asset or liability. Therefore, the measurement should consider attributes specific to the asset or liability, for example, the condition and/or location of the asset or liability and restrictions, if any, on the sale or use of the asset at the measurement date. The asset or liability might be a standalone asset or liability (for example, a financial instrument or an operating asset) or a group of assets and/or liabilities (for example, an asset group, a reporting unit, or a business).

6. **Price** – A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale). The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. Therefore, the objective of a fair value measurement is to determine the price that would be received to sell the asset or paid to transfer the liability at the measurement date (an exit price).

7. **Principal (or Most Advantageous) Market** – A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The principal market is the market in which the reporting entity would sell the asset or transfer the liability with the greatest volume and level of activity for the asset or liability. The most advantageous market is the market in which the reporting entity would sell the asset or transfer the liability with the price that maximizes the amount that would be received for the asset or minimizes the amount that would be paid to transfer the liability, considering transaction costs in the respective market(s). In either case, the principal (or most advantageous) market (and thus, market participants) should be considered from the perspective of the reporting entity, thereby allowing for differences between and among entities with different activities. If there is a principal market for the asset or liability, the fair value measurement shall represent the price in that market (whether that price is directly observable or otherwise determined using a valuation technique), even if the price in a different market is potentially more advantageous at the measurement date.

8. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. Transaction costs represent the incremental direct costs to sell the asset or transfer the liability in the principal (or most advantageous) market for the asset or liability. Transaction costs are not an attribute of the asset or liability; rather, they are specific to the transaction and will differ depending on how the reporting entity transacts. However, transaction costs do not include the costs that would be incurred to transport the asset or liability to (or from) its principal (or most advantageous) market. If location is an attribute of the asset or liability (as might be the case for a commodity), the price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall be adjusted for the costs, if any, that would be incurred to transport the asset or liability to (or from) its principal (or most advantageous) market.

9. Market Participants – Market participants are buyers and sellers in the principal (or most advantageous) market for the asset or liability that are:

- a. Independent of the reporting entity; that is, they are not related parties;
- b. Knowledgeable, having a reasonable understanding about the asset or liability and the transaction based on all available information, including information that might be obtained through due diligence efforts that are usual and customary;
- c. Able to transact for the asset or liability; and
- d. Willing to transact for the asset or liability; that is, they are motivated but not forced or otherwise compelled to do so.

10. The fair value of the asset or liability shall be determined based on the assumptions that market participants would use in pricing the asset or liability. In developing those assumptions, the reporting entity need not identify specific market participants. Rather, the reporting entity should identify characteristics that distinguish market participants generally, considering factors specific to (a) the asset or liability, (b) the principal (or most advantageous) market for the asset or liability, and (c) market participants with whom the reporting entity would transact in that market.

11. Application to Assets – A fair value measurement assumes the highest and best use of the asset by market participants, considering the use of the asset that is physically possible, legally permissible, and financially feasible at the measurement date. In broad terms, highest and best use refers to the use of an asset by market participants that would maximize the value of the asset or the group of assets within which the asset would be used. Highest and best use is determined based on the use of the asset by market participants, even if the intended use of the asset by the reporting entity is different.

12. The highest and best use of the asset establishes the valuation premise used to measure the fair value of the asset. Specifically:

- a. In-use – The highest and best use of the asset is in-use if the asset would provide maximum value to market participants principally through its use in combination with other assets as a group (as installed or otherwise configured for use). For example, that might be the case for certain nonfinancial assets. If the highest and best use of the asset is in-use, the fair value of the asset shall be measured using an in-use valuation premise. When using an in-use valuation premise, the fair value of the asset is determined based on the price that would be received in a current transaction to sell the asset assuming that the asset would be used with other assets as a group and that those assets would be available to market participants. Generally, assumptions about the highest and best use of the asset should be consistent for all of the assets of the group within which it would be used.

- b. In-exchange – The highest and best use of the asset is in-exchange if the asset would provide maximum value to market participants principally on a standalone basis. For example, that might be the case for a financial asset. If the highest and best use of the asset is in-exchange, the fair value of the asset shall be measured using an in-exchange valuation premise. When using an in-exchange valuation premise, the fair value of the asset is determined based on the price that would be received in a current transaction to sell the asset standalone.

13. Because the highest and best use of the asset is determined based on its use by market participants, the fair value measurement considers the assumptions that market participants would use in pricing the asset, whether using an in-use or an in-exchange valuation premise.

14. Application to Liabilities – Consideration of non-performance risk (own credit-risk) should not be reflected in the fair value calculation for liabilities (including derivative liabilities) at subsequent measurement. At initial recognition, it is perceived that the consideration of own-credit risk may be inherent in the contractual negotiations resulting in the liability. The consideration of non-performance risk for subsequent measurement is inconsistent with the conservatism and recognition concepts as well as the assessment of financial solvency for insurers, as a decrease in credit standing would effectively decrease reported liabilities and thus seemingly increase the appearance of solvency. Furthermore, liabilities reported or disclosed at “fair value” shall not reflect any third-party credit guarantee of debt.

Equity Securities Subject to Contractual Sale Restrictions

15. An equity security that an entity cannot sell on the measurement date because of a contractual sale restriction shall be measured at fair value on the basis of the price in the principal (or most advantageous) market¹. A contractual sale restriction does not change the market in which that equity security would be sold. A discount applied to the price of an equity security because of a contractual sale restriction is not a characteristic of the equity security. A contractual sale restriction is a characteristic of the reporting entity holding the equity security rather than a characteristic of the asset and, therefore, is not considered in measuring the fair value of an equity security. A contractual sale restriction prohibiting the sale of an equity security is a characteristic of the reporting entity holding the equity security and shall not be separately recognized as its own unit of account.

16. The effect on a fair value measurement arising from a restriction on the sale or use of an asset by a reporting entity will differ depending on whether the restriction would be taken into account by market participants when pricing the asset. When the restriction is a characteristic of the asset, the restriction should be considered in measuring the fair value of the asset. For example, an equity security issued through a private placement is not registered and is legally restricted from being sold on a national securities exchange or an over-the-counter market until the shares are registered or the conditions necessary for an exemption from registration have been satisfied. A market participant would sell the private placement equity securities in a different market than the market used for registered equity securities on the measurement date. Because that restriction would be a characteristic of the equity security, a market participant would consider the inability to resell the security on a national securities exchange or an over-the-counter market when pricing the equity security; therefore, the reporting entity that holds the Class A shares acquired through a private placement transaction would consider that restriction a characteristic of the asset, and the reporting entity should measure the fair value of the equity security on the basis of the market price of the similar unrestricted equity security adjusted to reflect the effect of the restriction¹.

¹ Refer to SSAP No. 4—*Assets and Nonadmitted Assets* for admissibility guidance for restricted equity securities.

Fair Value at Initial Recognition

~~15.~~17. When an asset is acquired or a liability is assumed in an exchange transaction for that asset or liability, the transaction price represents the price paid to acquire the asset or received to assume the liability (an entry price). In contrast, the fair value of the asset or liability represents the price that would be received to sell the asset or paid to transfer the liability (an exit price). Conceptually, entry prices and exit prices are different. Entities do not necessarily sell assets at the prices paid to acquire them. Similarly, entities do not necessarily transfer liabilities at the prices received to assume them.

~~16.~~18. In many cases, the transaction price will equal the exit price and, therefore, represent the fair value of the asset or liability at initial recognition. In determining whether a transaction price represents the fair value of the asset or liability at initial recognition, the reporting entity shall consider factors specific to the transaction and the asset or liability. For example, a transaction price might not represent the fair value of an asset or liability at initial recognition if:

- a. The transaction is between related parties.
- b. The transaction occurs under duress or the seller is forced to accept the price in the transaction. For example, that might be the case if the seller is experiencing financial difficulty.
- c. The market in which the transaction occurs is different from the market in which the reporting entity would sell the asset or transfer the liability, that is, the principal or most advantageous market. For example, those markets might be different if the reporting entity is a securities dealer that transacts in different markets, depending on whether the counterparty is a retail customer (retail market) or another securities dealer (inter-dealer market).
- d. For liabilities, differences may exist as non-performance risk (own credit risk) is not reflected in the fair value (i.e., exit price) determination of all liabilities (including derivatives).

Valuation Techniques

~~17.~~19. Valuation techniques consistent with the market approach, income approach, and/or cost approach shall be used to measure fair value. Key aspects of those approaches are summarized below:

- a. Market approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities (including a business). For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparables. Multiples might lie in ranges with a different multiple for each comparable. The selection of where within the range the appropriate multiple falls requires judgment, considering factors specific to the measurement (qualitative and quantitative). Valuation techniques consistent with the market approach include matrix pricing. Matrix pricing is a mathematical technique used principally to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities.
- b. Income approach. The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present amount (discounted). The measurement is based on the value indicated by current market expectations about those future amounts. Those valuation techniques include present value techniques; option-pricing models, such as the Black-Scholes-Merton formula (a closed-form model) and a binomial model (a lattice model), which incorporate present value techniques; and

the multiperiod excess earnings method, which is used to measure the fair value of certain intangible assets.

- c. **Cost approach.** The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (often referred to as current replacement cost). From the perspective of a market participant (seller), the price that would be received for the asset is determined based on the cost to a market participant (buyer) to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence. Obsolescence encompasses physical deterioration, functional (technological) obsolescence, and economic (external) obsolescence and is broader than depreciation for financial reporting purposes (an allocation of historical cost) or tax purposes (based on specified service lives).

~~18.~~20. Valuation techniques that are appropriate in the circumstances and for which sufficient data are available shall be used to measure fair value. In some cases, a single valuation technique will be appropriate (for example, when valuing an asset or liability using quoted prices in an active market for identical assets or liabilities). In other cases, multiple valuation techniques will be appropriate (for example, as might be the case when valuing a reporting unit). If multiple valuation techniques are used to measure fair value, the results (respective indications of fair value) shall be evaluated and weighted, as appropriate, considering the reasonableness of the range indicated by those results. A fair value measurement is the point within that range that is most representative of fair value in the circumstances.

~~19.~~21. Valuation techniques used to measure fair value shall be consistently applied. However, a change in a valuation technique or its application (for example, a change in its weighting when multiple valuation techniques are used) is appropriate if the change results in a measurement that is equally or more representative of fair value in the circumstances. That might be the case if, for example, new markets develop, new information becomes available, information previously used is no longer available, or valuation techniques improve. Revisions resulting from a change in the valuation technique or its application shall be accounted for as a change in accounting estimate pursuant to *SSAP No. 3—Accounting Changes and Corrections of Errors*. The disclosure provisions of SSAP No. 3 for a change in accounting estimate are not required for revisions resulting from a change in a valuation technique or its application.

Inputs to Valuation Techniques

~~20.~~22. In this standard, inputs refer broadly to the assumptions that market participants would use in pricing the asset or liability, including assumptions about risk, for example, the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model) and/or the risk inherent in the inputs to the valuation technique. Inputs may be observable or unobservable:

- a. **Observable inputs** are inputs that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the reporting entity.
- b. **Unobservable inputs** are inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

Valuation techniques used to measure fair value shall maximize the use of observable inputs and minimize the use of unobservable inputs.

Fair Value Hierarchy

21-23. To increase consistency and comparability in fair value measurements and related disclosures, the fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). In some cases, the inputs used to measure fair value might fall in different levels of the fair value hierarchy. The level in the fair value hierarchy within which the fair value measurement in its entirety falls shall be determined based on the lowest level input that is significant to the fair value measurement in its entirety. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability.

22-24. The availability of inputs relevant to the asset or liability and the relative reliability of the inputs might affect the selection of appropriate valuation techniques. However, the fair value hierarchy prioritizes the inputs to valuation techniques, not the valuation techniques. For example, a fair value measurement using a present value technique might fall within Level 2 or Level 3, depending on the inputs that are significant to the measurement in its entirety and the level in the fair value hierarchy within which those inputs fall.

Level 1 Inputs

23-25. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available, except as discussed in paragraphs 24-26 and 25-27.

24-26. If the reporting entity holds a large number of similar assets or liabilities (for example, debt securities) that are required to be measured at fair value, a quoted price in an active market might be available but not readily accessible for each of those assets or liabilities individually. In that case, fair value may be measured using an alternative pricing method that does not rely exclusively on quoted prices (for example, matrix pricing) as a practical expedient. However, the use of an alternative pricing method renders the fair value measurement a lower level measurement.

25-27. In some situations, a quoted price in an active market might not represent fair value at the measurement date. That might be the case if, for example, significant events (principal-to-principal transactions, brokered trades, or announcements) occur after the close of a market but before the measurement date. The reporting entity should establish and consistently apply a policy for identifying those events that might affect fair value measurements. However, if the quoted price is adjusted for new information, the adjustment renders the fair value measurement a lower level measurement.

26-28. If the reporting entity holds a position in a single financial instrument (including a block) and the instrument is traded in an active market, the fair value of the position shall be measured within Level 1 as the product of the quoted price for the individual instrument times the quantity held. The quoted price shall not be adjusted because of the size of the position relative to trading volume (blockage factor). The use of a blockage factor is prohibited, even if a market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

Level 2 Inputs

27-29. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term,

a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

- a. Quoted prices for similar assets or liabilities in active markets
- b. Quoted prices for identical or similar assets or liabilities in markets that are not active, that is, markets in which there are few transactions for the asset or liability, the prices are not current, or price quotations vary substantially either over time or among market makers (for example, some brokered markets), or in which little information is released publicly (for example, a principal-to-principal market)
- c. Inputs other than quoted prices that are observable for the asset or liability (for example, interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates)
- d. Inputs that are derived principally from or corroborated by observable market data by correlation or other means (market-corroborated inputs).

~~28,30.~~ 29,31. Adjustments to Level 2 inputs will vary depending on factors specific to the asset or liability. Those factors include the condition and/or location of the asset or liability, the extent to which the inputs relate to items that are comparable to the asset or liability, and the volume and level of activity in the markets within which the inputs are observed. An adjustment that is significant to the fair value measurement in its entirety might render the measurement a Level 3 measurement, depending on the level in the fair value hierarchy within which the inputs used to determine the adjustment fall.

~~29,31.~~ 29,31. The reporting entity should evaluate the following factors to determine whether there has been a significant decrease in the volume and level of activity for the asset or liability when compared with normal market activity for the asset or liability (or similar assets or liabilities). The factors include, but are not limited to:

- a. There are few recent transactions.
- b. Price quotations are not based on current information.
- c. Price quotations vary substantially either over time or among market makers (for example, some brokered markets).
- d. Indexes that previously were highly correlated with the fair values of the asset or liability are demonstrably uncorrelated with recent indications of fair value for that asset or liability.
- e. There is a significant increase in implied liquidity risk premiums, yields, or performance indicators (such as delinquency rates or loss severities) for observed transactions or quoted prices when compared with the reporting entity's estimate of expected cash flows, considering all available market data about credit and other nonperformance risk for the asset or liability.
- f. There is a wide bid-ask spread or significant increase in the bid-ask spread.
- g. There is a significant decline or absence of a market for new issuances (that is, a primary market) for the asset or liability or similar assets or liabilities.
- h. Little information is released publicly (for example, a principal-to-principal market).

The reporting entity shall evaluate the significance and relevance of the factors to determine whether, based on the weight of the evidence, there has been a significant decrease in the volume and level of activity for the asset or liability.

~~30.~~32. If the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities), transactions or quoted prices may not be determinative of fair value (for example, there may be increased instances of transactions that are not orderly). Further analysis of the transactions or quoted prices is needed, and a significant adjustment to the transactions or quoted prices may be necessary to estimate fair value in accordance with this standard. Significant adjustments also may be necessary in other circumstances (for example, when a price for a similar asset requires significant adjustment to make it more comparable to the asset being measured or when the price is stale).

~~31.~~33. This standard does not prescribe a methodology for making significant adjustments to transactions or quoted prices when estimating fair value. Paragraphs ~~17-19~~19-21 discuss the use of valuation techniques in estimating fair value. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate (for example, the use of a market approach and a present value technique). When weighting indications of fair value resulting from the use of multiple valuation techniques, the reporting entity shall consider the reasonableness of the range of fair value estimates. The objective is to determine the point within that range that is most representative of fair value under current market conditions. A wide range of fair value estimates may be an indication that further analysis is needed.

~~32.~~34. Even in circumstances where there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. Determining the price at which willing market participants would transact at the measurement date under current market conditions if there has been a significant decrease in the volume and level of activity for the asset or liability depends on the facts and circumstances and requires the use of significant judgment. However, the reporting entity's intention to hold the asset or liability is not relevant in estimating fair value. Fair value is a market-based measurement, not an entity-specific measurement.

~~33.~~35. Even if there has been a significant decrease in the volume and level of activity for the asset or liability, it is not appropriate to conclude that all transactions are not orderly (that is, distressed or forced). Circumstances that may indicate that a transaction is not orderly include, but are not limited to:

- a. There was not adequate exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities under current market conditions.
- b. There was a usual and customary marketing period, but the seller marketed the asset or liability to a single market participant.
- c. The seller is in or near bankruptcy or receivership (that is, distressed), or the seller was required to sell to meet regulatory or legal requirements (that is, forced).
- d. The transaction price is an outlier when compared with other recent transactions for the same or similar asset or liability.

The reporting entity shall evaluate the circumstances to determine whether the transaction is orderly based on the weight of the evidence.

34.36. The determination of whether a transaction is orderly (or not orderly) is more difficult if there has been a significant decrease in the volume and level of activity for the asset or liability. Accordingly, the reporting entity shall consider the following guidance:

- a. If the weight of the evidence indicates the transaction is not orderly, the reporting entity shall place little, if any, weight (compared with other indications of fair value) on that transaction price when estimating fair value or market risk premiums.
- b. If the weight of the evidence indicates the transaction is orderly, the reporting entity shall consider that transaction price when estimating fair value or market risk premiums. The amount of weight placed on that transaction price when compared with other indications of fair value will depend on the facts and circumstances such as the volume of the transaction, the comparability of the transaction to the asset or liability being measured at fair value, and the proximity of the transaction to the measurement date.
- c. If the reporting entity does not have sufficient information to conclude that the transaction is orderly or that the transaction is not orderly, it shall consider that transaction price when estimating fair value or market risk premiums. However, that transaction price may not be determinative of fair value (that is, that transaction price may not be the sole or primary basis for estimating fair value or market risk premiums). The reporting entity shall place less weight on transactions on which the reporting entity does not have sufficient information to conclude whether the transaction is orderly when compared with other transactions that are known to be orderly.

In its determinations, the reporting entity need not undertake all possible efforts, but shall not ignore information that is available without undue cost and effort. The reporting entity would be expected to have sufficient information to conclude whether a transaction is orderly when it is party to the transaction.

35.37. Regardless of the valuation technique(s) used, the reporting entity shall include appropriate risk adjustments. Risk-averse market participants generally seek compensation for bearing the uncertainty inherent in the cash flows of an asset or liability (risk premium). A fair value measurement should include a risk premium reflecting the amount market participants would demand because of the risk (uncertainty) in the cash flows. Otherwise, the measurement would not faithfully represent fair value. In some cases, determining the appropriate risk premium might be difficult. However, the degree of difficulty alone is not a sufficient basis on which to exclude a risk adjustment. Risk premiums should be reflective of an orderly transaction (that is, not a forced or distressed sale) between market participants at the measurement date under current market conditions.

36.38. When estimating fair value, this standard does not preclude the use of quoted prices provided by third parties, such as pricing services or brokers, when the reporting entity has determined that the quoted prices provided by those parties are determined in accordance with this standard. However, when there has been a significant decrease in the Volume or level of activity for the asset or liability, the reporting entity should evaluate whether those quoted prices are based on current information that reflects orderly transactions or a valuation technique that reflects market participant assumptions (including assumptions about risks). In weighting a quoted price as an input to a fair value measurement, the reporting entity should place less weight (when compared with other indications of fair value that are based on transactions) on quotes that do not reflect the result of transactions. Furthermore, the nature of the quote (for example, whether the quote is an indicative price or a binding offer) should be considered when weighting the available evidence, with more weight given to quotes based on binding offers.

Level 3 Inputs

37.39. Level 3 inputs are unobservable inputs for the asset or liability. Unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for

situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, that is, an exit price from the perspective of a market participant that holds the asset or owes the liability. Therefore, unobservable inputs shall reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). Unobservable inputs shall be developed based on the best information available in the circumstances, which might include the reporting entity's own data. In developing unobservable inputs, the reporting entity need not undertake all possible efforts to obtain information about market participant assumptions. However, the reporting entity shall not ignore information about market participant assumptions that is reasonably available without undue cost and effort. Therefore, the reporting entity's own data used to develop unobservable inputs shall be adjusted if information is reasonably available without undue cost and effort that indicates that market participants would use different assumptions.

Inputs Based on Bid and Ask Prices

~~38.~~40. If an input used to measure fair value is based on bid and ask prices (for example, in a dealer market), the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value, regardless of where in the fair value hierarchy the input falls (Level 1, 2, or 3). This standard does not preclude the use of mid-market pricing or other pricing conventions as a practical expedient for fair value measurements within a bid-ask spread.

Utilizing Net Asset Value Per Share as a Practical Expedient to Fair Value

~~39.~~41. A reporting entity may utilize net asset value per share (NAV)² as a practical expedient to fair value in either of the following situations, unless, as prescribed in paragraph ~~44.~~46. it is probable that the reporting entity will sell the investment for an amount different from the net asset value per share (or its equivalent):

- a. When a SSAP specifically identifies NAV as a permitted practical expedient.
- b. When the conditions specified in paragraph ~~40.~~42. are met.

~~40.~~42. Pursuant to paragraph ~~39.~~41., a reporting entity is permitted to utilize NAV as a practical expedient to fair value when the investment meets both of the following criteria:

- a. The investment does not have a readily determinable fair value as defined in paragraph ~~41.~~43.
- b. The investment is in an investment company or is an investment in a real estate fund for which it is industry practice to measure investment assets at fair value on a recurring basis and to issue financial statements consistent with the measurement principles of an investment company.

~~41.~~43. An equity security has a readily determinable fair value if it meets any of the following conditions:

- a. The fair value of an equity security is readily determinable if sales prices or bid-and-asked quotations are currently available on a securities exchange registered with the U.S. Securities and Exchange Commission (SEC) or in the over-the-counter market, provided that those prices or quotations for the over-the-counter market are publicly reported by

² Net asset value per share is the amount of net assets attributable to each share of capital stock (other than senior equity securities, that is, preferred stock) outstanding at the close of the period. It excludes the effects of assuming conversion of outstanding convertible securities, whether or not their conversion would have a diluting effect. *(This footnote reflects the definition of Net Asset Value Per Share from the FASB Codification Master Glossary.)*

the National Association of Securities Dealers Automated Quotations systems or by OTC Markets Group Inc. Restricted stock meets that definition if the restriction terminates within one year³.

- b. The fair value of an equity security traded only in a foreign market is readily determinable if that foreign market is of a breadth and scope comparable to one of the U.S. markets identified in paragraph 41.43.a.
- c. The fair value of an equity security that is an investment in a mutual fund or in a structure similar to a mutual fund (that is, a limited partnership or a venture capital entity) is readily determinable if the fair value per share (unit) is determined and published and is the basis for current transactions.

42.44. An entity is considered an investment company if it qualifies under the following assessments:

- a. An entity regulated under the Investment Company Act of 1940.
- b. An entity that is not regulated under the Investment Company Act of 1940, but that possesses all of the following fundamental characteristics:
 - i. The entity, 1) obtains funds from one or more investors and provides the investors with investment management services, and 2) commits to its investors that its business purpose and only substantive activities are investing the funds solely for returns from capital appreciation, investment income, or both.
 - ii. The entity or its affiliates do not obtain or have the objective of obtaining returns or benefits from an investee or its affiliates that are not normally attributable to ownership interests or that are other than capital appreciation or investment income.
- c. The following characteristics are not required, but are typically found in an investment company. If the entity does not possess one or more of these typical characteristics, the reporting entity shall conduct further assessments to determine whether the entity's activities are consistent with those of an investment company:
 - i. The entity has more than one investment.
 - ii. The entity has more than one investor.
 - iii. The entity has investors that are not related parties of the parent or the investment manager.
 - iv. The entity has ownership interests in the form of equity or partnership interests.
 - v. The entity manages substantially all of its investments on a fair value basis.

43.45. If a reporting entity is permitted under paragraph 39.41 to utilize NAV as a practical expedient, the reporting entity shall identify whether the holdings of the investment company, in determining NAV, are measured at fair value as of the reporting entity's measurement date. If the NAV of the investment obtained from the entity is not as of the reporting entity's measurement date, or is not based on a fair value measurement of the underlying investments, the reporting entity shall consider whether an adjustment to the most recent NAV is necessary. The objective of any adjustment is to estimate a net asset

³ If an investment would otherwise have a readily determinable fair value, except that the investment has a restriction expiring in more than one year, the reporting entity is not permitted to use NAV for that investment.

value per share for the investment that is calculated on the basis of underlying investments held at fair value.

~~44.~~46. A reporting entity shall decide on an investment-by-investment basis whether to apply the practical expedient in paragraph ~~39~~41 and shall apply that practical expedient consistently to the fair value measurement of the reporting entity's entire position in a particular investment, unless it is probable at the measurement date that the reporting entity will sell a portion of an investment at an amount different from NAV. In those situations, the reporting entity shall account for the portion of the investment that is being sold at fair value, as defined in paragraph 4, without use of the NAV practical expedient.

~~45.~~47. A reporting entity is not permitted to estimate the fair value of an investment (or a portion of the investment) using the NAV of the investment (or its equivalent) as a practical expedient if, as of the reporting entity's measurement date, it is probable that the reporting entity will sell the investment for an amount different from the net asset value per share (or its equivalent). A sale is considered probable only if all of the following criteria have been met as of the reporting entity's measurement date:

- a. Management having the authority to approve the action commits to a plan to sell the investment.
- b. An active program to locate a buyer and other actions required to complete the plan to sell the investment have been initiated.
- c. The investment is available for immediate sale subject only to terms that are usual and customary for sales of such investments (for example, a requirement to obtain approval of the sale from the investee or a buyer's due diligence procedures).
- d. Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

~~46.~~48. An investment reported at NAV as a practical expedient pursuant to paragraph ~~39~~41, shall not be categorized within the fair value hierarchy. Although the investment is not categorized within the fair value hierarchy, a reporting entity shall separately identify NAV (or its equivalent) as required under paragraphs ~~48~~50.a. and ~~48~~50.b. to permit reconciliations.

Disclosures

~~47.~~49. The objective of the disclosure requirements is to provide information about assets and liabilities measured at fair value in the financial statements as well as fair value amounts disclosed in the notes to financial statements or reporting schedules. To meet these objectives, the reporting entity shall disclose the information in paragraphs ~~48~~50 through ~~57~~59.

~~48.~~50. For each class of assets and liabilities measured and reported⁴ 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.

- a. The fair value/NAV measurements at the reporting date.

⁴ 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.

- b. The level of the fair value hierarchy within which the fair value measurements are categorized in their entirety (Level 1, 2 or 3). Investments reported at NAV shall not be captured within the fair value hierarchy, but shall be separately identified.
- c. For fair value measurements categorized within Level 2 and Level 3 of the fair value hierarchy, a description of the valuation technique(s) and the inputs used in the fair value measurement. If there has been a change in the valuation technique (for example, changing from a market approach to an income approach or the use of an additional valuation technique), the reporting entity shall disclose that change and the reason(s) for making it.
- d. For fair value measurements categorized within Level 3 of the fair value hierarchy a reconciliation from the opening balances to the closing balances disclosing separately changes during the period attributable to the following:
 - i. Total gains or losses for the period recognized in income or surplus.
 - ii. Purchases, sales, issues, and settlements (each type disclosed separately).
 - iii. The amounts of any transfers into or out of Level 3 and the reasons for those transfers. Transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3.
- e. A reporting entity shall consistently follow its policy for determining when transfers between levels are recognized. The policy about the timing of recognizing transfers shall be the same for transfers into Level 3 as that for transfers out of Level 3. Examples of policies for when to recognize the transfers are as follows:
 - i. The actual date of the event or change in circumstances that caused the transfer.
 - ii. The beginning of the reporting period.
 - iii. The end of the reporting period.

~~49~~51. For derivative assets and liabilities, the reporting entity shall present both of the following:

- a. The disclosures required by paragraphs ~~48~~50.a. and ~~48~~50.b. on a gross basis.
- b. The reconciliation disclosures required by paragraph ~~48~~50.c., ~~48~~50.d. and ~~48~~50.e. on either a gross or net basis.

~~50~~52. The quantitative disclosures required in paragraphs ~~48-49~~50-51 of this standard shall be presented using a tabular format.

~~51~~53. The reporting entity shall disclose the fair value hierarchy and the method used to obtain the fair value measurement, or the use of NAV, for all items in which fair value is disclosed within the annual statement investment schedules. This disclosure is satisfied by the completion of the investment schedules in the Annual statement and is not required quarterly.

~~52~~54. For investments measured using the NAV practical expedient pursuant to paragraph ~~39~~41, a reporting entity shall disclose information that helps users of its financial statements to understand the nature and risks of the investments and whether the investments, if sold, are probable of being sold at amounts different from net asset value per share. A reporting entity shall disclose the following information for instances in which the investment may be sold below NAV, or if there are significant restrictions in the liquidation of an investment held at NAV:

- a. The NAV along with a description of the investment/investment strategy of the investee.
- b. If the investment that can never be redeemed with the investees, but the reporting entity receives distributions through the liquidation of the underlying assets of the investees, the period of time over which the underlying assets are expected to be liquidated by the investees if the investee has communicated the timing to the reporting entity or announced the timing publicly. If the timing is unknown, the reporting entity shall disclose that fact.
- c. The amount of the reporting entity's unfunded commitments related to investments in the class.
- d. A general description of the terms and conditions upon which the investor may redeem the investment.
- e. The circumstances in which an otherwise redeemable investment in the class (or a portion thereof) might not be redeemable (for example, investments subject to a lockup or gate). Also, for those otherwise redeemable investments that are restricted from redemption as of the reporting entity's measurement date, the reporting entity shall disclose when the restriction from redemption might lapse if the investee has communicated that timing to the reporting entity or announced the timing publicly. If the timing is unknown, the reporting entity shall disclose that fact and how long the restriction has been in effect.
- f. Any other significant restriction on the ability to sell investments in the class at the measurement date.
- g. If a group of investments would otherwise meet the criteria in paragraph 4547 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 3941, the reporting entity shall disclose its plans to sell and any remaining actions required to complete the sale(s).

53.55. The reporting entity is encouraged, but not required, to combine the fair value information disclosed under this standard with the fair value information disclosed under other accounting pronouncements (for example, disclosures about fair value of financial instruments) in the periods in which those disclosures are required, if practicable. The reporting entity also is encouraged, but not required, to disclose information about other similar measurements, if practicable.

Disclosures about Fair Value of Financial Instruments

54.56. A reporting entity shall disclose in the notes to the financial statements, as of each date for which a statement of financial position is presented in the quarterly or annual financial statements, the aggregate fair value or NAV for all financial instruments and the level within the fair value hierarchy in which the fair value measurements in their entirety fall. This disclosure shall be summarized by type of financial instrument, for which it is practicable to estimate fair value, except for certain financial instruments identified in paragraph 5557. Fair value disclosed in the notes shall be presented together with the related admitted values in a form that makes it clear whether the fair values and admitted values represent assets or liabilities and to which line items in the Statement of Assets, Liabilities, Surplus and Other Funds they relate. Unless specified otherwise in another SSAP, the disclosures may be made net of encumbrances, if the asset or liability is so reported. A reporting entity shall also disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments. If it is not practicable for an entity to estimate the fair value of the financial instrument or a class of financial instruments, and the investment

does not qualify for the NAV practical expedient, the aggregate carrying amount for those items shall be reported as “not practicable” with additional disclosure as required in paragraph 4850.

~~55~~57. The disclosures about fair value prescribed in paragraph ~~54~~56 are not required for the following:

- a. Employers' and plans' obligations for pension benefits, other postretirement benefits including health care and life insurance benefits, postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements, as defined in *SSAP No. 12—Employee Stock Ownership Plans*, *SSAP No. 92—Postretirement Benefits Other Than Pensions*, *SSAP No. 102—Pensions* and *SSAP No. 104R—Share-Based Payments*.
- b. Substantively extinguished debt subject to the disclosure requirements of *SSAP No. 103R—Transfer and Servicing of Financial Assets and Extinguishments of Liabilities*.
- c. Insurance contracts, other than financial guarantees and deposit-type contracts .
- d. Lease contracts as defined in *SSAP No. 22R—Leases*.
- e. Warranty obligations and rights.
- f. Investments accounted for under the equity method.
- g. Equity instruments issued by the entity.
- h. Deposit liabilities with no defined or contractual maturities.

~~56~~58. If it is not practicable for an entity to estimate the fair value of a financial instrument or a class of financial instruments, and the investment does not qualify for the NAV practical expedient, the following shall be disclosed:

- a. Information pertinent to estimating the fair value of that financial instrument or class of financial instruments, such as the carrying amount, effective interest rate, and maturity; and
- b. The reasons why it is not practicable to estimate fair value.

~~57~~59. In the context of this standard, practicable means that an estimate of fair value can be made without incurring excessive costs. It is a dynamic concept: what is practicable for one entity might not be for another; what is not practicable in one year might be in another. For example, it might not be practicable for an entity to estimate the fair value of a class of financial instruments for which a quoted market price is not available because it has not yet obtained or developed the valuation model necessary to make the estimate, and the cost of obtaining an independent valuation appears excessive considering the materiality of the instruments to the entity. Practicability, that is, cost considerations, also may affect the required precision of the estimate; for example, while in many cases it might seem impracticable to estimate fair value on an individual instrument basis, it may be practicable for a class of financial instruments in a portfolio or on a portfolio basis. In those cases, the fair value of that class or of the portfolio should be disclosed. Finally, it might be practicable for an entity to estimate the fair value only of a subset of a class of financial instruments; the fair value of that subset should be disclosed.

Relevant Literature

60. For equity securities that are subject to contractual sales, disclose the fair value of equity securities subject to contractual sale restrictions.

~~58.~~61. This standard adopts with modification *FAS 157, Fair Value Measurements*; (FAS 157) *FSP FAS 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement Under Statement 13*, (FSP FAS 157-1) and *FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP FAS 157-4). Modifications from FAS 157, FSP FAS 157-1 and FSP FAS 157-4 include:

- a. This standard does not adopt the scope exclusions within paragraph 3 of FAS 157 for accounting pronouncements that require or permit measurements that are similar to fair value but that are not intended to measure fair value, including (a) accounting pronouncements that permit measurements that are based on, or otherwise use, vendor-specific objective evidence of fair value and (b) inventory pricing. These items are excluded as they are not prevalent within statutory accounting.
- b. This standard does not adopt guidance from FAS 157 regarding the consideration of non-performance risk (own credit risk) in determining the fair value measurement of liabilities. The consideration of own credit-risk in the measurement of fair value liabilities is inconsistent with the statutory accounting concept of conservatism and the assessment of financial solvency for insurers. The fair value determination for liabilities should follow the guidance adopted from FAS 157, with the exception of the consideration of own-performance risk.
- c. This standard includes revisions to reference statutory standards or terms instead of GAAP standards or terms.
- d. This standard incorporates the guidance from SSAP No. 27 regarding disclosures about fair value of financial instruments. This incorporated SSAP No. 27 guidance was adopted from *FAS 107, Disclosures about Fair Value of Financial Instruments* (FAS 107) and was revised to adopt *FSP FAS 107-1 and APB-1, Interim Disclosures about Fair Value of Financial Instruments* (FSP FAS 107-1 and APB-1). For statutory purposes, the incorporation of this guidance within one standard results in having one comprehensive standard addressing fair value measurements and disclosures.

~~59.~~62. In August 2010, this statement adopted with modification the new and revised disclosure requirements within *ASU 2010-06, Fair Value Measurements and Disclosures – (Topic 820): Improving Disclosures about Fair Value Measurements* (ASU 2010-06). GAAP revisions within ASU 2010-06 that modify the FASB Codification on aspects originally added by *ASU 2009-05, Fair Value Measurements and Disclosures, Measuring Liabilities at Fair Value* (ASU 2009-05). These revisions are not adopted, as the underlying GAAP guidance within ASU 2009-05 has not been considered for statutory accounting. When ASU 2009-05 is reviewed for statutory accounting, the GAAP guidance considered will reflect the revisions from ASU 2010-06. Subsequent nonsubstantive revisions to the guidance adopted from ASU 2010-06 were incorporated within this statement in November 2010 to clarify the disclosure requirements for statutory accounting. These revisions removed the distinction between recurring and non-recurring fair value measurements and clarified disclosure requirements for assets and liabilities measured and reported at fair value in the statement of financial position. In April 2019 this statement adopted with modification disclosure revisions from *ASU 2018-13, Changes to the Disclosure Requirements for Fair Value Measurement*. Modifications to ASU 2018-13 incorporate revisions to previously adopted GAAP disclosures, and do not incorporate revisions related to disclosures not previously reflected for statutory accounting.

~~60.~~63. In November 2017, substantive revisions, as detailed in Issue Paper No. 157, were incorporated to this statement to adopt *ASU 2009-12, Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)* and *ASU 2015-07, Disclosures for Investments in Certain Entities that*

Calculate Net Asset Value per Share (or Its Equivalent). These substantive revisions incorporated new guidance allowing reporting entities to utilize net asset value per share as a practical expedient to fair value when certain conditions are met.

~~64.~~ Paragraphs ~~54-57~~~~56-59~~ of this statement adopt FAS 107 as amended by *FASB Statement No. 119, Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments* (FAS 119), except that paragraph 15(c) of FAS 119 relating to disclosure of financial instruments held or issued for trading is rejected and *FASB Emerging Issues Task Force No. 85-20, Recognition of Fees for Guaranteeing a Loan*. Financial instruments named within paragraph 8 of FAS 107 that are exempt from disclosure are adopted to the extent applicable for statutory accounting and are reflected in paragraph ~~55~~~~57~~ of this statement. This standard also adopts revisions to FAS 107 reflected in *FSP FAS 107-1 and APB-1, Interim Disclosures about Fair Value of Financial Instruments* (FSP FAS 107-1 and APB-1), and thus requires disclosure in both annual and quarterly financial statements. In addition, this standard rejects FASB Statement No. 126, Exemptions from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities, an amendment of FAS 107. FAS 119 is addressed in SSAP No. 31.

~~64-65.~~ This standard adopts *ASU 2022-03, Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions*, with modification to be consistent with statutory language in the respective statutory accounting statements.

~~62-66.~~ This standard rejects *ASU 2019-05, Financial Instruments—Credit Losses: Targeted Transition Relief*, *ASU 2018-03, Recognition and Measurement of Financial Assets and Financial Liabilities*, *ASU 2013-03, Financial Instruments – Clarifying the Scope and Applicability of a Particular Disclosure to Nonpublic Entities* (ASU 2013-03), *ASU 2016-01, Financial Instruments – Overall* (ASU 2016-01), *FSP FAS 157-2: Effective Date of FASB Statement No. 157* (FSP FAS 157-2) and *FSP FAS 157-3: Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active* (FSP FAS 157-3).

Effective Date and Transition

~~63-67.~~ This standard shall be effective for December 31, 2010, annual financial statements, with interim and annual financial statement reporting thereafter. Early adoption is permitted for December 31, 2009, annual financial statements, with interim and annual reporting thereafter. Nonsubstantive disclosure revisions adopted in August and November 2010 to paragraphs ~~48-49~~~~50-51~~ and the corresponding disclosure illustrations are initially effective for year-end 2010 financial statements, with interim and annual reporting thereafter. Nonsubstantive revisions adopted March 2011 to paragraphs ~~48~~~~50~~.a., ~~48~~~~50~~.d.ii., ~~51~~~~53~~ and ~~54~~~~56~~ of this statement are effective January 1, 2012, with interim and annual reporting thereafter as required in this statement. (Paragraph ~~54~~~~53~~ is satisfied by the annual statement investment schedules and is not required quarterly.) Revisions to adopt ASU 2009-12 and ASU 2015-07, and provide guidance for allowing net asset value per share as a practical expedient to fair value when certain conditions are met as detailed in Issue Paper No. 157, is effective January 1, 2018, with early adoption permitted.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 138—Fair Value Measurements*
- *Issue Paper No. 157—Use of Net Asset Value*

Statement of Statutory Accounting Principles No. 101

Income Taxes

STATUS

Type of Issue.....	Common Area
Issued	August 31, 2011
Effective Date	January 1, 2012
Affects.....	Supersedes SSAP No. 10 and SSAP No. 10R; Nullifies INT 00-21, INT 00-22, INT 01-19 and INT 01-20
Affected by.....	No other pronouncements
Interpreted by.....	INT 01-18; INT 06-12; INT 18-03; INT 22-02; INT 23-03
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	2
Current Income Taxes.....	2
Deferred Income Taxes.....	3
Admissibility of Income Tax Assets.....	4
Realization Threshold Limitation Table – RBC Reporting Entities	6
Realization Threshold Limitation Table – Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entities.....	6
Realization Threshold Limitation Table – Other Non-RBC Reporting Entities.....	6
Realization of Tax Benefits and Tax Planning Strategies.....	7
Intercompany Income Tax Transactions.....	8
Intraperiod Tax Allocation.....	8
Interim Periods.....	9
Disclosures.....	9
Relevant Literature.....	11
Effective Date and Transition	13
REFERENCES.....	13
Relevant Issue Papers	13
EXHIBIT A – IMPLEMENTATION QUESTIONS AND ANSWERS.....	14

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for current and deferred federal and foreign income taxes and current state income taxes. This statement supersedes conclusions reached in *SSAP No. 10—Income Taxes* and *SSAP No. 10R—Income Taxes, A Temporary Replacement of SSAP No. 10*.

SUMMARY CONCLUSION

2. For purposes of accounting for federal and foreign income taxes, reporting entities shall adopt *FASB Statement No. 109, Accounting for Income Taxes* (FAS 109) with modifications for state income taxes^(INT 18-03), the realization criteria for deferred tax assets, and the recording of the impact of changes in deferred tax balances. One objective of accounting for income taxes is to recognize the estimated amount of taxes payable or refundable for the current year as a tax liability or asset. A second objective is to recognize deferred tax liabilities and assets for the future tax consequences of events that have been recognized in a reporting entity's statutory financial statements or tax returns. However, the second objective is realistically constrained because (a) the tax payment or refund that results from a particular tax return is a joint result of all the items included in that return, (b) taxes that will be paid or refunded in future years are the joint result of events of the current or prior years and events of future years, and (c) information available about the future is limited. As a result, financial statements will recognize current and deferred income tax assets and liabilities in accordance with the provisions of this statement based upon estimates and approximations. For purposes of this statement, only adjusted gross deferred tax assets that are more likely than not (a likelihood of more than 50%~~-percent~~) to be realized shall be considered in determining admitted adjusted gross deferred tax assets.

Current Income Taxes

3. "Income taxes incurred" shall include current income taxes, the amount of federal and foreign income taxes paid (recovered) or payable (recoverable) for the current year. Current income taxes are defined as:

- a. Current year estimates (including quarterly estimates) of federal and foreign income taxes payable or refundable, based on tax returns for the current and prior years, except as addressed in paragraph 3.b., and tax loss contingencies (including related interest and penalties) for current and all prior years, computed in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* with the following modifications:
 - i. The term "probable" as used in *SSAP No. 5R* shall be replaced by the term "more likely than not (a likelihood of more than 50%~~-percent~~)" for federal and foreign income tax loss contingencies only.
 - ii. For purposes of the determination of a federal and foreign income tax loss contingency, it shall be presumed that the reporting entity will be examined by the relevant taxing authority that has full knowledge of all relevant information.
 - iii. If the estimated tax loss contingency is greater than 50% of the tax benefit originally recognized, the tax loss contingency recorded shall be equal to 100% of the original tax benefit recognized.
- b. Amounts incurred or received during the current year relating to prior periods, to the extent not previously provided, as such amounts are deemed to be changes in accounting estimates as defined in *SSAP No. 3—Accounting Changes and Corrections of Errors*.
- c. In determining when tax loss contingencies associated with temporary differences should be included in current income taxes under paragraph 3.a., and therefore included in deferred taxes under paragraph 7, a reporting entity is not required to "gross-up" its current and deferred taxes until such time as an event has occurred that would cause a re-evaluation of the contingency and its probability of assessment, e.g., the IRS has identified the item as one which may be adjusted upon audit. Such an event could be the reporting entity's (or its affiliate or parent in a consolidated income tax return) receipt of a Form 5701, Proposed Audit Adjustment, or could occur earlier upon receipt of an

Information Document Request. At such time, the company must reassess the probability of an adjustment, reasonably re-estimate the amount of tax contingency as determined in accordance with paragraph 3.a., make any necessary adjustment to deferred taxes, and re-determine the admissibility of any adjusted gross deferred tax asset as provided in paragraph 11.

4. State taxes (including premium, income and franchise taxes) shall be computed in accordance with SSAP No. 5R and shall be limited to (a) taxes due as a result of the current year's taxable basis calculated in accordance with state laws and regulations and (b) amounts incurred or received during the current year relating to prior periods, to the extent not previously provided as such amounts are deemed to be changes in accounting estimates. Property and casualty insurance companies shall report state taxes as other underwriting expenses under the caption "Taxes, licenses, and fees." Life and accident and health insurance companies shall report such amounts as general expenses under the caption "Insurance taxes, licenses, and fees, excluding federal income taxes." Other health entities shall report such amounts as general administration expenses under the caption "Taxes, licenses, and fees." State tax recoverables that are reasonably expected to be recovered in a subsequent accounting period are admitted assets. State taxes are reasonably expected to be recovered if the refund is attributable to overpayment of estimated tax payments, errors, carrybacks, or items for which the reporting entity has authority to recover under a state regulation or statute.

Deferred Income Taxes

5. Because tax laws and statutory accounting principles differ in their recognition and measurement of assets, liabilities, equity, revenues, expenses, gains, and losses, differences arise between:

- a. The amount of taxable income and pretax statutory financial income for a year, and
- b. The tax bases of assets or liabilities and their reported amounts in statutory financial statements.

6. A reporting entity's balance sheet shall include deferred income tax assets (DTAs) and liabilities (DTLs) related to the estimated future tax consequences of temporary differences and carryforwards, generated by statutory accounting, as defined in paragraph 11 of FAS 109.

7. A reporting entity's deferred tax assets and liabilities are computed as follows:

- a. Temporary differences are identified and measured using a "balance sheet" approach whereby statutory and tax basis balance sheets are compared;
- b. Temporary differences include unrealized gains and losses and nonadmitted assets but do not include asset valuation reserve (AVR), interest maintenance reserve (IMR), Schedule F penalties and, in the case of a mortgage guaranty insurer, amounts attributable to its statutory contingency reserve to the extent that "tax and loss" bonds have been purchased;
- c. Total DTAs and DTLs are computed using enacted tax rates;
- d. A DTL is not recognized for amounts described in paragraph 31 of FAS 109; and
- e. Gross DTAs are reduced by a statutory valuation allowance adjustment if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50% ~~percent~~) that some portion or all of the gross DTAs will not be realized. The statutory

valuation allowance adjustment¹, determined in a manner consistent with paragraphs 20-25 of FAS 109², shall reduce the gross DTAs to the amount that is more likely than not to be realized (the adjusted gross deferred tax assets).

8. Changes in DTAs and DTLs, including changes attributable to changes in tax rates and changes in tax status, if any, shall be recognized as a separate component of gains and losses in unassigned funds (surplus)³. Admitted adjusted gross DTAs and DTLs shall be offset and presented as a single amount on the statement of financial position.

Admissibility of Income Tax Assets

9. Current income tax recoverables shall include all current income taxes, including interest, reasonably expected to be recovered in a subsequent accounting period, whether or not a return or claim has been filed with the taxing authorities. Current income tax recoverables are reasonably expected to be recovered if the refund is attributable to overpayment of estimated tax payments, errors, carrybacks, as defined in paragraph 289 of FAS 109, or items for which the reporting entity has substantial authority, as that term is defined in Federal Income Tax Regulations.^(INT 06-12)

10. Current income tax recoverables meet the definition of assets as specified in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement.

11. The net admitted DTA shall not exceed the excess of the adjusted gross DTA, as determined under paragraph 7.e., over gross DTL. Adjusted gross DTAs shall be admitted based upon the three-component admission calculation at an amount equal to the sum of paragraphs 11.a., 11.b., and 11.c.:

- a. Federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse during a timeframe corresponding with IRS

¹ The statutory valuation allowance adjustment is utilized strictly to calculate the “adjusted gross DTA”. (Admittance criteria in paragraph 11 are applied to the “adjusted gross DTA”). In determining the amount of adjusted gross DTA, the reporting entity shall consider reversal patterns of temporary differences to the extent necessary to support establishing or not establishing a valuation allowance adjustment, determined in accordance with paragraphs 228 and 229 of FAS 109. For purposes of this accounting statement, consideration of reversal patterns does not require scheduling beyond that necessary to support establishing or not establishing a valuation allowance adjustment. The application of the statutory valuation allowance adjustment in this statement shall not result in a statutory valuation allowance reserve within the statutory financial statements, but rather should result in a reduction of the gross DTA.

² For purposes of determining the amount of adjusted gross DTA and the amount admitted under paragraph 11, the admission calculation shall be made on a separate company, reporting entity basis. A reporting entity that files a consolidated federal income tax return with its parent should look to the amount of taxes it paid (or were allocated to it) as a separate legal entity in determining the admitted DTA under paragraph 11.a. Furthermore, the DTA under this paragraph may not exceed the amount that the reporting entity could reasonably expect to have refunded by its parent. The taxes paid by the reporting entity represent the maximum DTA that may be admitted under paragraph 11.a., although the amount could be reduced pursuant to the group’s tax allocation agreement. The amount of admitted adjusted gross DTA under paragraph 11.b.i. is limited to the amount that the reporting entity expects to realize within the applicable realization period, on a separate company basis. The reporting entity must estimate its separate company taxable income and the tax benefit that it expects to receive from reversing deductible temporary differences in the form of lower tax payments to its parent. A reporting entity that projects a tax loss in the applicable realization period cannot admit a DTA related to the loss under paragraph 11.b., even if the loss could offset taxable income of other members in the consolidated group and the reporting entity could expect to be paid for the tax benefit pursuant to its tax allocation agreement.

³ Changes in DTAs and DTLs due to changes to tax rates and tax status shall be recorded as a “change in net deferred income tax,” excluding any change reflected in unrealized capital gains. Tax effects previously reflected in unrealized capital gains (to present unrealized gains and losses “net of tax”) shall be re-measured for the change in the tax rate in the same reporting line. Changes in net deferred tax shall not include changes in nonadmitted DTAs, as changes in nonadmittance are reported on a separate reporting line.

tax loss carryback provisions⁴, not to exceed three years, including any amounts established in accordance with the provision of SSAP No. 5R as described in paragraph 3.a. of this statement related to those periods.

- b. If the reporting entity is subject to risk-based capital requirements or is required to file a Risk-Based Capital Report with the domiciliary state, the reporting entity shall use the *Realization Threshold Limitation Table – RBC Reporting Entities* (RBC Reporting Entity Table) in this component of the admission calculation. The RBC Reporting Entity Table's threshold limitations are contingent upon the ExDTA ACL RBC Ratio⁵.

If the reporting entity is either a mortgage guaranty insurer or financial guaranty insurer that is not subject to risk-based capital requirements and is not required to file a Risk-Based Capital Report with the domiciliary state and the reporting entity meets the minimum capital and reserve requirements for the state of domicile, then the reporting entity shall use the *Realization Threshold Limitation Table – Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entities* (Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table) in this component of the admission calculation. The Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table's threshold limitations are contingent upon the following ratio: the numerator is equal to the sum of 1) surplus to policyholders, 2) less the amount of the admitted DTA in paragraph 11.a. (ExDTA Surplus) plus, 3) contingency reserves. The denominator is equal to the required amount of minimum aggregate capital required to be maintained under the applicable NAIC model law or state variation thereof based on the risk characteristics and the amount of insurance in force (Required Aggregate Risk Capital)⁶.

If the reporting entity (1) is not subject to risk-based capital requirements, (2) is not required to file a Risk-Based Capital Report with the domiciliary state, (3) is not a mortgage guaranty or financial guaranty insurer, and (4) meets the minimum capital and reserve requirements, then the reporting entity shall use the *Realization Threshold Limitation Table – Other Non-RBC Reporting Entities* (Other Non-RBC Reporting Entity Table). The Other Non-RBC Reporting Entity Table's threshold limitations are contingent upon the ratio of adjusted gross DTA (Adjusted gross DTA less the amount of DTA admitted in paragraph 11.a.) to adjusted capital and surplus⁷.

⁴ For example, under the Federal Internal Revenue Code, ordinary losses can be carried back two years for entities taxed as nonlife insurance companies, while capital losses for entities taxed both as nonlife and life insurance companies can be carried back three years. For losses arising in tax years after 2017, entities taxed as life insurance companies are not permitted to carryback ordinary losses.

⁵ The December 31 Risk-Based Capital ratio is calculated based on the Authorized Control Level RBC for the current reporting period, which is in the process of being filed with the state of domicile, and computed without net deferred tax assets (ExDTA ACL RBC). The interim period (March 31, June 30, and September 30) ExDTA ACL RBC ratio numerator shall use the Total Adjusted Capital (TAC) with current quarter surplus ExDTA and current quarter TAC adjustments. The interim period denominator shall use the Authorized Control Level RBC as filed for the most recent calendar year.

⁶ If the reporting entity is a mortgage guaranty insurer, this ratio is based on the requirements of Section 12 of the NAIC Mortgage Guaranty Insurance Model Law and state laws that, based on the risk characteristics and amount of insurance in force, require aggregate capital to be maintained in a risk-to-capital ratio of not less than 25 to 1. If the reporting entity is a financial guaranty insurer, this ratio is based on the requirements of Section 4C of the NAIC Financial Guaranty Insurance Model Guideline 1626 and state laws that require aggregate capital to be maintained based on the risk characteristics and amount of insurance in force.

⁷ Consistent with the requirements of paragraph 11.b.ii., adjusted statutory capital and surplus used in this calculation component is based on statutory capital and surplus for the current reporting period excluding any net DTA, EDP equipment and operating system software and any net positive goodwill.

Realization Threshold Limitation Table – RBC Reporting Entities

ExDTA ACL RBC (%)	11.b.i.	11.b.ii.
Greater than 300%	3 years	15%
200 – 300%	1 year	10%
Less than 200%	0 years	0%

Realization Threshold Limitation Table – Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entities

(See paragraph 11.b.) Ex DTA Surplus plus Contingency Reserves/Required Aggregate Risk Capital (%)	11.b.i.	11.b.ii.
Greater than 115%	3 years	15%
100% to 115%	1 year	10%
Less than 100%	0 years	0%

Realization Threshold Limitation Table – Other Non-RBC Reporting Entities

Adjusted Gross DTA / Adjusted Capital & Surplus (%)	11.b.i.	11.b.ii.
Less than 50%	3 years	15%
50% to 75%	1 year	10%
Greater than 75%	0 years	0%

The reporting entity shall admit:

- i. The amount of adjusted gross DTAs, after the application of paragraph 11.a.⁸, expected to be realized within the applicable period (refer to the 11.b.i. column of the applicable Realization Threshold Limitation Table above; the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table, or the Other Non-RBC Reporting Entity Table) following the balance sheet date limited to the amount determined in paragraph 11.b.ii.
- ii. An amount that is no greater than the applicable percentage (refer to the 11.b.ii. column of the applicable Realization Threshold Limitation Table above: the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table, or the Other Non-RBC Reporting Entity Table) of statutory capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for the current reporting period's statement filed with the domiciliary state commissioner adjusted to exclude any net DTAs, EDP equipment and operating system software and any net positive goodwill.^(INT 01-18) For financial guaranty or mortgage guaranty non-RBC reporting entities, the amount of statutory capital and surplus utilized for this part of the calculation does not include contingency reserves.

⁸ Under the Federal Internal Revenue Code, entities taxed as life insurance companies are not permitted to carryback ordinary losses arising in tax years after 2017. As such, admittance of ordinary DTAs for such entities will be limited to paragraph 11.b. and paragraph 11.c. for reporting periods ending with and subsequent to December 31, 2017.

- c. The amount of adjusted gross DTAs, after application of paragraphs 11.a. and 11.b. that can be offset against existing gross DTLs. The reporting entity shall consider the character (i.e., ordinary versus capital) of the DTAs and DTLs such that offsetting would be permitted in the tax return under existing enacted federal income tax laws and regulations. Additionally, for purposes of this component, the reporting entity shall consider the reversal patterns of temporary differences; however, this consideration does not require scheduling beyond that required in paragraph 7.e.
12. In computing a reporting entity's admitted adjusted gross DTA pursuant to paragraph 11;
- a. For purposes of paragraph 11.a., existing temporary differences that reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years, shall be determined in accordance with paragraphs 228 and 229 of FAS 109;
 - b. In determining the amount of federal income taxes that can be recovered through loss carrybacks, the amount and character (i.e., ordinary versus capital) of the loss carrybacks and the impact, if any, of the Alternative Minimum Tax shall be determined in accordance with the provisions of the Internal Revenue Code, and regulations thereunder;
 - c. The amount of carryback potential that may be considered in calculating the admitted adjusted gross DTAs of a reporting entity in paragraph 11.a. that files a consolidated income tax return with one or more affiliates, may not exceed the amount that the reporting entity could reasonably expect to have refunded by its parent; and
 - d. The phrases "reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years," "realized within one year of the balance sheet date" and "realized within three years of the balance sheet date" are intended to accommodate interim reporting dates and reporting entities that file on an other than calendar year basis for federal income tax purposes.

Realization of Tax Benefits and Tax Planning Strategies

13. Future realization of the tax benefit of an existing deductible temporary difference or carryforward ultimately depends on the existence of sufficient taxable income of the appropriate character (for example, ordinary income or capital gain) within the carryback, carryforward period available under the tax law. The following four possible sources of taxable income may be available under the tax law to realize a tax benefit for deductible temporary differences and carryforwards:

- a. Future reversals of existing taxable temporary differences.
- b. Future taxable income exclusive of reversing temporary differences and carryforwards.
- c. Taxable income in prior carryback year(s) if carryback is permitted under the tax law.
- d. Tax-planning strategies in paragraph 14 that would, if necessary, be implemented to, for example:
 - i. Accelerate taxable amounts to utilize expiring carryforwards;
 - ii. Change the character of taxable or deductible amounts from ordinary income or loss to capital gain or loss; and
 - iii. Switch from tax-exempt to taxable investments.

Evidence available about each of those possible sources of taxable income will vary for different tax jurisdictions and, and possibly, from year to year. To the extent evidence about one or more sources of taxable income is sufficient to support a conclusion that the reporting entity will realize the full or a partial amount of its adjusted gross deferred tax assets, other sources need not be considered. Consideration of each source is required, however, to determine the amount of the statutory valuation allowance adjustment that is recognized for gross deferred tax assets under paragraph 7.e.

14. In some circumstances, there are tax-planning strategies (including elections for tax purposes) that (a) are prudent and feasible, (b) a reporting entity ordinarily might not take, but would take to prevent an operating loss or tax credit carryforward from expiring unused, and (c) would result in realization of deferred tax assets. A reporting entity shall consider tax-planning strategies in determining the amount of the statutory valuation allowance adjustment necessary under paragraph 7.e. Consideration of tax planning strategies for the realization of deferred tax assets when determining admission under paragraph 11 is not required; however, such strategies shall not conflict with the tax planning strategies used when computing the statutory valuation allowance. Any significant potential expenses to implement a tax-planning strategy or any significant losses that would be recognized if that strategy were implemented (net of any recognizable tax benefits associated with those expenses or losses) shall reduce the amount of admission under paragraph 11.

15. When a prudent and feasible tax-planning strategy is contemplated, and management determines this strategy would more likely than not enable the reporting entity to realize the full or a partial amount of its adjusted gross deferred tax assets, paragraph 3 of this statement related to tax loss contingencies shall be applied in determining admissibility of deferred tax assets under paragraph 11 of this statement.

Intercompany Income Tax Transactions

16. In the case of a reporting entity that files a consolidated income tax return with one or more affiliates, income tax transactions (including payment of tax contingencies to its parent) between the affiliated parties shall be recognized if:

- a. Such transactions are economic transactions as defined in *SSAP No. 25—Affiliates and Other Related Parties*;
- b. Are pursuant to a written income tax allocation agreement; and
- c. Income taxes incurred are accounted for in a manner consistent with the principles of FAS 109, as modified by this statement.

17. Amounts owed to a reporting entity pursuant to a recognized transaction shall be treated as a loan or advance, and nonadmitted, pursuant to SSAP No. 25, to the extent that the recoverable is not settled within 90 days of the filing of a consolidated income tax return, or where a refund is due the reporting entity's parent, within 90 days of the receipt of such refund.

Intraperiod Tax Allocation

18. In accordance with paragraph 35 of FAS 109, a reporting entity's unrealized gains and losses shall be recorded net of any allocated DTA or DTL. The amount allocated shall be computed in a manner consistent with paragraph 38 of FAS 109.

19. Income taxes incurred shall be allocated to net income and realized capital gains or losses in a manner consistent with paragraph 38 of FAS 109. Furthermore, income taxes incurred or received during the current year attributable to prior years shall be allocated, to the extent not previously provided, to net income in accordance with SSAP No. 3 unless attributable, in whole or in part, to realized capital gains or losses, in which case, such amounts shall be apportioned between net income and realized capital gains and losses, as appropriate.

Interim Periods

20. Income taxes incurred in interim periods shall be computed using an estimated annual effective current tax rate for the annual period in accordance with the methodology described in paragraphs 19 and 20 of *Accounting Principles Board Opinion No. 28, Interim Financial Reporting*. Estimates of the annual effective tax rate at the end of interim periods are, of necessity, based on estimates and are subject to subsequent refinement or revision. If a reliable estimate cannot be made, the actual effective tax rate for the year-to-date may be the best estimate of the annual effective tax rate. If a reporting entity is unable to estimate a part of its “ordinary” income (or loss) or the related tax (or benefit) but is otherwise able to make a reliable estimate, the tax (or benefit) applicable to the item that cannot be estimated shall be reported in the interim period in which the item is reported.

Disclosures

21. Statutory financial statement disclosures shall be made in a manner consistent with the provisions of paragraphs 43-45 and 48 of FAS 109. However, required disclosures with regard to a reporting entity’s GAAP valuation allowance shall be replaced with disclosures relating to the statutory valuation allowance adjustment and the nonadmittance of some portion or all of a reporting entity’s DTAs. The financial statements shall include the disclosures required by paragraph 47 of FAS 109 for non-public companies. Paragraphs 22-28 describe the disclosure requirements as modified for the difference between the requirements of FAS 109 and those prescribed by this statement.

22. The components of the net DTA or DTL recognized in a reporting entity’s financial statements shall be disclosed as follows:

- a. The total of all DTAs (gross, adjusted gross, admitted and nonadmitted) by tax character;
- b. The total of all DTLs by tax character;
- c. The total DTAs nonadmitted as the result of the application of paragraph 11;
- d. The net change during the year in the total DTAs nonadmitted;
- e. The amount of each result or component of the calculation, by tax character of paragraphs 11.a., 11.b.i., 11.b.ii., and 11.c., and the ExDTA ACL RBC Ratio, the ExDTA Surplus plus Contingency Reserves/Required Aggregate Risk Capital Ratio, or the Adjusted Gross DTA/Adjusted Capital and Surplus Ratio used in the applicable *Realization Threshold Limitation Table* (the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table, or the Other Non-RBC Reporting Entity Table) in paragraph 11.b., as applicable; and
- f. The impact of tax-planning strategies on the determination of adjusted gross DTAs and the determination of net admitted DTAs, by percentage and by tax character, and whether the tax-planning strategies include the use of reinsurance-related tax planning strategies.

23. To the extent that DTLs are not recognized for amounts described in paragraph 31 of FAS 109, the following shall be disclosed:

- a. A description of the types of temporary differences for which a DTL has not been recognized and the types of events that would cause those temporary differences to become taxable;
- b. The cumulative amount of each type of temporary difference;

- c. The amount of the unrecognized DTL for temporary differences related to investments in foreign subsidiaries and foreign corporate joint ventures that are essentially permanent in duration if determination of that liability is practicable or a statement that determination is not practicable; and
 - d. The amount of the DTL for temporary differences other than those in paragraph 23.c. that is not recognized in accordance with the provisions of paragraphs 31 of FAS 109.
24. The significant components of income taxes incurred (i.e., current income tax expense) and the changes in DTAs and DTLs shall be disclosed. Those components would include, for example:
- a. Current tax expense or benefit;
 - b. The change in DTAs and DTLs (exclusive of the effects of other components listed below);
 - c. Investment tax credits;
 - d. The benefits of operating loss carryforwards;
 - e. Adjustments of a DTA or DTL for enacted changes in tax laws or rates or a change in the tax status of the reporting entity; and
 - f. Adjustments to gross deferred tax assets because of a change in circumstances that causes a change in judgment about the realizability of the related deferred tax asset, and the reason for the adjustment and change in judgment.
25. Additionally, to the extent that the sum of a reporting entity's income taxes incurred and the change in its DTAs and DTLs is different from the result obtained by applying the federal statutory rate to its pretax net income, a reporting entity shall disclose the nature of the significant reconciling items.
26. A reporting entity shall also disclose the following:
- a. The amounts, origination dates and expiration dates of operating loss and tax credit carryforwards available for tax purposes;
 - b. The amount of federal income taxes incurred in the current year and each preceding year, which are available for recoupment in the event of future net losses; and
 - c. The aggregate amount of deposits admitted under Section 6603 of the Internal Revenue Service Code.
27. For any federal or foreign income tax loss contingencies as determined in accordance with paragraph 3.a. for which it is reasonably possible that the total liability will significantly increase within 12 months of the reporting date, the reporting entity shall disclose an estimate of the range of the reasonably possible increase or a statement that an estimate of the range cannot be made.
28. If a reporting entity's federal income tax return is consolidated with those of any other entity or entities, the following shall be disclosed:
- a. A list of names of the entities with whom the reporting entity's federal income tax return is consolidated for the current year; and
 - b. The substance of the written agreement, approved by the reporting entity's Board of Directors, which sets forth the manner in which the total combined federal income tax for

all entities is allocated to each entity which is a party to the consolidation. (If no written agreement has been executed, explain why such an agreement has not been executed.) Additionally, the disclosure shall include the manner in which the entity has an enforceable right to recoup federal income taxes in the event of future net losses which it may incur or to recoup its net losses carried forward as an offset to future net income subject to federal income taxes.

29. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

30. This statement adopts the provisions of FAS 109 except as modified in paragraph 2 of this statement which results in paragraphs 29-30, 36-37, 39, 41-42, 46, and 49-59 of FAS 109 being rejected, inasmuch as they are not applicable to reporting entities subject to this statement or are inconsistent with other statutory accounting principles. Paragraph 47 of FAS 109 is adopted with modification to provide for the disclosures required for non-public reporting entities. This statement rejects *ASU 2016-16, Intra-Entity Transfers of Assets Other than Inventory*.

31. This statement rejects *ASU 2013-11, Income Taxes: Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*, *ASU 2015-17 Balance Sheet Classification of Deferred Taxes*, *FASB Interpretation No. 18, Accounting for Income Taxes in Interim Periods...an interpretation of APB Opinion No. 28* and *FIN 48: Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109*.

32. The following lists FASB Staff Positions that are adopted or rejected by this statement:

- a. *FASB Staff Position FAS 109-1, Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004* is adopted in its entirety.
- b. *FASB Staff Position FAS 109-2, Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004* is rejected in its entirety.
- c. *FASB Staff Position FIN 48-2, Effective Date of FIN 48 for Certain Nonpublic Enterprises* is rejected in its entirety.
- d. *FASB Staff Position FIN 48-3, Effective Date of FIN 48 for Certain Nonpublic Enterprises* is rejected in its entirety.

33. The following lists Accounting Principles Board Opinions that are adopted or rejected by this statement:

- a. *Accounting Principles Board Opinion No. 2, Accounting for the "Investment Credit,"* paragraphs 9-15 are adopted with modification to utilize the cost reduction method only and rejects all other paragraphs;
- b. *Accounting Principles Board Opinion No. 4 (Amending No. 2), Accounting for the "Investment Credit,"* is rejected in its entirety;
- c. *Accounting Principles Board Opinion No. 10, Omnibus Opinion—1966,* paragraph 6 is adopted;

- d. *Accounting Principles Board Opinion No. 23, Accounting for Income Taxes—Special Areas*, paragraphs 1-3, 5-9, 12-13, and 15-18 are adopted, and paragraphs 19-25, and 31-33 are rejected;
 - e. *Accounting Principles Board Opinion No. 28, Interim Financial Reporting*, paragraphs 19 and 20 are adopted and all other paragraphs rejected.
34. The following lists FASB Technical Bulletins that are adopted or rejected by this statement:
- a. *FASB Technical Bulletin No. 79-9, Accounting in Interim Periods for Changes in Income Tax Rates* is rejected in its entirety;
 - b. *FASB Technical Bulletin No. 82-1, Disclosure of the Sale or Purchase of Tax Benefits through Tax Leases* is adopted in its entirety.
35. The following lists FASB Emerging Issues Task Force Issues that are adopted or rejected by this statement:
- a. *FASB Emerging Issues Task Force No. 91-8, Application of FASB Statement No. 96 to a State Tax Based on the Greater of a Franchise Tax or an Income Tax*, is rejected in its entirety;
 - b. *FASB Emerging Issues Task Force No. 92-8, Accounting for the Income Tax Effects under FASB Statement No. 109 of a Change in Functional Currency When an Economy Ceases to Be Considered Highly Inflationary*, is adopted in its entirety;
 - c. *FASB Emerging Issues Task Force No. 93-13, Effect of a Retroactive Change in Enacted Tax Rates That Is Included in Income from Continuing Operations*, is rejected in its entirety;
 - d. *FASB Emerging Issues Task Force No. 93-16, Application of FASB Statement No. 109 to Basis Differences within Foreign Subsidiaries That Meet the Indefinite Reversal Criterion of APB Opinion No. 23*, is rejected in its entirety;
 - e. *FASB Emerging Issues Task Force No. 93-17, Recognition of Deferred Tax Assets for a Parent Company's Excess Tax Basis in the Stock of a Subsidiary That Is Accounted for as a Discontinued Operation*, is adopted in its entirety;
 - f. *FASB Emerging Issues Task Force No. 94-10, Accounting by a Company for the Income Tax Effects of Transactions among or with Its Shareholders under FASB Statement No. 109*, is rejected in its entirety;
 - g. *FASB Emerging Issues Task Force No. 95-9, Accounting for Tax Effects of Dividends in France in Accordance with FASB Statement No. 109*, is rejected in its entirety;
 - h. *FASB Emerging Issues Task Force No. 95-10, Accounting for Tax Credits Related to Dividend Payments in Accordance with FASB Statement No. 109*, is rejected in its entirety;
 - i. *FASB Emerging Issues Task Force No. 95-20, Measurement in the Consolidated Financial Statements of a Parent of the Tax Effects Related to the Operations of a Foreign Subsidiary That Receives Tax Credits Related to Dividend Payments*, is rejected in its entirety.

36. This statement rejects AICPA Accounting Interpretations, Accounting for the Investment Credit: Accounting Interpretations of APB Opinion No. 4 in its entirety.

Effective Date and Transition

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

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 83—Accounting for Income Taxes*

Not for Distribution

EXHIBIT A – IMPLEMENTATION QUESTIONS AND ANSWERS

The National Association of Insurance Commissioners issued *SSAP No. 101—Income Taxes*, with a corresponding implementation question and answer exhibit, with an effective date of January 1, 2012. Further nonsubstantive revisions were developed to update the Q&A for the revised corporate federal income tax rate and certain other federal tax law changes primarily under the Tax Cuts and Jobs Act enacted in December 2017 and to clarify deferred tax asset and deferred tax liability offsetting under SSAP No. 101, paragraph 11.c. These revisions to the implementation guidance are effective for financial accounting years ending December 31, 2019. Any change in income tax balances resulting from the August 2019 revisions are accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

Index to Questions:

Question No.	Question	SSAP No. 101 Paragraph Reference	Page Number
1	What are the primary differences between the accounting for income taxes pursuant to FAS 109 and SSAP No. 101?	-	15
2	How should an entity measure its adjusted gross deferred tax assets and gross deferred tax liabilities?	7	18
3	What is the meaning of the term “enacted tax rates”?	7.c.	22
4a	How should a reporting entity calculate the amount of its admitted adjusted gross DTAs?	11	23
4b	How is the ExDTA ACL RBC ratio calculated?	11.b.	33
4c	What is meant by the phrase “an amount no greater than”?	11.b.ii.	36
5a	How is the timing of reversals of temporary differences and carryforwards determined for SSAP No. 101 purposes?	7, 11.a., 11.b.i. and 12.a.	36
5b	How should future originating differences impact the scheduling of temporary difference reversals during the applicable period?	11.a., 11.b.i., 11.c. and 12.a.	40
6	What is meant by the phrase “expected to be realized”?	11.b.i.	40
7	What is the meaning of the term “taxes paid”?	11.a.	42
8	How is a company’s computation of adjusted gross and admitted adjusted gross deferred taxes impacted if it joins in the filing of a consolidated federal income tax return?	7, 11, 12.c. and 16	43
9a	How does the modification provided in paragraph 3.a.iii. impact the calculation of the tax contingencies recorded?	3.a.iii.	44
9b	What impact, if any, does the inclusion of tax contingencies as a component of current income taxes have on the determination of deferred income taxes?	3.a. and 3.c.	45
10a	If the reporting entity adjusts the amount of regular taxable income and capital gains reported on a prior year income tax return from the amount originally determined for financial reporting purposes, how is the effect of the change reported in the current year?	19	46
10b	What is meant by the phrase in paragraph 18 “a reporting entity’s unrealized gains and losses shall be recorded net of any allocated DTA or DTL”?	18	47
11	How are current and deferred income taxes to be accounted for in interim periods?	12.d. and 20	48

Question No.	Question	SSAP No. 101 Paragraph Reference	Page Number
12	How do you present deferred taxes in the annual statement?	8, 18 and 21-28	52
13	How are tax-planning strategies to be considered in determining adjusted gross DTAs and admitted adjusted gross DTAs?	11.a., 11.b.i., 14 and 15	61

1. Q – What are the primary differences between the accounting for income taxes pursuant to FAS 109 and SSAP No. 101? [No specific paragraph reference]

1.1 A – SSAP No. 101 establishes statutory accounting principles for current and deferred federal and foreign income taxes and current state income taxes. In general, SSAP No. 101 adopts the concepts of FAS 109, with modifications. The primary differences and modifications are summarized below:

1.2 State Income Tax

- FAS 109 – State income taxes should be included as “income taxes incurred.” Deferred state income taxes are recognized.
- SSAP No. 101 – State income taxes should be included as “Taxes, Licenses, and Fees” by property and casualty insurers and as “Insurance taxes, licenses, and fees, excluding federal income taxes” by life and accident and health insurers. No deferred state income taxes are recognized.

1.3 Valuation Allowance

- FAS 109 – Gross deferred tax assets (DTAs) are reduced by a valuation allowance if it is more likely than not that some portion or all of the DTAs will not be realized. The valuation allowance should be sufficient to reduce the DTA to the amount that is more likely than not to be realized.
- SSAP No. 101 – Gross DTAs are reduced by a statutory valuation allowance adjustment that is determined on a separate company, reporting entity basis. Pursuant to paragraphs 2 and 7.e. of SSAP No. 101, gross DTAs are adjusted to an amount that is more likely than not to be realized (a likelihood of more than 50% ~~percent~~). Only adjusted gross DTAs shall be considered in determining admitted adjusted gross DTAs. See Question 2 for further discussion of the statutory valuation allowance adjustment. See Question 4 for a further discussion of the admissibility test. See Question 12 for further discussion of presentation and disclosure of the statutory valuation allowance adjustment.

1.4 Unique Statutory Accounting Items

- FAS 109 – In general, the effects of all temporary differences must be reflected with limited exceptions provided in FAS 109 paragraphs 31-34 (relating to items specified in Accounting Principles Board Opinion No. 23) and for temporary differences related to goodwill for which amortization is not deductible for tax purposes.
- SSAP No. 101 – In addition to the exceptions provided in FAS 109, temporary differences do not include asset valuation reserve (AVR), interest maintenance reserve (IMR), Schedule F penalties and, in the case of a mortgage guaranty insurer, amounts attributable to its statutory contingency reserve to the extent that “tax and loss” bonds have been purchased.

1.5 Changes in Deferred Tax Assets and Liabilities

- FAS 109 – Changes in DTAs and deferred tax liabilities (DTLs) are included in income tax expense or benefit and are allocated to continuing operations, discontinued operations, extraordinary items and items charged directly to shareholders' equity.
- SSAP No. 101 – Changes in DTAs and DTLs are recognized as a separate component of gains and losses in surplus, except to the extent allocated to changes in unrealized gains and losses.

1.6 Regulated Enterprises

- FAS 109 – Regulated enterprises that meet the criteria for application of FAS 71, *Accounting for the Effects of Certain Types of Regulation*, are not exempt from the requirements of FAS 109. However, assets are reported on a net-of-tax basis (see paragraphs 29, 57, 58 and 59 of FAS 109).
- SSAP No. 101 – These special paragraphs do not apply pursuant to paragraph 30 of SSAP No. 101.

1.7 Business Combinations

- FAS 109 – Paragraphs 30 and 53-56 of FAS 109 provide certain guidance regarding the treatment of business combinations. In general, a deferred tax asset or liability is recognized for the differences between the assigned values and the tax bases of the assets and liabilities recognized in a purchased business combination. If financial statements for prior years are restated, all purchase business combinations that were consummated in those prior years shall be remeasured in accordance with FAS 109.
- SSAP No. 101 – These special paragraphs do not apply pursuant to paragraph 30 of SSAP No. 101.

1.8 Intraproduct Tax Allocation

- FAS 109 – Income tax expense or benefit is allocated among continuing operations, discontinued operations, extraordinary items, and items charged or credited directly to shareholders' equity pursuant to paragraphs 36 and 37 of FAS 109.
- SSAP No. 101 – These paragraphs of FAS 109 do not apply pursuant to paragraph 30 of SSAP No. 101. Instead, paragraphs 18 and 19 of SSAP No. 101 provide special rules for statutory accounting. See Question 10 for a further discussion of these rules.

1.9 Certain Quasi-Reorganizations

- FAS 109 – Paragraph 39 provides special rules relating to the treatment of deductible temporary differences and carryforwards as of the date of a quasi-reorganization.
- SSAP No. 101 – Paragraph 39 of FAS 109 does not apply pursuant to paragraph 30 of SSAP No. 101.

1.10 Financial Statement Classification of DTAs and DTLs

- FAS 109 – Pursuant to paragraphs 41 and 42 of FAS 109, DTAs and DTLs are to be classified separately as either current or noncurrent, depending on the classification of the

related asset or liability. Furthermore, current DTAs and DTLs and noncurrent DTAs and DTLs are netted within the classification and with the net amount reported.

- SSAP No. 101 – These paragraphs do not apply to statutory accounting pursuant to paragraph 30 of SSAP No. 101. The net admitted DTA, or the net DTL, should be reported in the statutory financial statements.

1.11 Accounting for Uncertainty in Income Taxes

- FAS 109 – Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48) provides accounting and reporting guidance for uncertain tax positions under GAAP.
- SSAP No. 101 – FIN 48 is rejected for statutory accounting pursuant to paragraph 31 of SSAP No. 101. *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* provides guidance in determining the amount of federal and foreign income tax loss contingencies with the following modifications. The term “probable” as used in SSAP No. 5R is replaced by the term “more likely than not (a likelihood of more than 50% ~~percent~~)”. In determining the amount of a federal or foreign income tax loss contingency, it shall be assumed that the reporting entity will be examined by the tax authority that has full knowledge of all relevant information. If the estimated tax loss contingency is greater than 50% of the tax benefit originally recognized, the tax loss contingency recorded shall be equal to 100% of the original tax benefit recognized. See Question 9 for further discussion of income tax loss contingencies.

1.12 Classification of Interest and Penalties

- FAS 109 – FIN 48 allows interest on tax assessments to be reported as either income taxes or interest expense and penalties to be reported as either income taxes or another expense classification, based on the accounting policy election of the enterprise.
- SSAP No. 101 – Interest and penalties related to foreign or federal income tax are included in income taxes pursuant to paragraph 3.a. of SSAP No. 101.

1.13 Financial Statement Disclosures

- FAS 109 – Paragraphs 43-45 and 47-48 of FAS 109 provide various requirements for providing information in the financial statements regarding the income taxes of the reporting entity. In general, the reporting entity is to provide certain information regarding the components of its DTAs and DTLs, the amount of and changes in its valuation allowance, significant components of income tax expense, differences between the expected amount of income tax expense using current tax rates and the amount of reported income tax expense, and tax attributes being carried over. In addition, FIN 48 includes specific disclosures related to uncertain tax positions.
- SSAP No. 101 – In general, paragraphs 21-29 of SSAP No. 101 follow the disclosure requirements provided by FAS 109, but with the following modifications and additions:
 - The disclosures regarding valuation allowance are replaced with disclosures relating to the statutory valuation allowance adjustment and the nonadmitted portion of the DTA.
 - The amount of the gross DTA, adjusted gross DTA, DTL, admitted and nonadmitted DTA is required to be separately disclosed, by tax character (ordinary or capital).

- Disclose the amount of each result or component of the admission calculation, by tax character, for paragraphs 11.a, 11.b.i, 11.b.ii, and 11.c. In addition, disclose the ExDTA Authorized Control Level (ACL) RBC Ratio, the ExDTA Surplus plus Contingency Reserves/Required Aggregate Risk Capital Ratio (see paragraph 11.b.), or the Adjusted Gross DTA/Adjusted Capital and Surplus Ratio used in the applicable Realization Threshold Limitation Table (the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table, or the Other Non-RBC Reporting Entity Table) in paragraph 11.b., as applicable.
- The impact of tax-planning strategies on the determination of adjusted gross DTAs and the determination of net admitted adjusted gross DTAs, by percentage and by tax character, must be disclosed. In addition, disclose whether tax-planning strategies include the use of reinsurance-related tax planning strategies.
- FIN 48 and the associated disclosure requirements are rejected for statutory accounting purposes and replaced with the following disclosure. For any federal or foreign income tax loss contingencies for which it is reasonably possible that the total liability will significantly increase within 12 months of the reporting date, a disclosure of an estimate of the range of the reasonably possible increase is required. If determination of a reasonable range of the significant increase is not possible, the reporting entity is to provide a statement that an estimate cannot be made.
- The disclosures relating to deferred income tax expense or benefit are replaced with certain disclosures relating to the reporting entity's "change in DTAs and DTLs."
- Only the nature of significant reconciling items between the reported amount and "expected" amount of income tax expense and change in DTAs and DTLs are to be disclosed. This generally follows the disclosure requirements of FAS 109 for nonpublic entities.
- See Question 12 for a more detailed discussion of the disclosure requirements of SSAP No. 101.

2. Q – How should an entity measure its adjusted gross deferred tax assets and its gross deferred tax liabilities? [Paragraph 7]

2.1 A – An enterprise shall record a gross deferred tax liability or asset for all temporary differences and operating loss, capital loss and tax credit carryforwards. Temporary differences include unrealized gains and losses and nonadmitted assets but do not include AVR, IMR, Schedule F penalties and, in the case of a mortgage guaranty insurer, amounts attributable to its statutory contingency reserve to the extent that "tax and loss" bonds have been purchased. In general, temporary differences produce taxable income or result in tax deductions when the related asset is recovered or the related liability is settled. A deferred tax asset or liability represents the increase or decrease in taxes payable or refundable in future years as a result of temporary differences and carryforwards at the end of the current year. Additionally, gross DTAs are reduced by a statutory valuation allowance adjustment if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50%~~percent~~) that some portion or all of the gross DTAs will not be realized. The statutory valuation allowance adjustment, determined in a manner consistent with paragraphs 20-25 of FAS 109, shall reduce gross DTAs to the amount that is more likely than not to be realized (the adjusted gross deferred tax assets).⁹ This answer only addresses the recognition of adjusted gross DTAs and gross DTLs and does not address the admissibility of such amounts. See Question 4 for a discussion of the admissibility criteria of SSAP No. 101.

⁹ SSAP No. 101 requires the statutory valuation allowance adjustment to be presented in the annual statement as a direct reduction in the gross DTA. It is not included in non-admitted DTA.

2.2 Paragraph 7 of SSAP No. 101 states that temporary differences are identified and measured using a “balance sheet” approach whereby the statutory balance sheet and the tax basis balance sheet are compared. Operating loss, capital loss and tax credit carryforwards are computed in accordance with the applicable Internal Revenue Code.

2.3 The following illustrates the recognition and measurement of a typical book to tax difference for an insurance company:

Illustration

Assumptions:

- 1/1/X2 Purchase 100 shares of Darby/Allyn Corp. stock for \$25 a share
 3/31/X2 Fair Value of Darby/Allyn Corp. stock has increased to \$35 a share
 3/31/X2 Tax basis reserves are computed and determined to be 80% of the statutory basis reserves

Balance Sheet at 3/31/X2:

	Statutory Basis	Tax Basis	Basis Difference	Tax Effect DTA (DTL) (21%)¹⁰
Common Stock	\$3,500	\$2,500	(\$1,000) ¹¹	(\$210)
Reserves	\$100,000	\$80,000	\$20,000 ¹²	\$4,200

Journal Entries:

1/1/X2	DR	Common stock	\$2,500
	CR	Cash	(\$2,500)
		<i>Acquisition of common stock at \$25 per share</i>	

3/31/X2	DR	Common stock	\$1,000
	CR	Change in unrealized capital gains and losses	(\$1,000)
		<i>Adjust carrying value to FV of \$35 per share at end of quarter</i>	

3/31/X2	DR	Change in reserves or unpaid losses	\$100,000
	CR	Reserves or Unpaid losses	(\$100,000)
		<i>Recognition of reserves computed on a statutory basis</i>	
3/31/X2	DR	Deferred tax asset	\$4,200
	CR	Change in deferred income taxes	(\$3,990)
	CR	Deferred tax liability	(\$210)
		<i>Recognition of deferred taxes</i>	

¹⁰ See Question 3 for a discussion of “enacted rates.”

¹¹ The carrying value of the stock on the statutory balance sheet reflects the fair value of the common stock per *SSAP No. 30R—Unaffiliated Common Stock* whereas the carrying value of the stock for tax purposes is its original cost. This difference is defined as temporary in that the \$1,000 appreciation in value will be recognized in the tax return when the stock is disposed of. The difference is a deferred tax liability in that the reversal of this temporary difference will increase future taxable income.

¹² The reserve difference arises because, even though tax reserves are based on statutory reserves, they generally are reduced below statutory reserves pursuant to various provisions of the Internal Revenue Code. This amount is a temporary difference in that the entity will recognize the difference between statutory and tax carrying values over the life of the reserve or upon settlement of the claim or payment of the reserve. The difference is a deferred tax asset in that the reversal of this temporary difference will decrease future taxable income.

NOTE: Presentation of deferred tax amounts and unrealized gain or losses net of tax is addressed in Question 12.

2.4 As depicted in the Illustration, the deferred tax assets and liabilities are tracked gross in the entity's ledger and not netted until after consideration of the statutory valuation allowance adjustment, if any (see below), and the admissibility of deferred tax assets.

Statutory Valuation Allowance Adjustment

2.5 SSAP No. 101 paragraph 7.e., provides that gross DTAs are reduced by a statutory valuation allowance *adjustment* if, based on the weight of available evidence, it is more likely than not that some portion or all of the gross DTAs will not be realized. The statutory valuation allowance adjustment is determined on a separate company, reporting entity basis. The determination of whether gross DTAs will be realized is based on the existence of sufficient taxable income of the appropriate character (ordinary income or capital gain) within the carryback, carryover period available under the tax law. Paragraph 13.a. through 13.d. of SSAP No. 101 identifies four sources of taxable income to be considered in evaluating the existence of sufficient taxable income. These sources are identical to those to be considered under FAS 109 paragraph 21. FAS 109 paragraph 20 provides that "all available evidence, both positive and negative, should be considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. Information about an enterprise's current financial position and its results of operations for the current and preceding years ordinarily is readily available. That historical information is supplemented by all currently available information about future years. Sometimes, however, historical information may not be available (for example, start-up operations) or it may not be as relevant (for example, if there has been a significant, recent change in circumstances) and special attention is required." A reporting entity is not required to consider all four sources of taxable income in determining the need for a statutory valuation allowance adjustment if one or more sources are alone sufficient to support the conclusion that the entity will realize the tax benefits of its gross deferred tax assets (i.e., a conclusion that no valuation allowance is necessary). However, the reporting entity is required to consider all of the potential sources of taxable income to determine the amount of the adjustment if a conclusion is reached that a statutory valuation allowance adjustment is necessary. SSAP No. 101 modifies FAS 109 related to admission of DTAs. Admission of DTAs is calculated irrespective of the conclusion reached in establishing or not establishing a statutory valuation allowance adjustment. See Question 4.13 for discussion regarding consideration of reversal patterns specific to paragraph 11.c. of the admissibility test.

2.6 Footnote 1 to paragraph 7.e. of SSAP No. 101 indicates that a reporting entity shall consider reversal patterns of temporary differences, and might be required to schedule such differences:

...to the extent necessary to support establishing or not establishing a valuation allowance adjustment, determined in accordance with paragraphs 228 and 229 of FAS 109. For purposes of this accounting statement, consideration of reversal patterns does not require scheduling beyond that necessary to support establishing or not establishing a valuation allowance adjustment.

Paragraph 228 of FAS 109 generally holds that a company may need to schedule its temporary differences to determine the particular years in which the reversal of temporary differences is expected to occur. As discussed in Question 5b, paragraph 229 of FAS 109 indicates that future originating temporary differences and their subsequent reversal should be considered in determining the existence of future taxable income.

2.7 Although a reporting entity may need to consider the reversal pattern of temporary differences in evaluating the need for a statutory valuation allowance adjustment, scheduling the reversal pattern of such differences is not required in every instance. Under SSAP No. 101 and consistent with FAS 109, a general understanding of reversal patterns is, in many cases, relevant in assessing the need for a valuation allowance. Judgment is crucial in making this assessment. The amount of scheduling, if any, that will be

required will depend on the facts and circumstances of each situation. For example, a reporting entity which relies upon future taxable income exclusive of reversing temporary differences and carryforwards¹³ for realization of DTAs is not required to schedule the reversal pattern of its existing temporary differences. This is consistent with guidance provided by the Financial Accounting Standards Board (FASB) in its answer to question 2 of *A Guide to Implementation of Statement 109 on Accounting for Income Taxes: Question and Answers* (Special Report on Statement 109) which states that scheduling of existing temporary differences is unnecessary for purposes of determining the need for a valuation allowance “where it can be easily demonstrated that future taxable income will more likely than not be adequate to realize future tax benefits of existing deferred tax assets.” In contrast, a reporting entity which relies upon the future reversal of existing taxable temporary differences to realize the tax benefits of its deductible temporary differences and carryforwards may be required to consider the reversal patterns of its taxable temporary differences.¹⁴ The degree of scheduling required, however, depends on the facts and circumstances of each situation and the relative magnitude of the taxable and deductible temporary differences. In certain situations, the ability to reasonably conclude that reversing taxable temporary differences will more likely than not create sufficient taxable income to realize reversing deductible temporary differences can be done without detailed scheduling.¹⁵

2.8 If scheduling is considered necessary, the amount of scheduling required will depend on the particular facts and circumstances and be subject to judgment. There may be more than one acceptable approach. The FASB’s answer to question 1 of the Special Report on Statement 109 indicates that the following concepts underlie the determination of reversal patterns under Statement 109:

- a. The particular years in which temporary differences result in taxable or deductible amounts generally are determined by the timing of the recovery of the related asset or settlement of the related liability’ (paragraph 228).
- b. The tax law determines whether future reversals of temporary differences will result in taxable and deductible amounts that offset each other in future years’ (paragraph 227).

In addition, the FASB noted that “minimizing complexity is an appropriate consideration in selecting a method for determining reversal patterns”¹⁶, but that the methods used must be systematic and logical and should be consistently applied for all similarly categorized temporary differences and from year to year. Furthermore, the same method should be utilized in determining the reversal patterns in every taxing jurisdiction for which the temporary difference exists.

¹³ One of the four possible sources of taxable income that can be used to realize a tax benefit. See paragraph 13.b. of SSAP No. 101.

¹⁴ For example, due to the relatively short loss carryback periods (or, in the case of entities taxed as life insurance companies, no carryback of operating losses) under current tax law, such consideration may be appropriate when taxable temporary differences are expected to reverse in a short number of future years while the deductible temporary differences are expected to reverse over a long number of future years. In addition, for “indefinite-lived” intangible assets (i.e., intangible assets like those discussed in paragraph 11 of FAS 142 for which no legal, regulatory, contractual, competitive, economic, or other factors limit their useful lives), predicting reversal of temporary differences related to such assets would be inconsistent with financial reporting assertions that the assets are indefinite-lived. In such a case, the reversal of taxable temporary differences with respect to such indefinite-lived intangible assets should not be considered a source of future taxable income when determining the statutory valuation allowance adjustment for entities taxed as non-life insurance companies. On the other hand, entities taxed as life insurance companies may, under current tax law, carry forward operating losses with no expiration period, subject to a utilization limit of 80% of taxable income (before the loss carry forward) in the carry forward year. In such case, the reversal of taxable temporary differences with respect to indefinite-lived intangible assets may be considered a source of taxable income, subject to the applicable tax law limitations.

¹⁵ Q&A 2 from the Special Report on Statement 109 published by the FASB.

¹⁶ Q&A 1 from the Special Report on Statement 109 published by the FASB.

Grouping of Assets and Liabilities for Measurement

2.9 The manner in which an entity groups its assets and liabilities for measurement shall be conducted in a reasonable and consistent manner. For instance, an entity may group its invested assets into annual statement classifications (stocks, bonds, preferred stocks, etc.) or other reasonable groupings (lines of business for grouping its reserves). Entities have the option of recognizing the DTA and DTL within each grouping on a net or gross basis. For instance, a portfolio of common stocks will have both unrealized gain and unrealized losses associated with them. The reporting entity may elect to combine the unrealized gains and losses and compute a single DTA or DTL or it may elect to segregate the unrealized gains from the unrealized losses and compute separate DTAs and DTLs. This option might also arise with respect to depreciable assets. Regardless of which method an entity elects, it is crucial that consistency is maintained to and within each grouping from period to period. An entity shall retain internal documentation to support its grouping in addition to the methodologies employed to arrive at such. An entity is permitted to modify its groupings should events or circumstances change from a previous period. Examples include a change in materiality of underlying assets and liabilities, administrative costs associated with detailing groupings increases or changes in the computer systems that allow more specificity. Entities that modify their groupings should be prepared to rationalize these changes. These entities should also disclose that a modification was made and general reason for such in the notes to the financial statements.

Measurement of Nonadmitted Assets

2.10 As noted in paragraph 7.b. of SSAP No. 101, temporary differences include nonadmitted assets. The measurement of these types of assets is not addressed in FAS 109 in that the concept of nonadmission is unique to statutory accounting. For assets that are nonadmitted for statutory accounting purposes, DTAs and DTLs should be measured after nonadmission.

Illustration:

	Statutory Before Nonadmit (Info Purpose)	Statutory After Nonadmit	Tax	Basis Difference¹⁷	Tax Effect DTA (DTL) (21%)
Furniture Fixtures and Equipment	\$1,000	0	\$1,000		
Accumulated Depreciation	200	0	400		
Basis	\$800	0	\$600	\$600	\$126

2.11 The effect of this illustration is a reduction of surplus by \$674 (\$800 decrease for nonadmitted asset and \$126 increase for DTA), provided the resulting DTA meets the admissibility test in paragraph 11 of SSAP No. 101.

3. Q – A reporting entity’s deferred tax assets and liabilities are computed using “enacted tax rates.” What is the meaning of the term “enacted tax rates”? [Paragraph 7.c.]

3.1 A – Paragraph 7.c. of SSAP No.101 provides that total DTAs and DTLs are computed using enacted tax rates.

3.2 Consistent with FAS 109, SSAP No. 101 further requires that deferred tax assets and liabilities be measured using the enacted tax rate that is expected to apply to taxable income in the periods in which the

¹⁷ Difference is computed from the “Statutory After Nonadmit” balance.

deferred tax asset or liability is expected to be settled or realized. The effects of future changes in tax rates are not anticipated in the measurement of deferred tax assets and liabilities. Deferred tax assets and liabilities are adjusted for changes in tax rates and other changes in the tax law, and the effects of those changes are recognized at the time the change is enacted.

3.3 Tax laws may apply different tax rates to ordinary income and capital gains. In instances where the enacted tax law provides for different rates on income of different character, deferred tax assets and liabilities should be measured by applying the appropriate enacted tax rate based on the type of taxable or deductible amounts expected to be realized from the reversal of existing temporary differences.

4a. Q – How should a reporting entity calculate the amount of its admitted adjusted gross DTAs? [Paragraph 11]

4.1 A – After a reporting entity has calculated the amount of its adjusted gross DTAs and gross DTLs pursuant to paragraph 7, it must determine the amount of its adjusted gross DTAs that can be admitted under paragraph 11, not to exceed the amount of total adjusted gross DTAs. The amount of adjusted gross DTAs is not recalculated under paragraph 11; rather, some or all of the adjusted gross DTA may not be currently admitted. As noted in paragraph 11, the net admitted DTA shall not exceed the excess of the adjusted gross DTAs over gross DTLs.

4.2 Paragraphs 11.a., 11.b. and 11.c. require three interdependent calculations or components that when added together equal the amount of the reporting entity's admitted adjusted gross DTAs. Each of the calculations starts with the total of the reporting entity's adjusted gross DTAs, and determines the amount of such adjusted gross DTAs that can be admitted under that part. For example, the consideration of existing temporary differences in the calculation of admitted adjusted gross DTAs under paragraph 11.a., does not prevent the reconsideration of the same temporary differences in the paragraph 11.b.i. calculation. However, to avoid duplication of admitted adjusted gross DTAs when adding the three parts together, the amount of admitted adjusted gross DTAs under paragraph 11.a. must be subtracted from the amount of adjusted gross DTAs in the paragraph 11.b.i. calculation. Similarly, the amount of admitted adjusted gross DTAs under paragraphs 11.a. and 11.b. must be subtracted from the total adjusted gross DTAs in the paragraph 11.c. calculation. For illustrations of the paragraph 11 DTA admission calculations, see Question 4.16 through Question 4.25.

First Component – Admission Based on Previously Paid Taxes [Paragraph 11.a.]

4.3 Under paragraphs 11.a. and 12.b., a reporting entity can admit adjusted gross DTAs to the extent that it would be able to recover federal income taxes paid in the carryback period, by treating existing temporary differences that reverse during a timeframe corresponding with Internal Revenue Code tax loss carryback provisions¹⁸, not to exceed three years as ordinary or capital losses that originated in each such subsequent year. The reversing temporary differences are specific to each year in which they reverse, and in turn, to the specific year(s) to which they can be carried back corresponding with tax loss carryback provisions. Reversing temporary differences for unrealized losses and nonadmitted assets are treated as capital or ordinary losses depending on their character for tax purposes. The entity is not required to project an actual net operating loss in future periods. This first component of admission is available to all entities, regardless of whether they meet any of the threshold limitations in paragraph 11.b. for reversals expected to be realized against future taxable income.

4.4 Paragraph 12.b. limits the amount of federal income taxes recoverable under paragraph 11.a. to the amount that would be refunded to the reporting entity if a carryback claim was filed with the Internal

¹⁸ For example, under the Federal Internal Revenue Code, ordinary losses can be carried back two years for entities taxed as nonlife insurance companies, while capital losses for entities taxed both as nonlife and life insurance companies can be carried back three years. For losses arising in tax years after 2017, entities taxed as life insurance companies are not permitted to carryback ordinary losses.

Revenue Service (IRS). If some amount of taxes paid in the carryback period is not recovered because of limitations imposed by the Alternative Minimum Tax system in effect in taxable years prior to 2018, the resulting AMT credit is not treated as a newly created DTA. Paragraph 12.c. further limits the amount of federal income taxes recoverable under paragraph 11.a. for a reporting entity that files a consolidated income tax return with one or more affiliates, to the amount that the reporting entity could reasonably expect to have refunded by its parent. See Question 8 for a further discussion of the impact of filing a consolidated federal income tax return.

Second Component – Admission Based On Projected Future Tax Savings [Paragraph 11.b.]

4.5 The amount of a reporting entity's adjusted gross DTAs that can be admitted pursuant to paragraph 11.b. is in part, dependent on the amount of the reporting entity's adjusted capital and surplus. Accordingly, a reporting entity must determine which Realization Threshold Limitation Table set forth in paragraph 11.b. is applicable to the reporting entity and then, based on its respective facts, determine what applicable period to apply under paragraph 11.b.i. and applicable percentage to use under paragraph 11.b.ii.

4.6 If the reporting entity is subject to risk-based capital requirements or is required to file a Risk-Based Capital Report with the domiciliary state, it should use the RBC Reporting Entity Table set forth in paragraph 11.b. Threshold limitations for this table are contingent upon the ExDTA ACL RBC ratio. See Question 4b for a discussion on the ExDTA ACL RBC ratio.

4.7 If the reporting entity is (1) either a mortgage guaranty insurer or financial guaranty insurer that is not subject to risk-based capital requirements, (2) is not required to file a Risk-Based Capital Report with the domiciliary state, and (3) the reporting entity meets the minimum capital and reserve requirements¹⁹ for the state of domicile, then it should use the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table set forth in paragraph 11.b. Threshold limitations for this table are contingent upon the ratio of ExDTA Surplus plus contingency reserves divided by the minimum aggregate capital required (see further detail in paragraph 11.b.).

4.8 If the reporting entity (1) is not subject to risk-based capital requirements, (2) is not required to file a Risk-Based Capital Report with the domiciliary state, (3) is not a mortgage guaranty or financial guaranty insurer, and (4) meets the minimum capital and reserve requirements¹⁹, it should use the Other Non-RBC Reporting Entity Table set forth in paragraph 11.b. Threshold limitations for this table are contingent upon the ratio of adjusted gross DTA less the amount of adjusted gross DTA admitted in paragraph 11.a. to adjusted capital and surplus.

4.9 The amount of admitted adjusted gross DTAs under paragraph 11.b.i., is limited to the amount that the reporting entity expects to realize within the applicable period as determined using the applicable Realization Threshold Limitation Table following the balance sheet date. See Question 6 for a further discussion of the meaning of "expected to be realized." See Question 4.2 regarding the amount of adjusted gross DTAs considered in the paragraph 11.b.i. calculation. The amount of admitted adjusted gross DTAs under the paragraph 11.a. calculation is subtracted from the amount of adjusted gross DTAs under paragraph 11.b.i., to prevent the counting of the same admitted adjusted gross DTAs more than once. If the reporting entity expects to realize an amount of adjusted gross DTAs under paragraph 11.b.i. that is equal to or less than the admitted adjusted gross DTAs calculated under paragraph 11.a., then the resulting admitted adjusted gross DTAs under paragraph 11.b.i. will be zero.

4.10 The reference to applicable period following the balance sheet date in 4.9 refers to the paragraph 11.b.i. column of the applicable Realization Threshold Limitation Table, the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table or the Other Non-RBC Reporting Entity Table.

¹⁹ If a reporting entity is not at the minimum capital and reserve requirements, the admitted adjusted gross DTA for this component is zero.

4.11 The amount of admitted adjusted gross DTAs under paragraph 11.b.i. is also limited to an amount that is no greater than the applicable percentage of adjusted statutory capital and surplus specified in paragraph 11.b.ii. See Question 4c for a discussion of the meaning of “an amount that is no greater than”.

4.12 The reference to an amount no greater than the applicable percentage of statutory capital and surplus in 4.11 refers to the 11.b.ii. column of the applicable Realization Threshold Limitation Table; the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table or the Other Non-RBC Reporting Entity Table.

Third Component – Admission Based On Offset Against DTL [Paragraph 11.c.]

4.13 Under paragraph 11.c., a reporting entity can admit adjusted gross DTAs as an offset against gross DTLs in an amount equal to the lesser of: (1) its adjusted gross DTAs, after subtracting the amount of admitted adjusted gross DTAs under paragraphs 11.a. and 11.b., or (2) its gross DTLs. See Question 4.2 regarding the amount of adjusted gross DTAs considered in the paragraph 11.c. calculation. In determining the amount of adjusted gross DTAs that can be offset against existing gross DTLs in the paragraph 11.c. calculation, the character (i.e., ordinary versus capital) of the DTAs and DTLs must be taken into consideration such that offsetting would be permitted in the tax return under existing enacted federal income tax laws and regulations. For example, an adjusted gross DTA related to unrealized capital losses could not be offset against an ordinary income DTL. Ordinary DTAs can be admitted by offset with ordinary DTLs and/or capital DTLs. However, capital DTAs can only be admitted by offset with capital DTLs. In addition, for reporting entities that consider reversal of existing temporary differences in determining the need for a statutory valuation allowance adjustment, significant and relevant historical and/or currently available information may exist specific to the remaining amount of total adjusted gross DTAs and gross DTLs must also be taken into consideration in the determination of the admission of adjusted gross DTAs under paragraph 11.c. However, for those reporting entities, no scheduling is required beyond that necessary in determining the need for a statutory valuation allowance adjustment. As stated in paragraph 11.c., “for purposes of this component, the reporting entity shall consider the reversal patterns of temporary differences; however, this consideration does not require scheduling beyond that required in paragraph 7.e.” See Question 2.5 through Question 2.8 for further discussion of scheduling for purposes of determining the reporting entity’s statutory valuation allowance adjustment.) This consideration requires a scheduling exercise if scheduling is needed for determination of the statutory valuation allowance adjustment and, as a result, should be consistent with the determination of any statutory valuation allowance adjustment, which occurs prior to performing the admissibility calculations.²⁰ However, as noted in Question 2.7, scheduling reversal patterns of temporary differences in evaluating the need for a statutory valuation allowance adjustment where a reporting entity relies on sources of future taxable income, exclusive of reversals of temporary differences, is not required. In such case, that reporting entity is not required to schedule reversal patterns of temporary differences for purposes of paragraph 11.c. of SSAP No. 101. This is the case even if the reversal pattern of the temporary difference is readily determinable, such as straight-line amortization of a fixed amount. It also is the case if, for example, the reporting entity in determining its statutory valuation allowance adjustment has considered a source of future income reversal of existing temporary differences that are capital in character, but not those that are ordinary in character. In such case, the reporting entity is not required to schedule reversal patterns of ordinary temporary differences for purposes of paragraph 11.c.

²⁰ Footnote 1 of SSAP No. 101 provides that a reporting entity “shall consider reversal patterns of temporary differences *to the extent necessary* to support establishing or not establishing a valuation allowance adjustment.” (Emphasis added).

Other Considerations

4.14 In certain situations, a reporting entity's expected federal income tax rate on its reversing temporary differences are expected to be less than the enacted tax rate used in the determination of its gross DTAs and DTLs. Examples of such entities include: Blue Cross-Blue Shield Organizations with section 833(b) deductions, reporting entities projecting a tax loss, and entities that file in a consolidated federal income tax return that cannot realize the full amount of their adjusted gross DTAs under the existing intercompany tax sharing or tax allocation agreement. Pursuant to paragraphs 231, 232 and 238 of FAS 109, such entities are required to report their gross DTLs at the enacted tax rate, and cannot take into consideration the impact of other adjustments such as the section 833(b) deduction to reduce their gross DTLs.

4.15 For those entities, the amount of admitted adjusted gross DTAs calculated under paragraph 11.a. will reflect the actual tax rate in the carryback period under paragraph 11.a. which takes into consideration the impact in the carryback years of the AMT and special deductions, as well as the provisions of the intercompany tax sharing or allocation agreement. Likewise, the amount of admitted adjusted gross DTAs calculated under paragraph 11.b. will reflect the expected tax rate in the applicable period as discussed in paragraph 4.14, which takes into consideration the impact of special deductions and the provisions of the intercompany tax sharing or allocation agreement. See Question 6 for further discussion of this issue. As such, the entity's admitted adjusted gross DTAs under paragraphs 11.a. and 11.b. may be less than its adjusted gross DTAs on temporary differences at the enacted rate. Any unused amount of DTAs resulting from this differential under paragraphs 11.a. and 11.b. can be used under paragraph 11.c. to offset existing DTLs.

4.16 The above principles can be illustrated by the following examples:

4.17 Facts:

RBC Reporting Entity Example

1. Life Insurance Company ABC²¹ has \$9,500,000 of deductible temporary differences (\$6,000,000 ordinary and \$3,500,000 capital) at 12-31-20X2 that generate \$1,995,000 of gross DTAs (\$1,260,000 ordinary, \$735,000 capital), at the enacted federal income tax rate of 21%. ABC has sufficient evidence of projected future taxable income exclusive of reversing temporary differences and carryforwards to support a conclusion that it will realize the full amount of its ordinary gross DTAs, and it was unnecessary in reaching that conclusion (i.e., that no valuation allowance adjustment need be established for ordinary DTAs) to consider reversal patterns of temporary differences. However, management has concluded, after considering all four sources of taxable income described in paragraph 13 of SSAP No. 101, that a statutory valuation allowance adjustment should be recognized for \$168,000 of capital DTAs, reducing capital DTAs from \$735,000 to \$567,000. Thus, in total, management has concluded that ABC will more likely than not realize gross DTAs of \$1,827,000 (\$1,260,000 ordinary, \$567,000 capital) related to its \$9,500,000 of deductible temporary differences. ABC also has \$4,000,000 of taxable temporary differences (\$2,800,000 ordinary and \$1,200,000 capital) resulting in \$840,000 (\$588,000 ordinary, \$252,000 capital) of gross DTLs.

2. ABC has determined that \$2,000,000 of its \$6,000,000 existing deductible ordinary temporary differences will reverse in 20X3, another \$1,500,000 will reverse in 20X4, and another \$2,000,000 will reverse in 20X5. The remaining \$500,000 of ABC's existing deductible ordinary temporary differences will reverse in years 20X6 or later. ABC has determined that \$200,000, \$300,000, and \$400,000 of its \$3,500,000 deductible capital

²¹ Please note the results in this example may be different due to differences in the applicable carryback periods if ABC was taxed as a non-life insurance company.

temporary differences are expected to reverse in 20X3, 20X4, and 20X5, respectively, and the remaining \$2,600,000 will reverse in years 20X6 or later.

3. ABC reported \$400,000 (\$300,000 ordinary, \$100,000 capital) and \$1,000,000 (\$800,000 ordinary, \$200,000 capital) of taxable income in 20X0 and 20X1, respectively. ABC reported \$84,000 (\$63,000 ordinary, \$21,000 capital) and \$210,000 (\$168,000 ordinary, \$42,000 capital) of tax expense on its 20X0 and 20X1 federal income tax returns, respectively. It has also projected taxable income of \$1,500,000 (\$1,200,000 ordinary, \$300,000 capital) and \$315,000 (\$252,000 ordinary, \$63,000 capital) of federal income taxes for 20X2 that have been reflected in its current statutory income tax provision calculation.

4. ABC expects to realize²² a federal income tax benefit of 21% from 20X3 through 20X5 related to reversing ordinary temporary differences. ABC does not anticipate any capital gain income in 20X3 through 20X5.

5. ABC has an ExDTA ACL RBC Ratio at 12-31-20X2 of 600%. Adjusted statutory capital and surplus under paragraph 11.b.ii. is \$7,000,000 at 12-31-20X2, and was computed by subtracting the admitted balances of net DTA's, goodwill and EDP from the current period statutory surplus. Statutory surplus is defined in paragraph 2 of SSAP No. 72.

6. The above facts are summarized in the following table:

	Ordinary	Capital	Total
20X2 – Current Year Taxable Income & Tax:			
Taxable Income in CY	\$ 1,200,000	\$ 300,000	\$ 1,500,000
Tax Provision @ 21%	\$ 252,000	\$ 63,000	\$ 315,000
Deductible Temporary Differences	\$ 6,000,000	\$ 3,500,000	\$ 9,500,000
DTA @21%	\$ 1,260,000	\$ 735,000	\$ 1,995,000
Taxable Temporary Differences	\$ 2,800,000	\$ 1,200,000	\$ 4,000,000
DTL @21%	\$ 588,000	\$ 252,000	\$ 840,000
Valuation Allowance		\$ 168,000	\$ 168,000
Carryback Taxable Income & Tax:			
20X0 Taxable Income	\$ 300,000	\$ 100,000	\$ 400,000
Tax	\$ 63,000	\$ 21,000	\$ 84,000
20X1 Taxable Income	\$ 800,000	\$ 200,000	\$ 1,000,000
Tax	\$ 168,000	\$ 42,000	\$ 210,000
Reversal of Deductible Temp Differences:			
20X3	\$ 2,000,000	\$ 200,000	\$ 2,200,000
20X4	\$ 1,500,000	\$ 300,000	\$ 1,800,000
20X5	\$ 2,000,000	\$ 400,000	\$ 2,400,000
20X6 and later	\$ 500,000	\$ 2,600,000	\$ 3,100,000
Total (before valuation allowance)	\$ 6,000,000	\$ 3,500,000	\$ 9,500,000

4.18 Calculation of ABC's Admitted Adjusted Gross DTAs:

1. Paragraph 11.a. calculation. ABC cannot admit any ordinary adjusted gross DTAs under paragraph 11.a., because entities taxed as life insurance companies are not permitted to carry back ordinary tax losses under existing Federal income tax law. However, ABC can admit

²² See Question 6 for discussion on the admittance calculation under paragraph 11.b.i. and what is meant by the phrase: "expected to be realized."

capital adjusted gross DTAs of \$126,000 under paragraph 11.a. because all capital losses are permitted a 3-year carryback under existing Federal income tax law and ABC paid taxes on capital gains in each year 20X0-20X2.

- a. ABC first carries \$100,000 of the hypothetical capital loss²³ of \$200,000 from 20X3 back to 20X0 recovering \$21,000 in taxes paid. The remaining \$100,000 of the 20X3 hypothetical capital loss (\$200,000 – \$100,000) is available for utilization in years 20X1 and 20X2.
- b. ABC would carry the remaining \$100,000 of the hypothetical capital loss from 20X3 back to 20X1 recovering \$21,000 in taxes paid. In addition, ABC would carry back \$100,000 of hypothetical capital loss from 20X4 to 20X1 to recover another \$21,000 of taxes paid.²⁴
- c. ABC would carry the remaining \$200,000 of the hypothetical capital loss from 20X4 plus an additional \$100,000 of the hypothetical capital loss from 20X5 back to 20X2, recovering \$63,000 in taxes projected to be paid.

2. Paragraph 11.b. calculation. ABC can admit \$1,050,000 of adjusted gross DTAs under paragraph 11.b. Since ABC has an ExDTA ACL RBC ratio of 600%, the Realization Threshold Limitation Table provides that the company can use the thresholds of 3 years for projected realization and 15% of adjusted capital and surplus. The company expects to realize a federal income tax benefit of \$1,155,000 (\$5,500,000 X 21%) in 20X3 through 20X5 related to its reversing ordinary deductible temporary differences and \$126,000 (\$600,000 X 21%) in 20X3 through 20X5 related to its reversing capital deductible temporary differences (through carryback to 20X0-20X2).²⁵ The \$1,281,000 amount (\$1,155,000 + \$126,000) must be reduced by the \$126,000 of admitted adjusted gross DTAs under paragraph 11.a. to prevent double counting of the same income tax benefit. As a result, ABC has projected adjusted gross DTAs available for admission under this component of \$1,155,000 (\$1,281,000 – \$126,000), all of which are ordinary in tax character. However, 15% of adjusted capital and surplus is a limiting factor in this example. As such, even though ABC has sufficient sources of future taxable income exclusive of reversing taxable temporary differences to realize a federal income tax benefit of \$1,155,000 in 20X3 through 20X5 related to its reversing ordinary deductible temporary differences, admission of those temporary differences is limited to \$1,050,000 (\$7,000,000 X 15%).

3. Paragraph 11.c. calculation. ABC can admit \$462,000 (\$210,000 ordinary, \$252,000 capital) of adjusted gross DTAs under paragraph 11.c. ABC has \$1,827,000 of total adjusted gross DTAs available for admission under paragraph 11. These DTAs are made up of \$1,260,000 ordinary DTAs and \$567,000 of capital DTAs. To prevent double counting of admitted adjusted gross DTAs, the \$1,260,000 of ordinary DTAs must be reduced by the \$1,050,000 admitted under paragraph 11.b., leaving \$210,000 for admission under paragraph 11.c. Likewise, the \$567,000 of capital DTAs must be reduced by the \$126,000 admitted under paragraph 11.a., leaving \$441,000 for admission under paragraph 11.c. There are \$588,000 of ordinary DTLs available to offset against the \$210,000 of ordinary DTAs. There are \$252,000 of

²³ It should be noted that if ABC's hypothetical 20X3 carryback was insufficient to fully offset all capital gain income in 20X0, the company would not be allowed to carryback any of the hypothetical loss from 20X4 or 20X5 to 20X0 per paragraph 11.a., as 20X0 is outside of the timeframe corresponding with capital loss carryback provisions for an insurance company.

²⁴ If ABC would not have had sufficient hypothetical capital loss from 20X4 to carryback to 20X1, the company would not have been able to carryback its hypothetical capital loss of \$400,000 from 20X5 back to 20X1 pursuant to the applicable tax loss carryback provisions.

²⁵ Because ABC projects no capital gain income in 20X3 through 20X5, it is not able to realize a federal income tax benefit on the remaining \$300,000 of capital temporary differences reversing in that 3-year period.

capital DTLs available to offset against the \$441,000 capital DTAs. However, the tax character of the DTAs and DTLs becomes a limiting factor for this component. While ordinary DTAs can be offset against both ordinary and capital DTLs, the reverse is not allowed in the tax return (see Question 4.13). Because ABC did not consider reversal of existing temporary differences in determining that no valuation allowance was necessary for gross ordinary DTAs, it need not consider reversal patterns of temporary differences for admission of ordinary DTAs in its paragraph 11.c. calculation. On the other hand, because ABC was required to consider all four sources of taxable income specified in paragraph 13 of SSAP No. 101 (including future reversals of existing taxable capital temporary differences) in establishing a valuation allowance for gross capital DTAs, it is required to consider reversal patterns of temporary differences for admission of capital DTAs in its paragraph 11.c. calculation, but this consideration does not require scheduling beyond that required by paragraph 7.e. of SSAP No. 101 (again see Question 4.13). In this situation, after the required consideration, ABC can admit \$210,000 and \$252,000 of its ordinary and capital DTAs, respectively.

4.19 Summary of ABC's Admitted Gross DTA Calculation:

	Ordinary	Capital	Total
Gross DTAs at Enacted Tax Rate	\$1,260,000	\$735,000	\$1,995,000
Less: Statutory Valuation Allowance		\$168,000	\$168,000
Adjusted Gross DTAs at Enacted Tax Rate	\$1,260,000	\$567,000	\$1,827,000
Admitted Gross DTAs (paragraph 11.a.)	0	\$126,000	\$126,000
Admitted Gross DTAs (paragraph 11.b.)	\$1,050,000	0	\$1,050,000
Admitted Gross DTAs (paragraph 11.c.)	<u>\$210,000</u>	<u>\$252,000</u>	<u>\$462,000</u>
Total Admitted Adjusted Gross DTAs (sum of 11.a, 11.b., and 11.c)	\$1,260,000	\$378,000	\$1,638,000
Nonadmitted Adjusted Gross DTAs	0	<u>\$239,000</u>	<u>\$239,000</u>
Admitted DTA	\$1,260,000	\$378,000	\$1,638,000
Gross DTL	<u>\$(588,000)</u>	<u>\$(252,000)</u>	<u>\$(840,000)</u>
Net Admitted DTA/DTL	\$672,000	\$126,000	\$798,000

4.20 Facts:

Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Example

1. Financial Guaranty Insurance Company DEF has the same facts as Life Insurance Company ABC except:

- a. DEF is not an RBC reporting entity and therefore does not calculate an RBC percentage. DEF is a financial guaranty insurer and has an ExDTA Surplus plus Contingency Reserve/Required Aggregate Risk Capital ratio of 105%. This ratio represents the sum of surplus to policyholders (excluding any admitted DTA from 11.a.) plus contingency reserves divided by the minimum aggregate capital required.
- b. DEF reported \$1,000,000 of taxable income and \$210,000 of tax expense on its 20X1 federal income tax return. It has also projected taxable income of \$1,500,000 and \$315,000 of federal income taxes for 20X2 that has been reflected in its current statutory income tax provision calculation. DEF recognized no capital gain income in 20X1 or 20X2, so all of its taxable income in those years was ordinary in character. But DEF has \$1,000,000 less deductible capital temporary differences than ABC and so, after considering all four sources

of taxable income specified in paragraph 13 of SSAP No. 101, DEF establishes the same valuation allowance against gross capital DTAs as ABC. After the valuation allowance, DEF has \$357,000 ($\$2,500,000$ gross capital DTAs $\times$ 21% = $\$525,000$ less $\$168,000$ valuation allowance = $\$357,000$) of adjusted gross capital DTAs.

4.21 Calculation of DEF's Admitted Adjusted Gross DTAs:

1. Paragraph 11.a. calculation. DEF can admit $\$525,000$ ($\$210,000 + \$315,000$) of adjusted gross DTAs under paragraph 11.a, all of which are ordinary in tax character.

- a. As an entity taxed as a nonlife insurance company, DEF, unlike ABC, is permitted to carry back ordinary tax losses. DEF first carries $\$1,000,000$ of the hypothetical net operating loss²⁶ of $\$2,000,000$ from 20X3 back to 20X1 recovering $\$210,000$ in taxes paid. The remaining $\$1,000,000$ of the hypothetical net operating loss ($\$2,000,000 - \$1,000,000$) is available for utilization in 20X2.
- b. DEF would carry the remaining $\$1,000,000$ of the hypothetical net operating loss from 20X3 plus an additional $\$500,000$ of the hypothetical net operating loss from 20X4 back to 20X2 recovering $\$315,000$ in taxes projected to be paid.²⁷

2. Paragraph 11.b. calculation. DEF cannot admit any additional adjusted gross DTAs under paragraph 11.b. Since DEF has an ExDTA Surplus/Policyholders and Contingency Reserves ratio of 105%, the Realization Threshold Limitation Table provides that the company can use the thresholds of 1 year for projected realization and 10% of adjusted capital and surplus. The company expects to realize a federal income tax benefit of $\$420,000$ ($\$2,000,000 \times 21\%$) in 20X3 related to its reversing deductible temporary differences. The $\$420,000$ amount must be reduced by the $\$525,000$ of admitted adjusted gross DTAs under paragraph 11.a. to prevent double counting of the same income tax benefit. DEF admitted $\$105,000$ ($\$525,000 - \$420,000$) more adjusted gross DTAs based on carryback of hypothetical net operating losses under paragraph 11.a. than is projected to be realized within the 1- year applicable threshold limitation. As a result, there is $\$0$ of expected additional reversing deductible differences available for admission under paragraph 11.b.

3. Paragraph 11.c. calculation. DEF can admit $\$840,000$ ($\$588,000$ ordinary, $\$252,000$ capital) of adjusted gross DTAs under paragraph 11.c. DEF has $\$1,617,000$ of total adjusted gross DTAs available for admission under paragraph 11. These DTAs are made up of $\$1,260,000$ ordinary DTAs and $\$357,000$ of capital DTAs. To prevent double counting of admitted adjusted gross DTAs, the $\$1,260,000$ of ordinary adjusted gross DTAs must be reduced by the $\$525,000$ admitted under paragraph 11.a., leaving $\$735,000$ for admission under paragraph 11.c. There are $\$588,000$ of ordinary DTLs to offset against the $\$735,000$ of ordinary DTAs. There are $\$252,000$ of capital DTLs to offset against the $\$357,000$ capital DTAs. However, the tax character of the DTAs and DTLs must be considered as a potential limiting factor for this component because while ordinary DTAs can be offset against both ordinary and capital DTLs, the reverse is not allowed in the tax return (see Question 4.13). In this situation, DEF can admit $\$588,000$ and $\$252,000$ of its ordinary and capital DTAs,

²⁶ It should be noted that if DEF's hypothetical 20X3 carryback was insufficient to fully offset all positive taxable income in 20X1, the company would not be allowed to carryback any of the hypothetical loss from 20X4 or 20X5 to 20X1 per paragraph 11.a., as 20X1 is outside of the timeframe corresponding with the tax loss carryback provisions for a non-life insurance company.

²⁷ If DEF would not have had sufficient hypothetical NOL from 20X4 to carryback to 20X2, the company would not have been able to carryback is hypothetical NOL of $\$2,000,000$ from 20X5 back to 20X2 as 20X2 is outside of the timeframe corresponding with the tax loss carryback provisions for a nonlife insurance company.

respectively.²⁸ If DEF's adjusted gross DTAs, after reduction for the amount of adjusted gross DTAs admitted under paragraphs 11.a. and 11.b., were less than \$840,000 in this example, DEF would be limited to the balance of its adjusted gross DTAs in the paragraph 11.c. calculation, subject to the rules of offset under existing enacted federal income tax laws and regulations.

4.22 Summary of DEF's Admitted Gross DTA Calculation:

	Ordinary	Capital	Total
Gross DTAs at Enacted Tax Rate	\$1,260,000	\$525,000	\$1,785,000
Less: Statutory Valuation Allowance		\$168,000	\$168,000
Adjusted Gross DTAs at Enacted Tax Rate	\$1,260,000	\$357,000	\$1,617,000
Admitted Gross DTAs (paragraph 11.a.)	\$525,000	\$0	\$525,000
Admitted Gross DTAs (paragraph 11.b.)	\$0	\$0	\$0
Admitted Gross DTAs (paragraph 11.c.)	<u>\$588,000</u>	<u>\$252,000</u>	<u>\$840,000</u>
Total Admitted Adjusted Gross DTAs (sum of 11.a, 11.b., and 11.c)	\$1,113,000	\$252,000	\$1,365,000
Nonadmitted Adjusted Gross DTAs	<u>\$147,000</u>	<u>\$105,000</u>	<u>\$352,000</u>
Admitted DTA	\$1,113,000	\$252,000	\$1,365,000
Gross DTL	<u>\$(588,000)</u>	<u>\$(252,000)</u>	<u>\$(840,000)</u>
Net Admitted DTA/DTL	\$525,000	\$0	\$525,000

4.23 Facts:

Other Non-RBC Reporting Entity Example

1. Title Insurance Company GHI has the same facts as Life Insurance Company ABC except:

- a. GHI is not a RBC reporting entity and therefore does not calculate a RBC percentage. GHI is also not a financial guaranty or mortgage guaranty insurer. As such, GHI must use the Other Non-RBC Reporting Entity Threshold Limitation Table under paragraph 11.b.
- b. GHI reported \$1,000,000 of taxable income and \$210,000 of tax expense on its 20X1 federal income tax return. It has also projected taxable income of \$1,500,000 and \$315,000 of federal income taxes for 20X2 that has been reflected in its current statutory income tax provision calculation. GHI recognized no capital gain income in 20X1 or 20X2, so all of its taxable income in those years was ordinary in character. But GHI has \$1,000,000 less deductible capital temporary differences than ABC and so, after considering all four sources of taxable income specified in paragraph 13 of SSAP No. 101, GHI establishes the same valuation allowance against gross capital DTAs as ABC. After the valuation allowance, DEF has \$357,000 (\$2,500,000 gross capital DTAs x 21% = \$525,000 less \$168,000 valuation allowance = \$357,000) of adjusted gross capital DTAs.

²⁸ DEF's required consideration of reversal patterns of temporary differences is the same as ABC's. See Question 4.18.3.

4.24 Calculation of GHI's Admitted Adjusted Gross DTAs:

1. Paragraph 11.a. calculation. GHI can admit \$525,000 (\$210,000 + \$315,000) of adjusted gross DTAs under paragraph 11.a, all of which are ordinary in tax character.

a. As an entity taxed as a nonlife insurance company, GHI, unlike ABC, is permitted to carry back ordinary tax losses. GHI first carries \$1,000,000 of the hypothetical net operating loss²⁹ of \$2,000,000 from 20X3 back to 20X1 recovering \$210,000 in taxes paid. The remaining \$1,000,000 of the hypothetical net operating loss (\$2,000,000 – \$1,000,000) is available for utilization in 20X2.

b. GHI would carry the remaining \$1,000,000 of the hypothetical net operating loss from 20X3 plus an additional \$500,000 of the hypothetical net operating loss from 20X4 back to 20X2 recovering \$315,000 in taxes projected to be paid.³⁰

2. Paragraph 11.b. calculation. GHI can admit \$630,000 of adjusted gross DTAs under paragraph 11.b. Since GHI has an Adjusted Gross DTA to Adjusted Capital and Surplus ratio of 15.6% (\$1,092,000/\$7,000,000), the Realization Threshold Limitation Table provides that the company can use the thresholds of 3 years for projected realization and 15% of adjusted capital and surplus. The company expects to realize a federal income tax benefit of \$1,155,000 (\$5,500,000 X 21%) in 20X3 through 20X5 related to its reversing deductible temporary differences. The \$1,155,000 amount must be reduced by the \$525,000 of admitted adjusted gross DTAs under paragraph 11.a. to prevent double counting of the same income tax benefit. As a result, GHI has projected adjusted gross DTAs available for admission under this component of \$630,000 (\$1,155,000 – \$525,000), all of which is ordinary in tax character. 15% of adjusted capital and surplus (\$7,000,000 X 15% = \$1,050,000) is not a limiting factor in this example. As such, admission of reversing deductible temporary differences that are projected to be realized during 20X3 through 20X5 is \$630,000.

3. Paragraph 11.c. calculation. GHI can admit \$357,000 (\$105,000 ordinary, \$252,000 capital) of adjusted gross DTAs under paragraph 11.c. GHI has \$1,617,000 of total adjusted gross DTAs available for admission under paragraph 11. These DTAs are made up of 1,260,000 ordinary DTAs and \$357,000 of capital DTAs. To prevent double counting of admitted adjusted gross DTAs, the \$1,260,000 of ordinary adjusted gross DTAs must be reduced by the \$525,000 admitted under paragraph 11.a. and the \$630,000 admitted under paragraph 11.b., leaving \$105,000 for admission under paragraph 11.c. There is \$588,000 of ordinary DTLs available to offset against the \$105,000 of ordinary DTAs. There is \$252,000 of capital DTLs to offset against the \$357,000 capital DTAs. Accordingly, the tax character of the DTAs and DTLs becomes a limiting factor for this component. While ordinary DTAs can be offset against both ordinary and capital DTLs, the reverse is not allowed in the tax return (see Question 4.13). In this situation, GHI can admit \$105,000 and \$252,000 of its ordinary and capital DTAs, respectively³¹.

²⁹ It should be noted that if GHI's hypothetical 20X3 carryback was insufficient to fully offset all positive taxable income in 20X1, the company would not be allowed to carryback any of the hypothetical loss from 20X4 or 20X5 to 20X1 per paragraph 11.a., as 20X1 is outside of the timeframe corresponding with the tax loss carryback provisions for a non-life insurance company.

³⁰ If GHI would not have had sufficient hypothetical NOL from 20X4 to carryback to 20X2, the company would not have been able to carryback its hypothetical NOL of \$2,000,000 from 20X5 back to 20X2 as 20X2 is outside of the timeframe corresponding with the tax loss carryback provisions for a nonlife insurance company.

³¹ GHI's required consideration of reversal patterns of temporary differences is the same as ABC's. See Question 4.18.3.

4.25 Summary of GHI's Admitted Gross DTA Calculation:

	Ordinary	Capital	Total
Gross DTAs at Enacted Tax Rate	\$1,260,000	\$525,000	\$1,785,000
Less: Statutory Valuation Allowance		\$168,000	\$168,000
Adjusted Gross DTAs at Enacted Tax Rate	\$1,260,000	\$357,000	\$1,617,000
Admitted Gross DTAs (paragraph 11.a.)	\$525,000	\$0	\$525,000
Admitted Gross DTAs (paragraph 11.b.)	\$630,000	0	\$630,000
Admitted Gross DTAs (paragraph 11.c.)	\$105,000	\$252,000	\$357,000
Total Admitted Adjusted Gross DTAs (sum of 11.a, 11.b., and 11.c)	\$1,260,000	\$252,000	\$1,512,000
Nonadmitted Adjusted Gross DTAs	\$0	\$105,000	\$352,000
Admitted DTA	\$1,260,000	\$252,000	\$1,512,000
Gross DTL	\$(588,000)	\$(252,000)	\$(840,000)
Net Admitted DTA/DTL	\$ 672,000	\$0	\$672,000

4b. Q – How is the ExDTA ACL RBC ratio calculated? [Paragraph 11.b.i.]

4.26 A – The December 31 ExDTA ACL RBC ratio is calculated in the same manner as in the ACL RBC Ratio computed in the Annual RBC Report, where Total Adjusted Capital (TAC) is divided by ACL RBC. However, for purposes of paragraph 11.b.i., TAC does not include any DTAs of the reporting entity. The ACL RBC would be the amount calculated in the Annual RBC Report.

4.27 The interim period (March 31, June 30, and September 30) ExDTA ACL RBC ratio calculation is discussed in 4.29-4.33.

4.28 For all companies, the TAC will include current period capital and surplus, excluding any DTAs of the reporting entity. Other TAC adjustments are dependent on whether the company is a Life, P&C or Health insurer.

4.29 For life companies, the AVR adjustment is calculated as a required part of the development of capital and surplus each quarter and is one of the major adjustments to TAC (added back to surplus). As noted on the illustrative interim TAC calculation in 4.33 for life companies, there are other TAC adjustments such as subsidiaries' dividend liabilities, etc., that are drawn from the quarterly statement.

4.30 For P&C and Health companies, except for the AVR and life subsidiaries' dividend liability amounts (both of which are only applicable to P&C companies with life subsidiaries), which are readily available on the quarter, the prior year's annual TAC adjustments should be used in the current quarter's TAC calculation. The P&C and Health interim TAC illustrations in 4.33 provide example details of various interim RBC TAC adjustments.

4.31 The ACL RBC used for the interim RBC calculation is the ACL RBC from the most recently filed annual statement for the most recent calendar year. For example, for June 30, 20X3, the ACL for the interim RBC calculation is taken from the 20X2 RBC Report based on the 20X2 annual statement.

4.32 In most instances, the prior year's annual ACL RBC will suffice. A company should only revise its interim ACL RBC for a material change in its risk profile when requested to do so by its domiciliary state or subject to domiciliary state approval.

4.33 The above principles are illustrated below:

Interim Life RBC Example			
Based on the 2018 Life RBC Report page LR033			
	SOURCE OF THE DATA	Reported 12/31/20X2	Interim Period 3/31/20X3
Capital and Surplus	P3, L38	\$1,800,000,000	\$1,700,000,000
Adjustments:			
AVR	P3, L24.01	60,000,000	65,000,000
Dividend Liability	P3, L6.1, L6.2 in part	0	0
Sub AVR	P3, L24.01 of subs	5,000,000	4,500,000
Sub Dividend Liability	P3, L6.1, L6.2 in part of subs	0	0
P&C Non-Tabular Discounts and/or Alien Insurance Subsidiary: Other	P&C Subs P3, L1 & L3 in part	0	0
Hedging Fair Value Adjustment	Company Records	0	0
Credit for Capital Notes	P3, L24.11	0	0
Total Adjusted Capital (TAC)	5-Year Historical Data, P22, C1, L30	1,865,000,000	1,769,500,000
Less: Deferred Tax Asset	P2, C3, L18.2	190,000,000	200,000,000
TAC ExDTA		\$1,675,000,000	\$1,569,500,000
Authorized Control Level RBC	5-Year Historical Data	\$175,000,000	\$175,000,000*
Total Adjusted Capital ExDTA/Authorized Control Level RBC		957%	897%
*ACL RBC amount for interim period is the 12/31/20X2 amount			
Interim P&C RBC Example			
(Based on the 2018 P&C RBC Report page PR026)			
	SOURCE OF THE DATA	Reported 12/31/20X2	Interim Period 3/31/20X3
Capital and Surplus	P3, C1, L37 (Ann. & Qtrly. Stmt.)	\$850,000,000	\$765,000,000
Adjustments:			
Non-Tabular Discount-Losses	SCHEDULE P P1-SUM C32, L12 (Ann. Stmt. Only)	(800,000)	(800,000)
Non-Tabular Discount-Expense	SCHEDULE P P1-SUM C33, L12 (Ann. Stmt. Only)	(60,000)	(60,000)
Discount on Medical Loss Reserves Reported as Tabular in Schedule P	Company Records	0	0

Discount on Medical Expense Reserves Reported as Tabular in Schedule P	Company Records	0	0
P&C Subs Non-Tabular Discount-Losses	SCHEDULE P P1-SUM C32, L12 (Ann. Stmt. Only)	0	0
P&C Subs Non-Tabular Discount-Expenses	SCHEDULE P P1-SUM C33, L12 (Ann. Stmt. Only)	0	0
P&C Subs Discount on Medical Loss Reserves Reported as Tabular in Schedule P	Subs' Company Records	0	0
P&C Subs Discount on Medical Expense Reserves Reported as Tabular in Schedule P	Subs' Company Records	0	0
AVR - Life Subs	Subs P3, C1, L24.01 (Ann. & Qtrly. Stmt.)	5,000,000	6,000,000
Dividend Liability - Life Subs	Subs P3 C1 L6.1 + L6.2 (Ann. & Qtrly. Stmt.)	0	0
Total Adjusted Capital	5-Year Historical Data P17, C1, L28 (Annual/Current calc. on Qtr.)	854,140,000	770,140,000
Less: Deferred Tax Asset	P2, C3, L18.2 (Ann. & Qtrly. Stmt.)	82,000,000	72,000,000
Total Adjusted Capital ExDTA	PR026 (Annual RBC Report/Current Calc. on Qtr.)	772,140,000	698,140,000
Authorized Control Level Risk-Based Capital	5-Year Historical Data P17, C1, L29 (Annual)	171,000,000	171,000,000*
Total Adjusted Capital ExDTA/Authorized Control Level Risk-Based Capital		452%	408%
*ACL RBC amount for interim period is the 12/31/20X2 amount			

Interim Health RBC Example**(Based on the 2018 Health RBC Report page XR024)**

	SOURCE OF THE DATA	Reported 12/31/20X2	Interim Period 3/31/20X3
Capital and Surplus	P3, C3, L33 (Ann. & Qtrly. Stmt.)	\$850,000,000	\$765,000,000
Adjustments:			
AVR – Life Subs	Subs' Company Records	0	0
Dividend Liability – Life Subs	Subs' Company Records	0	0
Tabular Discounts – P&C subs	Subs' Company Records	0	0
Non-Tabular Discounts – P&C Subs	Subs' Company Records	0	0

Total Adjusted Capital	5-Year Historical Data P28, C1, L14 (Annual/ Current calc. on Qtr.)	850,000,000	765,000,000
Less: Deferred Tax Asset	P2, C3, L18.2 (Ann. & Qtrly. Stmt.)	82,000,000	72,000,000
Total Adjusted Capital ExDTA	XR 24 (Annual RBC Report/Current Calc. on Qtr.)	768,000,000	693,000,000
Authorized Control Level Risk- Based Capital	5-Year Historical Data P28, C1, L15 (Annual)	171,000,000	171,000,000*
Total Adjusted Capital ExDTA/ Authorized Control Level Risk- Based Capital		449%	405%
*ACL RBC amount for interim period is the 12/31/20X2 amount			

4c. Q – What is meant by the phrase “an amount that is no greater than”? [Paragraph 11.b.ii.]

4.34 A – As discussed in question 4.11 the amount of admitted adjusted gross DTAs under paragraph 11.b.i. is also limited to an amount that is no greater than the applicable percentage of statutory capital and surplus test specified in paragraph 11.b.ii. For purposes of this test, statutory capital and surplus as shown on the statutory balance sheet of the reporting entity for the current period’s statement filed with the domiciliary state commissioner is adjusted to exclude any net DTAs, EDP equipment and operating system software and any net positive goodwill.

4.35 The phrase “an amount that is no greater than” in paragraph 11.b.ii. allows an entity to utilize an amount lower (e.g., from the reporting entity’s most recently filed statement) than what would be allowed if it utilized the amount of statutory capital and surplus adjusted to exclude any net DTAs, EDP equipment and operating system software and any net positive goodwill as required to be shown on the statutory balance sheet of the reporting entity for the current period’s statement filed with the domiciliary state commissioner. This ability to utilize a lower amount is for administrative ease if a reporting entity’s surplus is increasing.

4.36 For example, at 12/31/20X2 if adjusted capital and surplus is \$100M and at 9/30/20X2 it was \$80M, the entity may utilize the \$80M amount from the prior quarter.

4.37 If instead 12/31/20X2 adjusted capital and surplus were \$60M, the entity may not utilize the \$80M amount from the prior quarter as that would overstate the limitation under paragraph 11.b.ii.

4.38 If at 12/31/20X2 an entity’s adjusted capital and surplus was initially determined to be \$150M, the entity can still utilize that amount under paragraph 11.b.ii., if there is a late accounting adjustment that increases that amount to \$160M.

5a. Q – How is the timing of reversals of temporary differences and carryforwards determined for SSAP No. 101 purposes? [Paragraphs 7, 11.a., 11.b.i. and 12.a.]

5.1 A – The timing of temporary difference reversals is critical in determining the amount of admitted adjusted gross DTAs. Determining the reversal of temporary differences impacts the adjusted gross DTA admitted pursuant to paragraphs 11.a., 11.b.i. and potentially 11.c. of SSAP No. 101. For purposes of paragraph 11.c., determining the reversal of temporary differences is necessary only to the extent required by paragraph 7.e. as discussed in Question 4.13.

5.2 Paragraph 12.a. of SSAP No. 101 states that “For purposes of paragraph 11.a., existing temporary differences that reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years, shall be determined in accordance with paragraphs 228 and 229 of FAS 109.” The timing of reversals of temporary differences and carryforwards for purposes of paragraph 11.b. of SSAP No. 101 shall be determined under similar principles.

5.3 Paragraph 228 of FAS 109 states, in pertinent part, that “[t]he particular years in which temporary differences result in taxable or deductible amounts generally are determined by the timing of the recovery of the related asset or settlement of the related liability.” Question 1 of the FASB’s Special Report on Statement 109 provides additional guidance on scheduling. It defines “scheduling” as the analysis performed to determine the pattern and timing of the reversal of temporary differences. The FASB’s Special Report also provides certain scheduling guidelines to be followed, including the need for the method employed to be systematic and logical, that a consistent method be used for each category of temporary differences, and that a change in the method used be considered a change in accounting principle.

5.4 Assume Company A purchases its only asset for \$1,000, an asset that is admissible for statutory accounting purposes and depreciated over five years on a straight-line basis. Assume also that the asset is depreciated over seven years for tax purposes using the Modified Accelerated Cost Recovery System (MACRS). The following table summarizes the statutory and tax basis of the asset at the end of each year.

Year	Cost	Statutory Depreciation	Statutory Basis	Tax Depreciation	Tax Basis	Deductible/ (Taxable) Temporary Difference
1	\$1,000	\$200	\$800	\$143	\$857	\$57
2	-	200	600	245	612	12
3	-	200	400	175	437	37
4	-	200	200	125	312	112
5	-	200	-	89	223	223
6	-	-	-	89	134	134
7	-	-	-	89	45	45
8	-	-	-	45 ³²	-	-

5.5 At the end of year one, the Company would conclude that \$45 (\$57 - \$12) of the \$57 outstanding deductible temporary difference would reverse within one year, leaving a temporary difference of \$12 at the end of year two. However, for computing a two or three-year reversal, the Company would not project a reversal of the temporary difference by the end of year three or four as the deductible temporary difference is scheduled to increase (from \$12 to \$37 and from \$37 to \$112, respectively). If the Company had decided to sell the asset in year two, it may be appropriate to conclude that the outstanding deductible temporary difference of \$57 would reverse in year two.

³² Due to the mid-year convention applicable to most asset acquisitions for tax purposes, the asset is treated as acquired in mid-year, meaning that a seven (7) year asset is depreciated over eight (8) tax years.

5.6 A similar rationale would apply in the instance of a nonadmitted asset. Assume the same facts as aforementioned, except that the asset is nonadmitted for statutory accounting purposes. The results are summarized in tabular form below.

Year	Cost	Statutory Charge to Surplus	Statutory Basis	Tax Depreciation	Tax Basis	Deductible/ (Taxable) Temporary Difference
1	\$1,000	\$1,000	-	\$143	\$857	\$857
2	-	-	-	245	612	612
3	-	-	-	175	437	437
4	-	-	-	125	312	312
5	-	-	-	89	223	223
6	-	-	-	89	134	134
7	-	-	-	89	45	45
8	-	-	-	45	-	-

5.7 In this example, the Company has a steady decline in the deductible temporary difference that is not complicated by competing depreciation regimes. This is due to the fact that the Company took the large surplus charge when the asset was nonadmitted, thereby creating a significant deductible temporary difference. The Company would project a \$245 temporary difference reversal in year two (from \$857 to \$612), a \$175 temporary difference reversal in year three (from \$612 to \$437), and a \$125 temporary difference reversal in year four (from \$437 to \$312). Although the Company will take income statement charges for depreciation on the nonadmitted asset, the statutory basis is nonetheless zero from the moment the asset was nonadmitted. Future statutory depreciation deductions will not impact the statutory basis and have no impact on the analysis.

5.8 The above examples assume a single asset. However, the analysis becomes more complicated when the Company has hundreds or thousands of assets within its fixed asset pool. In this instance, it is expected that management will make its best estimate of the expected reversal pattern determined in a manner consistent with the grouping for measurement (see question 2 for more discussion about grouping).

5.9 As indicated above, the timing of the reversal of a particular balance sheet item will depend on the expected recovery of the related asset and liability. For example, the temporary difference associated with property & casualty loss reserves would be expected to reverse in a manner consistent with the payout pattern (“development”) of the underlying loss reserves. Historical loss development triangles may be useful in substantiating a reversal pattern. For instance, assume Company A writes two types of property and casualty policies: auto liability and workers’ compensation. The following table details the components of the statutory and tax reserves for Company A as of December 31, 20X2.³³

Private Passenger Auto Liability	Statutory Reserves	Tax Reserves	Temporary Difference
AY + 0	\$1,000	\$900	\$100
AY + 1	850	690	160
AY + 2	700	580	120
AY + 3	550	490	60
AY + 4	400	385	15
AY + 5	300	275	25
AY + 6	200	175	25
AY + 7	100	90	10

³³ Under current tax law, the loss payment period extends for more years, but the concepts illustrated herein are unchanged.

AY + 8	80	75	5
AY + 9	70	65	5
Prior	50	45	5
Total	\$4,300	\$3,770	\$530

Workers' Compensation	Statutory Reserves	Tax Reserves	Temporary Difference
AY + 0	\$1,000	\$825	\$175
AY + 1	900	800	100
AY + 2	850	770	80
AY + 3	790	695	95
AY + 4	725	610	115
AY + 5	695	600	95
AY + 6	655	575	80
AY + 7	605	545	60
AY + 8	575	505	70
AY + 9	550	495	55
Prior	505	450	55
Total	\$7,850	\$6,870	\$980

5.10 One option in analyzing the reversal of the temporary difference would be to calculate the historical loss development patterns for the two lines of business by accident year for each year in the applicable reversal period. By applying these development patterns to the individual temporary differences, the Company could estimate the expected reversal of the temporary difference as a whole for each year in the applicable reversal period.

5.11 Another option would be to apply the average development factor by line of business to each reserve for each year in the applicable reversal period. If the average one-year development factor for all accident years for auto liability and workers' compensation were 70% and 35%, respectively, the one-year temporary difference reversal would be \$371 (\$530 x 70%) for auto liability and \$343 (\$980 x 35%) for workers' compensation. The same approach could be used in determining the reversal for any other year in the applicable reversal period.

5.12 The temporary difference related to property and casualty unearned premiums is typically ~~twenty percent~~ (20%) of the outstanding statutory unearned premium reserve. If a company issues only one-year policies, it is reasonable to assume that the entire temporary difference will reverse in one year. If a company writes multi-year contracts, management will be required to estimate the percentage of the unearned premium that will be earned within each year of the applicable reversal period and apply these percentages to the outstanding temporary difference.

5.13 The reversal of the temporary difference related to life insurance reserves may require actuarial assistance, normally involving anticipated development of the statutory and tax reserves for policies issued prior to the end of the current reporting year. In computing the anticipated development, it would be expected that reasonable assumptions be used, which may include cash-flow modeling of the entity's reserves. Deferred acquisition costs on life insurance policies are amortized over prescribed periods pursuant to federal tax law. The amortization schedules should provide management with the ability to estimate the reversal for each year in the applicable reversal period with reasonable accuracy.

5.14 For those temporary differences that do not have a defined reversal period, such as unrealized losses on common stock or deferred compensation liabilities, management will need to determine when the temporary difference is "expected" to reverse. For instance, assume a company has an unrealized loss

of \$200 in its equity portfolio and that, on average, the portfolio turns over ~~twenty percent (20%)~~ per year. It would be appropriate for the company to conclude that \$40 of the temporary difference will reverse in each year in the applicable reversal period. When determining when the temporary difference would be “expected” to reverse, management should normally 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 ~~10.1~~ of SSAP No. 30R—*Unaffiliated Common Stock*.

5.15 In summary, the methodology used to develop the reversal pattern should be consistent, systematic, and rational. Although consistency is encouraged, business conditions may dictate that certain factors be given more or less weight than in previous periods. Factors to be considered include historical patterns, recent trends, and the likely impact of future initiatives (without regard to future originating temporary differences). For instance, if a company has migrated to a more efficient claims management system, outstanding reserves may be settled more quickly than historical payment patterns may indicate. A company that expects to enter into a loss portfolio transfer reinsurance transaction should consider the implications of that treaty in determining the reversal of the loss reserve temporary difference.

5b. Q – How should future originating differences impact the scheduling of temporary difference reversals during the applicable period? [Paragraphs 11.a., 11.b.i., 11.c. and 12.a]

5.16 A – Future originating differences, and their subsequent reversals, are considered in assessing the existence of future taxable income. However, they should not impact the scheduling of existing temporary difference reversals during the applicable period. Paragraph 229 of FAS 109 provides the following:

229. For some assets or liabilities, temporary differences may accumulate over several years and then reverse over several years. That pattern is common for depreciable assets. Future originating differences for existing depreciable assets and their subsequent reversals are a factor to be considered when assessing the likelihood of future taxable income (paragraph 21(b)) for realization of a tax benefit for existing deductible temporary differences and carryforwards.

6. Q – What is meant by the phrase “expected to be realized”? [Paragraph 11.b.i.]

6.1 A – A reporting entity calculates the amount of its adjusted gross DTAs and gross DTLs under paragraph 7 using the enacted tax rate. The amount of adjusted gross DTAs and gross DTLs is not recalculated under paragraph 11. The purpose of paragraph 11 is to determine the amount of adjusted gross DTAs that can be admitted in the reporting period.

6.2 An excerpt of SSAP No. 4 – *Assets and Nonadmitted Assets* indicates:

2. For purposes of statutory accounting, an asset shall be defined as: probable³⁴ future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.

6.3 The phrase “expected to be realized” encompasses a reasonable expectation as to the value of the DTAs consistent with SSAP No. 4. This means that if a reporting entity’s management expects that deductible temporary differences that reverse in the applicable period will produce a federal income tax benefit at a rate that is lower than the enacted rate, the expected rate should be taken into consideration in the determination of the amount of admitted adjusted gross DTAs under paragraph 11.b.i. In other words, available evidence causes the reporting entity to expect the asset to be realized at less than the enacted

³⁴ FASB Statement of Financial Accounting Concepts No. 6, *Elements of Financial Statements* (CON 6) states, “Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement No. 5, Accounting for Contingencies, par. 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.”

rate. In such cases, it would not be appropriate to calculate the amount of admitted adjusted gross DTAs under paragraph 11.b.i. on the basis of reversing deductible temporary differences at the enacted tax rate.

6.4 The following examples illustrate situations where the amount of admitted adjusted gross DTAs under paragraph 11.b.i. would be less than the adjusted gross DTAs calculated using deductible temporary differences reversing in the applicable period at the enacted income tax rate. The approach in these examples is to determine the tax savings that the company would expect to realize from its reversing deductible temporary differences. This is accomplished through a calculation of the company's income tax liability "with and without" these temporary differences. It is assumed that in these examples there are no prudent and feasible tax-planning strategies that would cause the entity to expect the asset to be realized at a rate different than that presented in the examples.

Example 1:

6.5 BCBS is a Blue Cross/Blue Shield Organization that expects to fully offset its regular taxable income with available section 833 (b) deductions in 20X2. Prior to considering the section 833 (b) deduction, BCBS projects \$8,000,000 of taxable income in 20X3, which includes \$3,000,000 of reversing deductible temporary differences that were part of its deferred inventory at 12/31/X2. The Company's ExDTA ACL RBC percentage is 250% and therefore it is required to use the one-year applicable period under paragraph 11.b.i.

20X3	Without Reversing Temporary Differences	With Reversing Temporary Differences
Taxable Income Before 833(b)	\$11,000,000	\$11,000,000
Reversing Temporary Differences		(3,000,000)
Net	11,000,000	8,000,000
Section 833 (b) Deduction	(11,000,000)	(8,000,000)
Taxable Income	0	0
Tax	0	0

6.6 BCBS has a 0% effective tax rate on taxable income in 20X3. Its regular taxable income is \$0, both "with and without" the \$3,000,000 reversing deductible temporary differences since the section 833 (b) deduction changes by an equal amount. Therefore, BCBS would admit zero adjusted gross DTAs under paragraph 11.b.i., before reduction for any adjusted gross DTAs admitted under paragraph 11.a. The unused amount of adjusted gross DTAs related to the 21% rate differential under paragraph 11.b.i. would be taken into account under paragraph 11.c. as part of the amount of adjusted gross DTAs, after reduction for adjusted gross DTAs admitted under paragraphs 11.a. and 11.b., that can be offset against existing gross DTLs. The same approach would be used in 20X4 and 20X5 if the Company instead qualified for the three-year applicable period under paragraph 11.b.i.

Example 2:

6.7 ABC, a company taxed as a nonlife insurance company, is projecting an income tax loss in 20X3 of \$20,000,000, which includes \$5,000,000 of reversing deductible temporary differences that were part of its deferred inventory at 12/31/X2. ABC expects to pay \$0 federal income taxes in 20X3 as a result of its tax loss. The Company's ExDTA ACL RBC percentage is 250% and therefore, it is required to use the one-year applicable period under paragraph 11.b.i.

20X3	Without Reversing Temporary Differences	With Reversing Temporary Differences
Taxable Income (Loss)	(\$15,000,000)	(\$15,000,000)
Reversing Temporary Differences		(5,000,000)
Taxable Income (Loss)	(15,000,000)	(20,000,000)
Tax	0	0

6.8 In 20X3, ABC expects to realize no tax benefit related to the \$5,000,000 of reversing deductible temporary differences since they simply increase the amount of an NOL. Its expected income tax rate for 20X3 would be 0% and ABC would have \$0 admitted adjusted gross DTAs under paragraph 11.b.i. However, if some or all of the reversing temporary differences could be absorbed in the carryback period, ABC would have an admitted adjusted gross DTA under paragraph 11.a.³⁵ The adjusted gross DTAs of \$1,050,000 (\$5,000,000 x 21%), related to ABC's reversing temporary differences, would also be available as part of its total adjusted gross DTAs, after reduction for adjusted gross DTAs admitted under paragraphs 11.a. and 11.b., that can be offset against gross DTLs in the paragraph 11.c. calculation.

6.9 If a company qualified to utilize the three-year applicable period under paragraph 11.b.i. and within that applicable period forecasted a taxable loss in one or more of the years and taxable income in the other years, the loss may be utilized in determining the with and without calculation. This loss utilization must be within the applicable period and would be limited to the amount allowed to be carried back or carried forward under applicable tax law.

7. Q – SSAP No. 101 provides that a reporting entity may admit deferred tax assets in an amount equal to federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years, including any amounts established in accordance with the provisions of SSAP No. 5R as described in paragraph 3.a. of this statement related to those periods. What is the meaning of the term “taxes paid”? [Paragraph 11.a.]

7.1 A – Under paragraph 11.a. of SSAP No. 101, the term “taxes paid” means the total tax (not including interest and penalties), that was or will be reported on the reporting entity's federal income tax returns for the applicable carryback period including any amounts established in accordance with the provision of SSAP No. 5R as described in paragraph 3.a. of SSAP No. 101 related to those periods. If a federal income tax return in the applicable carryback period has been amended, or adjusted by the IRS, “taxes paid” would reflect the impact of the amended tax return, or settlement with the IRS.

7.2 In applying the term “taxes paid” to a reporting entity that is party to a consolidated federal income tax return, the term “taxes paid” means the total federal income tax that was paid, or is expected to be paid to the common parent of the reporting entity's affiliated group, in accordance with the intercompany tax sharing agreement, with respect to the income tax years included in the applicable carryback period. “Taxes paid” includes amounts established in accordance with the provision of SSAP No. 5R as described in paragraph 3.a. of SSAP No. 101 related to those periods, including current federal income taxes payable (i.e., accrued in the entity's financial statements) related to the applicable carryback period. The ability of the reporting entity to recover (through loss or credit carrybacks) taxes that were paid to its common parent is generally governed by the terms and provisions of the affiliated group's intercompany tax sharing or tax allocation agreement.

7.3 For purposes of paragraphs 7.1 and 7.2, “taxes paid” includes both regular tax and alternative minimum tax for taxable years beginning before January 1, 2018. For taxable years beginning after

³⁵ For purposes of determining the amount of admitted adjusted gross DTAs under paragraph 11.a., ABC would look to the amount of existing temporary differences that reverse during a timeframe corresponding with the tax loss carryback provisions allowed by the applicable tax law, in this case 2 years, notwithstanding that it is limited to a one-year applicable period for purposes of paragraph 11.b.i.

December 31, 2017, the applicable carryback periods are two years for ordinary losses for entities taxed as nonlife insurance companies, and three years for capital losses for entities taxed both as nonlife and life insurance companies. Entities taxed as life insurance companies are not permitted to carryback ordinary losses arising in tax years after 2017.

8. Q – How is a company’s computation of adjusted gross and admitted adjusted gross deferred tax assets impacted if it joins in the filing of a consolidated federal income tax return? [paragraphs 7, 11, 12 and 16]

8.1 A – For purposes of determining the amount of DTAs and the amount admitted under paragraph 11, the calculation should be made on a separate company, reporting entity basis. Under paragraph 7, a reporting entity’s gross deferred tax assets and liabilities are determined by identifying its temporary differences. These temporary differences are measured using a “balance sheet” approach by comparing statutory and tax basis balance sheets for that entity. Once a reporting entity determines its gross DTAs, they are reduced for any statutory valuation allowance adjustment that may be necessary to determine the adjusted gross DTAs. The amount of adjusted gross DTAs that are admitted is determined in accordance with paragraph 11.

8.2 Under paragraph 11.a., an entity shall determine the amount of “federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years.” Such amount shall include any amounts established for tax loss contingencies in accordance with paragraph 3.a. Consistent with guidance promulgated in other EAIWG interpretations, a reporting entity that files a consolidated federal income tax return with its parent should look to the amount of taxes it paid (or were allocable to it) as a separate legal entity in determining the admitted adjusted gross DTAs under paragraph 11.a. Furthermore, the admitted adjusted gross DTAs under paragraph 11.a. may not exceed the amount that the entity could reasonably expect to have refunded by its parent (paragraph 12.c.). The taxes paid by the reporting entity represent the maximum DTAs that may be admitted under paragraph 11.a., although the amount could be reduced pursuant to the group’s tax allocation agreement.

8.3 The amount of admitted adjusted gross DTAs under paragraph 11.b.i. is limited to the amount that the reporting entity expects to realize within the applicable period (refer to the 11.b.i. column of the applicable Realization Threshold Limitation Table in paragraph 11.b.) following the balance sheet date on a separate company basis. The entity must estimate its separate company taxable income and the tax benefit that it expects to receive from reversing deductible temporary differences in the form of lower tax payments to its parent. If the reporting entity has reversing adjusted gross DTAs during the applicable period for which it does not expect to realize a benefit under paragraph 11.b. on a separate company basis, the reporting entity cannot admit an amount related to such DTAs under paragraph 11.b., even though the reporting entity may be paid a tax benefit for such items pursuant to its tax allocation agreement.

8.4 The following examples reflect this analysis and assume that the surplus limitation of paragraph 11.b.ii. is not applicable:

Example 1:

8.5 Assume Company A, an entity taxed as a nonlife insurance company, joins in the filing of a consolidated federal income tax return. Consolidated taxes paid in prior carryback years total \$150, of which Company A paid \$100. Company A has existing temporary differences that reverse by the end of the second calendar year following the balance sheet date³⁶ that, on a separate company reporting entity

³⁶ Corresponds to the timeframe permitted by the Internal Revenue Code for carrybacks of tax losses for a nonlife insurance company. For tax years beginning after 2017, entities taxed as life insurance companies are not permitted to carry back ordinary tax losses. However, entities taxed both as life insurance and nonlife insurance companies are permitted to carry back capital losses three taxable years. Accordingly, if this example involved a capital loss, it could apply either to an entity taxed as a life insurance company or as a nonlife insurance company.

basis and following the applicable carryback provisions of the Internal Revenue Code for each year in which temporary differences reverse, would give rise to a tax recovery of \$125.

8.6 Under paragraph 11.a., Company A could record an admitted DTA of \$100, equal to the taxes it paid. Due to the consolidated return filing, the \$100 admitted under paragraph 11.a. could only be admitted provided this amount could reasonably be expected to be refunded by the parent [paragraph 12.c.] and would be available pursuant to a written income tax allocation agreement [paragraph 16.b.]. Additionally, assume Company A's ExDTA ACL RBC exceeds 300%, and that it expects to realize \$175 from 3 years of DTA reversals, based on its separate company analysis. A 3-year period is applicable for paragraph 11.b.i., notwithstanding that only 2 years of DTA reversals may be taken into account under paragraph 11.a. due to tax limitations on operating loss carrybacks. In such case, Company A could admit an additional \$75 under paragraph 11.b.i. (\$175 less the \$100 admitted under paragraph 11.a.).

Example 2:

8.7 Assume the same facts as in Example 1, except consolidated taxes paid in prior carryback years that could be recovered are \$70 and, pursuant to a written income tax allocation agreement, taxes recoverable through loss carrybacks may not exceed consolidated taxes paid in prior carryback years.

8.8 In this situation, Company A would admit a DTA of \$70 under paragraph 11.a. (recoverable taxes limited to consolidated taxes paid which could be refunded by the parent). In addition, \$105 (\$175-\$70) of DTA may be admitted under paragraph 11.b.i., on the basis of Company A's separate company estimated taxable income and temporary differences that are expected to be realized within the applicable 3-year period following the balance sheet date.

Example 3:

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

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

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

9a. Q – Current income taxes are defined by paragraph 3.a. to include tax loss contingencies for current and all prior years, computed in accordance with SSAP No. 5R, including the modifications in paragraphs 3.a.i, 3.a.ii. and 3.a.iii. How does the modification provided in paragraph 3.a.iii. impact the calculation of the tax contingencies recorded?

9.1 A – Paragraph 3.a.iii. provides the following rule: If the estimated tax loss contingency is greater than 50% of the tax benefit originally recognized, the tax loss contingency recorded shall be equal to 100% of the original tax benefit recognized.

9.2 For example, assume that a company claimed a deduction in its current year federal income tax return that resulted in a \$100 permanent tax benefit³⁷. Management must assume that the tax position will be examined by a taxing authority that has full knowledge of all relevant information (paragraph 3.a.ii.). In addition, management has determined that the probability of a liability is more likely than not (a likelihood of more than 50% pursuant to paragraph 3.a.i.) and that the liability can be reasonably estimated. Management's best estimate of the loss of the tax benefit is \$40 (an amount not greater than 50% of the tax benefit originally recognized). Under these facts, the company would establish a current tax liability in the amount of \$40, increasing its current income tax expense by \$40.

DR	Current income tax expense	\$40
CR	Liability for current income tax	\$40

9.3 Assume the same facts as 9.2, except that management determines the best estimate of the liability to be \$60 (an amount greater than 50% of the tax benefit originally recorded). Under paragraph 3.a.iii., the company would be required to record a tax contingency of \$100 offsetting the entire original tax benefit recorded. Under these facts, the company would establish a current tax liability in the amount of \$100, increasing its current income tax expense by \$100.

DR	Current income tax expense	\$100
CR	Liability for current income tax	\$100

9b. Q – What impact, if any, does the inclusion of tax contingencies as a component of current income taxes have on the determination of deferred income taxes? [Paragraph 3.c.]

9.4 A – The purpose of this interpretation is to address when such contingencies should be “grossed-up” and reflected in the calculation of both statutory current and deferred federal income taxes.

9.5 Gross deferred tax assets and liabilities are determined in accordance with paragraph 7 of SSAP No. 101 and reflect the changes in temporary differences considered in estimating taxes currently payable and are manifested in the enterprise's tax basis balance sheet. If gross tax loss contingencies associated with temporary differences have been included in taxes currently payable, a corresponding adjustment must be made to the tax basis balance sheet used in the determination of gross deferred tax assets and liabilities. Deferred tax assets and liabilities are not adjusted for tax contingencies not associated with temporary differences (i.e. permanent differences).

9.6 For example, assume that a company determines, in accordance with SSAP No. 5R, including the modifications in paragraph 3.a. of SSAP No. 101, a tax loss contingency is required to be established for a \$100 deduction claimed in a prior year federal income tax return. Assuming a 21% tax rate, the company would establish a current tax liability in the amount of \$21, increasing its current income tax expense by \$21.

DR	Current income tax expense	\$21
CR	Liability for current income tax	\$21

³⁷ The treatment of tax contingencies related to temporary differences is discussed in Question 9b.

9.7 If the \$100 deduction was associated with a temporary difference such as reserves, the company would make a corresponding adjustment to deferred taxes. The company would increase its gross deferred tax asset for reserves by \$21 to reflect the future tax benefit associated with that reserve deduction. Any gross deferred tax asset recorded would still be subject to the admissibility requirements of paragraph 11.

DR	Gross deferred tax asset	\$21
CR	Change in net deferred tax (surplus)	\$21

9.8 If the \$100 deduction was associated with a permanent item such as meals and entertainment expenses, the company would make no corresponding adjustment to the deferred tax assets.

9.9 In determining the timing of when a tax loss contingency for a temporary item should be grossed up, paragraph 3.c. of SSAP No. 101 provides the following guidance:

3.c. In determining when tax loss contingencies associated with temporary differences should be included in current income taxes under Paragraph 3.a., and therefore included in deferred taxes under paragraph 7, a reporting entity is not required to “gross-up” its current and deferred taxes until such time as an event has occurred that would cause a re-evaluation of the contingency and its probability of assessment, e.g., the IRS has identified the item as one which may be adjusted upon audit. Such an event could be the reporting entity’s (or its affiliate or parent in a consolidated income tax return) receipt of a Form 5701, Proposed Audit Adjustment, or could occur earlier upon receipt of an Information Document Request. At such time, the company must reassess the probability of an adjustment, reasonably re-estimate the amount of tax contingency as determined in accordance with paragraph 3.a., make any necessary adjustment to deferred taxes, and re-determine the admissibility of any adjusted gross deferred tax asset as provided in paragraph 11.

10a. Q – If the reporting entity adjusts the amount of regular taxable income and capital gains reported on a prior year income tax return from the amount originally determined for financial reporting purposes, how is the effect of the change reported in the current year? [Paragraph 19]

10.1 A – Paragraph 19 of SSAP No. 101 indicates that “income taxes incurred or received during the current year attributable to prior years shall be allocated, to the extent not previously provided, to net income in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors* unless attributable, in whole or in part, to realized capital gains or losses, in which case, such amounts shall be apportioned between net income and realized capital gains and losses, as appropriate”. Paragraph 19 also indicates that income taxes incurred are to be allocated to ordinary income and realized capital gains consistent with paragraph 38 of FAS 109. Paragraph 38 of FAS 109 provides, in general, that the portion of the total income tax expense remaining after allocation to ordinary income would be allocated to realized capital gains or losses.

10.2 In accordance with paragraph 19, the amount of additional federal income taxes incurred in the current year with respect to the prior year would be allocated between ordinary income and realized capital gain items. The amount of additional federal income tax expense allocated to ordinary income should be determined by comparing the amount of additional tax expense actually incurred to the amount of tax expense that would have been incurred had the adjustment to ordinary income been zero (a “with and without” computation). The remaining amount of additional federal income tax expense would then be allocated to realized capital gains. The amounts of additional federal income tax expense allocated to ordinary income and realized capital gains would be included in the current period’s federal income tax expense and not as a direct adjustment to surplus.

10.3 As an example, assume Company X files its 20X1 federal income tax return and reports \$1,000,000 of taxable income comprised of \$800,000 of ordinary income and \$200,000 of capital gain

income. Since the company is subject to taxation at a 21% ~~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.

10.4 In determining the amount of “income taxes incurred” for its 20X2 financial statement, Company X must include the additional \$63,000 of income tax expense incurred on its 20X1 federal income tax return (\$210,000 actual tax incurred less \$147,000 originally reported) in net income for 20X2 pursuant to paragraph 19 of SSAP No. 101 and not as a surplus adjustment. The \$63,000 additional expense would be allocated to federal income taxes on net income and realized capital gains and losses as follows:

Total additional income tax expense	\$63,000
Tax expense allocated to operations (\$200,000 additional income x 34%)	42,000
Tax expense allocated to realized gains	\$21,000

The tax expense allocated to operations was determined as follows:

Total recomputed tax expense	\$210,000
Tax expense with only capital gain changes	168,000
Tax expense allocated to operations	\$42,000

10.5 For all purposes of computing and allocating federal income taxes between operations and capital gains and losses, the character of the income or loss item as determined for statutory accounting purposes should be followed. Thus, if an income item is treated as a capital gain for statutory accounting purposes but as ordinary income for tax purposes, the federal income tax allocable to such income would be considered tax expense attributable to capital gains.

10b. Q – What is meant by the phrase in paragraph 18 “a reporting entity’s unrealized gains and losses shall be recorded net of any allocated DTA or DTL”? [Paragraph 18]

10.6 A – Pursuant to Paragraph 18 of SSAP No. 101, a reporting entity’s unrealized gains and losses shall be recorded net of any allocated DTA or DTL in accordance with paragraph 35 of FAS 109. Paragraph 35 of FAS 109 indicates that income taxes incurred are to be allocated between various items, including gains from operations and items charged or credited directly to shareholders’ equity, such as the change in unrealized gains and losses.

10.7 To the extent a reporting entity’s admitted DTA or its DTL changes during the year, the portion of such change allocable to changes in unrealized gains and losses during the year should be determined. The portion so allocable would be reported with, and netted against, the related change in unrealized gains and losses reported as a component of changes in surplus. The remaining portion of the change in DTA or DTL allocable to other temporary differences should be reported as a separate component of changes in surplus and/or change in nonadmitted assets.

10.8 For example, assume the reporting entity has DTAs of \$1,000 relating to temporary differences other than unrealized losses, and a \$100 DTL relating to unrealized gains as of the beginning of the year. Since the entity is subject to tax at 21% ~~percent~~ and all of its DTAs are expected to reverse within one year, the entity recorded a \$900 net admitted DTA as of the beginning of the year.

10.9 During the current year, the DTAs relating to temporary differences other than unrealized losses did not change, but the DTL relating to the entity’s unrealized gains increased by \$100 (unrealized gains increased by \$476 during the year). As a result, the amount of the entity’s net admitted DTAs decreased by \$100.

10.10 Pursuant to paragraph 18 of SSAP No. 101, the \$100 decrease in the DTA during the year is to be allocated between changes attributable to temporary differences other than unrealized gains and losses and those attributable to unrealized gains and losses. Since the DTA relating to temporary differences other than unrealized gains and losses did not change during the year, the entire decrease is allocable to the change in unrealized gains. Therefore, the \$100 decrease is to be allocated and netted against the \$476 change in unrealized gains reported in change in surplus, resulting in a \$376 net increase in surplus relating to its unrealized gains. If a portion of the unrealized loss DTA is determined to be nonadmitted, that amount is not recorded separately from the operating differences DTA. The change in the total nonadmitted DTA from period to period is recorded in surplus as a Change in Nonadmitted Assets.

11. Q – How are current and deferred income taxes to be accounted for in interim periods? [Paragraphs 12.d. and 20]

11.1 A – In setting forth the methodology for the computation of current income taxes (income taxes incurred) in interim periods, paragraph 20 states:

20. Income taxes incurred in interim periods shall be computed using an estimated annual effective current tax rate for the annual period in accordance with the methodology described in paragraphs 19 and 20 of *Accounting Principles Board Opinion No. 28, Interim Financial Reporting*. Estimates of the annual effective tax rate at the end of interim periods are, of necessity, based on estimates and are subject to subsequent refinement or revision. If a reliable estimate cannot be made, the actual effective tax rate for the year-to-date may be the best estimate of the annual effective tax rate. If an insurer is unable to estimate a part of its “ordinary” income (or loss) or the related tax (or benefit) but is otherwise able to make a reliable estimate, the tax (or benefit) applicable to the item that cannot be estimated shall be reported in the interim period in which the item is reported.

11.2 As a result, to the extent a reliable estimate can be made of an expected annual effective tax rate, reporting entities should apply this rate to net income before federal and foreign income taxes, in the case of property and casualty insurers and health insurers, and net income and realized capital gains before federal and foreign income taxes in the case of life insurers. If a reliable estimate of the expected annual effective tax rate cannot be made, reporting entities should compute current and deferred taxes at interim reporting dates using the most reliable information that is available.

11.3 The following examples illustrate the estimation process for income taxes incurred using the estimated annual effective rate:

Projected statutory net income ³⁸ for current year		\$10,000,000
Estimated annual permanent differences		(2,800,000)
Estimated annual temporary differences:		2,000,000
Projected taxable income for current year		\$9,200,000
Projected federal tax for current year (at 21%)		\$1,932,000
Estimated annual effective tax rate		19.322%

³⁸ For all examples in Question 11, statutory net income represents operating and capital gain income before federal and foreign income taxes.

11.4 As a result, assuming that during the calendar year the reporting entity's expectations as to its statutory and taxable income do not change, income tax incurred will be recorded on a quarterly basis as follows:

Quarter	Statutory Income (Loss)	Income Taxes Incurred
1	\$(2,000,000)	\$(386,400)
2	4,000,000	772,800
3	6,000,000	1,159,200
4	2,000,000	386,400
Total	\$10,000,000	\$1,932,000

11.5 If the reporting entity's expectations as to its statutory and taxable income change in the second quarter so that it expects that its annual effective rate will increase from 19.32% to 20%, it will record income taxes incurred in the second quarter of \$786,400 (cumulative statutory income at end of the second quarter of \$2,000,000 at 20% or \$400,000 less \$386,400 tax benefit recorded in first quarter).

11.6 As noted above, life insurers must estimate their annual effective tax rate and record income taxes incurred based on net income and realized capital gains before federal and foreign income taxes. With regard to intraperiod tax allocation, paragraph 19 states in relevant part:

19. Income taxes incurred shall be allocated to net income and realized capital gains or losses in a manner consistent with paragraph 38 of FAS 109.

11.7 As a result of the above and where the reporting entity expects realized capital gains or losses for the annual period, income taxes incurred must be allocated using a "with and without" methodology to net income before taxes and realized capital gains (see Question 10.4 for further discussion).

11.8 An example of this "with and without" methodology is as follows:

Projected statutory net income for current year	\$10,000,000
Realized gains included above	(1,000,000)
	9,000,000
Estimated annual permanent differences:	(2,800,000)
Estimated annual temporary differences:	2,000,000
Projected ordinary taxable income for current year	\$8,200,000
Projected ordinary federal tax for current year (at 21%)	\$1,722,000
Projected capital gain federal tax for current year (at 21%)	210,000
Projected total federal tax for current year	\$1,932,000
Estimated ordinary annual effective tax rate (\$1,722,000 / \$9,000,000)	19.13%
Estimated capital gain annual effective tax rate (\$210,000 / \$1,000,000)	21.0%
Estimated total annual effective tax rate (\$1,932,000 / \$10,000,000)	19.32%

11.9 As a result, assuming that during the calendar year the reporting entity's expectations as to its statutory and taxable income (including the amounts of ordinary and capital income) do not change, income tax incurred will be recorded on a quarterly basis as follows:

Quarter	Ordinary Income (Loss)	Capital Income (Loss)	Ordinary Taxes Incurred	Capital Taxes Incurred
1	\$(1,000,000)	\$(1,000,000)	\$(191,333)	\$(210,000)
2	3,000,000	1,000,000	573,999	210,000
3	5,000,000	1,000,000	956,667	210,000
4	2,000,000	0	383,667	0
Total	\$9,000,000	\$1,000,000	\$1,722,000	\$210,000

11.10 With respect to the recording of deferred taxes on an interim basis paragraph 12.d. states:

- 12.d. The phrases “reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years,” “realized within one year of the balance sheet date” and “realized within three years of the balance sheet date” are intended to accommodate interim reporting dates and reporting entities that file on an other than calendar year basis for federal income tax purposes.

11.11 When considered in the context of paragraph 20, this paragraph requires the use of the annual effective rate when determining deferred taxes at an interim reporting date. As such, a reporting entity’s admitted adjusted gross DTAs are determined in accordance with paragraph 11 by reference to the adjusted gross DTAs that will reverse each year in the applicable period. Note however, that due to the inherent unpredictability, and general inability to project changes in capital gains and losses on a quarter by quarter basis, the deferred tax implications of the changes in unrealized gains and losses should be recorded on a discrete period basis (i.e., based on the change in the amounts on a quarter by quarter basis). For example, in determining its admitted adjusted gross DTAs at March 31, 20X2, the reversal period referred to above is calendar years 20X3, 20X4 and 20X5 (i.e., expected adjusted gross DTAs at December 31, 20X2 that are expected to reverse in 20X3, 20X4 and 20X5).

11.12 This methodology is illustrated by the following example:

In this example, XYZ Co. is a nonlife insurance company³⁹ that has a two-year carryback potential and also has an ExDTA ACL RBC percentage of 700%.

Projected statutory net income for 20X3		\$10,000,000
Estimated annual permanent differences:		(2,800,000)
Estimated annual temporary differences:		2,000,000
Projected ordinary taxable income for current year		\$9,200,000
Temporary differences at December 31, 20X2:		\$5,000,000
Estimated temporary differences at December 31, 20X3:		\$7,000,000
Taxable income in carryback period (taxes paid at 21%):		
Year ended December 31, 20X1	2,000,000	(420,000)
Year ended December 31, 20X2	3,000,000	(630,000)
Year ended December 31, 20X3	\$9,200,000	(\$1,932,000)

Note: Year ended December 31, 20X3 taxable income and taxes paid considered in the calculation of its interim tax accruals are based on the reporting entity’s estimate of its annual taxable income and taxes to be paid. This amount may differ from the quarterly federal income tax estimates it expects to make during the year.

	Reversing Period		
	20X3	20X4	20X5
December 31, 20X2 Temporary difference reversals:	\$2,000,000	\$1,500,000	\$1,500,000
	20X4	20X5	20X6
December 31, 20X3 Temporary difference reversals:	\$3,000,000	\$2,000,000	\$2,000,000

³⁹ Please note the results in this example could be different if XYZ Co. was a life insurance company because, under current Federal income tax law, life insurance companies are not permitted to carry back net operating losses. In such case, XYZ would not admit any deferred tax assets under paragraph 11.a. However, if XYZ were able to admit deferred tax assets for all of its 20X3-20X5 temporary difference reversals at December 31, 20X2 and for all of its 20X4-20X6 temporary difference reversals at December 31, 20X3 under paragraph 11.b. (based on adequate sources of projected taxable income in those reversal periods), then the results in this example would be unchanged.

Admitted deferred tax assets at December 31, 20X2:			
Paragraph 11.a.			
	20X1	\$2,000,000	
	20X2	1,500,000	
		3,500,000	
	Taxes paid at 21%		\$735,000
Paragraph 11.b.			
Paragraph 11.c.			
	Total admitted		\$1,050,000
<i>Note: The recovery of federal income taxes paid in prior years under paragraph 11.a. is calculated in this example by carrying back 20X3's temporary difference reversals of \$2,000,000 to offset 20X1's taxable income of \$2,000,000; then carrying back 20X4's temporary difference reversals of \$1,500,000 to offset \$1,500,000 of 20X2's taxable income of \$3,000,000 XYZ's projected taxable income for 20X3 (\$9,200,000) is more than adequate to allow the remaining \$315,000 of the \$1,050,000 expected to be realized from temporary difference reversals in 20X3-20X5 (\$5,000,000 x 21% = \$1,050,000) to be recognized under paragraph 11.b.</i>			
Admitted deferred tax assets at December 31, 20X3:			
Paragraph 11.a.			
	20X2	\$3,000,000	
	20X3	2,000,000	
		5,000,000	
	Taxes paid at 21%		\$1,050,000
Paragraph 11.b.			
Paragraph 11.c.			
	Total admitted		\$1,470,000
<i>Note: The recovery of federal income taxes paid in prior years under paragraph 11.a. is calculated in this example by carrying back 20X4's temporary difference reversals of \$3,000,000 to offset 20X2's taxable income of \$3,000,000; then carrying back 20X5's temporary difference reversals of \$2,000,000 to offset \$2,000,000 of 20X3's taxable income. It is assumed for this example that XYZ has more than adequate amounts of projected income for 20X4-20X6 to allow the remaining \$420,000 of the \$1,470,000 expected to be realized from temporary difference reversals in 20X4-20X6 (\$7,000,000 x 21% = \$1,470,000) to be recognized under paragraph 11.b.</i>			
Total estimated federal taxes for 20X3:			
	Income taxes incurred (current tax) (\$9,200,000 X 21%)		\$1,932,000
	Change in deferred tax (\$1,050,000 – \$1,470,000)		(420,000)
			\$1,512,000

11.13 As a result of the above, the annual effective tax rate for current and deferred income taxes is as follows:

Current (\$3,220,000/\$10,000,000)	19.32%
Deferred ((-\$700,000)/\$10,000,000)	(4.2)%
Total annual effective rate	15.12%

Quarter	Statutory Income (Loss)	Income Taxes Incurred	Deferred Taxes
1	\$(2,000,000)	\$(386,400)	\$84,000
2	4,000,000	772,800	(168,000)
3	6,000,000	1,159,200	(252,000)
4	2,000,000	386,400	(84,000)
Total	\$10,000,000	\$1,932,000	\$(420,000)

11.14 To the extent that a reporting entity's estimated year end⁴⁰ admitted adjusted gross deferred tax assets are limited by its surplus pursuant to paragraph 11.b.ii., the annual effective deferred tax rate must be adjusted to consider the impact of this limitation on a quarterly basis.

12. Q – How do you present deferred taxes in the Annual Statement? [Paragraphs 8, 18, 21-28 and 36]

12.1 A – This answer is divided into three different parts.

Unrealized Capital Gains and Losses

12.2 SSAP No. 101 paragraph 18 states:

14. In accordance with paragraph 35 of FAS 109, a reporting entity's unrealized gains and losses shall be recorded net of any allocated DTA or DTL. The amount allocated shall be computed in a manner consistent with paragraph 38 of FAS 109.

12.3 The following illustrates the presentation of such requirement in the annual statement:

Illustration A Assumptions:

12.4 Entity grouped its investments in a reasonable and consistent manner and calculated the following gross amounts attributable to appreciation and depreciation in the fair value of its common stocks during 20X2 (see question 2 regarding grouping of assets and liabilities for measurement):

	Gross	Carrying Value	Rate	Tax Effected DTA (DTL)
Common stock carrying value 1/1/X2		\$800,000		
Unrealized (loss)	(\$714,286)		21%	\$150,000
Unrealized gain	571,429		21%	(120,000)
Net (loss) gain		(142,857)		\$30,000
Common stock carrying value 12/31/X2		\$657,143		

12.5 The journal entries need to present unrealized losses and gains net of tax are:

12/31/X2	DR	Change in unrealized capital gains and losses	\$142,857
	CR	Common stock	(\$142,857)
<i>Recognition of net depreciation in FV of common stock</i>			

12/31/X2	DR	Deferred tax asset	\$150,000
	CR	Deferred tax liability	(\$120,000)
	CR	Change in deferred income taxes	(\$30,000)
<i>Recognition of gross deferred tax amounts</i>			

⁴⁰ In the previous example, year-end is December 31, 20X3.

12/31/X2	DR	Change in deferred income taxes	\$30,000
	CR	Change in unrealized capital gains and losses	(\$30,000)
		<i>Reclass tax effect of net unrealized loss per paragraph 18 of SSAP No. 101</i>	

12.6 Condensed 12/31/X2 Balance Sheet:

ASSETS	20X2	20X1	LIABILITIES, SURPLUS AND OTHER FUNDS	20X2	20X1
Common Stock	\$657,143	\$800,000	Surplus:		
Net deferred tax asset	30,000		Beginning of year	\$800,000	
			Change in UNL	(112,857) ⁴¹	
Total Assets	\$687,143	\$800,000	Liabilities & Surplus	\$687,143	\$800,000

Annual Statement Presentation

12.7 In accordance with SSAP No. 101, DTAs and DTLs shall be offset and presented as a single amount on the statement of financial position. The following illustrates this requirement:

Illustration B Assumptions:

12.8 The entity had the following balances:

	1/1/X2	12/31/X2	Change
Gross DTA	\$200,000	\$510,000	\$310,000
Statutory Valuation Allowance Adjustment	0	10,000	10,000
Adjusted Gross DTA	200,000	500,000	300,000 ⁴²
DTA Nonadmitted	25,000	150,000	125,000
Admitted Adjusted Gross DTA	175,000	350,000	175,000
Gross DTL	100,000	200,000	100,000
Net Admitted Adjusted Gross DTA	\$75,000	\$150,000	\$75,000
Current FIT Recoverable	\$18,000	\$20,000	\$2,000

12.9 Illustrative 12/31/X2 Balance Sheet for Illustration B:

ASSETS	Current Year			Prior Year
	1	2	3	4
	Assets	Nonadmitted Assets	Net Admitted Assets (Cols. 1 - 2)	Net Admitted Assets
Current Federal and foreign income tax recoverable and interest thereon	\$20,000	\$0	\$20,000	\$18,000
Net deferred tax asset	\$300,000	\$150,000	\$150,000	\$75,000

⁴¹ Computed at \$142,857 (total change in UNG/UNL) - \$30,000 tax effect.

⁴² Includes \$30,000 resulting from net unrealized losses as shown in Illustration A. As such the change in net deferred income taxes at 12/31/X2 is \$170,000 (\$300,000 (gross change in DTA) - \$100,000 (gross change in DTL) - \$30,000 reclass to net unrealized capital gains (losses)).

12.10 Illustrative 12/31/X2 Income Statement for Illustration B:

STATEMENT OF INCOME (P/C) SUMMARY OF OPERATIONS (Life & Health) STATEMENT OF REVENUES AND EXPENSES (Health)	1 Current Year	2 Prior Year
Gains and (losses) in surplus		
Change in net unrealized capital gains (losses) less capital gains tax of \$30,000	\$112,857	0
Change in net deferred income tax	\$170,000	0
Change in nonadmitted assets	(\$125,000)	0

12.11 Illustrative 12/31/X2 Exhibit of Nonadmitted Assets for Illustration B:

	1 End of Current Year	2 End of Prior Year	3 Changes for Year (Increase) Decrease
Net deferred tax asset	\$150,000	\$25,000	(\$125,000)
Total	\$150,000	\$25,000	(\$125,000)

Illustration C Assumptions:

12.12 The entity had the following balances (1/1/X2 balances carried forward from Illustration B):

	1/1/X2	12/31/X2	Change
Gross DTA	\$200,000	\$510,000	\$310,000
Statutory Valuation Allowance Adjustment	0	10,000	10,000
Adjusted Gross DTA	200,000	500,000	300,000 ⁴³
DTA Nonadmitted	25,000	150,000	125,000
Net Admitted Adjusted Gross DTA	175,000	350,000	175,000
Gross DTL	100,000	200,000	100,000
Net Admitted Adjusted Gross DTA	\$75,000	\$150,000	\$75,000
Current FIT Liability	\$7,000	\$12,000	\$5,000

12.13 Illustrative 12/31/X2 Balance Sheet for Illustration C:

ASSETS	Current Year			Prior Year
	1	2	3	4
	Assets	Nonadmitted Assets	Net Admitted Assets (Cols. 1 - 2)	Net Admitted Assets
Net deferred tax asset	\$300,000	\$150,000	\$150,000	75,000

LIABILITIES, SURPLUS AND OTHER FUNDS	1 Current Year	2 Prior Year
Current Federal and foreign income taxes (including \$0 on realized capital gains (Losses))	\$12,000	\$7,000

⁴³ Includes \$30,000 resulting from net unrealized losses as shown in Illustration A. As such the change in net deferred income taxes at 12/31/X2 is \$170,000 (\$300,000 (gross change in DTA) – \$100,000 (gross change in DTL) – \$30,000 reclass to net unrealized capital gains (losses)).

12.14 Illustrative 12/31/X2 Income Statement for Illustration C:

STATEMENT OF INCOME (P/C) SUMMARY OF OPERATIONS (Life & Health) STATEMENT OF REVENUES AND EXPENSES (Health)	1 Current Year	2 Prior Year
Gains and (losses) in surplus		
Change in net unrealized capital gains (losses) less capital gains tax of \$30,000	\$112,857	0
Change in net deferred income tax	\$170,000	0
Change in nonadmitted assets	(\$125,000)	0

12.15 Illustrative 12/31/X2 Exhibit of Nonadmitted Assets for Illustration C:

	1 End of Current Year	2 End of Prior Year	3 Changes for Year (Increase) Decrease
Net deferred tax asset	\$150,000	\$25,000	(\$125,000)
Total	\$150,000	\$25,000	(\$125,000)

Notes to the Financial Statements Disclosures:

12.16 SSAP No. 101 paragraphs 21-28 include extensive disclosure requirements. Although some of these amounts are presented on the face of the financial statements or in schedules or exhibits to the annual statement, they will be included in the Notes to the Financial Statements both in the annual statement and in the annual audited financial statements.

12.17 This section provides specific examples that illustrate the disclosures required in SSAP No. 101. The formats in the illustrations are not requirements. Some of the disclosure paragraphs of SSAP No. 101 are not specific as to whether the entity should disclose the nature of certain items or whether the entity should disclose specific amounts. The illustrations included herein use a combination of each method. The NAIC encourages a format that provides the information in the most understandable manner in the specific circumstances. The following illustrations are for a single hypothetical insurance enterprise, referred to as AlphaBeta Property & Casualty Insurance Company. All of the disclosures would be completed in the year-end annual statement and audited statutory financial statements.

12.18 Selected AlphaBeta P/C Company Financial Data at December 31, 20X2 (Balance Sheet information carried forward from Illustration B):

ASSETS	Current Year			Prior Year
	1	2	3	4
	Assets	Nonadmitted Assets	Net Admitted Assets (Cols. 1 - 2)	Net Admitted Assets
Current federal and foreign income tax recoverable and interest thereon	\$20,000	\$0	\$20,000	\$18,000
Net deferred tax asset	\$300,000	\$150,000	\$150,000	\$75,000

CAPITAL AND SURPLUS ACCOUNT	1 Current Year	2 Prior Year
Change in net unrealized capital gains (losses) less capital gains tax of \$30,000	(\$112,857)	0
Change in net deferred income tax	\$170,000	0
Change in nonadmitted assets	(\$125,000)	0

	1 End of Current Year	2 End of Prior Year	3 Changes for Year (Increase) Decrease
EXHIBIT OF NONADMITTED ASSETS			
Net deferred tax asset	\$150,000	\$25,000	(\$125,000)

STATEMENT OF INCOME	20X2
UNDERWRITING INCOME	
Premiums earned	\$5,250,000
DEDUCTIONS:	
Losses incurred	3,550,000
Loss adjustment expenses incurred	1,750,000
Other underwriting expenses incurred	525,000
Net underwriting gain (loss)	(575,000)
INVESTMENT INCOME	
Net investment gain (loss)	1,350,000
OTHER INCOME	
Total other income	125,000
Net income before dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	900,000
Dividends to policyholders	200,000
Net income, after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	700,000
Federal and foreign income taxes incurred	220,000
Net income	\$480,000

Paragraph 22 Illustration:

12.19 The components of the net DTA recognized in the Company's Assets, Liabilities, Surplus and Other Funds are as follows:

	12/31/20X2			12/31/20X1			Change		
	Ordinary	Capital	Total	Ordinary	Capital	Total	Ordinary	Capital	Total
Gross Deferred Tax Assets	\$375,000	\$135,000	\$510,000	\$93,000	\$107,000	\$200,000	\$282,000	\$28,000	\$310,000
Statutory Valuation Allowance Adjustments	0	10,000	10,000	0	0	0	0	10,000	10,000
Adjusted Gross Deferred Tax Assets	375,000	125,000	500,000	93,000	107,000	200,000	282,000	18,000	300,000
Deferred Tax Assets Nonadmitted	150,000	0	150,000	20,000	5,000	25,000	130,000	(5,000)	125,000
Subtotal Net Admitted Deferred Tax Asset	225,000	125,000	350,000	73,000	102,000	175,000	152,000	23,000	175,000
Deferred Tax Liabilities	21,000	179,000	200,000	15,000	85,000	100,000	6,000	94,000	100,000
Net Admitted Deferred Tax Asset/(Net Deferred Tax Liability)	\$204,000	(\$54,000)	\$150,000	\$58,000	\$17,000	\$75,000	\$146,000	(\$71,000)	\$75,000
Admission Calculation Components									
SSAP No. 101 (Paragraph 11)									

	12/31/20X2			12/31/20X1			Change		
	Ordinary	Capital	Total	Ordinary	Capital	Total	Ordinary	Capital	Total
a. Federal Income Taxes Paid In Prior Years Recoverable Through Loss Carrybacks.	\$85,000	\$5,000	\$90,000	\$45,000	\$5,000	\$50,000	\$40,000	0	\$40,000
b. Adjusted Gross Deferred Tax Assets Expected To Be Realized (Excluding The Amount Of Deferred Tax Assets From a, above) After Application of the Threshold Limitation. (The Lesser of b.i. and b.ii. Below)	50,000	10,000	60,000	13,000	12,000	25,000	37,000	(2,000)	35,000
i. Adjusted Gross Deferred Tax Assets Expected to be Realized Following the Balance Sheet Date.	NA	NA	60,000	NA	NA	25,000	NA	NA	35,000
ii. Adjusted Gross Deferred Tax Assets Allowed per Limitation Threshold.	NA	NA	900,000	NA	NA	750,000	NA	NA	150,000
c. Adjusted Gross Deferred Tax Assets (Excluding the Amount Of Deferred Tax Assets From a. and b. above) Offset by Gross Deferred Tax Liabilities.	90,000	110,000	200,000	15,000	85,000	100,000	75,000	25,000	100,000
Deferred Tax Assets Admitted as the result of application of SSAP No. 101.Total (a. + b. + c.)	\$225,000	\$125,000	\$350,000	\$73,000	\$102,000	\$175,000	\$152,000	\$23,000	\$175,000
	20X2 Percentage	20X1 Percentage							
Ratio Percentage Used to Determine Recovery Period and Threshold Limitation Amount ⁴⁴	600%	500%							
Amount of Adjusted Capital and Surplus Used to Determine Recovery Period And Threshold Limitation ⁴⁵	\$6,000,000	\$5,000,000	0						
The Company's tax-planning strategies include the use of reinsurance-related tax-planning strategies.									
Impact of Tax Planning Strategies	12/31/20X2			12/31/20X1			Change		
	Ordinary Percent	Capital Percent	Total Percent ⁴⁶	Ordinary Percent	Capital Percent	Total Percent	Ordinary Percent	Capital Percent	Total Percent
Adjusted Gross DTAs (% of Total Adjusted Gross DTAs)	6%	7%	13%	7%	7%	14%	-1%	0%	-1%
Net Admitted Adjusted Gross DTAs (% of Total Net Admitted Adjusted Gross DTAs)	14%	15%	29%	15%	15%	30%	-1%	0%	-1%

Paragraph 23 Illustration:

12.20 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

⁴⁴ Disclose the ratio used by the reporting entity from the applicable Realization Threshold Limitation Table in paragraph 11.b. of SSAP No. 101 to determine the appropriate limitations of paragraph 11.b. In the event that late immaterial modifications to a reporting entity's statutory financial statements occur subsequent to initial completion of the statutory financial statements but prior to filing or similar deadline, these immaterial changes do not need to be reflected in this ratio if such modifications do not cause the reporting entity to change the threshold limitation from the applicable Realization Threshold Limitation Table.

⁴⁵ Provide the amount of adjusted capital and surplus used to calculate the limitation under paragraph 11.b.ii.

⁴⁶ The total percentage should be separately calculated and is not intended to be a summation of the percentages by tax character.

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.

Paragraph 24 Illustration:

12.21 The provisions for incurred taxes on earnings for the years ended December 31 are:

	20X2	20X1
Federal	\$180,000	\$135,000
Foreign	40,000	15,000
	220,000	150,000
Federal income tax on net capital gains	52,000	36,000
Utilization of capital loss carry-forwards	(52,000)	(36,000)
Federal and foreign income taxes incurred	\$220,000	\$150,000

12.22 The tax effects of temporary differences that give rise to significant⁴⁷ portions of the deferred tax assets and deferred tax liabilities are as follows:

	12/31/20X2	12/31/20X1	Change
Deferred Tax Assets:			
Ordinary			
Discounting of unpaid losses	30,000	10,000	20,000
Unearned premium reserve	235,000	50,000	185,000
Investments	25,000	15,000	10,000
Pension accrual	65,000	15,000	50,000
Other (including items <5% of total ordinary tax assets)	20,000	3,000	17,000
Subtotal	375,000	93,000	282,000
Statutory valuation allowance adjustment	0	0	0
Nonadmitted	150,000	20,000	130,000
Admitted ordinary deferred tax assets	225,000	73,000	152,000
Capital			
Investments	125,000	45,000	80,000
Net capital loss carry-forward	10,000	62,000	(52,000)
Other (including items <5% of total capital tax assets)	0	0	0
Subtotal	135,000	107,000	28,000
Statutory valuation allowance adjustment	10,000	0	10,000
Nonadmitted	0	5,000	(5,000)
Admitted capital deferred tax assets	125,000	102,000	23,000
Admitted deferred tax assets	350,000	175,000	175,000
Deferred Tax Liabilities:			
Ordinary			
Investments	10,000	5,000	5,000
Fixed assets	6,000	5,000	1,000
Other (including items <5% of total ordinary tax liabilities)	5,000	5,000	0
Subtotal	21,000	15,000	6,000

⁴⁷ Significant is defined as any amount in excess of 5% of the total applicable DTAs or DTLs.

Capital:			
Investments	110,000	55,000	55,000
Real estate	64,000	25,000	39,000
Other (including items <5% of total capital tax liabilities)	5,000	5,000	
Subtotal	179,000	85,000	94,000
Deferred tax liabilities	200,000	100,000	100,000
Net deferred tax assets/liabilities	150,000	75,000	75,000

12.23 The change in net deferred income taxes is comprised of the following (this analysis is exclusive of nonadmitted assets as the Change in Nonadmitted Assets is reported separately from the Change in Net Deferred Income Taxes in the surplus section of the annual statement):

	Dec. 31, 20X2	Dec. 31, 20X1	Change
Adjusted gross deferred tax assets	\$500,000	\$200,000	\$300,000
Total deferred tax liabilities	200,000	100,000	100,000
Net deferred tax assets (liabilities)	\$300,000	\$100,000	200,000
Tax effect of unrealized gains (losses)			(30,000)
Change in net deferred income tax			\$170,000

Paragraph 25 Illustration⁴⁸:

12.24 The provision for federal and foreign income taxes incurred is different from that which would be obtained by applying the statutory Federal income tax rate to income before income taxes. The significant items causing this difference are as follows:

	Dec. 31, 20X2	Effective Tax Rate
Provision computed at statutory rate	\$147,000	21.0%
Tax exempt income deduction	(61,000)	(8.7)
Dividends received deduction	(50,000)	(7.1)
Tax differentials on foreign earnings	(21,000)	(3.0)
Change in statutory valuation allowance adjustment	10,000	1.4
Nondeductible goodwill	8,000	1.1
Other	7,000	2.4
Total	\$50,000	7.1%
Federal and foreign income taxes incurred	\$220,000	31.4%
Change in net deferred income taxes ⁴⁹	(170,000)	(24.3)
Total statutory income taxes	\$50,000	7.1%

Paragraph 26 Illustration:

12.25 The Company has net capital loss carryforwards which expire as follows: 20X5, \$9,000; 20X6, \$1,000.

⁴⁸ This illustration includes both the rate reconciliation and the tax effected amounts although only one of these is required to be disclosed under SSAP No. 101.

⁴⁹ As reported in the surplus section of the annual statement. The change in net deferred income taxes is before nonadmission of any DTA. The change in nonadmitted DTA is reported together with the total change in nonadmitted assets and presented as a separate component of surplus.

Paragraph 27 Illustration:

12.26 The Company believes it is reasonably possible that the liability related to any federal or foreign tax loss contingencies may significantly increase within the next 12 months. However, an estimate of the reasonably possible increase cannot be made at this time.

Paragraph 28 Illustration:

12.27 The Company is included in a consolidated federal income tax return with its parent company, Alpha Corporation. The Company has a written agreement, approved by the Company's Board of Directors, which sets forth the manner in which the total combined federal income tax is allocated to each entity which is a party to the consolidation. Pursuant to this agreement, the Company has the enforceable right to recoup federal income taxes paid in prior years in the event of future net losses, which it may incur, or to recoup its net losses carried forward as an offset to future net income subject to federal income taxes.

13. Q – How are tax-planning strategies to be considered in determining adjusted gross DTAs [Paragraph 7.e.] and admitted adjusted gross DTAs [Paragraphs 11.a., 11.b.i., 14 and 15]?

Overview:

13.1 A – Paragraph 14 of SSAP No. 101 states:

In some circumstances, there are tax-planning strategies (including elections for tax purposes) that (a) are prudent and feasible, (b) a reporting entity ordinarily might not take, but would take to prevent an operating loss or tax credit carryforward from expiring unused, and (c) would result in realization of deferred tax assets. A reporting entity shall consider tax-planning strategies in (1) determining the amount of the statutory valuation allowance adjustment necessary under paragraph 7.e. and (2) the realization of deferred tax assets when determining admission under paragraph 11...

13.2 Paragraph 248 of FAS 109 additionally states that:

Tax-planning strategies also may shift the estimated pattern and timing of future reversals of temporary differences. A tax-planning strategy to accelerate the reversal of deductible temporary differences in time to offset taxable income that is expected in an early future year might be the only means to realize a tax benefit for those deductible temporary differences if they otherwise would reverse and provide no tax benefit in some later future year(s).

13.3 As also provided in paragraph 14 of SSAP No. 101, if a tax-planning strategy is used to accelerate the reversal or realization of an item, any significant net-of-tax potential costs or losses associated with the implementation of the strategy should reduce the adjusted gross or admitted DTA.

13.4 When considering a prudent and feasible tax-planning strategy that is more likely than not to enable realization of all or part of an adjusted gross DTA or admitted DTA, paragraph 15 of SSAP No. 101 states that "paragraph 3 of this statement related to tax loss contingencies shall be applied in determining admissibility of deferred tax assets under paragraph 11 of this statement." Accordingly, a reporting entity must evaluate the likelihood, if a tax-planning strategy were implemented, of whether a tax loss contingency would be required to be recorded under paragraph 3.a. If so, the admitted tax benefit of a tax-planning strategy must be reduced by the amount of tax loss contingency so required. For example, if a tax-planning strategy provided a \$100 admitted DTA, but the reporting entity estimated that a tax loss contingency reserve of \$40 would be required if the strategy was implemented, the admitted DTA resulting from the tax-planning strategy would be reduced by \$40. Since the admitted DTA would be net of any applicable tax loss contingencies, no separate tax loss contingencies would actually be recorded for these items.

Statutory Valuation Allowance Adjustment:

13.5 As discussed in Question 2.5, future realization of gross DTAs ultimately depends on the existence of sufficient taxable income of the appropriate character within the carryback or carryforward period available under the tax law. In determining adjusted gross DTAs, a reporting entity shall consider the four sources of taxable income that may be available under the tax law, one of which is tax-planning strategies⁵⁰. As noted in paragraph 13 of SSAP No. 101, a reporting entity is not required to consider all four sources of taxable income if one or more sources are alone sufficient to support the conclusion that the entity will realize the tax benefits of its adjusted gross DTAs (i.e., a conclusion that no statutory valuation allowance is necessary). Accordingly, tax-planning strategies need not be considered if the other sources of taxable income are sufficient to realize the benefits of reversing existing DTAs. However, the reporting entity is required to consider the impact of tax planning strategies to determine the amount of the adjustment if a conclusion is reached that a statutory valuation allowance adjustment is necessary.

Tax-Planning Strategies for Admission of DTAs:

13.6 In order for a tax-planning strategy to support admission of adjusted gross DTAs under paragraph 11, the reporting entity must demonstrate that (1) the admitted DTAs would be realized either within a period that would give rise to a carryback of tax losses under the Internal Revenue Code, not to exceed three years (for admission under paragraph 11.a.), or within the applicable period (refer to the 11.b.i. column of the applicable Realization Threshold Limitation Table in paragraph 11) and (2) it would have the ability to implement the strategy. In such circumstances an entity may recognize, as admitted assets, the related DTAs that are realizable as a result of the available tax-planning strategy in accordance with paragraphs 11.a., 11.b.i. and 11.c. of SSAP No. 101. Using tax-planning strategies in determining the admissible DTA is analogous to the use of tax-planning strategies in determining the amount of the statutory valuation allowance adjustment required under paragraph 7.e. of SSAP No. 101 and paragraph 22 of FAS 109. Although a reporting entity may use tax-planning strategies in determining the portion of its adjusted gross DTAs that are admissible, it is not required to do so.

13.7 The requirement in paragraph 11.a. and 11.b.i. of SSAP No. 101 to consider only those DTAs that reverse or are realized within a period that would give rise to a carryback of losses under the Internal Revenue Code not to exceed three years (paragraph 11.a.) or within the applicable period following the balance sheet date (paragraph 11.b.i.) causes those DTAs which would otherwise reverse beyond such period to potentially provide no tax benefit (unless admitted under paragraph 11.c.). The potential reversal beyond the appropriate period is comparable to an expiring operating loss or tax credit carryforward, in that the deduction would not provide a tax benefit under SSAP No. 101. Thus, to the extent prudent and feasible tax-planning strategies exist to accelerate the reversal or realization of these DTAs, these strategies are comparable to those contemplated in paragraph 248 of FAS 109 above.

13.8 An example of a prudent and feasible tax-planning strategy is as follows:

13.9 Company A, a property/casualty insurance company for federal income tax purposes, has paid federal income taxes of \$500,000 in each of calendar years 20X1 and 20X2. The company has an ExDTA ACL RBC percentage of 250% and, therefore, is required to use the one-year applicable period under paragraph 11.b.i. of SSAP No. 101. It has capital and surplus for purposes of paragraph 11.b.ii. of SSAP No. 101 of \$20,000,000. Company A has an obligation to provide post-retirement health benefits to its employees. At December 31, 20X2, Company A has included a liability for \$1,000,000 on its statutory-basis financial statements for post-retirement health benefits. This liability is not currently deductible for federal income tax purposes, and only \$25,000 reverses within each of the next two calendar years. This is Company A's only DTA under SSAP No. 101, and there are no DTLs. Company

⁵⁰ See paragraph 13 of SSAP No. 101 and paragraph 21 of FAS 109. Examples of tax-planning strategies as provided in paragraph 13.d. are (1) accelerate taxable amounts to utilize expiring carryforward, (2) change the character of taxable or deductible amounts from ordinary income or loss to capital gain or loss, and (3) switch from tax-exempt to taxable investments.

A, absent any tax- planning strategies, would compute a DTA of \$210,000 ($\$1,000,000 \times 21\%$), and would admit \$10,500 ($\$50,000 \times 21\%$) under paragraph 11.a., and has no additional admitted DTA under paragraph 11.b.

13.10 Company A could implement a welfare benefit fund for tax purposes and contribute assets to the fund to cover qualifying welfare benefits. The contribution, subject to limitations, would be deductible for federal income tax purposes, and would have the effect of accelerating the deduction for Company A's post-retirement health benefits. Company A has computed that \$300,000 could be contributed during 20X3 to the welfare benefit fund, and to implement this strategy, it would cost \$15,000 on an after-tax basis. Company A management believe that this strategy is prudent and feasible, and the Company would be able to implement this strategy if necessary. Company A would be able to admit an additional \$48,000 of DTAs ($\$300,000 \times 21\%$, or \$63,000, less \$15,000 in costs) under paragraph 11.a., with no additional admitted DTA under paragraph 11.b.

13.11 A tax-planning strategy would not be considered prudent or feasible if use of the strategy would be inconsistent with assumptions inherent in statutory or other accounting basis financial statements. For instance, a tax-planning strategy to sell securities identified as "held to maturity" for GAAP-basis financial statements at a loss would not be prudent or feasible. Additionally, if a potential tax planning strategy were to involve selling debt securities at a loss, it would not be prudent or feasible if the securities had not been identified as impaired and the loss recognized for statutory-basis financial statements. Additionally, a tax-planning strategy that could not be implemented to realize a tax benefit within the requisite period following the balance sheet date or is inconsistent with management's business plan objectives would not be prudent and/or feasible.

Not for Distribution

Statement of Statutory Accounting Principles No. 102

Pensions

STATUS

Type of Issue.....	Common Area
Issued	Finalized March 3, 2012
Effective Date	January 1, 2013
Affects.....	Supersedes SSAP No. 89; Nullifies INT 99-26, INT 01-16, INT 03-18, INT 04-03, INT 04-12 and INT 13-03
Affected by.....	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS.....	1
SCOPE OF STATEMENT.....	2
SUMMARY CONCLUSION	2
Defined Benefit Plans	2
Single-Employer Defined Benefit Pension Plans	2
Elements of Pension Accounting	3
Recognition of Net Periodic Pension Cost.....	3
Recognition of Liabilities and Assets	6
Measurement of Cost and Obligations	6
Measurement of Plan Assets	9
Employers with Two or More Plans	10
Annuity Contracts	10
Other Contracts with Insurance Companies.....	11
Defined Benefit Plans – Settlements and Curtailments	11
Curtailment	11
Relationship of Settlements and Curtailments to Other Events	11
Accounting for Settlement of the Pension Obligation	12
Accounting for a Plan Curtailment	12
Termination Benefits	13
Disclosures – Single-Employer Defined Benefit Plans	13
Disclosures – Employers with Two or More Defined Benefit Plans	16
Interim Financial Disclosures –Defined Benefit Plans	16
Defined Contribution Plans.....	17
Disclosures - Defined Contribution Plans.....	17
Multiemployer Plans.....	17
Disclosures - Multiemployer Plans.....	18
Multiple-Employer Plans	18
Non-U.S. Pension Plans	18
Business Combinations.....	19
Consolidated/Holding Company Plans	19
Relevant Literature.....	19

Effective Date and Transition	21
REFERENCES.....	24
Other	24
Relevant Issue Papers	25
EXHIBIT A - CHANGES IN THE MEASUREMENT DATE AND PLAN SETTLEMENT.....	94

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles and related reporting for employers' pension obligations.
2. This statement establishes financial accounting and reporting standards for an insurer that offers pension benefits to its employees. Ordinarily, such benefits are periodic pension payments to retired employees or their survivors, but they may also include benefits payable as a single lump sum and other types of benefits, such as death benefits provided through a pension plan. (This statement does not apply to life insurance benefits provided outside a pension plan or postretirement health and welfare benefits.) Arrangements to provide pension benefits may take a variety of forms and may be financed in different ways. This statement applies to any arrangement that is similar in substance to a pension plan regardless of form or financing. This statement applies to a written plan and to a plan whose existence may be implied from a well-defined, although perhaps unwritten, practice of paying postretirement benefits. This statement supersedes the guidance in *SSAP No. 89—Accounting for Pensions, A Replacement of SSAP No. 8*, nullifies and incorporates the guidance in *INT 99-26: Offsetting Pension Assets and Liabilities*, and *INT 04-12: Determining the Classification and Benefit Attribution Method for a "Cash Balance" Pension Plan*, and nullifies *INT 01-16: Measurement Date for SSAP No. 8 Actuarial Valuations*, *INT 03-18: Accounting for a Change in the Additional Minimum Liability in SSAP No. 8—Pensions* and *INT 04-03: Clarification for Calculating the Additional Minimum Pension Liability under SSAP No. 89—Accounting for Pensions, A Replacement of SSAP No. 8, paragraph 16.f.* This statement also modifies *INT 04-17: Impact of Medicare Modernization on Postretirement Benefits* to remove reference to pensions as this interpretation only addresses postretirement benefits other than pensions.

SUMMARY CONCLUSION

Defined Benefit Plans

Single-Employer Defined Benefit Pension Plans

3. A defined benefit pension plan is one that defines an amount of pension benefit to be provided, usually as a function of one or more factors such as age, years of service, or compensation. (Hybrid pension plans that refer to an account balance, rather than a monthly annuity at retirement (also known as cash balance plans) are considered defined benefit plans for purposes of applying this statement.) For defined benefit plans, reporting entities shall adopt *FAS 158: Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (FAS 158) and *FASB Staff Position FAS 136(R)-1, Employers' Disclosures about Postretirement Benefit Plan Assets* (FSP FAS 136(R)-1) with modifications as discussed within paragraph 87.
4. A pension benefit is part of the compensation paid to an employee for services. In a defined benefit pension plan, the employer promises to provide, in addition to current wages, retirement income payments in future years after the employee retires or terminates service. Generally, the amount of benefit to be paid depends on a number of future events that are incorporated in the plan's benefit formula, often including how long the employee and any survivors live, how many years of service the employee renders, and the employee's compensation in the years immediately before retirement or termination. In

most cases, services are rendered over a number of years before an employee retires and begins collecting the pension. Even though the services rendered by an employee are complete and the employee has retired, the total amount of benefit that the employer has promised and the cost to the employer of the services rendered are not precisely determinable but can only be estimated using the benefit formula and estimates of the relevant future events, many of which the employer cannot control.

Elements of Pension Accounting

5. Net periodic pension cost is made up of several components that reflect different aspects of the employer's financial arrangements as well as the cost of benefits earned by employees. The cost of a benefit can be determined without regard to how the employer decides to finance the plan. The service cost component of net periodic pension cost is the actuarial present value of benefits attributed by the plan's benefit formula to services rendered by employees during the period. The service cost component is conceptually the same for an unfunded plan, a plan with minimal funding, and a well-funded plan. The other components of net periodic pension cost are interest cost (interest on the projected benefit obligation, which is a discounted amount), actual¹ return on plan assets, amortization of any prior service cost or credit included in unassigned funds (surplus), and gain or loss, which includes, to the extent recognized, amortization of the net gain or loss included in unassigned funds (surplus) (refer to paragraph 24).

6. The projected benefit obligation is the actuarial present value of all benefits attributed by the plan's benefit formula to employee service rendered prior to that date. The projected benefit obligation is measured using an assumption as to future compensation levels if the pension benefit formula is based on those future compensation levels. The projected benefit obligation is a measure of benefits attributed to service to date assuming that the plan continues in effect and that estimated future events (including compensation increases, turnover, and mortality) occur.

7. The accumulated benefit obligation is the actuarial present value of benefits attributed by the pension benefit formula to employee service rendered prior to that date and based on current and past compensation levels. The accumulated benefit obligation differs from the projected benefit obligation in that it includes no assumption about future compensation levels. For plans with flat-benefit or non-pay-related pension benefit formulas, the accumulated benefit obligation and the projected benefit obligation are the same.

8. Plan assets are assets that have been segregated and restricted to provide for pension benefits. The amount of plan assets includes amounts contributed by the employer and amounts earned from investing the contributions, less benefits paid. Assets not segregated in a trust or otherwise effectively restricted so that they cannot be used by the employer for other purposes are not considered plan assets even though it may be intended that such assets be used to provide for pension benefits. Amounts accrued by the employer but not yet paid to the plan are also not considered plan assets. Securities of the employer held by the plan are includable in plan assets provided they are transferable.

Recognition of Net Periodic Pension Cost

9. The following components shall be included in the net pension cost for a period by an employer sponsoring a defined benefit pension plan: a) Service cost; b) Interest cost; c) Actual return on plan assets;

¹ To address a question on how the expected return on plan assets affects the determination of net periodic pension cost if the actual return on plan assets for a period is a component of net periodic pension cost, it is noted that the expected return on plan assets generally will be different from the actual return on plan assets for the year. This statement provides for recognition of that difference (a net gain or loss) in unassigned funds in the period it arises. The amount recognized in unassigned funds is also a component of net periodic pension cost for the current period. Thus, the amount recognized in unassigned funds and the actual return on plan assets, when aggregated, equal the expected return on plan assets. The amount recognized in unassigned funds affects future net periodic pension cost through subsequent amortization, if any, of the net gain or loss. (This footnote reflects guidance included in E12 of FSP FAS 158-1.)

d) Amortization of any prior service cost or credit included in unassigned funds (surplus); e) Gain or loss (including the effects of changes in assumptions) to the extent recognized; and f) Amortization of any net transition asset or obligation existing at the date of initial application of this statement and remaining in unassigned funds (surplus).

Service Cost

10. The service cost component recognized in a period shall be determined as the actuarial present value of benefits attributed by the pension benefit formula to employee service (including both vested and nonvested employees) during that period.

11. The prior service cost for nonvested employees not previously recognized² is not required to be included in net periodic pension cost entirely in the year this standard is adopted. Unrecognized prior service cost for nonvested employees shall be amortized as a component of net periodic pension cost by assigning an equal amount to each expected future period of service before vesting occurs for nonvested employees active at the date of the amendment. Unassigned funds (surplus) is adjusted each period as prior service cost is amortized ~~(refer to paragraphs 91-93 for transition guidance related to the recognition of the prior service cost for nonvested employees though unassigned surplus).~~

Interest Cost

12. The interest cost component recognized in a period shall be determined as the increase in the projected benefit obligation due to the passage of time. Measuring the projected benefit obligation as a present value requires accrual of an interest cost at rates equal to the assumed discount rates.

Actual Return on Plan Assets

13. For a funded plan, the actual return on plan assets shall be determined based on the fair value of plan assets at the beginning and the end of the period, adjusted for contributions and benefit payments.

Prior Service Cost

14. Plan amendments (including initiation of a plan) often include provisions that grant increased benefits based on services rendered in prior periods. Because plan amendments are granted with the expectation that the employer will realize economic benefits in future periods, the cost of providing such retroactive benefits (prior service cost) is not required to be included in net periodic pension cost entirely in the year of the amendment but provides for recognition during the future service periods of those employees active at the date of the amendment who are expected to receive benefits under the plan.

15. A plan amendment that retroactively increases benefits (including benefits that are granted to retirees) increases the projected benefit obligation. The cost of the benefit improvement shall be recognized as a charge to unassigned funds (surplus) at the date of the amendment. Except as specified in paragraphs 16-17, that prior service cost shall be amortized as a component of net periodic pension cost by assigning an equal amount to each future period of service of each employee active at the date of the amendment who is expected to receive benefits under the plan. If all or almost all of a plan's participants are inactive, the cost of retroactive plan amendments affecting benefits of inactive participants shall be amortized based on the remaining life expectancy of those participants instead of based on the remaining service period. Unassigned funds (surplus) is adjusted each period as prior service cost is amortized.

² The previous statutory accounting guidance in *SSAP No. 89—Accounting for Pensions, A Replacement of SSAP No. 8* excluded nonvested employees from the service cost calculation. This exclusion has been eliminated with the issuance of this SSAP.

16. Consistent use of an alternative approach that more rapidly amortizes the cost of retroactive amendments is acceptable. For example, a straight-line amortization of the cost over the average remaining service period of employees expected to receive benefits under the plan is acceptable. The alternative method used shall be disclosed.

17. In some situations, a history of regular plan amendments and other evidence may indicate that the period during which the employer expects to realize economic benefits from an amendment granting retroactive benefits is shorter than the entire remaining service period of the active employees. Identification of such situations requires an assessment of the individual circumstances and the substance of the particular plan situation. In those circumstances, the amortization of prior service cost shall be accelerated to reflect the more rapid expiration of the employer's economic benefits and to recognize the cost in the periods benefited.

18. A plan amendment that retroactively reduces, rather than increases, benefits decreases the projected benefit obligation. The reduction in benefits shall be recognized as a credit (prior service credit) to unassigned funds (surplus) that shall be used first to reduce any remaining prior service cost included in unassigned funds (surplus). Any remaining prior service credit shall be amortized as a component of net periodic pension cost on the same basis as the cost of a benefit increase.

Gains and Losses

19. Gains and losses are changes in the amount of either the projected benefit obligation or plan assets resulting from experience different from that assumed and from changes in assumptions. This statement does not distinguish between those sources of gains and losses. Gains and losses include amounts that have been realized, as well as amounts that are unrealized. Because gains and losses may reflect refinements in estimates as well as real changes in economic values and because some gains in one period may be offset by losses in another or vice versa, recognition of gains and losses as components of net pension cost of the period in which they arise is not required. Gains and losses that are not recognized immediately as a component of net periodic pension cost shall be recognized as increases or decreases in unassigned funds (surplus) as they arise.

20. The expected return on plan assets shall be determined based on the expected long-term rate of return on plan assets and the fair value of plan assets.

21. Asset gains and losses are differences between the actual return on assets during a period and the expected return on assets for that period. Asset gains and losses include changes reflected in the fair value of assets.

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.

23. Any systematic method of amortizing gains or losses may be used in lieu of the minimum specified in paragraph 22 provided that (a) the minimum is used in any period in which the minimum amortization is greater (reduces the net balance included in unassigned funds (surplus) by more), (b) the method is applied consistently, (c) the method is applied similarly to both gains and losses, and (d) the method used is disclosed.

24. The gain or loss component of net periodic pension cost shall consist of (a) the difference between the actual return on plan assets and the expected return on plan assets and (b) amortization of the net gain or loss included in unassigned funds (surplus).

Recognition of Liabilities and Assets

25. If the projected benefit obligation (considering both vested and nonvested participants) exceeds the fair value of plan assets, the employer shall recognize in its statement of financial position a liability that equals the unfunded projected benefit obligation. If the fair value of plan assets exceeds the projected benefit obligation, the employer shall recognize in its statement of financial position an asset that equals the overfunded projected benefit obligation. This prepaid asset resulting from the excess of the fair value of plan assets over the projected benefit obligation shall be nonadmitted.

26. If multiple single-employer plans exist, the employer shall aggregate the statuses of all overfunded plans and recognize that amount as an asset in its statement of financial position. It also shall aggregate the statuses of all underfunded plans and recognize that amount as a liability in its statement of financial position. It is not acceptable statutory accounting practice to offset pension or postretirement benefits other than pensions liability generated by one plan against the prepaid assets of another plan.

27. The asset or liability that is recognized pursuant to paragraph 25 may result in a temporary difference, as defined in *SSAP No. 101—Income Taxes*. The deferred tax effects of any temporary differences shall be recognized in income tax expense or benefit for the year and shall be allocated pursuant to SSAP No. 101.

28. If a new determination of the funded status of a plan to be recognized as an asset or a liability in the employer's statement of financial position is made, or when net gains or losses, prior service costs or credits, or the net transition asset or obligation existing at the date of initial application of this statement are amortized as components of net periodic pension cost, the related balances for those net gains or losses, prior service costs or credits, and transition asset or obligation in unassigned funds (surplus) shall be adjusted as necessary and reported in unassigned funds (surplus).

Measurement of Cost and Obligations

29. The service component of net periodic pension cost, the projected benefit obligation, and the accumulated benefit obligation are based on an attribution of pension benefits to periods of employee service and on the use of actuarial assumptions to calculate the actuarial present value of those benefits. Actuarial assumptions reflect the time value of money (discount rate) and the probability of payment (assumptions as to mortality, turnover, early retirement, and so forth).

Attribution

30. Pension benefits ordinarily shall be attributed to periods of employee service based on the plan's benefit formula to the extent that the formula states or implies an attribution. In some situations a history of regular increases and other evidence may indicate that an employer has a present commitment to make future amendments and that the substance of the plan is to provide benefits attributable to prior service that are greater than the benefits defined by the written terms of the plan. In those situations, the substantive commitment shall be the basis for the accounting, and the existence and nature of the commitment to make future amendments shall be disclosed.

31. In some situations a history of regular increases in non-pay-related benefits or benefits under a career-average-pay plan and other evidence may indicate that an employer has a present commitment to make future amendments and that the substance of the plan is to provide benefits attributable to prior service that are greater than the benefits defined by the written terms of the plan. In those situations, the

substantive commitment shall be the basis for the accounting, and the existence and nature of the commitment to make future amendments shall be disclosed.

32. Some plans may have benefit formulas that attribute all or a disproportionate share of the total benefits provided to later years of service, thereby achieving in substance a delayed vesting of benefits. For such plans the total projected benefit shall be considered to accumulate in proportion to the ratio of the number of completed years of service to the number that will have been completed when the benefit is first fully vested. If a plan's benefit formula does not specify how a particular benefit relates to services rendered, the benefit shall be considered to accumulate as follows:

- a. For benefits of a type includable in vested benefits, in proportion to the ratio of the number of completed years of service to the number that will have been completed when the benefit is first fully vested.
- b. For benefits of a type not includable in vested benefits, in proportion to the ratio of completed years of service to total projected years of service.

Assumptions

33. Each significant actuarial assumption used shall reflect the best estimate solely with respect to that individual assumption. All assumptions shall presume that the plan will continue in effect in the absence of evidence that it will not continue.

34. Assumed discount rates shall reflect the rates at which the pension benefits could be effectively settled. It is appropriate in estimating those rates to look to available information about rates implicit in current prices of annuity contracts that could be used to effect settlement of the obligation. In making those estimates, employers may also look to rates of return on high-quality fixed-income investments currently available and expected to be available during the period to maturity of the pension benefits. Assumed discount rates are used in measurements of the projected, accumulated, and vested benefit obligations and the service and interest cost components of net periodic pension cost.

35. The objective of selecting assumed discount rates using the method noted in paragraph 34 is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash flows to pay the pension benefits when due. Notionally, that single amount, the projected benefit obligation, would equal the fair value of a portfolio of high-quality zero-coupon bonds whose maturity dates and amounts would be the same as the timing and amount of the expected future benefit payments. Because cash inflows would equal cash outflows in timing and amount, there would be no reinvestment risk in the yields to maturity of the portfolio. However, in other than a zero coupon portfolio, such as a portfolio of long-term debt instruments that pay semiannual interest payments or whose maturities do not extend far enough into the future to meet expected benefit payments, the assumed discount rates (the yield to maturity) need to incorporate expected reinvestment rates available in the future. Those rates shall be extrapolated from the existing yield curve at the measurement date. The determination of the assumed discount rate is separate from the determination of the expected rate of return on plan assets whenever the actual portfolio differs from the hypothetical portfolio above. Assumed discount rates shall be reevaluated at each measurement date. If the general level of interest rates rises or declines, the assumed discount rates shall change in a similar manner.

36. Interest rates vary depending on the duration of investments; for example, U.S. Treasury bills, 7-year bonds and 30-year bonds have different interest rates. Thus, the weighted-average discount rate (interest rate) inherent in the prices of annuities (or a dedicated bond portfolio) will vary depending on the length of time remaining until individual benefit payment dates. A plan covering only retired employees would be expected to have significantly different discount rates from one covering a work force of 30-

year-olds. A properly weighted average rate can be used for aggregate computations such as the service cost and interest cost component of net pension cost for the period.

37. In addition to a properly weighted average rate, as stated in paragraph 36, an entity may elect to measure the service cost and interest cost components of net periodic benefit cost by using individual spot rates derived from an acceptable high-quality corporate bond yield curve and matched with separate cash flows for each future year (also known as the spot rate approach). If the election is made to switch from a weighted-average approach to the spot rate approach, this approach shall be consistently applied to all defined benefit plans and to the measurement of both service and interest cost. This change shall be reflected as a change in estimate as prescribed in *SSAP No. 3—Accounting Changes and Corrections of Errors* and once changed; the company should not revert back to the weighted-average discount rate in future periods. This change in estimate shall be appropriately disclosed in accordance with this statement, SSAP No. 3 and the Preamble.

38. An insurance company deciding on the price of an annuity contract will consider the rates of return available to it for investing the premium received and the rates of return expected to be available to it for reinvestment of future cash flows from the initial investment during the period until benefits are payable. That consideration is indicative of a relationship between rates inherent in the prices of annuity contracts and rates available in investment markets. It would be appropriate for employers to consider that relationship and information about investment rates in estimating the discount rates required for application of this statement.

39. The expected long-term rate of return on plan assets shall reflect the average rate of earnings expected on the funds invested or to be invested to provide for the benefits included in the projected benefit obligation. In estimating that rate, appropriate consideration should be given to the returns being earned by the plan assets in the fund and the rates of return expected to be available for reinvestment. The expected long-term rate of return on plan assets is used to compute the expected return on assets.

40. The service cost component of net periodic pension cost and the projected benefit obligation shall reflect future compensation levels to the extent that the pension benefit formula defines pension benefits wholly or partially as a function of future compensation levels. Future increases for which a present commitment exists shall be similarly considered. Assumed compensation levels shall reflect an estimate of the actual future compensation levels of the individual employees involved, including future changes attributed to general price levels, productivity, seniority, promotion, and other factors. All assumptions shall be consistent to the extent that each reflects expectations of the same future economic conditions, such as future rates of inflation. Measuring service cost and the projected benefit obligation based on estimated future compensation levels entails considering indirect effects, such as changes under existing law in social security benefits or benefit limitations that would affect benefits provided by the plan.

41. The accumulated benefit obligation shall be measured based on employees' history of service and compensation without an estimate of future compensation levels. Excluding estimated future compensation levels also means excluding indirect effects of future changes such as increases in the social security wage base. In measuring the accumulated benefit obligation, projected years of service shall be a factor only in determining employees' expected eligibility for particular benefits, such as:

- a. Increased benefits that are granted provided a specified number of years of service are rendered
- b. Early retirement benefits
- c. Death benefits
- d. Disability benefits

42. Automatic benefit increases specified by the plan (for example, automatic cost-of-living increases) that are expected to occur shall be included in measurements of the projected, accumulated, and vested benefit obligations, and the service cost component. Also, retroactive plan amendments shall be included in the computation of the projected and accumulated benefit obligations once they have been contractually agreed to, even if some provisions take effect only in future periods.

Measurement of Plan Assets

43. Plan investments, whether equity or debt securities, real estate, or other, shall be measured at their fair value as of the measurement date. The fair value of an investment shall be reduced by brokerage commissions and other costs normally incurred in a sale, if those costs are significant (similar to fair value less costs to sell).

44. Plan assets used in plan operations (for example, buildings, equipment, furniture and fixtures, and leasehold improvements) shall be measured at cost less accumulated depreciation or amortization for all purposes.

45. The measurements of plan assets and benefit obligations shall be as of the date of the employer's fiscal year-end statement of financial position. Requiring that the pension measurements be as of a particular date is not intended to require that all procedures be performed after that date. As with other financial statement items requiring estimates, much of the information can be prepared as of an earlier date and projected forward to account for ~~subsequent~~ events occurring between the most recent valuation date and the plan's year end (for example, employee service and benefit payments). Unless a business entity remeasures both its plan assets and benefit obligations during the fiscal year, the funded status it reports in its interim-period statement of financial position shall be the same asset or liability recognized in the previous year-end statement of financial position adjusted for (1) subsequent accruals of net periodic pension cost that exclude the amortization of amounts previously recognized in other unassigned funds (surplus) (for example, subsequent accruals of service cost, interest cost, and return on plan assets) and (2) contributions to a funded plan, or benefit payments. Sometimes, a business entity remeasures both plan assets and benefit obligations during the fiscal year. That is the case, for example, when a significant event such as a plan amendment, settlement, or curtailment occurs that calls for a remeasurement. Upon remeasurement, a business entity shall adjust its statement of financial position in a subsequent interim period to reflect the overfunded or underfunded status of the plan consistent with that measurement date.

46. If a significant event caused by the employer (such as a plan amendment, settlement, or curtailment) that requires an employer to re-measure both plan assets and benefit obligations does not coincide with a month-end, the employer may elect to re-measure plan assets and benefit obligations using the month-end that is closest to the date of the significant event. This re-measurement would not eliminate the requirement for a year-end measurement of plan assets and benefit obligations required in paragraph 45.

47. If an employer re-measures plan assets and benefit obligations during the fiscal year in accordance with paragraph 46, the employer shall adjust the fair value of plan assets and the actuarial present value of benefit obligations for any effects of the significant event that may or may not be captured in the month-end measurement (for example, if the closest month-end is before the date of a partial settlement, then the measurement of plan assets may include assets that are no longer part of the plan). An employer shall not adjust the fair value of plan assets and the actuarial present value of benefit obligations for other events occurring between the month-end date used to re-measure plan assets and benefit obligations and the employer's fiscal year-end that may be significant to the measurement of defined benefit plan assets and obligations, but are not caused by the employer (for example, changes in market prices or interest rates).

48. Measurements of net periodic pension cost for both interim and annual financial statements shall be based on the assumptions used for the previous year-end measurements unless more recent

measurements of both plan assets and obligations are available or a significant event occurs, such as a plan amendment, that would ordinarily call for such measurements.

Employers with Two or More Plans

49. An employer that sponsors two or more separate defined benefit pension plans shall determine net periodic pension cost, liabilities, and assets by separately applying the provisions of this statement to each plan. In particular, unless an employer clearly has a right to use the assets of one plan to pay benefits of another, a liability required to be recognized for one plan shall not be reduced or eliminated because the employer has recognized an asset for another plan that has assets in excess of its projected benefit obligation. (As noted within paragraph 26, overfunded plans shall be aggregated for asset reporting (nonadmitted) and underfunded plans shall be aggregated for liability reporting.)

Annuity Contracts

50. An annuity contract is a contract in which an insurance company unconditionally undertakes a legal obligation to provide specified benefits to specific individuals in return for a fixed consideration or premium. An annuity contract is irrevocable and involves the transfer of significant risk from the employer to the insurance company. Some annuity contracts ~~(participating annuity contracts)~~ include participation rights (participating annuity contract), which provide that the purchaser (either the plan or the employer) may participate in the experience of the insurance company. Under those contracts, the insurance company ordinarily pays dividends to the purchaser. If the substance of a participating annuity contract is such that the employer remains subject to all or most of the risks and rewards associated with the benefit obligation covered and the assets transferred to the insurance company, that contract is not an annuity contract for purposes of this statement.

51. To the extent that benefits currently earned are covered by annuity contracts, the cost of those benefits shall be the cost of purchasing the contracts, except as provided in paragraph 54. That is, if all the benefits attributed by the plan's benefit formula to service in the current period are covered by nonparticipating annuity contracts, the cost of the contracts determines the service cost component of net pension cost for that period.

52. Benefits provided by the pension benefit formula beyond benefits provided by annuity contracts (for example, benefits related to future compensation levels) shall be accounted for according to the provisions of this statement applicable to plans not involving insurance contracts.

53. Benefits covered by annuity contracts shall be excluded from the projected benefit obligation and the accumulated benefit obligation. Except as provided in paragraph 54, annuity contracts shall be excluded from plan assets.

54. Some annuity contracts provide that the purchaser (either the plan or the employer) may participate in the experience of the insurance company. Under those contracts, the insurance company ordinarily pays dividends to the purchaser, the effect of which is to reduce the cost of the plan. The purchase price of a participating annuity contract ordinarily is higher than the price of an equivalent contract without participation rights. The difference is the cost of the participation right. The cost of the participation right shall be recognized at the date of purchase as a nonadmitted asset. In subsequent periods, the participation right shall be nonadmitted and measured at its fair value if the contract is such that fair value is reasonably estimable. Otherwise, the participation right shall be measured at its amortized cost (not in excess of its net realizable value), and the cost shall be amortized systematically over the expected dividend period under the contract.

Other Contracts with Insurance Companies

55. Insurance contracts that are in substance equivalent to the purchase of annuities shall be accounted for as such. Other contracts with insurance companies shall be accounted for as investments and measured at fair value. For some contracts, the best available evidence of fair value may be contract value. If a contract has a determinable cash surrender value or conversion value, that is presumed to be its fair value.

Defined Benefit Plans – Settlements and Curtailments

56. A settlement is defined as a transaction that (a) is an irrevocable action, (b) relieves the employer (or the plan) of primary responsibility for a pension benefit obligation, and (c) eliminates significant risks related to the obligation and the assets used to effect the settlement. Examples of transactions that constitute a settlement include (a) making lump-sum cash payments to plan participants in exchange for their rights to receive specified pension benefits and (b) purchasing nonparticipating annuity contracts to cover vested benefits.

57. A transaction that does not meet all of the above three criteria does not constitute a settlement for purposes of this statement. For example, investing in a portfolio of high-quality fixed-income securities with principal and interest payment dates similar to the estimated payment dates of benefits may avoid or minimize certain risks. However, that does not constitute a settlement because the investment decision can be reversed, and such a strategy does not relieve the employer (or the plan) of primary responsibility for a pension obligation nor does it eliminate significant risks related to the obligation.

58. The definition of an annuity contract is included in paragraph 50. If the substance of a participating annuity contract is such that the employer remains subject to all or most of the risks and rewards associated with the benefit obligation covered or the assets transferred to the insurance company, the purchase of the contract does not constitute a settlement.

Curtailment

59. A curtailment is an event that significantly reduces the expected years of future service of present employees or eliminates for a significant number of employees the accrual of defined benefits for some or all of their future services. Curtailments include:

- a. Termination of employees' services earlier than expected, which may or may not involve closing a facility or discontinuing a component of an entity.
- b. Termination or suspension of a plan so that employees do not earn additional defined benefits for future services. In the latter situation, future service may be counted toward vesting of benefits accumulated based on past service.

Relationship of Settlements and Curtailments to Other Events

60. A settlement and a curtailment may occur separately or together. If benefits to be accumulated in future periods are reduced but the plan remains in existence and continues to pay benefits, to invest assets, and to receive contributions, a curtailment has occurred but not a settlement. If an employer purchases nonparticipating annuity contracts for vested benefits and continues to provide defined benefits for future service, either in the same plan or in a successor plan, a settlement has occurred but not a curtailment. If a plan is terminated (that is, the obligation is settled and the plan ceases to exist) and not replaced by a successor defined benefit plan, both a settlement and a curtailment have occurred (whether or not the employees continue to work for the employer).

Accounting for Settlement of the Pension Obligation

61. The maximum gain or loss subject to recognition in earnings when a pension obligation is settled is the net gain or loss remaining in unassigned funds (surplus) plus any transition asset remaining in unassigned funds (surplus) from initial application of SSAP No. 89. That maximum amount includes any gain or loss first measured at the time of settlement. The maximum amount shall be recognized in earnings if the entire projected benefit obligation is settled. If only part of the projected benefit obligation is settled, the employer shall recognize in earnings a pro rata portion of the maximum amount equal to the percentage reduction in the projected benefit obligation.

62. If the purchase of a participating annuity contract constitutes a settlement, the maximum gain (but not the maximum loss) shall be reduced by the cost of the participation right before determining the amount to be recognized in earnings.

63. If the cost of all settlements in a year is less than or equal to the sum of the service cost and interest cost components of net periodic pension cost for the plan for the year, gain or loss recognition is permitted but not required for those settlements. However, the accounting policy adopted shall be applied consistently from year to year.

Accounting for a Plan Curtailment

64. The prior service cost included in unassigned funds (surplus) associated with years of service no longer expected to be rendered as the result of a curtailment is a loss. For example, if a curtailment eliminates half of the estimated remaining future years of service of those who were employed at the date of a prior plan amendment and were expected to receive benefits under the plan, then the loss associated with the curtailment is half of the prior service cost included in unassigned funds (surplus) related to that amendment that has not been amortized as a component of net periodic pension cost. For purposes of applying the provisions of this paragraph, prior service cost includes the cost of retroactive plan amendments and any transition obligation remaining in unassigned funds (surplus) from initial application of SSAP No. 89.

65. The projected benefit obligation may be decreased (a gain) or increased (a loss) by a curtailment.
- a. To the extent that such a gain exceeds any net loss included in unassigned funds (surplus) (or the entire gain, if a net gain exists), it is a curtailment gain.
 - b. To the extent that such a loss exceeds any net gain included in unassigned funds (surplus) (or the entire loss, if a net loss exists), it is a curtailment loss.

For purposes of applying the provisions of this paragraph, any transition asset remaining in unassigned funds (surplus) from initial application of SSAP No. 89 shall be treated as a net gain and shall be combined with the net gain or loss arising subsequent to transition to SSAP No. 89.

66. If the sum of the effects identified in paragraphs 64 and 65 is a net loss, it shall be recognized in earnings when it is probable that a curtailment will occur, and the effects described are reasonably estimable. If the sum of those effects is a net gain, it shall be recognized in earnings when the related employees terminate, or the plan suspension or amendment is adopted.

Termination Benefits

67. An employer may provide benefits to employees in connection with their termination of employment. They may be either special termination benefits offered only for a short period of time or contractual termination benefits required by the terms of a plan only if a specified event, such as a plant closing, occurs. An employer that offers special termination benefits to employees shall recognize a liability and a loss when the employees accept the offer and the amount can be reasonably estimated. An employer that provides contractual termination benefits shall recognize a liability and a loss when it is probable that employees will be entitled to benefits and the amount can be reasonably estimated. Termination benefits may take various forms including lump-sum payments, periodic future payments, or both. They may be paid directly from an employer's assets, an existing pension plan, a new employee benefit plan, or a combination of those means. The cost of termination benefits recognized as a liability and a loss shall include the amount of any lump-sum payments and the present value of any expected future payments. A situation involving termination benefits may also involve a curtailment to be accounted for under paragraphs 64-66.

Disclosures – Single-Employer Defined Benefit Plans

68. An employer that sponsors one or more defined benefit pension plans or one or more other defined benefit postretirement plans shall provide the following information, separately for pension plans and other postretirement benefit plans. Amounts related to the employer's results of operations shall be disclosed for each period for which a statement of income is presented. Amounts related to the employer's statement of financial position, shall be disclosed as of the date of each statement of financial position presented.

- a. A reconciliation of beginning and ending balances of the benefit obligation showing separately, if applicable, the effects during the period attributable to each of the following: service cost, interest cost, contributions by plan participants, actuarial gains and losses, foreign currency exchange rate changes, benefits paid, plan amendments, business combinations, divestitures, curtailments, settlements, and special termination benefits.
- b. A reconciliation of beginning and ending balances of the fair value of plan assets showing separately, if applicable, the effects during the period attributable to each of the following: actual return on plan assets, foreign currency exchange rate changes, contributions by the employer, contributions by plan participants, benefits paid, business combinations, divestitures, and settlements.
- c. The funded status of the plans and the amounts recognized in the statement of financial position, showing separately the assets and liabilities recognized.
- d. The objectives of the disclosures about postretirement benefit plan assets are to provide users of financial statements with an understanding of:
 - i. How investment allocation decisions are made, including the factors that are pertinent to an understanding of investment policies and strategies
 - ii. The classes of plan assets
 - iii. The inputs and valuation techniques used to measure the fair value of plan assets
 - iv. The effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets for the period

v. Significant concentrations of risk within plan assets.

An employer shall consider those overall objectives in providing the following information about plan assets:

- (a) A narrative description of investment policies and strategies, including target allocation percentages or range of percentages considering the classes of plan assets disclosed pursuant to (b) below, as of the latest statement of financial position presented (on a weighted-average basis for employers with more than one plan), and other factors that are pertinent to an understanding of those policies and strategies such as investment goals, risk management practices, permitted and prohibited investments including the use of derivatives, diversification, and the relationship between plan assets and benefit obligations. For investment funds disclosed as classes as described in (b) below, a description of the significant investment strategies of those funds shall be provided.
- (b) The fair value of each class of plan assets as of each date for which a statement of financial position is presented. Asset classes shall be based on the nature and risks of assets in an employer's plan(s). Examples of classes of assets could include, but are not limited to, the following: cash and cash equivalents; equity securities, (segregated by industry type, company size, or investment objective); debt securities, issued by national, state, and local governments; corporate debt securities; asset-backed securities; structured debt; derivatives on a gross basis (segregated by type of underlying risk in the contract, for example, interest rate contracts, foreign exchange contracts, equity contracts, commodity contracts, credit contracts, and other contracts); investment funds (segregated by type of fund); and real estate. Those examples are not meant to be all inclusive. An employer should consider the overall objectives in paragraph 68.d. in determining whether additional classes of plan assets or further disaggregation of classes should be disclosed.
- (c) A narrative description of the basis used to determine the overall expected long-term rate-of-return-on-assets assumption, such as the general approach used, the extent to which the overall rate-of-return-on-assets assumption was based on historical returns, the extent to which adjustments were made to those historical returns in order to reflect expectations of future returns, and how those adjustments were determined. The description should consider the classes of assets described in (b) above, as appropriate.
- (d) Information that enables users of financial statements to assess the inputs and valuation techniques used to develop fair value measurements of plan assets at the reporting date. For fair value measurements using significant unobservable inputs, an employer shall disclose the effect of the measurements on changes in plan assets for the period. To meet those objectives, the employer shall disclose the following information for each class of plan assets disclosed pursuant to (b) above for each annual period:

- (1) The level within the fair value hierarchy in which the fair value measurements in their entirety fall,³ segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3)
 - (2) Information about the valuation technique(s) and inputs used to measure fair value and a discussion of changes in valuation techniques and inputs, if any, during the period.
- e. For defined benefit pension plans, the accumulated benefit obligation.
- f. The benefits (as of the date of the latest statement of financial position presented) expected to be paid in each of the next five fiscal years, and in the aggregate for the five fiscal years thereafter. The expected benefits should be estimated based on the same assumptions used to measure the company's benefit obligation at the end of the year and should include benefits attributable to estimated future employee service.
- g. The employer's best estimate, as soon as it can reasonably be determined, of contributions expected to be paid to the plan during the next fiscal year beginning after the date of the latest statement of financial position presented. Estimated contributions may be presented in the aggregate combining (1) contributions required by funding regulations or laws, (2) discretionary contributions, and (3) noncash contributions.
- h. The amount of net benefit cost recognized, showing separately the service cost component, the interest cost component, the expected return on plan assets for the period, the gain or loss component, the prior service cost or credit component, the transition asset or obligation component, and the gain or loss recognized due to settlements or curtailments.
- i. Separately the net gain or loss and net prior service cost or credit recognized in unassigned funds (surplus) for the period pursuant to paragraphs 15 and 19 and reclassification adjustments of unassigned funds (surplus) for the period, as those amounts, including amortization of the net transition asset or obligation, are recognized as components of net periodic benefit cost.
- j. The amounts in unassigned funds (surplus) that have not yet been recognized as components of net periodic benefit cost, showing separately the net gain or loss, net prior service cost or credit, and net transition asset or obligation.
- k. On a weighted-average basis, the following assumptions used in the accounting for the plans: discount rates, rates of compensation increase (for pay-related plans), expected long-term rates of return on plan assets specifying, in a tabular format, the assumptions used to determine the benefit obligation and the assumptions used to determine net benefit cost, and interest crediting rates (for cash balance plans and other plans with promised crediting rates).

³ In some cases, the inputs used to measure fair value might fall in different levels of the fair value hierarchy. The level in the fair value hierarchy within which the fair value measurement in its entirety falls shall be determined based on the lowest level input that is significant to the fair value measurement in its entirety. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability.

- l. If applicable, the amounts and types of securities of the employer and related parties included in plan assets.
- m. If applicable, any alternative method used to amortize prior service amounts or net gains and losses pursuant to paragraphs 16 and 23.
- n. If applicable, any substantive commitment, such as past practice or a history of regular benefit increases, used as the basis for accounting for the benefit obligation.
- o. If applicable, the cost of providing special or contractual termination benefits recognized during the period and a description of the nature of the event.
- p. An explanation of the following information:
 - i. The reasons for significant gains and losses related to changes in the defined benefit obligation for the period.
 - ii. Any other significant change in the benefit obligation or plan assets not otherwise apparent in the other disclosures required by this statement.

Disclosures – Employers with Two or More Defined Benefit Plans

69. The disclosures required by this statement shall be aggregated for all of an employer's defined benefit pension plans and for all of an employer's other defined benefit postretirement plans unless disaggregating in groups is considered to provide useful information or is otherwise required by this paragraph and paragraph 70. Disclosures shall be as of the date of each statement of financial position presented. Disclosures about pension plans with assets in excess of the accumulated benefit obligation generally may be aggregated with disclosures about pension plans with accumulated benefit obligations in excess of assets. The same aggregation is permitted for other postretirement benefit plans. If aggregate disclosures are presented, an employer shall disclose, as of the date of each financial statement position presented:

- a. The projected benefit obligation and fair value of plan assets for plans with projected benefit obligations in excess of plan assets.
- b. The accumulated benefit obligation and fair value of plan assets for pension plans with accumulated benefit obligations in excess of plan assets.

70. A U.S. reporting entity may combine disclosures about pension plans or other postretirement benefit plans outside the United States with those for U.S. plans unless the benefit obligations of the plans outside the United States are significant relative to the total benefit obligation and those plans use significantly different assumptions.

Interim Financial Disclosures –Defined Benefit Plans

71. The following shall be disclosed within interim financial statements that include a statement of income:

- a. The amount of net periodic benefit cost recognized, for each period for which a statement of income is presented, showing separately the service cost component, the interest cost component, the expected return on plan assets for the period, the gain or loss component, the amount of prior service cost or credit component, the transition asset or obligation component, and the gain or loss recognized due to a settlement or curtailment.

- b. The total amount of the employer's contributions paid, and expected to be paid, during the current fiscal year, if significantly different from amounts previously disclosed pursuant to paragraph 68.g. Estimated contributions may be presented in the aggregate combining (1) contributions required by funding regulations or laws, (2) discretionary contributions, and (3) noncash contributions.

Defined Contribution Plans

72. A defined contribution pension plan is a plan that provides pension benefits in return for services rendered, provides an individual account for each participant, and has terms that specify how contributions to the individual's account are to be determined rather than the amount of pension benefits the individual is to receive. Under a defined contribution plan, the pension benefits a participant will receive depend only on the amount contributed to the participant's account, the returns earned on investments of those contributions, and forfeitures of other participants' benefits that may be allocated to the participant's account.

73. To the extent that a plan's defined contributions to an individual's account are to be made for periods in which that individual renders services, the net pension cost for a period shall be the contribution called for in that period. If a plan calls for contributions for periods after an individual retires or terminates, the estimated cost shall be accrued during the employee's service period.

74. A pension plan having characteristics of both a defined benefit plan and a defined contribution plan requires careful analysis. If the substance of the plan is to provide a defined benefit, as may be the case with some "target benefit" plans, the accounting requirements shall be determined in accordance with the provisions applicable to a defined benefit plan and the disclosure requirements within paragraph 68 shall be followed.

Disclosures - Defined Contribution Plans

75. An employer shall disclose the amount of cost recognized for defined contribution pension plans and for other defined contribution postretirement benefit plans for all periods presented separately from the amount of cost recognized for defined benefit plans. The disclosures shall include a description of the nature and effect of any significant changes during the period affecting comparability, such as a change in the rate of employer contributions, a business combination, or a divestiture.

Multiemployer Plans

76. A multiemployer plan is a pension plan to which two or more unrelated employers contribute, usually pursuant to one or more collective-bargaining agreements. A characteristic of multiemployer plans is that assets contributed by one participating employer may be used to provide benefits to employees of other participating employers since assets contributed by an employer are not segregated in a separate account or restricted to provide benefits only to employees of that employer.

77. A reporting entity participating in a multiemployer plan shall recognize as net pension cost the required contribution for the period and shall recognize as a liability any contributions due and unpaid.

78. In some situations, withdrawal from a multiemployer plan may result in a reporting entity having an obligation to the plan for a portion of its unfunded benefit obligations. If withdrawal under circumstances that would give rise to an obligation is either probable or reasonably possible, the provisions of SSAP No. 5R—*Liabilities, Contingencies and Impairment of Assets* shall apply.

Disclosures - Multiemployer Plans

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.

80. In addition to the requirements of paragraph 79, the following information shall be disclosed:

- a. Whether a funding improvement plan or rehabilitation plan had been implemented or is pending.
- b. Whether the reporting entity paid a surcharge to the plan.
- c. A description of minimum contributions required for future periods, if applicable.
- d. A qualitative description of the extent to which the employer could be responsible for the obligations of the plan, including benefits earned by employees during employment with another employer.

81. In some situations, withdrawal from a multiemployer plan may result in a reporting entity having an obligation to the plan for a portion of the unfunded benefit obligation of the pension plans and other postretirement benefit plans. If withdrawal under circumstances that would give rise to an obligation is either probable or reasonably possible, the provisions of SSAP No. 5R shall apply. If it is either probable or reasonably possible that (a) an employer would withdraw from the plan under circumstances that would give rise to an obligation or (b) an employer's contribution to the fund would be increased during the remainder of the contract period to make up a shortfall in the funds necessary to maintain the negotiated level of benefit coverage (a "maintenance of benefits" clause), the employer shall apply the provisions and disclosures of SSAP No. 5R.

Multiple-Employer Plans

82. Some pension plans to which two or more unrelated employers contribute are not multiemployer plans. Rather, they are in substance aggregations of single-employer plans combined to allow participating employers to pool their assets for investment purposes and to reduce the costs of plan administration. Those plans ordinarily do not involve collective-bargaining agreements. They may also have features that allow participating employers to have different benefit formulas, with the employer's contributions to the plan based on the benefit formula selected by the employer. Such plans shall be considered single-employer plans rather than multiemployer plans, and each reporting entity's accounting shall be based on its respective interest in the plan.

Non-U.S. Pension Plans

83. Except for its effective date, this statement includes no special provisions applicable to pension arrangements outside the United States. To the extent that those arrangements are in substance similar to pension plans in the United States, they are subject to the provisions of this statement. The substance of an arrangement is determined by the nature of the obligation and by the terms or conditions that define the amount of benefits to be paid, not by whether (or how) a plan is funded, whether benefits are payable at intervals or as a single amount, or whether the benefits are required by law or custom or are provided under a plan the employer has elected to sponsor.

84. It is customary or required in some countries to provide benefits in the event of a voluntary or involuntary severance of employment (also called termination indemnities). If such an arrangement is in substance a pension plan (for example, if the benefits are paid for virtually all terminations), it is subject to the provisions of this statement.

Business Combinations

85. When an employer is acquired in a business combination and that employer sponsors a single-employer defined benefit pension plan, the assignment of the purchase price to individual assets acquired and liabilities assumed shall include a liability for the projected benefit obligation in excess of plan assets or an asset for plan assets in excess of the projected benefit obligation, thereby eliminating any previously existing net gain or loss, prior service cost or credit, or transition asset or obligation recognized in unassigned funds (surplus). If it is expected that the plan will be terminated or curtailed, the effects of those actions shall be considered in measuring the projected benefit obligation.

Consolidated/Holding Company Plans

86. The employees of many reporting entities are members of a plan sponsored by a parent company or holding company. A reporting entity who participates in these plans and is not directly liable for obligations under the plan shall recognize pension expense equal to its allocation from the holding company or parent company of the required contribution to the plan for the period. A liability shall be established for any such contributions due and unpaid. Furthermore, the reporting entity shall disclose in the notes to the financial statements that its employees participate in a plan sponsored by the holding company for which the reporting entity has no legal obligation. The amount of expense incurred, and the allocation methodology utilized by the provider of such benefits shall also be disclosed. If the reporting entity is directly liable for obligations under the plan, then the requirements outlined above in paragraphs 1-85 and 90-101 of this statement shall be applied.

Relevant Literature

87. This statement adopts with modification paragraphs 1-7 and 16-17 as well as Appendix C – Amendments to Statements 87 and 88 and Appendix E – Amendments to Statement 132(R) of *FASB Statement No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)* (FAS 158). Paragraphs 8-10 providing specific guidance for not-for-profit organizations is rejected. Paragraphs 11-15 regarding the effective dates for FAS 158 is rejected and paragraph 19 providing an alternative method for remeasuring plan assets and benefits obligations as of the fiscal year the measurement date provisions are applied is also rejected. Appendix D – Amendments to Statement 106 has not been incorporated within this statutory statement as it will be considered in accordance with revisions to *SSAP No. 14—Postretirement Benefits Other Than Pensions*. Disclosures included within FAS 132(R), as amended by FAS 158, pertaining to health care (paragraphs 5.l. and 5.m.) have been rejected for inclusion within this standard, but will also be considered in accordance with revisions to *SSAP No. 14*. This statement adopts the revisions to paragraph 5.d. of FAS 132(R) as amended by *FASB Staff Position FAS 132(R)-1, Employers' Disclosures about Postretirement Benefit Plan Assets* (FSP FAS 132(R)-1) and *ASU 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements* (ASU 2010-06). Other revisions to disclosures requirements as amended by FSP FAS 132(R)-1 relate to nonpublic entities and are rejected. This statement adopts by reference revisions to ASC 715-80 as detailed in *ASU 2011-09, Compensation – Retirement Benefits – Multiemployer Plans* with limited additional disclosures required within statutory financial statements. This statement adopts by reference *FSP FASB 158-1, Conforming Amendments to the Illustrations in FASB Statements No. 87, No. 88, and No. 106 and to the Related Staff Implementation Guides* (FSP FAS 158-1) to the extent that the examples and related implementation guides comply with the adopted GAAP guidance previously identified within this statement, as modified for statutory accounting. This statement adopts with modification the

disclosure revisions reflected in *ASU 2018-14, Changes to the Disclosure Requirements for Defined Benefit Plans*, consistent with the modifications from the adoption of FAS 158 and FAS 106. The following modifications from the adopted paragraphs of FAS 158 have been incorporated within this standard:

- a. All references to ‘other comprehensive income’ or ‘accumulated other comprehensive income’ within FAS 158 have been revised to reflect unassigned funds (surplus).
- b. Any prepaid asset resulting from the excess of the fair value of plan assets over the projected benefit obligation shall be nonadmitted. Furthermore, any asset recognized from the cost of a ‘participation right’ of an annuity contract per paragraph 54 shall also be nonadmitted.
- c. Provisions within paragraph 30 of FAS 87, as amended by FAS 158, permitting a market-related value of plan assets have been eliminated with only the fair value measurement method for plan assets being retained.
- d. The reduced disclosure requirements for nonpublic entities described in paragraph 8 of FAS 132(R), as amended by FAS 158, are rejected. All reporting entities shall follow the disclosure requirements included in paragraph 5 of FAS 132(R) as amended by FAS 158.
- e. Clarification has been included within this standard to ensure both vested and nonvested employees are included within the recognition of net periodic pension cost and in the pension benefit obligation. Although this is consistent with GAAP, this is a change from previous statutory accounting. As nonvested employees were excluded from statutory accounting under SSAP No. 89, guidance has been included to indicate that the unrecognized prior service cost attributed to nonvested individuals is not required to be included in net periodic pension cost entirely in the year this standard is adopted. The unrecognized prior service cost for nonvested employees shall be amortized as a component of net periodic pension cost by assigning an equal amount to each expected future period of service before vesting occurs for nonvested employees active at the date of the amendment. Unassigned funds (surplus) is then adjusted each period as prior service cost is amortized. (Guidance is included within the transition related to the recognition of the prior service cost for nonvested employees through unassigned funds (surplus).)
- f. Conclusion of *Interpretation 04-12: EITF 03-4: Determining the Classification and Benefit Attribution Method for a “Cash Balance” Pension Plan* indicating that ‘cash balance’ plans are considered defined benefit plans has been incorporated within paragraph 3 of this statement.
- g. Conclusion of *Interpretation 99-26: Offsetting Pension Assets and Liabilities* prohibiting the offset of defined benefit liabilities of one plan with prepaid assets of another plan has been incorporated within paragraph 26 of this statement.
- h. Provisions within paragraph 36 of FAS 87, as amended by FAS 158, regarding the classification of underfunded liabilities as current or noncurrent liabilities and the classification of assets from overfunded plans as noncurrent assets has been rejected as inconsistent with statutory accounting.
- i. Provisions within paragraph 49 of FAS 87, as amended by FAS 158, defining the fair value of investments have been rejected. Fair value definitions and measurement for investments shall be determined in accordance with statutory accounting guidance.

- j. Provisions within paragraph 52 of FAS 87, as amended by FAS 158, regarding the plan assets measurement date for consolidating subsidiaries or entities utilizing the equity method under APB Opinion No. 18 has been rejected. For statutory accounting, all entities shall follow the measurement date guidance within paragraph 45 of this statement.
- k. Transition under FAS 158 is different from this statement. FAS 158 requires entities with publicly traded equity securities to initially apply the requirement to recognize the funded status of a benefit plan; the gains/losses, prior service costs/credits and transition obligations/assets that have not yet been included in net periodic benefit cost; and the disclosure requirements as of the end of the fiscal year ending after December 15, 2006. ~~Transition guidelines for statutory accounting are defined in paragraphs 90-101.~~
- l. FAS 158 provided two approaches for an employer to transition to a fiscal year-end measurement date. For purposes of statutory accounting, the second approach permitting reporting entities to use earlier measurements determined for year-end reporting as of the fiscal year immediately preceding the year that the measurement date provisions is rejected. For consistency purposes, all reporting entities shall follow the first approach and remeasure plan assets and benefit obligations as of the beginning of the fiscal year that the measurement date provisions are applied.

88. This statement adopts the revisions to ASC 715-30 as it relates to interim re-measurement due to a significant event as detailed in *ASU 2015-04, Practical Expedient for the Measurement Date of An Employer's Defined Benefit Obligation and Plan Assets*. Other revisions are rejected as statutory accounting requires the annual measurement of benefit obligations and plan assets to be measured as of a year-end measurement date.

89. This statement rejects *ASU 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. Existing statutory disclosures on the components of pension costs shall be completed.

Effective Date and Transition

90. Reporting entities are required to disclose the projected benefit obligation, the accumulated benefit obligation and the fair value of plan assets for defined benefit pension plans in the first reporting period after the effective date of this standard and in each subsequent reporting period. This disclosure shall specifically note the funded/underfunded status of the pension plan based on the projected benefit obligation. Reporting entities shall also specifically note the surplus impact necessary, at each reporting date, to reflect the full projected benefit obligation within the financial statements.

91. This statement is effective for quarterly and annual reporting periods beginning on or after January 1, 2013 (transition date) with early adoption permitted. Any unfunded defined benefit pension amounts, as determined when the projected benefit obligation exceeds the fair value of plan assets, is a liability under SSAP No. 5R and shall be reported in the first quarter statutory financial statements after the transition date with a corresponding entry to unassigned funds (surplus). If the fair value of plan assets exceeds the projected benefit obligation, the asset shall be considered a nonadmitted asset. Net periodic pension cost shall include a component for unrecognized prior service cost for nonvested employees beginning in 2013.

~~92. Gains or losses, prior service costs or credits (including prior service costs for non-vested participants pursuant to paragraph 11), and remaining transition assets or obligations from prior application of SSAP No. 89 (collectively referred to as "unrecognized items") that have not yet been~~

~~included in net periodic benefit cost as of December 31, 2012⁴ shall be recognized as components of the balance of unassigned funds (surplus), net of tax, as of January 1, 2013 (provided that alternative transition is not elected per paragraph 93.b.). The offset to unassigned funds is reported separately as an “Aggregate Write-In for Other Than Invested Assets” or as an “Aggregate Write-In for Other Liabilities.” After recognition, the full unfunded or overfunded status of the plan shall be reflected within the financial statements.⁵ Any prepaid asset resulting from an overfunded plan shall be nonadmitted.~~

~~93. Due to the potential impact to surplus as a result of immediately applying the accounting guidance in paragraph 92, reporting entities may elect one of the following two methods, on an individual plan basis, to recognize the transition surplus impact:~~

- ~~a. Reporting entities may elect to recognize the entire transition surplus impact calculated from applying paragraph 92, on an individual plan basis, as of January 1, 2013.~~
- ~~b. Alternatively, reporting entities may elect to recognize the entire surplus impact from applying paragraph 92, on an individual plan basis, over a period not to exceed ten (10) years. The surplus impact initially recognized as of January 1, 2013, under this transition option, and subsequently over the transition period, shall be the greater of:~~
 - ~~i. Ten percent of the calculated surplus impact as of the transition date;~~
 - ~~ii. Amortization⁶ of the “unrecognized items” (defined in paragraph 92) into net periodic pension cost, including any accelerated amortization of these items from curtailments or settlements that occur after the transition date. (If the amortization cannot be determined at transition, at a minimum, the amount amortized for “unrecognized items” during the prior year shall be utilized for this component of the calculation. If the amount recognized for transition (greater of all three components in paragraph 93.b.) is subsequently determined to be less than what is amortized for the year (paragraph 93.b.ii.), the difference between what was recognized for transition, and what is amortized must immediately be recognized as an adjustment to the transition impact to unassigned funds (surplus);~~

⁴ ~~The intent of the guidance is to recognize the unrecognized amounts as of December 31, 2012, annual statements, even if new actuarial projections (accumulated benefit obligation/projected benefit obligation amounts) are calculated as of January 1, 2013. (These projections would be considered in the recognition of the 2013 pension cost.)~~

⁵ ~~Upon the effective date of this statement, reporting entities are required to reflect the full unfunded or overfunded status of their defined benefit pension plans. As such, the concept of an “additional minimum liability” previously reflected in SSAP No. 89—Pensions is not incorporated within this statement. If an additional minimum liability (and a corresponding intangible asset) had been recognized under SSAP No. 89, such items shall be eliminated with the implementation of this statement, and the guidance in paragraph 93 shall be followed. The elimination of any additional minimum liability and corresponding intangible asset shall also occur if the entity elects the transition option reflected in paragraph 93.b.~~

⁶ ~~Unless otherwise impacted from the provisions within this statement or in accordance with changes to the pension plan, the amortization of the unrecognized items into net periodic pension cost shall continue to follow the existing amortization schedules in effect on the transition date.~~

- iii. ~~Amount necessary to establish a total liability that is equal to any unfunded accumulated benefit obligation (the accumulated benefit obligation less the fair value of plan assets).⁷~~

94. ~~If the surplus deferral (paragraph 93.b.) is elected at the transition date, subsequently, starting with the 2014 year end financial statement, the reporting entity shall annually recognize the remaining surplus impact (collectively referred to as the “transition liability”⁸) on a systematic basis over a period not to exceed nine years. The minimum amount recognized each subsequent year shall be an amount that reflects the conditions within paragraph 93.b. Reporting entities that elect the transition option in paragraph 93.b. are permitted to recognize the remaining transition liability, or an amount in excess of the minimum requirement, at any time after the transition date.~~

95. ~~Reporting entities that elect the transition option in paragraph 93.b. must recognize any remaining transition liability to the extent that the plan reflects a prepaid benefit cost. (For example, if changes in circumstances have resulted with the plan reflecting an overfunded status, the remaining transition liability must be recognized to the extent that the plan is overfunded.) The transition guidance in paragraph 93.b. is not intended (on a net basis for each plan) to result in more favorable, subsequent surplus pension positions when there are remaining unrecognized liabilities as a result of the reporting entity’s initial election for surplus deferral. Therefore, if there is a plan curtailment, settlement, or other plan amendment resulting in a reduction of benefit obligations, or net benefit obligation gains due to revisions in assumptions (e.g., discount rates) or plan experience differing from assumptions, or plan asset gains due to the actual return on plan assets exceeding the expected return on plan assets, a corresponding amount of unrecognized liability from the surplus deferral shall be recognized. For this purpose, net gains, if any, are the net aggregation of all gains and losses (excluding plan amendments that increase benefit obligations) from factors such as those listed above, determined as of a measurement or remeasurement date. This shall occur regardless if the impact from the change results with the plan being in an overfunded state, or whether the gain is recognized in earnings. The transition guidance was to provide surplus relief from the immediate surplus impact from adopting SSAP No. 102, but in no instance should changes (on a net basis for each plan) attributed to pension plans result in more favorable, subsequent surplus positions when there are unrecognized liabilities remaining as a result of the reporting entity’s initial election for surplus deferral. The guidance in this paragraph was originally contained within *INT 13-03: Clarification of Surplus Deferral in SSAP No. 92 & SSAP No. 102* and was effective December 15, 2013.~~

96. ~~The transition guidance in paragraphs 92-95 is specific to the transition surplus impact from initially applying this statement on January 1, 2013. Thus, this transition guidance does not apply to additional liability calculated from subsequent comparison of the fair value of plan assets to the projected benefit obligation, or the impact of subsequent plan amendments.~~

97. ~~Reporting entities electing to apply the transition guidance in paragraph 93.b. must disclose the full transition surplus impact calculated from applying paragraph 92 in the first quarter statutory financial statements after the transition date and each reporting period thereafter. This disclosure shall include the~~

⁷ ~~The intent of this standard is to ensure that under the deferral option the liability initially recognized for an unfunded plan reflects the minimum liability previously recognized under SSAP No. 89. For any instances in which an additional minimum liability recognized under SSAP No. 89 is greater than the unfunded ABO at transition, an amount equal to the previously recognized additional minimum liability shall be used in determining this component of paragraph 93.b.iii. The deferral option under this standard is not intended to allow a surplus benefit to be recognized at initial transition for an unfunded plan.~~

⁸ ~~If the surplus deferral from paragraph 93.b. is elected, the deferred liability, although comprised of the previous “unrecognized items” shall be collectively referred to as the “transition liability.” Although reporting entities will need to continue to track the unrecognized items for amortization into net periodic cost (offset through unassigned funds), reporting entities shall not allocate the recognized surplus impact from transition to these categories. As noted in paragraph 93.b.ii., the minimum amount of liability recognized under the deferral option must cover the annual amortization of the “unrecognized items” into net periodic pension cost to prevent a surplus benefit.~~

~~initial “transition liability” calculated under paragraph 92, the annual amortization amount of the “unrecognized items” into net periodic pension cost, the amount of the unfunded accumulated benefit obligation, and the remaining unrecognized transition impact. This disclosure shall include a schedule of the entity’s anticipated recognition of the remaining surplus impact over the transition period.~~

~~98.~~92. The requirement to measure plan assets and benefit obligations as of the date of the reporting entity’s financial statement year-end is effective for financial statement years beginning January 1, 2014. (The measurement date change will be initially reflected in the December 31, 2014 financial statements.)

~~99.~~93. In order to transition to a fiscal year-end measurement date, the reporting entity shall remeasure plan assets and benefit obligations as of the beginning of the fiscal year that the measurement date provisions are applied. The reporting entity shall use those new measurements to determine the effects of the measurement date change as of the beginning of the fiscal year that the measurement date provisions are applied.

~~100.~~94. The reporting entity shall measure plan assets and benefit obligations as of the beginning of the fiscal year that the measurement date provisions are applied. This would result with the following:

- a. Net periodic benefit cost for the period between the measurement date that is used for the immediately preceding fiscal year-end and the beginning of the fiscal year that the measurement date provisions are applied, exclusive of any curtailment or settlement gain or loss, shall be recognized, net of tax, as a separate adjustment of the opening balance unassigned funds (surplus). That is, the pretax amount recognized as an adjustment to unassigned funds (surplus) is the net periodic benefit cost that without a change in measurement date otherwise would have been recognized on a delayed basis during the first interim period for the fiscal year that the measurement date provisions are applied.
- b. Any gain or loss arising from a curtailment or settlement between the measurement date that is used for the immediately preceding fiscal year-end and the beginning of the fiscal year that the measurement date provisions are applied shall be recognized in earnings in that period and not as an adjustment to unassigned funds (surplus). This provision prohibits a reporting entity from early application of the measurement date provisions when the reporting entity has issued financial statements for the prior year without recognition of such a settlement or curtailment.
- c. Other changes in the fair value of plan assets and the benefit obligations (for example, gains or losses) for the period between the measurement date that is used for the immediately preceding fiscal year-end and the beginning of the fiscal year that the measurement date provisions are applied shall be recognized, net of tax, as a separate adjustment of the opening balance of unassigned funds (surplus) for the fiscal year that the measurement date provisions are applied.

~~101.~~95. Earlier application of the recognition or measurement date provisions is encouraged, however, early applications must be for all of the reporting entity’s benefit plans. If early application is elected, the transition date shall reflect the January 1st of the year in which this standard is initially applied. Retrospective application is not permitted.

REFERENCES

Other

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- *SSAP No. 89—Accounting for Pensions, A Replacement of SSAP No. 8*

Relevant Issue Papers

- *Issue Paper No. 8—Accounting for Pensions*
- *Issue Paper No. 123—Accounting for Pensions, A Replacement of SSAP No. 8*
- *Issue Paper No. 132—Accounting for Pensions, A Replacement of SSAP No. 89*

Not for Distribution

EXHIBIT A—IMPLEMENTATION GUIDE

~~Note: After transition, new “unrecognized” amounts will be reflected in the year-end funded status, but not yet reflected in unassigned funds. Therefore, additional entries will be needed at the end of each year to recognize these new “unrecognized” amounts in unassigned funds. (An example includes gains and losses that will be included in unassigned funds (surplus), but not recognized in net periodic pension cost if they do not exceed 10% of the greater of the projected benefit obligation or the fair value of plan assets.) The entries in the implementation guide focus on the transition impact, and subsequent entries for “unrecognized” items have not been included within the illustrations.~~

Transition Implementation**1. ~~Overfunded Plan with Prepaid Benefit Cost~~**

~~Consideration of contributions or tax effects are not reflected in this example.~~

Example 1	Dec. 31, 2012	Jan. 1, 2013
Accumulated ~~Benefit~~ Obligation	~~\$(6,240)~~	~~\$(6,240)~~
Plus: Non-Vested Liability	~~(100)*~~	~~(100)~~
Total Accumulated Benefit Obligation	~~\$(6,340)~~	~~\$(6,340)~~
Projected Benefit Obligation	~~\$(6,437)~~	~~\$(6,437)~~
Plus: Non-Vested Liability	~~(100)~~	~~(100)~~
Total PBO	~~\$(6,537)~~	~~\$(6,537)~~
Plan Assets at Fair Value	~~\$9,268~~	~~\$9,268~~
Funded Status	~~\$2,731~~	~~\$2,731~~
Transition Obligation / (Asset)	~~\$36~~	
Prior Service Cost	~~214~~	

~~Prior Service Cost (Non-Vested)~~	~~100~~	
~~Unrecognized Losses / (Gains)~~	~~2,465~~	
~~Total Unrecognized Items~~	~~\$2,815~~	~~-~~
~~Net Overfunded Plan Asset / (Liability for Benefits)~~	~~\$5,546~~	~~\$2,731~~

~~*The amount shown for December 31, 2012 reflects the non-vested liability, which must be considered at transition under SSAP No. 102. However, the non-vested liability is not a factor in the December 31, 2012, financial statements under SSAP No. 89.~~

~~Overfunded Plan Asset and Liability for Benefits are terms to reflect the overfunded and unfunded status of the plan. For the amounts shown as of December 31, 2012, immediately prior to the effective date of the new standard, these terms reflect the balance sheet position. As overfunded plan assets are not admitted, these prepaids shall be reflected within Aggregate Write-Ins for Other Than Invested Assets. Transition liabilities recognized that have not been reflected through expense shall be reflected within Aggregate Write-Ins for Liabilities.~~

~~1a. January 1, 2013 Transition Date Recognize "Unrecognized Items"~~

~~1. Unassigned Funds Transition Obligation~~	~~36~~
~~Unassigned Funds Prior Service Cost~~	~~214~~
~~Unassigned Funds Prior Service Cost (Nonvested)~~	~~100~~
~~Unassigned Funds Unrecognized Losses~~	~~2,465~~
~~Overfunded Plan Asset~~	~~2,815~~

~~(Aggregate Write-Ins for Other Than Invested Assets)~~

~~For this plan, which is overfunded by more than the unrecognized liabilities, the entry at transition will be netted against the existing prepaid with an offset to unassigned funds.~~

~~2. Change in Nonadmitted - Overfunded Plan Asset 2,815~~

~~(Aggregate Write-Ins for Other Than Invested Assets)~~

~~Unassigned Funds 2,815~~

~~This entry illustrates the impact to the “change in nonadmitted” as a result of the decline in overfunded plan assets. For this particular example, with the transition entry to unassigned funds and the impact to nonadmitted assets, there is no surplus impact at transition.~~

1b. — December 31, 2013 — Recognition of Periodic Pension Cost

~~After transition, recognition of net periodic pension cost includes: 1) service cost, 2) interest cost, 3) expected return on plan assets, 4) amortization of prior service cost included in unassigned funds, 5) amortization of gains and losses, and 6) amortization of any transition asset or obligation remaining in unassigned funds.~~

~~(Per paragraph 93, if surplus deferral is elected at transition, beginning with 2014 annual financials, the entity shall recognize the remaining surplus impact on a systematic basis over a period not to exceed the remaining nine years. As this illustration is in an overfunded status, there is no surplus deferral. Recognition of net periodic cost, including amortization of the “unrecognized items” will occur each year regardless if surplus deferral is elected.)~~

Components of Net Periodic Cost	Dec. 31, 2013
Service Cost	550
Interest Cost	150
Expected Return on Plan Assets	(250)
Total	450
Amortization of:	
○ — Transition Obligation	7.2
○ — Prior Service Cost	42.8
○ — Prior Service Cost (nonvested)	20
○ — Unrecognized Losses	493
Total	563

Total Net Periodic Pension Cost	1,013

1. Net Periodic Pension Cost 1,013

Prepaid Benefit Cost 1,013

(Aggregate Write-Ins for Other Than Invested Assets)

~~This entry recognizes the periodic pension cost with an offset to the prepaid pension asset. (A prepaid benefit cost is created when cumulative contributions to a pension plan exceed cumulative net periodic pension costs. Thus, a prepaid benefit cost can only be reduced through the recognition of pension cost.)~~

2. Overfunded Plan Asset 563

(Aggregate Write-Ins for Other Than Invested Assets)

Unassigned Funds — Transition Obligation 7.2

Unassigned Funds — Prior Service Cost 42.8

Unassigned Funds — Prior Service Cost (Nonvested) 20

Unassigned Funds — Unrecognized Losses 493

~~This entry recognizes the transition amounts amortized through net periodic pension cost. The offset is to unassigned funds (as unassigned funds was used for the initial recognition of the unrecognized items). As this plan continues to be overfunded, these amounts are offset to overfunded plan assets.~~

3. Change in Nonadmitted — Prepaid Benefit Cost 1,013

(Aggregate Write-Ins for Other Than Invested Assets)

Unassigned Funds 1,013

~~This entry illustrates the impact of the change in nonadmitted prepaid benefit cost to unassigned funds.~~

4. Unassigned Funds 563

Change in Nonadmitted — Overfunded Plan Asset 563

(Aggregate Write-Ins for Other Than Invested Assets)

~~This entry illustrates the impact of the change in nonadmitted overfunded plan asset to unassigned funds.~~

~~1c. December 31, 2014 Recognition of Periodic Pension Cost~~

~~Components of Net Periodic Cost~~	~~Dec. 31, 2014~~
~~Service Cost~~	~~2500~~
~~Interest Cost~~	~~1000~~
~~Expected Return on Plan Assets~~	~~(500)~~
~~Total~~	~~3000~~
~~Amortization of:~~	
~~○ Transition Obligation~~	~~7.2~~
~~○ Prior Service Cost~~	~~42.8~~
~~○ Prior Service Cost (nonvested)~~	~~20~~
~~○ Unrecognized Losses~~	~~493~~
~~Total~~	~~563~~
~~Total Net Periodic Pension Cost~~	~~3,563~~

~~Note—This example was purposely completed to show a significant amount of periodic pension cost to create an underfunded plan status. This was done strictly for illustration purposes and is not intended to indicate that such significant changes would be expected, although they could occur.~~

~~1. Net Periodic Pension Cost 3,563~~

~~Prepaid Benefit Cost 3,563~~

~~(Aggregate Write-In for Other Than Invested Assets)~~

2. ~~Overfunded Plan Asset~~	~~1,282~~
~~Unassigned Funds — Transition Obligation~~	~~7.2~~
~~Unassigned Funds — Prior Service Cost~~	~~42.8~~
~~Unassigned Funds — Prior Service Cost (Nonvested)~~	~~20~~
~~Unassigned Funds — Unrecognized Losses~~	~~493~~
~~Liability for Pension Benefits~~	~~719~~

~~(Aggregate Write-In for Other Liabilities)~~

~~This entry recognizes the transition amounts that have been recognized through net periodic pension cost, with an offset to unassigned funds. The overfunded plan asset is initially offset, until the plan reaches an unfunded status, which is then reflected through a liability for pension benefits (aggregate write-in for other liabilities).~~

3. ~~Change in Nonadmitted — Prepaid Benefit Cost~~	~~3,563~~
~~Unassigned Funds~~	~~3,563~~
4. ~~Unassigned Funds~~	~~1,282~~
~~Change in Nonadmitted — Overfunded Plan Asset~~	~~1,282~~

~~These entries illustrate the impact of the change in nonadmitted to unassigned funds.~~

~~Illustration 1 — Example Paragraph 97 Note Disclosure:~~

~~SSAP No. 102 became effective January 1, 2013. This SSAP requires that any underfunded defined benefit pension amounts, as determined when the projected benefit obligation exceeds the fair value of plan assets, to be recognized as a liability under SSAP No. 5R. Such liability is required to be reported in the first quarter statutory financial statement after the transition date with a corresponding entry to unassigned funds. The adoption of SSAP No. 102 did not have a surplus impact on ABC entity as the pension plan was overfunded by more than the transition liabilities. At transition, ABC entity recognized \$2,815 in unrecognized transition obligations, prior service costs, and unrecognized losses as components of the ending balance of unassigned funds as of January 1, 2013. This recognition resulted in a financial presentation which reflects the actual \$2,731 overfunded status of the plan (fair value of plan assets exceeds the projected benefit obligation) as of January 1, 2013. As required under SSAP No. 102, overfunded plan assets are nonadmitted.~~

~~**For purposes of this example, tax effects are not reflected. However, the amount recognized at transition as components of the unassigned funds shall be net of tax.~~

~~The following provides the status of the pension plan as of December 31, 2012, and the transition date (January 1, 2013):~~

~~Example 1~~	~~Dec. 31, 2012~~	~~Jan. 1, 2013~~
~~Accumulated ——— Benefit Obligation~~	~~———— \$(6,240)~~	~~———— \$(6,240)~~
~~Plus: Non-Vested Liability~~	~~———— (100)~~	~~———— (100)~~
~~Total Accumulated Benefit Obligation~~	~~———— \$(6,340)~~	~~———— \$(6,340)~~
~~Projected Benefit Obligation~~	~~———— \$(6,437)~~	~~———— \$(6,437)~~
~~Plus: Non-Vested liability~~	~~———— (100)~~	~~———— (100)~~
~~Total PBO~~	~~———— \$(6,537)~~	~~———— \$(6,537)~~
~~Plan Assets at Fair Value~~	~~———— \$9,268~~	~~———— \$9,268~~
~~Funded Status~~	~~———— \$2,731~~	~~———— \$2,731~~
~~Transition Obligation / (Asset)~~	~~———— \$36~~	
~~Prior Service Cost~~	~~———— 214~~	
~~Prior Service Cost (Non-Vested)~~	~~———— 100~~	
~~Unrecognized Losses / (Gains)~~	~~———— 2,465~~	
~~Total Unrecognized Items~~	~~———— \$2,815~~	~~—~~
~~Net Overfunded Plan Asset / (Liability for Benefits)~~	~~———— \$5,546~~	~~———— \$2,731~~

~~In the March 31, 2013, financial statements, the \$2,731 overfunded plan assets was reflected as follows:~~

- ~~• Prepaid Benefit Cost \$5,546 (nonadmitted)~~
- ~~• Overfunded Plan Asset \$(2,815) (nonadmitted)~~

~~These amounts are reported net in Aggregate Write-Ins for Other-Than-Invested Assets:
\$2,731~~

Not for Distribution

Illustration of Example 1—Overfunded Plan with Prepaid Benefit Cost

	~~Aggregate Write-In for Other Than Invested Assets~~		~~Nonadmitted Assets~~	~~Unassigned Funds~~	~~Periodic Pension Cost~~	~~Aggregate Write-In for Other Liabilities~~
	~~Prepaid Benefit Cost~~	~~Overfunded Plan Asset~~				
Existing Balances 12/31/2012	5,546DR		5,546CR			
Transition Entries—1/1/2013						
A		2,815CR		2,815DR		
B			2,815DR	2,815CR		
After Transition	5,546DR	2,815CR	2,731CR	—		
After Transition—Net	2,731DR		2,731CR	—		
A—Recognize “unrecognized items” existing at 1/1/13 transition date (gains or losses, prior service costs or credits, and transition assets or obligations). For this plan, which is overfunded by more than the unrecognized liabilities, the entry at transition will be netted against the existing overfunded plan asset with an offset to unassigned funds. B—Illustrates the impact to the “change in nonadmitted” as a result of the decline in overfunded plan assets. For this particular example, with the transition entry to unassigned funds and the impact to nonadmitted assets, there is no surplus impact at transition. At transition, the net balance in aggregate write-ins reflects the overfunded state of the plan.						
Recognition of Net Periodic Pension Cost—12/31/2013						
C	1,013CR				1,013DR	—
D		563DR		563CR		
E			1,013DR	1,013CR		
F			563CR	563DR		
Net Impact	450CR		450DR	1,013CR	1,013DR	
Ending	4,533DR	2,252CR	2,281CR	1,013CR	1,013DR	
Ending Balances—Net	2,281DR		2,281CR	—		
C—Reflects the periodic pension cost with an offset to the prepaid pension asset.						

~~D—Recognizes the transition amounts amortized through net periodic pension cost. The offset is to unassigned funds (as that was how the “unrecognized items” were recognized at transition).~~

~~E/F—Reflects the change in nonadmitted assets to unassigned funds.~~

Recognition of Net Periodic Pension Cost—12/31/2014

G	3,563CR				3,563DR	
H		1,282DR		563CR		719CR
I			3,563DR	3,563CR		
J			1,282CR	1,282DR		
Net Impact	2,281CR		2,281DR	2,844CR	3,563DR	719CR
Ending Balances	970-DR	970-CR	—	2,844CR	3,563DR	
Ending Balances—Net	—		—	719DR		719CR

~~G/H—Reflects the periodic pension cost with an offset to the prepaid pension asset. As no contributions have been made, the 2014 pension cost moves the plan from an overfunded to underfunded state. The overfunded plan asset credit is reduced to equally offset the remaining prepaid benefit cost of \$970. The underfunded status is then reflected through a liability for pension benefits (aggregate write-in for other liabilities).~~

~~I/J—Reflects the change in nonadmitted assets to unassigned funds.~~

~~2. Underfunded Plan with Accrued Benefit Cost~~~~Consideration of contributions or tax effects are not reflected in this example.~~

~~Example 2~~	~~Dec. 31, 2012~~	~~Jan. 1, 2013~~
~~Accumulated Benefit Obligation~~	~~\$(2,015)~~	~~\$(2,015)~~
~~Plus: Non-Vested Liability~~	~~(60)*~~	~~(60)~~
~~Total Accumulated Benefit Obligation~~	~~\$(2,075)~~	~~\$(2,075)~~
~~Projected Benefit Obligation~~	~~\$(2,268)~~	~~\$(2,268)~~
~~Plus: Non-Vested Liability~~	~~(60)~~	~~(60)~~
~~Total PBO~~	~~\$(2,328)~~	~~\$(2,328)~~
~~Plan Assets at Fair Value~~	~~\$1,992~~	~~\$1,992~~
~~Funded Status~~	~~\$(336)~~	~~\$(336)~~
~~Transition Obligation / (Asset)~~	~~\$(544)~~	
~~Prior Service Cost / (Credit)~~	~~(494)~~	
~~Prior Service Cost (Non-Vested)~~	~~60~~	
~~Unrecognized Losses / (Gains)~~	~~926~~	
~~Total Unrecognized Items~~	~~\$(52)~~	~~-~~
~~Net Overfunded Plan Asset / (Liability for Benefits)~~	~~\$(388)~~	~~\$(336)~~

~~*The amount shown for December 31, 2012, reflects the non-vested liability, which must be considered at transition under SSAP No. 102. However, the non-vested liability is not a factor in the December 31, 2012, financial statements under SSAP No. 89.~~

~~Overfunded Plan Asset and Liability for Benefits are terms to reflect the overfunded and underfunded status of the plan. For the amounts shown as of December 31, 2012, immediately prior to the effective date of the new standard, these terms reflect the balance sheet position. As overfunded plan assets are not admitted, these prepaids shall be reported within Aggregate Write-Ins for Other Than Invested Assets. Transition liabilities recognized that have not been reflected through expense shall be reported within Aggregate Write-Ins for Liabilities.~~

~~2a. January 1, 2013 – Transition Date – Recognize “Unrecognized Items”~~

~~1. Liability for Pension Benefits~~	~~52~~
~~(Aggregate Write-In for Liabilities)~~	
~~Unassigned Funds – Prior Service Cost (Nonvested)~~	~~60~~
~~Unassigned Funds – Unrecognized Losses~~	~~926~~
~~Unassigned Funds – Transition Asset~~	~~544~~
~~Unassigned Funds – Prior Service Credit~~	~~494~~

~~For this plan, which is underfunded but has a net unrecognized asset, at transition the entity will improve their surplus presentation by \$52 through a contra-liability. Use of the contra-liability is necessary, as if the item were recorded as an asset, it would be nonadmitted and result in a surplus reduction. Although there is a net unrecognized asset, this plan is in an underfunded state.~~

~~2b. December 31, 2013 – Recognition of Net Periodic Pension Cost~~

~~Components of Net Periodic Cost~~	~~Dec. 31, 2012~~
~~Service Cost~~	~~250~~
~~Interest Cost~~	~~100~~
~~Expected Return on Plan Assets~~	~~(50)~~
~~Total~~	~~300~~
~~Amortization of:~~	
~~o Transition Obligation (Asset)~~	~~(272)~~

~~○ Prior Service Cost / (Credit)~~	~~(247)~~
~~○ Prior Service Cost (nonvested)~~	~~30~~
~~○ Unrecognized Losses~~	~~463~~
~~Total~~	~~(26)~~
~~Total Net Periodic Pension Cost~~	~~274~~

~~1. Unassigned Funds – Transition Asset 272~~

~~Unassigned Funds – Prior Service Credit 247~~

~~Unassigned Funds – Prior Service Cost (Nonvested) 30~~

~~Unassigned Funds – Unrecognized Losses 463~~

~~Liability for Pension Benefits 26~~

~~(Aggregate Write-In for Liabilities)~~

~~This entry occurs to amortize the transition items. Due to the nature of the unrecognized items (net asset – recorded as a contra liability), this entry reverses the original entry to remove the portion that will be amortized into periodic pension cost for the current period.~~

~~2. Net Periodic Pension Cost 274~~

~~Accrued Benefit Cost 274~~

~~This entry recognizes the net periodic pension cost for the service cost, interest cost, expected return on plan assets and the amortization of the unrecognized items.~~

~~Note: All references to “accrued benefit cost” represent an unpaid expense liability, these amounts will be reflected within general expenses due and accrued (life) or LAE/Other Underwriting expenses (p/c).~~

~~Note: This example uses a 2-year amortization period of the “unrecognized items.” In actuality, amortization periods of each item will vary. Disclosures shall continue to separately present these items.~~

2c. ~~December 31, 2014 – Recognition of Net Periodic Pension Cost~~

~~Components of Net Periodic Cost~~	~~Dec. 31, 2014~~
~~Service Cost~~	~~2500~~
~~Interest Cost~~	~~1000~~
~~Expected Return on Plan Assets~~	~~(500)~~
~~Total~~	~~3,000~~
~~Amortization of:~~	
<del>○ ~~Transition Obligation /~~</del> ~~(Asset)~~	~~(272)~~
<del>○ ~~Prior Service Cost /~~</del> ~~(Credit)~~	~~(247)~~
<del>○ ~~Prior Service Cost~~</del> ~~(nonvested)~~	~~30~~
<del>○ ~~Unrecognized Losses~~</del>	~~463~~
~~Total~~	~~(26)~~
~~Total Net Periodic Pension Cost~~	~~2,974~~

<del>1. ~~Unassigned Funds – Transition Asset~~</del>	~~272~~
~~Unassigned Funds – Prior Service Credit~~	~~247~~
~~Unassigned Funds – Prior Service Cost (Nonvested)~~	~~30~~
~~Unassigned Funds – Unrecognized Losses~~	~~463~~
~~Liability for Pension Benefits~~	~~26~~
~~(Aggregate Write-In for Liabilities)~~	

~~This entry occurs to amortize the transition items. Due to the nature of the unrecognized items (net asset – recorded as a contra liability), this entry reverses the original entry to remove the portion that will be amortized into periodic pension cost for the current period.~~

<del>2. ~~Net Periodic Pension Cost~~</del>	~~2,974~~

Accrued Benefit Cost **2,974**

This entry recognizes the net periodic pension cost for the service cost, interest cost, expected return on plan assets and the amortization of the unrecognized items.

Illustration 2—Paragraph 97 Example Note Disclosure:

SSAP No. 102 became effective January 1, 2013. This SSAP requires that any underfunded defined benefit pension amounts, as determined when the projected benefit obligation exceeds the fair value of plan assets, to be recognized as a liability under SSAP No. 5R. Such liability is required to be reported in the first quarter statutory financial statement after the transition date with a corresponding entry to unassigned funds. At transition, ABC entity recognized a net \$52 asset from unrecognized transition obligations/assets, prior service costs/credits, and unrecognized gains/losses as a component of the ending balance of unassigned funds as of January 1, 2013. This net impact was reflected as a contra liability as the plan is in an underfunded state.

***For purposes of this example, tax effects are not reflected. However, the amount recognized at transition as components of the unassigned funds shall be net of tax.*

The following provides the status of the pension plan as of December 31, 2012, and the transition date (January 1, 2013):

Example 2	Dec. 31, 2012	Jan. 1, 2013
Accumulated Benefit Obligation	\$(2,015)	\$(2,015)
Plus: Non-Vested Liability	(60)	(60)
Total Accumulated Benefit Obligation	\$(2,075)	\$(2,075)
Projected Benefit Obligation	\$(2,268)	\$(2,268)
Plus: Non-Vested Liability	(60)	(60)
Total PBO	\$(2,328)	\$(2,328)
Plan Assets at Fair Value	\$1,992	\$1,992

Funded Status	~~—————\$(336)~~	~~—————\$(336)~~
Transition Obligation / (Asset)	~~—————\$(544)~~	
Prior Service Cost / (Credit)	~~—————(494)~~	
Prior Service Cost (Non-Vested)	~~—————60~~	
Unrecognized Losses / (Gains)	~~—————926~~	
Total Unrecognized Items	~~—————\$(52)~~	~~—~~
Net Overfunded Plan Asset / (Liability for Benefits)	~~—————\$(388)~~	~~—————\$(336)~~

~~In the March 31, 2013, financial statements, underfunded pension obligations were reflected as follows:~~

- ~~• ——— Accrued Benefit Cost — \$388~~
- ~~• ——— Liability for Pension Benefits (Aggregate Write-In for Liabilities) — (\$52)~~

~~Illustration of Example 2 — Underfunded Plan with Accrued Benefit Cost~~

	~~Net — Periodic Cost (Expense Recognition)~~	~~Unassigned~~	~~Aggregate Write-In~~	
~~Existing Balance — 12/31/2012~~		~~388DR~~		~~388CR~~
~~Transition Entries — 1/1/2013~~				
~~A~~		~~52CR~~	~~52DR~~	
~~After Transition~~		~~336DR~~	~~52DR~~	~~388CR~~
~~A. ——— Recognize “unrecognized” items at transition. The above entry reflects the “net” impact, resulting with an unrecognized net asset (contra-liability) and an increase to the surplus presentation. (This unrecognized net asset is reflected as a contra-liability as it does not reflect a prepaid for the overfunding of plan assets. If this was reflected as an asset, it would be nonadmitted.)~~				

~~Recognition of Net Periodic Pension Cost — 12/31/2013~~				
~~B~~		~~26-DR~~	~~26-CR~~	
~~C~~	~~274-DR~~			~~274-CR~~
~~B. — Entry amortizes the transition items (entry is shown net.) Due to the nature of the unrecognized items, (net asset, recorded as a contra liability), this entry reverses the original entry to remove the portion that will be amortized into net periodic pension cost for the current period.~~ ~~C. — Entry recognizes the net periodic pension cost, interest cost, expected return on plan assets, and the amortization of the unrecognized items.~~				
~~Recognition of Net Periodic Pension Cost — 12/31/2014~~				
~~D~~		~~26-DR~~	~~26-CR~~	
~~E~~	~~2,974-DR~~			~~2,974-CR~~
~~D. — Entry occurs to amortize the transition items (entry is shown net). Due to the nature of the unrecognized items, (net asset, recorded as a contra liability), this entry reverses the original entry to remove the portion that will be amortized into net periodic pension cost for the current period.~~ ~~E. — Entry recognizes net periodic pension cost the service cost, interest cost, expected return on plan assets and the amortization of the unrecognized items.~~				

~~3. — Underfunded Plan with Accrued Benefit Cost with Surplus Deferral Elected~~

~~Consideration of contributions or tax effects are not reflected in this example.~~

~~Example 3~~	~~Dec. 31, 2012~~	~~Jan. 1, 2013~~
~~Accumulated — Benefit Obligation~~	~~— \$(1,819)~~	~~— \$(1,819)~~
~~Plus: Non-Vested Liability~~	~~— (103)*~~	~~— (103)~~
~~Total Accumulated Benefit Obligation~~	~~— \$(1,922)~~	~~— \$(1,922)~~

~~Projected Benefit Obligation~~	~~———— \$(2,099)~~	~~———— \$(2,099)~~
~~Plus: Non-Vested Liability~~	~~———— (103)~~	~~———— (103)~~
~~Total PBO as of January 1, 2012~~	~~———— \$(2,202)~~	~~———— \$(2,202)~~
~~Plan Assets at Fair Value~~	~~———— \$0~~	~~———— \$0~~
~~Funded Status~~	~~———— \$(2,202)~~	~~———— \$(2,202)~~
~~Transition Obligation / (Asset)~~	~~———— \$0~~	
~~Prior Service Cost~~	~~———— 0~~	
~~Prior Service Cost (Non-Vested)~~	~~———— 103~~	
~~Unrecognized Losses / (Gains)~~	~~———— 440~~	
~~Total Unrecognized Items~~	~~———— 543~~	~~—~~
~~Net Overfunded Plan Asset / (Liability for Benefits)~~	~~———— \$(1,659)~~	~~———— \$(1,922)~~

~~* The amount shown for December 31, 2012, reflects the non-vested liability, which must be considered at transition under SSAP No. 102. However, the non-vested liability is not a factor in the December 31, 2012, financial statements under SSAP No. 89.~~

~~Overfunded Plan Asset and Liability for Benefits are terms to reflect the overfunded and underfunded status of the plan. For the amounts shown as of December 31, 2012, immediately prior to the effective date of the new standard, these terms reflect the balance sheet position. As overfunded plan assets are not admitted, these prepaids shall be reflected within Aggregate Write-Ins for Other Than Invested Assets. Transition liabilities recognized that have not been reflected through expense shall be reflected within Aggregate Write-Ins for Liabilities.~~

~~As illustrated above, the liability for pension benefits as of January 1, 2013, does not equal the underfunded plan status as the entity elected the transition deferral. Rather, the liability for pension benefits equals, at a minimum, the accumulated benefit obligation (ABO) less the plan asset at fair value. (Minimum transition liability that equals the ABO is required in accordance with paragraph 93.) After the transition period, the net overfunded plan asset / (liability for benefits) should equal the funded status of the plan.~~

~~3a. January 1, 2013 Transition Date Recognize "Unrecognized Items"~~

~~In accordance with paragraph 93, the surplus impact initially recognized as of January 1, 2013 under the transition option, and subsequently over the transition period, shall be the greater of:~~

	~~Minimum Transition Liability~~	
~~93.b.i.~~	~~10% of Calculated Surplus Impact~~	~~54.3~~
~~93.b.ii.~~	~~Anticipated Annual Amortization of "Unrecognized Items" (Assumes 5-year Uniform Amortization)~~	~~108.6~~
~~93.b.iii.~~	~~Difference Between ABO and Accrued Benefit Cost~~	~~263~~
	~~Transition Liability~~	~~263~~

~~Note: Amortization of the unrecognized items (paragraph 93.b.ii.) may not be determinable at transition. If the amortization amount that will be recognized year-end 2013 is unknown at the transition date, at a minimum, the amount amortized for "unrecognized items" during the prior year shall be utilized for the component in paragraph 93.b.ii. of the minimum transition liability. If the amount recognized for transition (greater of all three components in paragraph 93.b.) is subsequently determined to be less than what is amortized for the year (paragraph 93.b.ii.), the difference between what was recognized for transition, and what is amortized must immediately be recognized as an adjustment to the transition impact to unassigned funds—surplus.)~~

~~January 1, 2013—Transition Date:~~

~~Reversal of Additional Minimum Liabilities/Intangible Plan Assets: As this plan has an unfunded ABO, following the guidance under SSAP No. 89, the entity had recognized an additional minimum liability and corresponding admitted intangible asset. As the concept of an additional minimum liability has been eliminated from SSAP No. 102, at transition these amounts are eliminated, with the determination of the overfunded/unfunded projected benefit obligation calculated subsequent to the elimination.~~

~~Balances as of 12/31/2012 under SSAP No. 89:~~

~~Accumulated Benefit Obligation: \$1,819~~

~~Accrued Liability: \$1,659~~

~~SSAP No. 89 Additional Minimum Liability: \$160~~

~~SSAP No. 89 Admitted Intangible Asset: \$160~~

~~Unassigned Funds 160~~

~~Intangible Asset 160~~

~~Additional Minimum Liability 160~~

~~Unassigned Funds 160~~

~~Application of SSAP No. 102 — Recognition of Unfunded Status with Surplus Deferral:~~

~~1. Unassigned Funds — Transition Liability 263~~

~~Liability for Pension Benefits 263~~

~~(Aggregate Write-In for Liabilities)~~

~~This entry represents the minimum transition liability required to be recognized at the transition date. As noted within the transition guidance, an entity may elect to transition the surplus impact over a period not to exceed 10 years. Paragraph 93 provides the specifications on the minimum liability recognized at transition. As this transition liability amount has yet to be recognized through expense (periodic cost), the liability is reflected through “aggregate write-ins for liabilities.”~~

~~3b. December 31, 2013 — Recognition of Net Periodic Pension Cost~~

~~Components of Net Periodic Cost~~	~~Dec. 31, 2013~~
~~Service Cost~~	~~250~~
~~Interest Cost~~	~~100~~
~~Expected Return on Plan Assets~~	~~(50)~~

~~Total~~	~~300~~
~~Amortization of:~~	
~~o Prior Service Cost (nonvested)~~	~~20.6~~
~~o Unrecognized Losses~~	~~88~~
~~Total~~	~~108.6~~
~~Total Net Periodic Pension Cost~~	~~408.6~~

~~1. Liability for Pension Benefits 108.6~~

~~(Aggregate Write-In for Liabilities)~~

~~Unassigned Funds – Prior Service Cost (Nonvested) 20.6~~

~~Unassigned Funds – Unrecognized Losses 88~~

~~This entry occurs prior to amortization of the transition items. This entry reverses a portion of the original transition entry for the amount that will be amortized into periodic pension cost for the current period.~~

~~2. Net Periodic Pension Cost 408.6~~

~~Accrued Benefit Cost 408.6~~

~~This entry recognizes net periodic pension cost for the service cost, interest cost, expected return on plan assets and amortization of the unrecognized items.~~

~~Note: Although the entity elected the transition option for surplus deferral, and the guidance allows up to 10 years for deferral, an entity must continue to recognize a minimum amount of the transition liability as determined in accordance with paragraph 93.b. This requires the entity to recognize an amount that is at the greater of either 10% of the initial surplus impact or the amortization of the unrecognized items in effect at transition.~~

~~In this example, the entity will only receive a 3-year deferral. This illustration assumes 5-year uniform amortization of the transition amounts into expense for illustration purposes only. In practice, the minimum transition liability amounts may not be determinable until the expense is calculated in each future year.~~

Surplus Impact at Transition		Prior Service Cost	Unrealized Losses	
Transition Liability:	543	103	440	
Amount Recognized Jan. 1, 2013	(263)			
Remaining Transition Liability	280			
				Remaining
Minimum Transition Liability:		Anticipated Amortization:		Transition Liability
2014	108.6	20.6	88	171.4
2015	108.6	20.6	88	62.8
2016	62.8	12	50.8	—

3c. December 31, 2014 — Recognition of Transition Liability:

1. Unassigned Funds — Transition Liability 108.6

Liability for Pension Benefits 108.6

(Aggregate Write-In for Liabilities)

This entry represents the minimum transition liability required to be recognized at the subsequent date.

3d. December 31, 2014 — Recognition of Net Periodic Benefit Cost

Components of Net Periodic Cost	Dec. 31, 2014
Service Cost	50
Interest Cost	30
Expected Return on Plan Assets	(35)

~~Total~~	~~45~~
~~Amortization of:~~	
~~○ Prior Service Cost (nonvested)~~	~~20.6~~
~~○ Unrecognized Losses~~	~~88~~
~~Total~~	~~108.6~~
~~Total Net Periodic Pension Cost~~	~~153.6~~

~~1. Liability for Pension Benefits 108.6~~

~~(Aggregate Write-In for Liabilities)~~

~~Unassigned Funds – Prior Service Cost (Nonvested) 20.6~~

~~Unassigned Funds – Unrecognized Losses 88~~

~~2. Net Periodic Pension Cost 153.6~~

~~Accrued Benefit Cost 153.6~~

~~This entry illustrates the December 2014 entries. The first removes the liability recognized for transition so that it could be recycled through expense, with the second recognizing net periodic cost (including the amortization of the unrecognized items.)~~

~~3e. December 31, 2015 Activity within the pension plan has resulted with an overfunded plan.~~

~~As required under paragraph 93, if the fair value of plan assets had changed so that the plan was in an overfunded status, the transition liability would also be impacted with accelerated recognition to the extent the plan is in an overfunded status:~~

~~Components of Net Periodic Cost~~	~~Dec. 31, 2015~~
~~Service Cost~~	~~100~~
~~Interest Cost~~	~~75~~

Expected Return on Plan Assets	(50)
Total	125
Amortization of:	
o Prior Service Cost (nonvested)	20.6
o Unrecognized Losses	88
Total	108.6
Total Net Periodic Pension Cost	233.6

Recognition of Remaining Transition Liability and Net Periodic Pension Cost:

1. **Unassigned Funds — Transition Liability** **171.40**
Liability for Pension Benefits **171.40**
(Aggregate Write-In for Liabilities)

This entry illustrates the immediate recognition of the remaining transition liability

2. **Liability for Pension Benefits** **108.6**
(Aggregate Write-In for Liabilities)
Unassigned Funds — Prior Service Cost (Nonvested) **20.6**
Unassigned Funds — Unrecognized Losses **88**

This entry reflects the amortization into net periodic pension cost of the “unrecognized items” within unassigned funds. Amortization has not changed with the recognition of the remaining transition liability.

3. **Net Periodic Pension Cost** **233.60**
Accrued Benefit Cost **233.60**

Recognizes net periodic pension cost for the service cost, interest cost, expected return on plan assets, and the amortization of unrecognized items.

~~4. **Accrued Benefit Cost** **2,456**~~

~~**Prepaid Benefit Cost** **844**~~

~~**(Aggregate Write-In – Assets)**~~

~~**Cash – Contribution** **3,300**~~

~~*This entry recognizes the cash contribution, the elimination of the accrued benefit cost and the establishment of the prepaid benefit cost from the contribution.*~~

~~5. **Liability for Pension Benefits** **217**~~

~~**Overfunded Plan Asset** **217**~~

~~*Since the plan is now in a net overfunded status, the liability for pension benefits is reduced to zero, and offset to the overfunded pension asset (contra-asset).*~~

~~6. **Unassigned Funds (Change in Nonadmitted)** **844**~~

~~**Prepaid Benefit Cost (Nonadmitted)** **844**~~

~~*This entry recognizes the prepaid benefit cost that is nonadmitted and the underlying impact on unassigned funds.*~~

~~7. **Overfunded Plan Asset (Nonadmitted)** **217**~~

~~**Unassigned Funds (Change in Nonadmitted)** **217**~~

~~*This entry illustrates the impact of the change in nonadmitted overfunded plan asset to unassigned funds.*~~

~~Example 3 – Comprehensive Illustration~~

~~*Consideration of contributions or tax effects are not reflected in the example.*~~

Underfunded Plan With Accrued Benefit Cost – Surplus Deferral Elected

		12/31/2012	1/1/2013	12/31/2013	12/31/2014	12/31/2015
ABO		(1,819)	(1,819)	(2,019)	(2,049)	(2,079)
Non-Vested Liability		(103)	(103)	(103)	(103)	(103)
Total ABO	A	(1,922)	(1,922)	(2,122)	(2,152)	(2,182)
-						
PBO	B	(2,099)	(2,099)	(2,399)	(2,444)	(2,569)
Non-Vested Liability	C	(103)	(103)	(103)	(103)	(103)
Total PBO	D	(2,202)	(2,202)	(2,502)	(2,547)	(2,672)
-						
Plan Assets at Fair Value	E	-	-	-	-	3,300
Funded Status	F	(2,202)	(2,202)	(2,502)	(2,547)	628
-						
Items Not Recognized in Unassigned Funds						
Transition Obligation (Asset)		-	-	-	-	-
Prior Service Cost		-	-	-	-	-
Prior Service Cost Non-Vested	G	103	-	-	-	-
Unrecognized Losses (Gains)	H	440	-	-	-	-
Total Unrecognized Items	I	543	-	-	-	-
Transition Items – Aggregate W/	J		(263)		(109)	(171)
Unassigned Funds – Transition	K			109	109	109
Periodic Pension Cost	L			(300)	(45)	(125)
Periodic Pension Cost – Amort.	M			(109)	(109)	(109)
Contribution	N		-	-	-	3,300
Overfunded Plan Asset	O	(1,659)	(1,922)	(2,222)	(2,376)	628
(Liability for Benefits)						
Unrecognized Transition Items	P		(280)	(280)	(171)	-

Funded Status	Q		(2,202)	(2,502)	(2,547)	628
Liability Reported Beg of Year	R		(1,659)	(1,922)	(2,222)	(2,375)
Recognized Transition Items	S		(263)		(109)	(171)
Unassigned Funds	T			109	109	109
Net Periodic Pension Cost	U		—	(409)	(154)	(235)
Contribution	V		—	—		3,300
Accrued/Prepaid End of Year	W	(1,659)	(1,922)	(2,222)	(2,375)	628
Unrecognized Items	X		(280)	(280)	(171)	0
Funded Status	Y		(2,202)	(2,502)	(2,547)	628
Reporting Lines:	-					
Accrued Benefit Cost	Z	1,659	1,659	2,068	2,221	0
Aggregate WI—Net Asset	AA					628
Aggregate WI—Liability	BB		263	154	154	0
Total Liability/(Asset) Reported	CC	1,659	1,922	2,222	2,376	(628)
Unfunded/(Overfunded) Status	DD		2,202	2,502	2,547	(628)
——— Liability Not Reported	EE		280	280	171	0

Underfunded Plan with Accrued Benefit Cost—Surplus Deferral Elected

Jan. 1, 2013
Transition

Entry A—Recognize Minimum Transition Liability

Unassigned Funds	263	
Liability for Pension Benefits		263
(Aggregate Write-In for Liabilities)		

Dec. 31, 2013—Recognize Periodic Pension Cost

Unassigned Funds	109

~~Entry B - Recognize net periodic cost~~

Accrued Benefit Cost 409

~~Dec. 31, 2014 - Recognize Transition and Periodic Pension Cost~~

~~Entry A - Recognize transition liability~~

~~(Aggregate Write-In for Liabilities)~~

~~Entry B – Reverses portion of transition entry for the amount that will be amortized into periodic cost for the period.~~

Unassigned Funds	109

~~Entry C—Recognize net periodic cost~~

~~Net Periodic Cost~~	~~154~~	
~~Accrued Benefit Cost~~		~~154~~

~~Dec. 31, 2015—Recognize Transition and Periodic Pension Cost~~~~Entry A—Recognize transition liability~~

~~Unassigned Funds~~	~~171~~	
~~Liability for Pension Benefits~~		~~171~~
~~(Aggregate Write-In for Liabilities)~~		

~~Entry B—Reverses portion of transition entry for the amount that will be amortized into periodic cost for the period.~~

~~Liability for Pension Benefits~~	~~109~~	
~~(Aggregate Write-In for Liabilities)~~		
~~Unassigned Funds~~		~~109~~

~~Entry C—Recognize net periodic cost~~

~~Net Periodic Cost~~	~~234~~	
~~Accrued Benefit Cost~~		~~234~~

~~Entry D—Recognize Cash Contribution~~

~~Accrued Benefit Cost~~	~~2,456~~	
~~Prepaid Benefit Cost~~	~~844~~	
~~(Aggregate Write-In Assets)~~		
~~Cash Contribution~~		~~3,300~~

~~Entry E – Reduce Liability to Zero and Record Overfunded Plan Asset~~

~~Liability for Pension Benefits~~	~~217~~	
~~Overfunded Plan Asset~~		~~217~~

~~Entry F – Recognize Nonadmitted Asset – Prepaid Benefit Cost~~

~~Unassigned Funds~~	~~844~~	
~~(Change in Nonadmitted)~~		
~~Prepaid Benefit Cost (Nonadmitted)~~		~~844~~

~~Entry G – Recognize Nonadmitted Asset – Overfunded Plan Asset~~

~~Overfunded Plan Asset (Nonadmitted)~~	~~217~~	
~~Unassigned Funds (Change in Nonadmitted)~~		~~217~~

~~Illustration 3 – Paragraph 97 Example Note Disclosure – March 31, 2013:~~

~~SSAP No. 102 became effective January 1, 2013. This SSAP requires that any underfunded defined benefit pension amounts, as determined when the projected benefit obligation exceeds the fair value of plan assets, to be recognized as a liability under SSAP No. 5R. Such liability is required to be reported in the first quarter statutory~~

~~financial statement after the transition date with a corresponding entry to unassigned funds. ABC entity elected to utilize the minimum transition option reflected in paragraph 93 of SSAP No. 102. The SSAP requires initial transition liability to be the greater of paragraphs 93.b.i, 93.b.ii., and 93.b.iii.:~~

	Minimum Transition Liability	
93.b.i.	10% of Calculated Surplus Impact	54.3
93.b.ii.	Annual Amortization of “Unrecognized Items” (Assumes 5-year Uniform Amortization)	108.6
93.b.iii.	Difference Between ABO and Accrued Benefit Cost	263
	-Minimum Transition Liability	263

~~Note – Amortization of the unrecognized items (paragraph 93.b.ii.) may not be determinable at transition. If the amortization amount that will be recognized year-end 2013 is unknown at the transition date, at a minimum, the amount amortized for “unrecognized items” during the prior year shall be utilized for the component in paragraph 93.b.ii. of the minimum transition liability. If the amount recognized for transition (greater of all three components in paragraph 93.b.) is subsequently determined to be less than what is amortized for the year (paragraph 93.b.ii.), the difference between what was recognized for transition, and what is amortized must immediately be recognized as an adjustment to the transition impact to unassigned funds – surplus.~~

~~Although the entity elected the transition option for surplus deferral, and SSAP No. 102 allows up to 10 years for deferral, an entity must continue to recognize a minimum amount of the transition liability as determined in accordance with paragraph 93.b. This requires the entity to recognize each year an amount that is at least equal to the amortization of the unrecognized items in effect at transition. Although the amortization of the transition items into future expenses (paragraph 93.b.ii.) may not be fully determinable at the time of transition (as they are dependent on the future expense calculations), the reporting entity anticipates that the remaining \$280 surplus impact from the election of the transition deferral in SSAP No. 102 will be recognized over a 3-year* period.~~

~~* This is a reporting entity projection and may be revised based on future expenses and activity.~~

~~Recognized Surplus Impact at Transition & Remaining Transition Liability~~		~~Prior Service Cost~~	~~Unrealized Losses~~
~~Transition Liability:~~	~~543~~	~~103~~	~~440~~
~~Amount Recognized Jan. 1, 2013~~	~~(263)~~		
~~Remaining Transition Liability~~	~~280~~		

~~The following provides the status of the pension plan as of December 31, 2012, and the transition date (January 1, 2013):~~

~~Example 3~~	~~Dec. 31, 2012~~	~~Jan. 1, 2013~~
~~Accumulated ——— Benefit Obligation~~	~~\$(1,922)~~	~~\$(1,922)~~
~~Projected Benefit Obligation~~	~~\$(2,099)~~	~~\$(2,099)~~
~~Plus: Non-Vested Liability~~	~~(103)~~	~~(103)~~
~~Total PBO~~	~~\$(2,202)~~	~~\$(2,202)~~
~~Plan Assets at Fair Value~~	~~0~~	~~0~~
~~Funded Status~~	~~\$(2,202)~~	~~\$(2,202)~~
~~Transition Obligation / (Asset)~~	~~0~~	
~~Prior Service Cost~~	~~0~~	
~~Prior Service Cost (Non-Vested)~~	~~103~~	
~~Unrecognized Losses / (Gains)~~	~~440~~	
~~Total Unrecognized Items~~	~~543~~	~~—~~

~~Overfunded Plan Asset / (Liability for Benefits)~~	~~(1,659)~~	~~(1,922)~~

~~In the March 31, 2013, financial statements, the \$1,922 liability for pension benefits was reflected in the financial statements as follows:~~

- ~~• Aggregate Write-Ins for Liabilities: \$263~~
- ~~• Accrued Benefit Cost: \$1,659~~
- ~~• Surplus Deferral - Unrecognized Transition Liability - \$280~~

~~(Note – This disclosure shall be completed on a quarterly and annual basis, with updated financial information reflecting the current and prior reporting periods, until the plan is fully funded without any transition liability remaining.)~~

~~Illustration 3 – Paragraph 97 Example Note Disclosure – December 31, 2015 – After Overfunded Contribution:~~

~~At December 31, 2015, ABC entity contributed \$3,300 towards the pension plan. This contribution resulted in the plan being in an overfunded status. Pursuant to the requirements of SSAP No. 102, ABC immediately recognized the remaining transition liability (\$171.40). Although the transition liability has been fully recognized to unassigned funds, the amortization of the liability into net periodic pension cost has not changed.~~

~~Although the entity elected the transition option for surplus deferral, and SSAP No. 102 allows up to 10 years for deferral, with the contribution resulting in an overfunded-plan status, ABC entity was restricted to a 3-year transition schedule as follows:~~

~~January 1, 2013 (Transition)~~	~~\$263.00~~
~~December 31, 2014~~	~~\$108.60~~
~~December 31, 2015~~	~~<u>\$171.40</u>~~
~~Total Transition Liability~~	~~\$543.00~~

~~In the December 31, 2015, annual financial statements, pension obligations were reflected as follows:~~

- ~~Prepaid Benefit Cost—\$844 (Nonadmitted)~~
- ~~Overfunded Plan Asset—\$(217) (Nonadmitted)~~

~~These amounts are both reported as Aggregate Write-Ins for Other Than Invested Assets resulting in a net \$628.~~

Not for Distribution

~~4. Underfunded Plan with Prepaid Benefit Cost—No Surplus Deferral Elected~~**~~Consideration of contributions or tax effects are not reflected in this example.~~**

Example 4	Dec. 31, 2012⁹	Jan. 1, 2013	Dec. 31, 2013	Jan. 1, 2014	Dec. 31, 2014
Accumulated Benefit Obligation	(1,532)	(1,532)	(1,732)	(1,732)	(1,957)
Plus: Non-Vested Liability	(100)	(100)	(100)	(100)	(100)
Total Accumulated Benefit Obligation	\$ (1,632)	\$ (1,632)	(1,832)	(1,832)	(2,057)
Projected Benefit Obligation	\$(1,752)	\$(1,752)	(2,052)	(2,052)	(2,277)
Plus: Non-Vested liability	(100)	(100)	(100)	(100)	(100)
Total PBO	\$(1,852)	\$(1,852)	(2,152)	(2,152)	(2,377)
Plan Assets at Fair Value	1,600	1,600	1,600	2,500	2,500
Funded Status	(\$252)	(\$252)	(552)	348	123
Transition Obligation / (Asset)	0	0	0	0	0
Prior Service Cost	48	0	0	0	0
Prior Service Cost (Non-Vested)	100	0	0	0	0
Unrecognized Losses / (Gains)	600	0	0	0	0
Total Unrecognized Items	748	0	0	0	0
Net Overfunded Plan Asset / (Liability for Benefits)	496	(252)	(552)	348	123

~~Overfunded Plan Asset and Liability for Benefits are terms to reflect the overfunded and unfunded status of the plan. For the amounts shown as of December 31, 2012 immediately prior to the effective date of the new standard, these terms reflect the~~

⁹ The amount shown for December 31, 2012, reflects the non-vested liability, which must be considered at transition under SSAP No. 102. However, the non-vested liability is not a factor in the December 31, 2012, financial statements under SSAP No. 89.

~~balance sheet position. As overfunded plan assets are not admitted, these prepaids shall be reflected within Aggregate Write-Ins for Other Than Invested Assets. Transition liabilities recognized that have not been reflected through expense shall be reflected within Aggregate Write-Ins for Liabilities.~~

~~January 1, 2013—Transition Date, Recognize “Unrecognized Items”~~

~~A.——Unassigned Funds——Prior Service Cost——48~~

~~Unassigned Funds——Prior Service Cost (Non-vested)——100~~

~~Unassigned Funds——Unrecognized Losses——600~~

~~Liability for Plan Benefits——252~~

~~(Aggregate Write-In for Liabilities)~~

~~Overfunded Plan Asset——496~~

~~(Aggregate Write-In for Other Than Invested Assets)~~

~~B.——Change in Nonadmitted——Overfunded Plan Asset——496~~

~~Unassigned Funds——496~~

~~Prepaid Benefit Cost and Overfunded Plan Assets are both reflected as Aggregate Write-Ins for Other Than Invested Assets. However, Prepaid Benefit Cost can only be reduced with a corresponding income statement impact. Entry A, which uses a contra-asset, effectively results with a net elimination of the assets reported for the plan and establishes the appropriate liability to reflect the unfunded status. (Reporting entities will need to continue to track these categories separately.)~~

~~December 31, 2013—Recognition of Net Periodic Pension Cost~~

~~After transition, recognition of net periodic pension cost includes: 1) service cost, 2) interest cost, 3) expected return on plan assets, 4) amortization of prior service cost included in unassigned funds, 5) amortization of gains and losses and 6) amortization of any transition asset or obligation remaining in unassigned funds.~~

Components of Net Periodic Cost	Dec. 31, 2013
Service Cost	250
Interest Cost	100

~~Expected Return on Plan Assets~~	~~(50)~~
~~Total~~	~~300~~
~~Amortization of:~~	
~~○ Prior Service Cost~~	~~1.20~~
~~○ Prior Service Cost (nonvested)~~	~~2.50~~
~~○ Unrecognized Losses~~	~~15.00~~
~~Total~~	~~18.70~~
~~Total Net Periodic Pension Cost~~	~~318.70~~

~~C. Liability for Pension Benefits 18.70~~

~~(Aggregate Write-In for Liabilities)~~

~~Unassigned Funds Transition Liability 18.70~~

~~This entry occurs prior to amortization of the items recognized at transition. This entry reverses a portion of the original transition entry for the amount that will be amortized into periodic pension cost for the current period.~~

~~D. Net Periodic Pension Cost 318.70~~

~~Prepaid Benefit Cost 318.70~~

~~(Aggregate Write-In for Other Than Invested Assets)~~

~~This entry recognizes net periodic pension cost for the service cost, interest cost, expected return on plan assets and amortization of the noted items. As the plan has a prepaid benefit cost, the prepaid benefit cost will be reduced with the recognition of periodic cost.~~

~~E. Overfunded Plan Asset 318.70~~

~~(Aggregate Write-In for Other Than Invested Assets)~~

~~Unassigned Funds 318.70~~

~~Entry reflects a reduction in the contra-asset recognized at transition at an amount equal to the reduction of prepaid benefit cost.~~

~~F. Change in Nonadmitted – Prepaid Benefit Cost 318.70~~

~~Unassigned Funds 318.70~~

~~G. Unassigned Funds 318.70~~

~~Change in Nonadmitted – Overfunded Plan Asset 318.70~~

~~Entries to reflect the change in nonadmitted assets for both entries “D” and “E.” These entries offset.~~

~~H. Unassigned Funds 318.70~~

~~Liability for Pension Benefits 318.70~~

~~(Aggregate Write-In for Liabilities)~~

~~Entry recognizes the unfunded liability from the 2013 net periodic costs. This entry assumes no additional changes in the PBO or Fair Value of Plan Assets at year-end. In practice, there will always be changes in the year-end PBO due to changes in the discount rate used to calculate the PBO, actuarial demographics different than expected, etc. An additional variation is actual return on plan assets different from expected return on plan assets. All of these factors will impact the year-end funded status, and will also need to be recorded as part of entry “H” at year-end.~~

~~January 1, 2014 – Contribution~~

	~~Jan. 1, 2014~~
~~Contribution~~	~~\$900~~

~~I. Prepaid Benefit Cost 900~~

~~(Aggregate Write-In for Other-Than-Invested Assets)~~

~~Cash 900~~

~~J. Liability for Pension Benefits 552~~

~~(Aggregate Write-In for Liabilities)~~

~~Overfunded Plan Asset 552~~

~~With the cash contribution, the plan becomes overfunded with a prepaid benefit cost. The contribution directly increases the Prepaid Benefit Cost. The liability for pension benefits is eliminated, with an offset to the Overfunded Plan asset. The plan now has a NET overfunded plan asset of \$348.~~

~~K. Unassigned Funds 900~~

~~Change in Nonadmitted - Prepaid Benefit Cost 900~~

~~L. Change in Nonadmitted - Overfunded Plan Asset 552~~

~~Unassigned Funds 552~~

~~Entries recognize the impact as a result of the nonadmitted overfunded plan asset from entry "I" and "J."~~

~~December 31, 2014 - Recognition of Net Periodic Pension Cost~~

~~After transition, recognition of net periodic pension cost includes: 1) service cost, 2) interest cost, 3) expected return on plan assets, 4) amortization of prior service cost included in unassigned funds, 5) amortization of gains and losses, and 6) amortization of any transition asset or obligation remaining in unassigned funds.~~

~~Components of Net Periodic Cost~~	~~Dec. 31, 2014~~
~~Service Cost~~	~~200~~
~~Interest Cost~~	~~75~~
~~Expected Return on Plan Assets~~	~~(50)~~
~~Total~~	~~225~~
~~Amortization of:~~	
~~o Prior Service Cost~~	~~1.20~~

~~0~~ ~~Prior Service Cost (nonvested)~~	~~2.50~~
~~0~~ ~~Unrecognized Losses~~	~~15.00~~
~~Total~~	~~18.70~~
~~Total Net Periodic Pension Cost~~	~~243.70~~

This example assumes no changes in the amortization timeframe. As noted in footnote 6 of SSAP No. 102, unless otherwise impacted from SSAP No. 102, or in accordance with changes to the pension plan, the amortization of the unrecognized items into net periodic pension cost shall continue to follow the existing amortization schedules in effect on the transition date.

Although the amortization of Prior Service Cost (assuming no additional changes) and non-vested Prior Service Cost will typically follow a straight-line amortization into Net Periodic Pension Cost, this is not the case for the Unrecognized Gains/Losses. The total amount of unrecognized gains/losses subject to amortization will continuously change due to changes in the discount rates, actuarial assumptions, differences between expected and actual return on assets, etc. In addition, unrecognized gains/losses are amortized into expense only to the extent that they exceed the 10% corridor (SSAP 102, paragraph 22). The 10% corridor is based on the greater of the PBO or the Fair Value of Plan assets, and these amounts are also continuously changing. Therefore, the amortization of the gain/loss will never occur on a straight-line basis using the corridor method described in paragraph 22. There is no “amortization schedule” in effect at transition date for the unrecognized gains/losses.

~~M. Overfunded Plan Assets 18.70~~

~~(Aggregate Write-In for Other Than Invested Assets)~~

~~Unassigned Funds Transition Liability 18.70~~

This entry occurs prior to amortization of the transition items. This entry reverses a portion of the original transition entry made to unassigned funds for the amount that will be amortized into periodic pension cost for the current period. Since the plan is currently overfunded, this is offset by overfunded plan asset.

~~N. Unassigned Funds 18.70~~

~~Change in Nonadmitted Overfunded Plan Asset 18.70~~

This entry reflects the change in nonadmitted from entry “M.”

~~O. Net Periodic Pension Cost 243.70~~

~~Prepaid Benefit Cost 243.70~~

~~(Aggregate Write-In for Other-Than-Invested Assets)~~

~~This entry recognizes net periodic pension cost for the service cost, interest cost, expected return on plan assets and amortization of the noted items. As the plan has a prepaid benefit cost, this will be reduced with the recognition of periodic cost. Once that amount is exhausted, an accrued liability would be recorded.~~

~~P. Change in Nonadmitted – Prepaid Benefit Cost 243.70~~

~~Unassigned Funds 243.70~~

~~Entries to reflect the change in nonadmitted assets for entry “O.”~~

~~Example 4 – Underfunded Plan with Prepaid Benefit Cost – No Surplus Deferral Elected:~~

	Aggregate Write-In For Other-Than-Invested Assets	Change in Nonadmitted Assets	Net Periodic Cost	Unassigned Funds	Liability for Pension Benefits	Cash
	Overfunded Plan Asset	Prepaid Benefit Cost				
Existing Balance 12/31/2012		496-DR	496-CR ¹⁰	496-CR 496-DR	-	
Transition Entries 1/1/2013						
A	496-CR			748-DR	252-CR	
B		496-DR		496-CR		
Jan. 1, 2013	496-CR	496-DR	-	252-DR	252-CR	
Jan. 1, 2013 – Net	-		-	252-DR	252-CR	-
Dec. 31, 2013:						

¹⁰ This reflects the change reported in prior years.

C					18.70-GR	18.70-DR	
D		318.70- CR		318.70-DR ¹¹			
E	318.70-DR				318.70-GR		
F			318.70-DR		318.70-GR		
G			318.70-GR		318.70-DR		
H					318.70-DR	318.70-GR	
Dec. 31, 2013	177.30-GR	177.30- DR	—		552-DR	552-GR	
Dec. 31, 2013—Net	—		—	—	552-DR	552-GR	
Jan. 1, 2014							
Contribution——							
I		900-DR					900-GR
J	552-GR					552-DR	
K			900-GR		900-DR		
L			552-DR		552-GR		
After Contribution	729.30-GR	1077.30- DR	348-GR		900-DR	—	900-GR
Jan. 1, 2014—Net	348-DR		348-GR		900-DR	—	900-GR
Dec. 31, 2014:							
M	18.70-DR				18.70-GR		
N			18.70-GR		18.70-DR		
O		243.70- GR		243.70- DR ¹¹			
P			243.70-DR		243.70-GR		
Dec. 31, 2014	710.60-GR	833.60- DR	123-GR		900-DR	—	900-GR
Dec. 31, 2014—Net	123-DR		123-GR		900-DR		900-GR

~~5. Underfunded Plan with Prepaid Benefit Cost—Surplus Deferral, Funded ABO~~

~~Consideration of contributions or tax effects are not reflected in this example.~~

¹¹ ~~Since Net Periodic Cost closes to unassigned funds at the end of each year, the balance does not carry forward.~~

Example 5	Dec. 31, 2012¹²	Jan. 1, 2013	Dec. 31, 2013	Dec. 31, 2014	Jan. 1, 2015	Dec. 31, 2015
Accumulated ——— Benefit Obligation	\$(1,032)	\$(1,032)	\$(1,232)	\$(1,457)	\$(1,457)	\$(1,657)
Plus: Non-Vested Liability	(100)	(100)	(100)	(100)	(100)	(100)
Total Accumulated Benefit Obligation	\$(1,132)	\$(1,132)	(1,332)	(1,557)	(1,557)	(1,757)
Projected ——— Benefit Obligation	\$(1,752)	\$(1,752)	(2,052)	(2,177)	(2,177)	(2,377)
Plus: Non-Vested liability	(100)	(100)	(100)	(100)	(100)	100
Total PBO	\$(1,852)	\$(1,852)	(2,152)	(2,277)	(2,277)	(2,477)
Plan Assets at Fair Value	1,600	1,600	1,600	1,600	2,500	2,500
Funded Status	(\$252)	(\$252)	(552)	(677)	223	23
Transition Obligation/(Asset)	0	0	0	0	0	
Prior Service Cost	48	0	0	0	0	
Prior Service Cost (Non- Vested)	100	0	0	0	0	
Unrecognized Losses/(Gains)	600	0	0	0	0	
Total Unrecognized Items	748	0	0	0	0	
Net — Overfunded — Plan Asset/ — (Liability — for Benefits)	496	(25.20)	(325.20)	(475.40)	223	23
Surplus Impact Deferred		(226.80)	(226.80)	(201.60)	-	-

Surplus Impact — The transition guidance in SSAP No. 92 and SSAP No. 102 requires a minimum of 10% of the surplus impact on the transition date. If a systematic 10-year allocation was applied to the total “unrecognized items” rather than the surplus impact,

¹² The amount shown for December 31, 2012, reflects the non-vested liability, which must be considered at transition under SSAP No. 102. However, the non-vested liability is not a factor in the December 31, 2012, financial statements under SSAP No. 89.

~~there would be a number of years in which a prepaid asset would still be reflected without any impact to surplus even though the plan is underfunded. This is because a reduction in overfunded plan assets alone has a corresponding change to nonadmitted assets, resulting in a net zero surplus impact.~~

~~Determine the initial transition surplus impact under the deferral election:~~

~~In accordance with paragraph 93.b. of SSAP No. 102, the surplus impact initially recognized as of January 1, 2013 under the transition option, and subsequently over the transition period, shall be the greater of:~~

	Minimum Transition Liability	
93.b.i.	10% of Calculated Surplus Impact	25.20
93.b.ii.	Anticipated Annual Amortization of "Unrecognized Items" (Assume 40-year Uniform Amortization)	18.70
93.b.iii.	Difference Between unfunded ABO and Accrued Benefit Cost. (In this example, ABO is fully funded.)	-
	Transition Liability	25.20

~~93.b.ii. Note: If the amortization cannot be determined at transition, at a minimum, the amount amortized for unrecognized items during the prior year shall be utilized for this calculation. If the amount recognized for transition (greater of all three components) is subsequently determined to be less than what was amortized for the year, the difference between what was recognized for transition and what is amortized must immediately be recognized as an adjustment to the transition impact to unassigned funds — surplus.~~

~~January 1, 2013 — Transition Date~~

~~2. — Unassigned Funds — 496~~

~~Overfunded Plan Asset — 496~~

~~(Aggregate Write-In for Other-Than-Invested Assets)~~

~~3. — Change in Nonadmitted — Overfunded Plan Asset — 496~~

~~Unassigned Funds — 496~~

~~4. — Unassigned Funds — Transition Liability — 25.20~~

Liability for Plan Benefits—25.20**(Aggregate for Write-In Liability)**

~~Prepaid Benefit Cost and Overfunded Plan Assets are both reflected as Aggregate Write-Ins for Other-Than-Invested Assets. However, Prepaid Benefit Cost can only be reduced with a corresponding income statement impact. Entry A, which uses a contra-asset, effectively results with a net elimination of the assets reported for the plan. (Reporting entities will need to continue to track these categories separately.) The first two entries (Entry A & B) have a ZERO surplus impact and the third entry recognizes a liability for 10% of the surplus impact calculated at transition as that is the greatest element from paragraph 93.b.~~

December 31, 2013—Recognition of Net Periodic Pension Cost

~~After transition, recognition of net periodic pension cost includes: 1) service cost, 2) interest cost, 3) expected return on plan assets, 4) amortization of prior service cost included in unassigned funds, 5) amortization of gains and losses, and 6) amortization of any transition asset or obligation remaining in unassigned funds.~~

~~As noted in paragraph 93.b., if surplus deferral is elected at the transition date, subsequently, starting with the 2014 year end financial statement, the reporting entity shall annually recognize the remaining surplus impact. As such, unless the entity elects to recognize the remaining surplus impact early (which is permitted under SSAP No. 102), there is no additional surplus impact from transition recognized as of December 31, 2013.~~

Components of Net Periodic Cost	Dec. 31, 2013
Service Cost	250
Interest Cost	100
Expected Return on Plan Assets	(50)
Total	300
Amortization of:	
○ Prior Service Cost	1.20
○ Prior Service Cost (nonvested)	2.50
○ Unrecognized Losses	15.00

Total	18.70
Total Net Periodic Pension Cost	318.70

~~Note — This example assumes no changes in the amortization timeframe. As noted in footnote 5 of SSAP No. 102, unless otherwise impacted from SSAP No. 102, or in accordance with changes to the pension plan, the amortization of the unrecognized items into net periodic pension cost shall continue to follow the existing amortization schedules in effect on the transition date. Although the amortization of Prior Service Cost (assuming no additional changes) and non-vested Prior Service Cost will typically follow a straight-line amortization into Net Periodic Pension Cost, this is not the case for the Unrecognized Gains/Losses. The total amount of unrecognized gains/losses subject to amortization will continuously change due to changes in the discount rates, actuarial assumptions, differences between expected and actual return on assets, etc. In addition, unrecognized gains/losses are amortized into expense only to the extent that they exceed the 10% corridor (SSAP No. 102, paragraph 22). The 10% corridor is based on the greater of the PBO or the Fair Value of Plan assets, and these amounts are also continuously changing. Therefore, the amortization of the gain/loss will never occur on a straight-line basis using the corridor method described in paragraph 22. There is no “amortization schedule” in effect at transition date for the unrecognized gains/losses.~~

~~D. — Liability for Pension Benefits — 18.70~~

~~— (Aggregate Write-In for Liabilities)~~

~~Unassigned Funds — Transition Liability 18.70~~

~~This entry occurs prior to amortization of the transition items. This entry reverses a portion of the original transition entry for the amount that will be amortized into periodic pension cost for the current period.~~

~~E. — Net Periodic Pension Cost 318.70~~

~~Prepaid Benefit Cost — 318.70~~

~~— (Aggregate Write-In for Other Than Invested Assets)~~

~~This entry recognizes net periodic pension cost for the service cost, interest cost, expected return on plan assets and amortization of the unrecognized items. (As the plan has a prepaid benefit cost, this will be reduced with the recognition of periodic cost.)~~

~~F. — Overfunded Plan Asset — 318.70~~

~~— (Aggregate Write-In for Other Than Invested Assets)~~

~~Unassigned Funds—318.70~~

~~Entry reflects a reduction in the contra-asset recognized at transition at an amount equal to the reduction of prepaid benefit cost.~~

~~G.——Change in Nonadmitted——Prepaid Benefit Cost 318.70~~~~Unassigned Funds 318.70~~~~H.——Unassigned Funds 318.70~~~~Change in Nonadmitted——Overfunded Plan Asset——318.70~~

~~Entries to reflect the change in nonadmitted assets for both entries “E” and “F.” These entries offset.~~

~~I.——Unassigned Funds 318.70~~~~Liability for Pension Benefits——318.70~~~~(Aggregate Write-In for Liabilities)~~

~~Entry reflects the unfunded liability from the 2013 plan-related costs. This entry assumes no additional changes in the PBO or Fair Value of Plan Assets at year-end. In practice, there will always be changes in the year-end PBO due to changes in the discount rate used to calculate the PBO, actuarial demographics different than expected, etc. An additional variation is actual return on plan assets different from expected return on plan assets. All of these factors will impact the year-end funded status, and will also need to be recorded as part of entry “I” at year-end.~~

~~December 31, 2014——Recognition of Deferred Transition Impact~~~~J.——Unassigned Funds——Transition Liability 25.20~~~~Liability for Pension Benefits——25.20~~~~(Aggregate Write-In for Liabilities)~~

~~Per paragraph 93, if surplus deferral is elected at transition, beginning with 2014 annual financials, the entity shall recognize the remaining surplus impact on a systematic basis over a period not to exceed the remaining nine years. This entry represents the minimum transition liability to be recognized subsequent to transition. Since it is assumed that there is no change in the amortization expectations, and ABO is still funded, this entry reflects 10% of the transition surplus impact.~~

~~December 31, 2014 — Recognition of Net Periodic Pension Cost~~

~~Components of Net Periodic Cost~~	~~Dec. 31, 2014~~
~~Service Cost~~	~~100~~
~~Interest Cost~~	~~75~~
~~Expected Return on Plan Assets~~	~~(50)~~
~~Total~~	~~125~~
~~Amortization of:~~	
~~o — Prior Service Cost~~	~~1.20~~
~~o — Prior Service Cost (nonvested)~~	~~2.50~~
~~o — Unrecognized Losses~~	~~15.00~~
~~Total~~	~~18.70~~
~~Total Net Periodic Pension Cost~~	~~143.70~~

~~Note — This example assumes no changes in the amortization timeframe. As noted in footnote 5 of SSAP No. 102, unless otherwise impacted from SSAP No. 102, or in accordance with changes to the pension plan, the amortization of the unrecognized items into net periodic pension cost shall continue to follow the existing amortization schedules in effect on the transition date. Although the amortization of Prior Service Cost (assuming no additional changes) and non-vested Prior Service Cost will typically follow a straight-line amortization into Net Periodic Pension Cost, this is not the case for the Unrecognized Gains/Losses. The total amount of unrecognized gains/losses subject to amortization will continuously change due to changes in the discount rates, actuarial assumptions, differences between expected and actual return on assets, etc. In addition, unrecognized gains/losses are amortized into expense only to the extent that they exceed the 10% corridor (SSAP No. 102, paragraph 22). The 10% corridor is based on the greater of the PBO or the Fair Value of Plan assets, and these amounts are also continuously changing. Therefore, the amortization of the gain/loss will never occur on a straight-line basis using the corridor method described in paragraph 22. There is no “amortization schedule” in effect at transition date for the unrecognized gains/losses.~~

~~K. Liability for Pension Benefits 18.70~~

~~(Aggregate Write-In for Liabilities)~~

~~Unassigned Funds – Transition Liability 18.70~~

~~This entry occurs prior to amortization of the transition items. This entry reverses a portion of the original transition entry for the amount that will be amortized into periodic pension cost for the current period.~~

~~L. Net Periodic Pension Cost 143.70~~

~~Prepaid Benefit Cost 143.70~~

~~(Aggregate Write-In for Other Than Invested Assets)~~

~~This entry recognizes net periodic pension cost for the service cost, interest cost, expected return on plan assets and amortization of the noted items. (As the plan has a prepaid benefit cost, this will be reduced with the recognition of periodic cost.)~~

~~M. Overfunded Plan Asset 143.70~~

~~(Aggregate Write-In for Other Than Invested Assets)~~

~~Unassigned Funds 143.70~~

~~Entry reflects the change in overfunded plan assets as a reduction in the contra-asset from initial transition.~~

~~N. Change in Nonadmitted – Prepaid Benefit Cost 143.70~~

~~Unassigned Funds 143.70~~

~~O. Unassigned Funds 143.70~~

~~Change in Nonadmitted – Overfunded Plan Asset 143.70~~

~~Entries reflect the change in nonadmitted assets for both entries "L" and "M." These entries offset.~~

~~P. Unassigned Funds 143.70~~

~~Liability for Pension Benefits 143.70~~

~~(Aggregate Write-In for Liabilities)~~

~~Entry reflects the unfunded liability from the 2014 plan-related costs. This entry assumes no additional changes in the PBO or Fair Value of Plan Assets at year-end. In practice, there will always be changes in the year-end PBO due to changes in the discount rate used to calculate the PBO, actuarial demographics different than expected, etc. An additional variation is actual return on plan assets different from expected return on plan assets. All of these factors will impact the year-end funded status and will also need to be recorded as part of entry "P" at year-end.~~

~~January 1, 2015—Recognition of Cash Contribution~~

	Jan. 1, 2015
Contribution	\$900

~~Q. Prepaid Benefit Cost 900.00~~

~~(Aggregate Write-In for Other Than Invested Assets)~~

~~Cash 900.00~~

~~R. Liability for Pension Benefits 475.40~~

~~(Aggregate Write-In for Liabilities)~~

~~Overfunded Plan Asset 475.40~~

~~(Aggregate Write-In for Other Than Invested Assets)~~

~~S. Unassigned Funds 900.00~~

~~Change in Nonadmitted — Prepaid Benefit Cost 900.00~~

~~T. Change in Nonadmitted Overfunded Plan Asset 475.40~~
~~Unassigned Funds 475.40~~

~~With the cash contribution, the plan becomes overfunded with a prepaid benefit cost. The contribution directly increases the Prepaid Benefit Cost. The liability for pension benefits is eliminated, with an offset to the Overfunded Plan asset. The plan now has a NET overfunded plan asset of \$223.~~

~~U. Unassigned Funds 201.60~~
~~Overfunded Plan Asset 201.60~~

~~Since the plan is in an overfunded status, per paragraph 93.b. of SSAP No. 102, the entity is required to recognize the deferred surplus impact from initial transition to the extent that the plan is overfunded. As the plan is overfunded by more than the remaining transition surplus impact, this entry recognizes the full remaining surplus impact deferred at transition.~~

~~V. Change in Nonadmitted Overfunded Plan Assets 201.60~~
~~Unassigned Funds 201.60~~

~~Entry reflects the change in nonadmitted assets from entry "U."~~

~~December 31, 2015 — Recognition of Net Periodic Pension Cost~~

~~Components of Net Periodic Cost~~	~~Dec. 31, 2015~~
~~Service Cost~~	~~100~~
~~Interest Cost~~	~~175~~
~~Expected Return on Plan Assets~~	~~(75)~~
~~Total~~	~~200~~
~~Amortization of:~~	
~~○ Prior Service Cost~~	~~1.20~~

~~0~~ ~~Prior Service Cost~~ (nonvested)	~~2.50~~
~~0~~ ~~Unrecognized Losses~~	~~15.00~~
~~Total~~	~~18.70~~
~~Total Net Periodic Pension Cost~~	~~218.70~~

~~(Previous notes on amortization continue to apply.)~~

~~W. Overfunded Plan Asset 18.70~~

~~(Aggregate Write-In for Other Than Invested Assets)~~

~~Unassigned Funds 18.70~~

~~This entry occurs prior to amortization of the transition items. This entry reverses a portion of the unrecognized items recognized to unassigned funds as part of the transition guidance (even if recognized subsequent to initial recognition under the deferral option) for the amount that will be amortized into periodic pension cost for the current period.~~

~~X. Unassigned Funds 18.70~~

~~Change in Nonadmitted Overfunded Plan Asset 18.70~~

~~Entry reflects the change in nonadmitted assets from entry "W."~~

~~Y. Net Periodic Pension Cost 218.70~~

~~Prepaid Benefit Cost 218.70~~

~~(Aggregate Write-In for Other Than Invested Assets)~~

~~This entry recognizes net periodic pension cost for the service cost, interest cost, expected return on plan assets and amortization of the noted items. As the plan has a prepaid benefit cost, this will be reduced with the recognition of periodic cost.~~

~~Z. Change in Nonadmitted Prepaid Benefit Cost 218.70~~

Unassigned Funds—218.70

Entry reflects the change in nonadmitted assets from entry “Y.” This example assumes no additional changes in the PBO or Fair Value of Plan Assets at year-end. In practice, there will always be changes in the year-end PBO due to changes in the discount rate used to calculate the PBO, actuarial demographics different than expected, etc. An additional variation is actual return on plan assets different from expected return on plan assets. All of these factors will impact the year-end funded status, and will also need to be recorded at year-end in an additional entry impacting the Overfunded Plan Asset. If the plan became underfunded due to these changes, then the amount of the underfunding would then be recorded as a Liability for Pension Benefits.

Example: Assume the PBO increased by \$100 at year-end due to discount rate changes, etc. This would cause the plan to be underfunded by \$77.00.

1. ~~Unassigned Funds 100.00~~

~~Overfunded Plan Asset 23.00~~

~~Liability for Pension Benefits 77.00~~

2. ~~Change in Nonadmitted—Overfunded Plan Asset 23.00~~

~~Unassigned Funds 23.00~~

Example 5—Underfunded Plan with Prepaid Benefit Cost—Surplus Deferral, Funded ABO:

	Aggregate Write-In For Other Than Invested Assets		Change in Nonadmitted Assets	Net Periodic Cost	Unassigned Funds	Liability for Pension Benefits	Cash
	Overfunded Plan Asset	Prepaid Benefit Cost					
Existing Balance 12/31/2012		496-DR			496-CR		
(This reflects pre- 2012 Entries)			496-CR ¹³	—	496-DR	—	

¹³ This reflects the change reported in prior years.

~~Transition Entries — 1/1/2013~~							
A	496- ~~CR~~				496- ~~DR~~		
B			496- ~~DR~~		496- ~~CR~~		
C					25.20- ~~DR~~	25.20- ~~CR~~	
Jan 1, 2013	496- ~~CR~~	496- ~~DR~~	—	—	25.20- ~~DR~~	25.20- ~~CR~~	
Jan 1, 2013 — Net	—		—	—	25.20- ~~DR~~	25.20- ~~CR~~	
~~Dec. 31, 2013:~~							
D					18.70- ~~CR~~	18.70- ~~DR~~	
E		318.70- ~~CR~~		318.70- ~~DR~~ ¹⁴			
F	318.70- ~~DR~~				318.70- ~~CR~~		
G			318.70- ~~DR~~		318.70- ~~CR~~		
H			318.70- ~~CR~~		318.70- ~~DR~~		
I					318.70- ~~DR~~	318.70- ~~CR~~	
Dec. 31, 2013	177.30- ~~CR~~	177.30- ~~DR~~	—		325.20- ~~DR~~	325.20- ~~CR~~	
Dec. 31, 2013 — Net	—		—	—	325.20- ~~DR~~	325.20- ~~CR~~	
~~Dec. 31, 2014:~~							
J					25.20- ~~DR~~	25.20- ~~CR~~	
K					18.70- ~~CR~~	18.70- ~~DR~~	
L		143.70- ~~CR~~		143.70- ~~DR~~ ¹⁴			
M	143.70- ~~DR~~				143.70- ~~CR~~		
N			143.70- ~~DR~~		143.70- ~~CR~~		
O			143.70- ~~CR~~		143.70- ~~DR~~		
P					143.70- ~~DR~~	143.70- ~~CR~~	
Dec. 31, 2014	33.60- ~~CR~~	33.60- ~~DR~~	—		475.40- ~~DR~~	475.40- ~~CR~~	
Dec. 31, 2014 — Net	—		—	—	475.40- ~~DR~~	475.40- ~~CR~~	

¹⁴ Since Net Periodic Cost closes to unassigned funds at the end of each year, the balance does not carry forward.

~~Jan. 1, 2015 — Contribution~~							
~~Q~~		~~900.00 DR~~					~~900.00 CR~~
~~R~~	~~475.40 CR~~					~~475.40 DR~~	
~~S~~			~~900.00 CR~~		~~900.00 DR~~		
~~T~~			~~475.40 DR~~		~~475.40 CR~~		
~~U~~	~~201.60 CR~~				~~201.60 DR~~		
~~V~~			~~201.60 DR~~		~~201.60 CR~~		
~~Jan. 1, 2015 — After Contribution~~	~~710.60 CR~~	~~933.60 DR~~	~~223.00 CR~~		~~900 DR~~	~~—~~	~~900 CR~~
~~Jan 1, 2015 — Net~~	~~223.00 DR~~		~~223.00 CR~~	~~—~~	~~900 DR~~	~~—~~	~~900 CR~~
~~Dec. 31, 2015:~~							
~~W~~	~~18.70 DR~~				~~18.70 CR~~		
~~X~~			~~18.70 CR~~		~~18.70 DR~~		
~~Y~~		~~218.70 CR~~		~~218.70 DR¹⁴~~			
~~Z~~			~~218.70 DR~~		~~218.70 CR~~		
~~Dec. 31, 2015~~	~~691.90 CR~~	~~714.90 DR~~	~~23.00 CR~~		~~900.00 DR~~		~~900.00 CR~~
~~Dec. 31, 2015 — Net~~	~~23.00 DR~~		~~23.00 CR~~		~~900.00 DR~~		~~900.00 CR~~

~~6. Underfunded Plan with Prepaid Benefit Cost — Surplus Deferral, Unfunded ABO~~

~~Consideration of contributions or tax effects are not reflected in this example.~~

~~Example 6~~	~~Dec. 31, 2012¹⁵~~	~~Jan. 1, 2013~~	~~Dec. 31, 2013~~	~~Dec. 31, 2014~~	~~Jan. 1, 2015~~	~~Dec. 31, 2015~~
~~Accumulated — Benefit Obligation~~	~~\$(1,632)~~	~~\$(1,632)~~	~~\$(1,932)~~	~~\$(2,057)~~	~~\$(2,457)~~	~~-(2,457)~~
~~Plus: — Non-Vested Liability~~	~~(100)~~	~~(100)~~	~~(100)~~	~~(100)~~	~~(100)~~	~~(100)~~
~~Total — Accumulated~~	~~\$(1,732)~~	~~\$(1,732)~~	~~(2,032)~~	~~(2,157)~~	~~(2,557)~~	~~(2,557)~~

¹⁵ The amount shown for December 31, 2012, reflects the non-vested liability, which must be considered at transition under SSAP No. 102. However, the non-vested liability is not a factor in the December 31, 2012, financial statements under SSAP No. 89.

Benefit Obligation						
Projected ~~Benefit~~ Obligation	~~\$(1,752)~~	~~\$(1,752)~~	~~(2,052)~~	~~(2,177)~~	~~(2,177)~~	~~(2,377)~~
Plus: ~~Non-Vested~~ liability	~~(100)~~	~~(100)~~	~~(100)~~	~~(100)~~	~~(100)~~	~~100~~
Total PBO	~~\$(1,852)~~	~~\$(1,852)~~	~~(2,152)~~	~~(2,277)~~	~~(2,277)~~	~~(2,477)~~
Plan ~~Assets~~ at Fair Value	~~1,600~~	~~1,600~~	~~1,600~~	~~1,600~~	~~2,500~~	~~2,500~~
Funded Status	~~(\$252)~~	~~(\$252)~~	~~(552)~~	~~(677)~~	~~223~~	~~23~~
Transition Obligation / (Asset)	~~0~~	~~0~~	~~0~~	~~0~~	~~0~~	
Prior Service Cost	~~48~~	~~0~~	~~0~~	~~0~~	~~0~~	
Prior ~~Service~~ Cost (Non-Vested)	~~100~~	~~0~~	~~0~~	~~0~~	~~0~~	
Unrecognized Losses / (Gains)	~~600~~	~~0~~	~~0~~	~~0~~	~~0~~	
Total ~~Unrecognized~~ Items	~~748~~	~~0~~	~~0~~	~~0~~	~~0~~	
Net ~~Overfunded~~ Plan Asset / (Liability for Benefits)	~~496~~	~~(132)~~	~~(432)~~	~~(582.20)~~	~~223~~	~~23~~
Additional ~~Minimum~~ Liability ~~(Unfunded ABO)~~	~~(32)~~	~~0~~	~~The concept of an additional minimum liability and related intangible asset for plans with an unfunded ABO is eliminated in SSAP No. 102.~~			
Intangible Asset	~~32~~	~~0~~				
Surplus ~~Impact~~ Deferred		~~(120)~~	~~(120)~~	~~(94.80)~~	~~-~~	~~-~~

Surplus Impact — ~~The transition guidance in SSAP No. 92 and SSAP No. 102 requires a minimum of 10% of the surplus impact on the transition date. If a systematic 10-year allocation was applied to the total “unrecognized items” rather than the surplus impact, there would be a number of years in which a prepaid asset would still be reflected, without any impact to surplus, even though the plan is underfunded. This is because a reduced in overfunded plan assets alone has a corresponding change to nonadmitted assets, resulting in a net zero surplus impact.~~

Determine the initial transition surplus impact under the deferral election:

~~In accordance with paragraph 93.b. of SSAP No. 102, the surplus impact initially recognized as of January 1, 2013 under the transition option, and subsequently over the transition period, shall be the greater of:~~

	Minimum Transition Liability	
93.b.i	10% of Calculated Surplus Impact at Transition	25.20
93.b.ii	Anticipated Annual Amortization of "Unrecognized Items" (Assume 40-year Uniform Amortization)	18.70
93.b.iii	Difference Between unfunded ABO and Accrued Benefit Cost.	132.00
	Transition Liability	132.00

~~93.b.ii. Note: If the amortization cannot be determined at transition, at a minimum, the amount amortized for unrecognized items during the prior year shall be utilized for this calculation. If the amount recognized for transition (greater of all three components) is subsequently determined to be less than what was amortized for the year, the difference between what was recognized for transition and what is amortized must immediately be recognized as an adjustment to the transition impact to unassigned funds—surplus.~~

January 1, 2013—Transition Date

~~Reversal of Additional Minimum Liabilities/Intangible Plan Assets: As this plan has an unfunded ABO, following the guidance under SSAP No. 89, the entity had recognized an additional minimum liability and corresponding admitted intangible asset. As the concept of an additional minimum liability has been eliminated from SSAP No. 102, at transition these amounts are eliminated, with the determination of the overfunded/unfunded projected benefit obligation calculated subsequent to the elimination.~~

~~Unassigned Funds—32~~

~~Intangible Asset—32~~

~~Additional Minimum Liability—32~~

~~Unassigned Funds—32~~

~~Application of SSAP No. 102—Recognition of Unfunded Status with Surplus Deferral:~~

~~A. Unassigned Funds 496~~

~~Overfunded Plan Asset 496~~

~~(Aggregate Write-In for Other Than Invested Assets)~~

~~B. Change in Nonadmitted Overfunded Plan Asset 496~~

~~Unassigned Funds 496~~

~~C. Unassigned Funds Transition Liability 132~~

~~Liability for Pension Benefits 132~~

~~Prepaid Benefit Cost and Overfunded Plan Assets are both reflected as Aggregate Write-Ins for Other Than Invested Assets. However, Prepaid Benefit Cost can only be reduced with a corresponding income statement impact. Entry A, which uses a contra-asset, effectively results with a net elimination of the assets reported for the plan. (Reporting entities will need to continue to track these categories separately.) Entries A & B have a ZERO surplus impact and the third entry recognizes a liability for the unfunded ABO per the requirements of paragraph 93.b.~~

~~December 31, 2013 Recognition of Net Periodic Pension Cost~~

~~After transition, recognition of net periodic pension cost includes: 1) service cost, 2) interest cost, 3) expected return on plan assets, 4) amortization of prior service cost included in unassigned funds, 5) amortization of gains and losses, and 6) amortization of any transition asset or obligation remaining in unassigned funds.~~

~~As noted in paragraph 93.b., if surplus deferral is elected at the transition date, subsequently, starting with the 2014 year-end financial statement, the reporting entity shall annually recognize the remaining surplus impact. As such, unless the entity elects to recognize the remaining surplus impact early (which is permitted under SSAP No. 102), there is no additional surplus impact from transition recognized as of December 31, 2013.~~

Components of Net Periodic Cost	Dec. 31, 2013

Service Cost	250
Interest Cost	100
Expected Return on Plan Assets	(50)
Total	300
Amortization of:	
○ Prior Service Cost	1.20
○ Prior Service Cost (nonvested)	2.50
○ Unrecognized Losses	15.00
Total	18.70
Total Net Periodic Pension Cost	318.70

~~Note — This example assumes no changes in the amortization timeframe. As noted in footnote 5 of SSAP No. 102, unless otherwise impacted from SSAP No. 102, or in accordance with changes to the pension plan, the amortization of the unrecognized items into net periodic pension cost shall continue to follow the existing amortization schedules in effect on the transition date. Although the amortization of Prior Service Cost (assuming no additional changes) and non-vested Prior Service Cost will typically follow a straight-line amortization into Net Periodic Pension Cost, this is not the case for the Unrecognized Gains/Losses. The total amount of unrecognized gains/losses subject to amortization will continuously change due to changes in the discount rates, actuarial assumptions, differences between expected and actual return on assets, etc. In addition, unrecognized gains/losses are amortized into expense only to the extent that they exceed the 10% corridor (SSAP 102, paragraph 22). The 10% corridor is based on the greater of the PBO or the Fair Value of Plan assets, and these amounts are also continuously changing. Therefore, the amortization of the gain/loss will never occur on a straight-line basis using the corridor method described in paragraph 22. There is no “amortization schedule” in effect at transition date for the unrecognized gains/losses.~~

~~D. Liability for Pension Benefits 18.70~~

~~(Aggregate Write-In for Liabilities)~~

~~Unassigned Funds — Transition Liability 18.70~~

~~This entry occurs prior to amortization of the transition items. This entry reverses a portion of the original transition entry for the amount that will be amortized into periodic pension cost for the current period.~~

~~E. Net Periodic Pension Cost 318.70~~

~~Prepaid Benefit Cost 318.70~~

~~(Aggregate Write-In for Other Than Invested Assets)~~

~~This entry recognizes net periodic pension cost for the service cost, interest cost, expected return on plan assets and amortization of the unrecognized items. (As the plan has a prepaid benefit cost, this will be reduced with the recognition of periodic cost.)~~

~~F. Overfunded Plan Asset 318.70~~

~~(Aggregate Write-In for Other Than Invested Assets)~~

~~Unassigned Funds 318.70~~

~~Entry reflects a reduction in the contra-asset recognized at transition at an amount equal to the reduction of prepaid benefit cost.~~

~~G. Change in Nonadmitted Prepaid Benefit Cost 318.70~~

~~Unassigned Funds 318.70~~

~~H. Unassigned Funds 318.70~~

~~Change in Nonadmitted Overfunded Plan Asset 318.70~~

~~Entries to reflect the change in nonadmitted assets for both entries "E" and "F." These entries offset.~~

~~I. Unassigned Funds 318.70~~

~~Liability for Pension Benefits 318.70~~

~~(Aggregate Write-In for Liabilities)~~

~~Entry reflects the unfunded liability from the 2013 plan-related costs. This entry assumes no additional changes in the PBO or Fair Value of Plan Assets at year-end. In practice, there will always be changes in the year-end PBO due to changes in the discount rate used to calculate the PBO, actuarial demographics different than expected, etc. An additional variation is actual return on plan assets different from expected return on plan~~

~~assets. All of these factors will impact the year-end funded status and will also need to be recorded as part of entry "I" at year-end.~~

~~December 31, 2014 — Recognition of Deferred Transition Impact~~

~~In accordance with paragraph 93 of SSAP No. 102, the minimum amount recognized each subsequent year shall be an amount that reflects the conditions of paragraph 93.b. As such, the surplus recognized shall be the greater of:~~

	~~Minimum Transition Liability~~	
~~93.b.i.~~	~~10% of Calculated Surplus Impact at Transition~~	~~25.20~~
~~93.b.ii.~~	~~Anticipated Annual Amortization of "Unrecognized Items" (Assume 40-year Uniform Amortization)~~	~~18.70~~
~~93.b.iii.~~	~~Difference Between unfunded ABO and Accrued Benefit Cost/Fair Value of Plan Assets.~~ ~~(Dec. 31, 2014 — Fair value of plan assets together with the Liability for Pension Benefits exceed the ABO.)~~	~~—~~
	~~Transition Liability~~	~~25.20~~

~~(Previous note on amortization continues to apply.)~~

~~J. — Unassigned Funds — Transition Liability 25.20~~

~~Liability for Pension Benefits — 25.20~~

~~(Aggregate Write-In for Liabilities)~~

~~Entry represents the minimum transition liability to be recognized subsequent to transition. (10% of the transition surplus impact is the greatest component of paragraph 93.b. as of Dec. 31, 2014.)~~

~~December 31, 2014 — Recognition of Net Periodic Pension Cost~~

~~Components of Net Periodic Cost~~	~~Dec. 31, 2014~~

~~Service Cost~~	~~100~~
~~Interest Cost~~	~~75~~
~~Expected Return on Plan Assets~~	~~(50)~~
~~Total~~	~~125~~
~~Amortization of:~~	
~~○ Prior Service Cost~~	~~1.20~~
~~○ Prior Service Cost (nonvested)~~	~~2.50~~
~~○ Unrecognized Losses~~	~~15.00~~
~~Total~~	~~18.70~~
~~Total Net Periodic Pension Cost~~	~~143.70~~

~~(Previous note on amortization continues to apply.)~~

~~K. Liability for Pension Benefits 18.70~~

~~(Aggregate Write-In for Liabilities)~~

~~Unassigned Funds – Transition Liability 18.70~~

~~This entry occurs prior to amortization of the transition items. This entry reverses a portion of the unrecognized items recognized to unassigned funds as part of the transition guidance (even if recognized subsequent to initial recognition under the deferral option) for the amount that will be amortized into periodic pension cost for the current period.~~

~~L. Net Periodic Pension Cost 143.70~~

~~Prepaid Benefit Cost 143.70~~

~~(Aggregate Write-In for Other Than Invested Assets)~~

~~This entry recognizes net periodic pension cost for the service cost, interest cost, expected return on plan assets and amortization of the unrecognized items. (As the plan has a prepaid benefit cost, this will be reduced with the recognition of periodic cost.)~~

~~M. Overfunded Plan Asset 143.70~~

~~(Aggregate Write-In for Other Than Invested Assets)~~

~~Unassigned Funds 143.70~~

~~Entry reflects the change in overfunded plan assets as a reduction in the contra-asset to correspond with the change in net periodic pension cost. With this entry, the Prepaid Benefit Cost and Overfunded Plan Assets net to zero. This is appropriate as the plan is underfunded and a liability is reflected.~~

~~N. Change in Nonadmitted Prepaid Benefit Cost 143.70~~

~~Unassigned Funds 143.70~~

~~O. Unassigned Funds 143.70~~

~~Change in Nonadmitted Overfunded Plan Asset 143.70~~

~~Entries to reflect the change in nonadmitted assets for both entries "L" and "M." These entries offset.~~

~~P. Unassigned Funds 143.70~~

~~Liability for Pension Benefits 143.70~~

~~(Aggregate Write-In for Liabilities)~~

~~Entry reflects the full unfunded liability, including impact from the 2014 plan-related costs.~~

~~Note—This entry assumes no additional changes in the PBO or Fair Value of Plan Assets at year-end. In practice, there will always be changes in the year-end PBO due to changes in the discount rate used to calculate the PBO, actuarial demographics different than expected, etc. An additional variation is actual return on plan assets different from expected return on plan assets. All of these factors will impact the year-end funded status and will also need to be recorded as part of entry "P" at year-end.~~

~~January 1, 2015—Recognition of Cash Contribution~~

	Jan. 1, 2015
Contribution	\$900

~~Q. Prepaid Benefit Costs 900.00~~

~~(Aggregate Write-In for Other Than Invested Assets)~~

~~Cash 900.00~~

~~R. Liability for Pension Benefits 582.20~~

~~(Aggregate Write-In for Liabilities)~~

~~Overfunded Plan Asset 582.20~~

~~(Aggregate Write-In for Other Than Invested Assets)~~

~~S. Unassigned Funds 900.00~~

~~Change in Nonadmitted Prepaid Benefit Cost 900.00~~

~~T. Change in Nonadmitted Overfunded Plan Asset 582.20~~

~~Unassigned Funds 582.20~~

~~With the cash contribution, the plan becomes overfunded with a prepaid benefit cost. The contribution directly increases the Prepaid Benefit Cost. The liability for pension benefits is eliminated, with an offset to the Overfunded Plan asset. The plan now has a NET overfunded plan asset of \$223.~~

~~U. Unassigned Funds 94.80~~

~~Overfunded Plan Assets 94.80~~

~~As the surplus deferral was elected, with the overfunded status, per paragraph 93.b. of SSAP No. 102, the entity is required to recognize the deferred surplus impact from initial transition to the extent that the plan is overfunded. As the plan is overfunded by more than the remaining transition surplus impact, this entry recognizes the full remaining surplus impact deferred at transition.~~

~~V. Change in Nonadmitted Overfunded Plan Assets 94.80~~

~~Unassigned Funds 94.80~~

~~Entry reflects the change in nonadmitted assets from entry U.~~

~~December 31, 2015 — Recognition of Net Periodic Pension Cost~~

~~Components of Net Periodic Cost~~	~~Dec. 31, 2015~~
~~Service Cost~~	~~100~~
~~Interest Cost~~	~~175~~
~~Expected Return on Plan Assets~~	~~(75)~~
~~Total~~	~~200~~
~~Amortization of:~~	
~~○ Prior Service Cost~~	~~1.20~~
~~○ Prior Service Cost (nonvested)~~	~~2.50~~
~~○ Unrecognized Losses~~	~~15.00~~
~~Total~~	~~18.70~~
~~Total Net Periodic Pension Cost~~	~~218.70~~

~~(Prior amortization note continues to apply.)~~

~~W. Overfunded Plan Asset 18.70~~

~~(Aggregate Write-In for Other Than Invested Assets)~~

~~Unassigned Funds 18.70~~

~~This entry occurs prior to amortization of the transition items. This entry reverses a portion of the original transition entry for the amount that will be amortized into periodic pension cost for the current period.~~

~~X. Unassigned Funds 18.70~~

~~Change in Nonadmitted — Overfunded Plan Asset 18.70~~

~~Entry reflects the change in nonadmitted assets from entry “W.”~~

~~Y. Net Periodic Pension Cost 218.70~~

~~Prepaid Benefit Cost 218.70~~

~~(Aggregate Write-In for Other Than Invested Assets)~~

~~This entry recognizes net periodic pension cost for the service cost, interest cost, expected return on plan assets and amortization of the unrecognized items. As the plan has a prepaid benefit cost, this will be reduced with the recognition of periodic cost.~~

~~Z. Change in Nonadmitted Prepaid Benefit Cost 218.70~~

~~Unassigned Funds 218.70~~

~~Entry reflects the change in nonadmitted assets from entry “Y.”~~

~~Example 6 Underfunded Plan with Prepaid Benefit Cost Surplus Deferral, Unfunded ABO:~~

	Aggregate Write-In For Other Than Invested Assets		Change in Nonadmitted Assets	Net Periodic Cost	Unassigned Funds	Liability for Pension Benefits	Cash
	Overfunded Plan Asset	Prepaid Benefit Cost					
Existing Balance 12/31/2012 (This reflects pre-2012 Entries)		496-DR	496-DR ¹⁶	—	496-CR 496-DR	—	
Transition Entries 1/1/2013 A	496-CR				496-DR		

¹⁶ This reflects the change reported in prior years.

B			496-DR		496-CR		
C					132-DR	132-CR	
Jan 1, 2013	496-CR	496-DR	—	—	132-DR	132-CR	
Jan. 1, 2013 — Net	—		—	—	132-DR	132-CR	—
Dec. 31, 2013:							
D					18.70-CR	18.70-DR	
E		318.70 CR		318.70 DR ¹⁷			
F	318.70-DR				318.70 CR		
G			318.70-DR		318.70 CR		
H			318.70-CR				
I					318.70 DR	318.70-CR	
					318.70 DR		
Dec. 31, 2013	177.30-CR	177.30 DR	—		432.00 DR	432.00-CR	
Dec. 31, 2013 — Net	—		—	—	432.00 DR	432.00-CR	—
Dec. 31, 2014:							
J					25.20-DR	25.20-CR	
K					18.70-CR	18.70-DR	
L		143.70 CR		143.70 DR ¹⁷			
M	143.70-DR				143.70 CR		
N			143.70-DR		143.70 CR		
O			143.70-CR				
P					143.70 DR	143.70-CR	
					143.70 DR		
Dec. 31, 2014	33.60-CR	33.60-DR	—		582.20 DR	582.20-CR	
Dec. 31, 2014 — Net	—		—	—	582.20	582.20-CR	—

¹⁷ Since Net Periodic Cost closes to unassigned funds at the end of each year, the balance does not carry forward.

					DR		
~~Jan. 1, 2015~~ Contribution							
Q		900-DR					900-CR
R	582.20-CR					582.20-DR	
S			900-CR		900-DR		
T			582.20-DR		582.20-CR		
U	94.80-CR				94.80-DR		
V			94.80-DR		94.80-CR		
Jan. 1, 2015 After Contribution	710.60-CR	933.60-DR	223.00-CR		900-DR		900-CR
Jan. 1, 2015 - Net	223.00-DR		223.00-CR	-	900-DR		900-CR
Dec. 31, 2015:							
W	18.70-DR				18.70-CR		
X			18.70-CR		18.70-DR		
Y		218.70-CR		218.70-DR ¹⁷			
Z			218.70-DR		218.70-CR		
Dec. 31, 2015	691.90-CR	714.90-DR	23-CR		900-DR		900-CR
Dec. 31, 2015 - Net	23-DR		23-CR	-	900-DR	-	900-CR

EXHIBIT BA - CHANGES IN THE MEASUREMENT DATE AND PLAN SETTLEMENT

Note: Footnote references in this section link numbers together for ease of reference.

The reporting entity adopted this SSAP as of the transition date (January 1, 2013.) In accordance with this SSAP, Company B is changing the measurement date for its defined benefit pension plan from September 30 to December 31 for its December 31, 2014, financial statements. In accordance with this SSAP, statutory accounting principles require that change to be implemented by remeasuring plan assets and obligations as of December 31, 2013. Company B has a plan settlement on November 30, 2013, and remeasures its plan assets and benefit obligations as of November 30, 2013, resulting in a settlement loss before taxes of \$60,000⁶, which is a portion of the net loss in unassigned funds (surplus). However, the effects of remeasuring plan assets and obligations as of November 30, 2013, on the funded status reported in Company B's statement of financial position are not recognized until the following fiscal year because the change in measurement date has not been adopted at November 30, 2013. In recognizing the effects of the plan settlement and change in measurement date:

- a. Recognize the settlement loss in net income in the fourth quarter of 2013 and a corresponding decrease in the cumulative net loss in unassigned funds (surplus).
- b. Recognize the net periodic pension cost incurred from October 1, 2013, to December 31, 2013, net of tax, as an adjustment to beginning unassigned funds (surplus) for 2014.
- c. Recognize any gains or losses arising during the period from October 1, 2013, to December 31, 2013, net of tax, as an adjustment to unassigned funds (surplus) for 2014.
- d. Recognize corresponding changes in pension liability and deferred tax amounts for the above items.

The funded status of Company B's Plan assets as of September 30, 2013, November 30, 2013, December 31, 2013 and December 31, 2014, and amounts included in unassigned funds (surplus) to be recognized as a component of net periodic pension cost are shown below. Company B has no remaining transition asset or obligation. Company B is not required to amortize the cumulative net loss because it is less than 10% of the greater of the fair value of plan assets or the projected benefit obligation for all years presented. The applicable tax rate for 2013 and 2014 is 40%.

	9/30/13	11/30/13	12/31/13	12/31/14
Projected Benefit Obligation	(3,660)	(3,200)	(3,210)	(3,700)
Plan Asset – Fair Value	2,600	2,200	2,225	2,200
Funded Status	(1,060)	(1,000)	(985)	(1,500)
Items not yet recognized as a component of net periodic cost:				
Prior Service Cost	380	360	350	230
	265 ⁵	220	315 ⁴	365
Net Loss	645	580	665	595

Based on actuarial valuations performed as of September 30, 2013, and November 30, 2013, the reporting entity determines its net periodic pension cost for the two-month period from October 1, 2013, to November 30, 2013, and for the one-month period from December 1, 2013, to December 31, 2013, as follows:

Net Periodic Pension Cost	2 Months	1 Month	Total
Service Cost	25	15	40
Interest Cost	30	15	45
Expected Return on Plan Assets	(30)	(15)	(45)
Total service cost, interest cost, and expected return on plan assets	25	15	40²
Amortization of prior service cost	20	10	30 ³
Amortization of net loss	0	0	0
Total Amortization	20	10	30
Net Periodic Benefit Cost	45	25	70¹

- a. In the fourth quarter of 2013, the reporting entity makes the following journal entry to recognize the \$60,000⁶ settlement loss: (40% tax rate - \$24,000)

Net Periodic Pension Cost (settlement loss)	60	
Deferred Tax Asset	24	
Unassigned Funds (Surplus)		84

- b. In 2014, the reporting entity makes the following net journal entry to apply the measurement date provisions and adjust the beginning balances of unassigned funds (surplus), pension liability and deferred tax accounts for the amortization of prior service cost and the service cost, interest cost, and expected return on plan assets.

Unassigned Funds (Surplus)	24	
Deferred Tax Asset	16	
Accrued Benefit Cost		40

This journal entry reflects the following considerations:

- Debit to unassigned funds (surplus) for the \$70¹ net periodic benefit cost
 - Debit to deferred tax asset for \$16 calculated as 40% of the \$40² total service cost, interest cost, and expected return on plan assets
 - Debit to unassigned funds (surplus) for \$12 for the tax impact calculated as 40% of the \$30³ amortization of the prior service cost
 - Credit to Unassigned funds (surplus) for \$28 for the tax impact calculated as 40% of the \$70¹ net periodic benefit cost
 - Credit to Unassigned funds (surplus) for \$30³ for the amortization of the prior service cost.
 - Credit to liability for pension benefits for the \$40² total service cost, interest cost, and expected return on plan assets
- c. The following entry adjusts the beginning balances of unassigned funds (surplus), pension liability and deferred tax accounts for the net loss arising during the period. (Net loss is calculated as follows: Net loss at December 31, 2013 of \$315⁴, less net loss at November 30, 2013 of \$265⁵, plus settlement loss of \$60⁶ to equal \$110.)

Unassigned Funds (Surplus)	66	
Deferred Tax Asset	44	
Accrued Benefit Cost		110

Statement of Statutory Accounting Principles No. 103 – Revised

Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

STATUS

Type of Issue	Common Area
Issued	March 3, 2012; Substantively revised June 9, 2016
Effective Date.....	January 1, 2013; Substantive revisions detailed in Issue Paper No. 152 effective January 1, 2017
Affects	Supersedes SSAP No. 91R; Nullifies and incorporates INT 99-22 and INT 03-05
Affected by	No other pronouncements
Interpreted by	INT 01-31; INT 04-21; INT 20-06
Relevant Appendix A Guidance.....	None

STATUS	1
SCOPE OF STATEMENT	2
SUMMARY CONCLUSION	3
Accounting for Transfers and Servicing of Financial Assets.....	3
Accounting for Transfers of Participating Interests	5
Accounting for Transfers of an Entire Financial Asset or Group of Entire Financial Assets	5
Secured Borrowing	6
Recognition and Measurement of Servicing Assets and Liabilities.....	6
Financial Assets Subject to Prepayment	7
Secured Borrowings and Collateral	7
Extinguishments of Liabilities	8
Disclosures	8
Application Guidance	18
Unit of Account.....	18
Participating Interests in an Entire Financial Asset	19
Isolation Beyond the Reach of the Transferor and Its Creditors.....	20
Conditions That Constrain a Transferee	21
Transferor's Rights or Obligations to Reacquire Transferred Assets or Beneficial Interests	22
Effective Control Over Transferred Financial Assets or Beneficial Interests.....	23
Agreement to Repurchase or Redeem Transferred Financial Assets	23
Unilateral Ability to Cause the Return of Specific Transferred Financial Assets	24
Arrangements to Reacquire Transferred Financial Assets	25
Changes That Result in the Transferor's Regaining Control of Financial Assets Sold	25
Measurement of Interests Held after a Transfer of Financial Assets	26
Assets Obtained and Liabilities Incurred as Proceeds	26
Participating Interests in Financial Assets That Continue to be Held by a Transferor	26
Servicing Assets and Liabilities	26
Securitizations.....	27
Isolation of Transferred Financial Assets in Securitizations.....	28
Sales of Future Revenues.....	29
Removal-of-Accounts Provisions	29
Short Sales	29

Securities Lending Transactions	30
Securities Lending Transactions – Collateral Requirements	32
Securities Borrowing Transactions – Sale Criteria is Not Met (Secured Borrowing)	32
Repurchase Agreements and "Wash Sales"	33
Repurchase Agreements	34
Repurchase Financing	34
Reverse Repurchase Agreements	35
Collateral Requirements – Repurchase and Reverse Repurchase Agreements	36
Dollar Repurchase Agreements	36
Separate Transactions	37
Offsetting	37
Loan Syndications	37
Loan Participations	37
Factoring Arrangements	38
Transfers of Receivables with Recourse	38
Extinguishments of Liabilities	38
Relevant Literature	38
Effective Date and Transition	41
REFERENCES	42
Other	42
Relevant Issue Papers	42
EXHIBIT A – GLOSSARY	43
EXHIBIT B – ILLUSTRATIONS	48
Illustration—Recording Transfers with Proceeds of Cash, Derivatives, and Other Liabilities	48
Illustration—Recording Transfers of Participating Interests	49
Illustration—Sale of Receivables with Servicing Obtained	50
Illustration—Securities Lending Transaction Treated as a Secured Borrowing	51
Illustration—Short Sale Settled with Securities Borrowed Under a Secured Borrowing Agreement	53
Illustration—Initial Transfer and Repurchase Financing	54

SCOPE OF STATEMENT

1. Transfers of financial assets take many forms. Accounting for transfers in which the transferor has no continuing involvement with the transferred financial assets or with the transferee are generally straightforward. However, transfers of financial assets often occur in which the transferor has some continuing involvement either with the assets transferred or with the transferee. Examples of continuing involvement include, but are not limited to, servicing arrangements, recourse or guarantee arrangements, agreements to purchase or redeem transferred financial assets, options written or held, derivative financial instruments that are entered into contemporaneously with, or in contemplation of the transfer, arrangements to provide financial support, pledges of collateral, and the transferor's beneficial interests in the transferred financial assets. Transfers of financial assets with continuing involvement raise issues about the circumstances under which the transfers should be considered as sales of all or part of the assets or as secured borrowings. An objective in accounting for transfers of financial assets is for each reporting entity that is a party to the transaction to recognize only assets it controls and liabilities it has incurred, to derecognize assets only when control has been surrendered, and to derecognize liabilities only when they have been extinguished. Sales and other transfers may frequently result in a disaggregation of financial assets and liabilities into components, which become separate assets and liabilities. [The guidance in this statement also applies to transactions in which servicing assets are transferred with loans retained by the transferor.](#)

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 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 securities are to be accounted for in accordance with *SSAP No. 43R—Loan-Backed and Structured Securities, Revised*.

3. *SSAP No. 25—Affiliates and Other Related Parties* shall be followed for accounting and disclosure requirements for all related party transactions.

4. *SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* has been superseded by this statement.

5. This statement does not address the securitization of mortality or morbidity risk. The National Association of Insurance Commissioners' (NAIC's) Insurance Securitization Working Group of the Financial Condition (E) Committee is charged with the development of model laws, model regulations and proposed accounting guidance for the securitization of mortality and morbidity risk. When such proposed accounting guidance is finalized the development of a statement will be considered.

SUMMARY CONCLUSION

Accounting for Transfers and Servicing of Financial Assets

6. The objective of paragraph 8 and related implementation guidance is to determine whether a transferor has surrendered control over transferred financial assets. This determination must consider the transferor's continuing involvement in the transferred financial assets and requires the use of judgment that must consider all arrangements or agreements made contemporaneously with, or in contemplation of, the transfer, even if they were not entered into at the time of the transfer.

7. The requirements of paragraph 8 apply to transfers of an entire financial asset, transfers of a group of entire financial assets, and transfers of a participating interest in an entire financial asset (all of which are referred to collectively in this statement as transferred financial assets). A participating interest has all of the following characteristics:

- a. From the date of the transfer, it represents a proportionate (pro rata) ownership interest in an entire financial asset. The percentage of ownership interests held by the transferor in the entire financial asset may vary over time, while the entire financial asset remains outstanding as long as the resulting portions held by the transferor (including any participating interest retained by the transferor or its agents) and the transferee(s) meet the other characteristics of a participating interest. For example, if the transferor's interest in an entire financial asset changes because it subsequently sells another interest in the entire financial asset, the interest held initially and subsequently by the transferor must meet the definition of a participating interest.
- b. From the date of the transfer, all cash flows received from the entire financial asset are divided proportionately among the participating interest holders in an amount equal to their share of ownership. Cash flows allocated as compensation for services performed, if any, shall not be included in that determination provided those cash flows are not subordinate

to the proportionate cash flows of the participating interest and are not significantly above an amount that would fairly compensate a substitute service provider, should one be required, which includes the profit that would be demanded in the marketplace. In addition, any cash flows received by the transferor as proceeds of the transfer of the participating interest shall be excluded from the determination of proportionate cash flows provided that the transfer does not result in the transferor receiving an ownership interest in the financial asset that permits it to receive disproportionate cash flows.

- c. The rights of each participating interest holder (including the transferor in its role as a participating interest holder) have the same priority, and no participating interest holder's interest is subordinated to the interest of another participating interest holder. That priority does not change in the event of bankruptcy or other receivership of the transferor, the original debtor, or any other participating interest holder. Participating interest holders have no recourse to the transferor, its agents or to each other, other than standard representations and warranties, ongoing contractual obligations to service the entire financial asset and administer the transfer contract, and contractual obligations to share in any set-off benefits received by any participating interest holder. That is, no participating interest holder is entitled to receive cash before any other participating interest holder under its contractual rights as a participating interest holder. For example, if a participating interest holder also is the servicer of the entire financial asset and receives cash in its role as servicer, that arrangement would not violate this requirement.
- d. No party has the right to pledge or exchange the entire financial asset unless all participating interest holders agree to pledge or exchange the entire financial asset.

If a transfer of a portion of an entire financial asset meets the definition of a participating interest, the transferor shall apply the guidance in paragraph 8. If a transfer of a portion of a financial asset does not meet the definition of a participating interest, the transferor and transferee shall account for the transfer in accordance with the guidance in paragraph 14 as a secured borrowing. However, if the transferor transfers an entire financial asset in portions that do not individually meet the participating interest definition, paragraph 8 shall be applied to the entire financial asset once all portions have been transferred.

8. A transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset in which the transferor surrenders control over those financial assets shall be accounted for as a sale if, and only if, all of the following conditions are met:

- a. The transferred financial assets have been isolated from the transferor—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership. Transferred financial assets are isolated in bankruptcy or other receivership only if the transferred financial assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor.
- b. Each transferee (or, if the transferee is an entity whose sole purpose is to engage in securitization or asset-backed financing activities and that entity is constrained from pledging or exchanging the assets it receives, each third-party holder of its beneficial interests) has the right to pledge or exchange the assets (or beneficial interests) it received, and no condition both constrains the transferee (or third-party holder of its beneficial interests) from taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the transferor (paragraphs 43-46).
- c. The transferor or its agents do not maintain effective control over the transferred financial assets or third-party beneficial interests related to those transferred assets (paragraph 50). Examples of a transferor's effective control over the transferred financial assets include, but are not limited to (1) an agreement that both entitles and obligates the transferor to

repurchase or redeem them before their maturity (paragraphs 51-52), (2) an agreement that provides the transferor with both the unilateral ability to cause the holder to return specific financial assets and a more-than-trivial benefit attributable to that ability, other than through a cleanup call (paragraphs 53-57), or (3) an agreement that permits the transferee to require the transferor to repurchase the transferred financial assets at a price that is so favorable to the transferee that it is probable that the transferee will require the transferor to repurchase them (paragraph 58).

Accounting for Transfers of Participating Interests

9. Upon completion of a transfer of a participating interest that satisfies the conditions to be accounted for as a sale (paragraph 8), the transferor (seller) shall:

- a. Allocate the previous carrying amount of the entire financial asset between the participating interests sold and the participating interest that continues to be held by the transferor on the basis of their relative fair values at the date of the transfer (paragraph 61).
- b. Derecognize the participating interest(s) sold.
- c. Recognize and initially measure at fair value servicing assets, servicing liabilities, and any other assets obtained and liabilities incurred in the sale (such as cash) (paragraphs 62-66).
- d. Recognize in earnings any gain or loss on the sale.
- e. Report any participating interest or interests that continue to be held by the transferor as the difference between the previous carrying amount of the entire financial asset and the amount derecognized.

The transferee shall recognize the participating interest(s) obtained, other assets obtained, and any liabilities incurred and initially measure them at fair value.

10. Upon completion of a transfer of participating interests that does not satisfy the conditions to be accounted for as a sale, the guidance in paragraph 14 shall be applied.

Accounting for Transfers of an Entire Financial Asset or Group of Entire Financial 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*.

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).

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.

12. Repurchase agreements, reverse repurchase agreements, repurchase financing, collateral requirements and dollar repurchase agreements are described in paragraphs 102-118. When an asset is sold and the proceeds are reinvested within 30 days in the same or substantially the same security, such transfers shall be considered to be wash sales and shall be accounted for as sales as discussed in paragraphs 96-101 and disclosed as required by paragraph 28². Unless there is a concurrent contract to repurchase or redeem the transferred financial assets from the transferee, the transferor does not maintain effective control over the transferred financial assets.

13. Upon completion of a transfer of an entire financial asset or a group of entire financial assets that does not satisfy the conditions to be accounted for as a sale in its entirety, the guidance in paragraph 14 shall be applied.

Secured Borrowing

14. If a transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset does not meet the conditions for a sale in paragraph 8, or if a transfer of a portion of an entire financial asset does not meet the definition of a participating interest (paragraph 7), the transferor and transferee shall account for the transfer as a secured borrowing with pledge of collateral (paragraph 19). The transferor shall continue to report the transferred financial assets in its statement of financial position with no change in their measurement (that is, basis of accounting).

Recognition and Measurement of Servicing Assets and Liabilities

15. An entity shall recognize and initially measure at fair value, a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in either of the following situations:

- a. A servicer's transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset that meets the requirements for sale accounting; or
- b. An acquisition or assumption of a servicing obligation that does not relate to financial assets of the servicer.

An entity that transfers its financial assets to an entity in a transfer that qualifies as a sale in which the transferor obtains the resulting securities and classifies them as debt securities shall separately recognize its servicing assets or servicing liabilities.

16. A servicer that transfers or securitizes financial assets in a transaction that does not meet the requirements for sale accounting and is accounted for as a secured borrowing with the underlying assets remaining on the transferor's balance sheet shall not be recognized as a servicing asset or servicing liability.

17. If distinct servicing rights exist in accordance with the above guidelines, the reporting entity shall recognize a servicing asset or liability. When the servicing fees to be received exceed the cost of servicing the transferred assets, a servicing asset is recognized and nonadmitted. When the cost of servicing the

² Paragraph 28.1. also details the items that are excluded from the wash sale disclosure.

transferred assets is greater than the servicing fees to be received, a liability shall be recorded for the excess to recognize this obligation. A corresponding loss shall be recorded through the Summary of Operations in other income. Servicing assets or liabilities shall be measured subsequently at fair value at each reporting date with fluctuations in fair value reported as unrealized gains and losses. Declines in fair value which are determined to be other than temporary shall be recorded as realized losses.

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 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.

Secured Borrowings and Collateral

19. A debtor may grant a security interest in certain assets to a lender (the secured party) to serve as collateral for its obligation under a borrowing, with or without recourse to other assets of the debtor. An obligor under other kinds of current or potential obligations, for example, interest rate swaps, also may grant a security interest in certain assets to a secured party. If collateral is transferred to the secured party, the custodial arrangement is commonly referred to as a pledge. Secured parties sometimes are permitted to sell or repledge (or otherwise transfer) collateral held under a pledge. The same relationships occur, under different names, in transfers documented as sales that are accounted for as secured borrowings (paragraph 14). The accounting for noncash³ collateral by the debtor (or obligor) and the secured party depends on whether the secured party or its agent has the right to sell or repledge the collateral and on whether the debtor has defaulted. (Paragraphs 85-121 provide application guidance for securities lending, securities borrowing and repurchase agreements.)

- a. If the secured party (transferee) or its agent has the right by contract or custom to sell or repledge the collateral, then the debtor (transferor) shall report that asset in its balance sheet.
- b. If the secured party (transferee) sells collateral pledged to it, it shall recognize the proceeds from the sale and its obligation to return the collateral. The sale of the collateral is a transfer subject to the provisions of this statement.
- c. If the debtor (transferor) defaults under the terms of the secured contract and is no longer entitled to redeem the pledged asset, it shall derecognize the pledged asset, and the secured party (transferee) shall recognize the collateral as its asset initially measured at fair value or, if it has already sold the collateral, derecognize its obligation to return the collateral.
- d. Except as provided in paragraph 19.c., the debtor (transferor) shall continue to carry the collateral as its asset, and the secured party (transferee) shall not recognize the pledged asset.

20. Reporting entities may enter into certain transactions that require the granting of a security interest in certain assets to another party to serve as collateral for their performance under a contract. If the assets pledged are recorded as admitted assets under *SSAP No. 4—Assets and Nonadmitted Assets* and *INT 01-31: Assets Pledged as Collateral* and are not impaired under the provisions of *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*, the pledging entity records the collateral as an admitted asset

³ Cash “collateral,” sometimes used, for example, in securities lending transactions, shall be derecognized by the payer and recognized by the recipient, not as collateral, but rather as proceeds of either a sale or a borrowing.

until committing a contract default that has not been cured in accordance with the contract provisions. At the time of an uncured default, the provisions of paragraph 19 shall be used to determine the appropriate accounting treatment for the collateral. If the secured party utilizes collateral to offset all or a portion of the liability owed by the pledging entity as a result of the default, then the collateral amount utilized to offset the liability shall be removed from the balance sheet. At the same time, the amount of the liability that was offset shall be removed from the balance sheet since that obligation has been satisfied through the secured party's utilization of that collateral. To the extent that an uncured default remains without the secured party utilizing the collateral to offset the obligation, the pledging insurer shall only record an admitted asset for the amount of collateral that it can redeem.

Extinguishments of Liabilities

21. A debtor shall derecognize a liability if and only if it has been extinguished (see *SSAP No. 15—Debt and Holding Company Obligations*). A liability has been extinguished if either of the following conditions is met:

- a. The debtor pays the creditor and is relieved of its obligation for the liability. Paying the creditor includes delivery of cash, other financial assets, goods, or services or reacquisition by the debtor of its outstanding debt securities whether the securities are canceled or held as so-called treasury bonds; or
- b. The debtor is legally released⁴ from being the primary obligor under the liability, either judicially or by the creditor.

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.

Disclosures

23. The principal objectives of the disclosures required by this statement are to provide users of the financial statements with an understanding of all of the following:

- a. A transferor's continuing involvement (as defined in the glossary of this statement), if any, with transferred financial assets.
- b. The nature of any restrictions on assets reported by an entity in its statement of financial position that relate to a transferred financial asset, including the carrying amounts of those assets.
- c. How servicing assets and servicing liabilities are reported under this statement.
- d. For transfers accounted for as sales when a transferor has continuing involvement with the transferred financial assets and for transfers of financial assets accounted for as secured

⁴ If nonrecourse debt (such as certain mortgage loans) is assumed by a third party in conjunction with the sale of an asset that serves as sole collateral for that debt, the sale and related assumption effectively accomplish a legal release of the seller-debtor for purposes of applying this statement.

borrowings, how the transfer of financial assets affects a transferor's financial position, financial performance, and cash flows.

Those objectives apply regardless of whether this statement requires specific disclosures. The specific disclosures required by this statement are minimum requirements and an entity may need to supplement the required disclosures specified in paragraph 28 depending on the facts and circumstances of a transfer, the nature of an entity's continuing involvement with the transferred financial assets, and the effect of an entity's continuing involvement on the transferor's financial position, financial performance, and cash flows. Disclosures required by other statement of statutory accounting principles (SSAPs) for a particular form of continuing involvement shall be considered when determining whether the disclosure objectives of this statement have been met.

24. Disclosures required by this statement may be reported in the aggregate for similar transfers if separate reporting of each transfer would not provide more useful information to financial statement users. A transferor shall disclose how similar transfers are aggregated. A transferor shall distinguish transfers that are accounted for as sales from transfers that are accounted for as secured borrowings. If specific disclosures are required for a particular form of a transferor's continuing involvement by other SSAPs, the transferor shall provide the information required in (a) through (c) with a cross-reference to the separate notes to financial statements so a financial statement user can understand the risks retained in the transfer. In determining whether to aggregate the disclosures for multiple transfers, the reporting entity shall consider quantitative and qualitative information about the characteristics of the transferred financial assets. For example, consideration should be given, but not limited, to the following:

- a. The nature of the transferor's continuing involvement.
- b. The types of financial assets transferred.
- c. Risks related to the transferred financial assets to which the transferor continues to be exposed after the transfer and the change in the transferor's risk profile as a result of the transfer.

25. The disclosures shall be presented in a manner that clearly and fully explains to financial statement users the transferor's risk exposure related to the transferred financial assets and any restrictions on the assets of the entity. An entity shall determine, in light of the facts and circumstances, how much detail it must provide to satisfy the disclosure requirements of this statement and how it aggregates information for assets with different risk characteristics. The entity must strike a balance between obscuring important information as a result of too much aggregation and excessive detail that may not assist financial statement users to understand the entity's financial position. For example, an entity shall not obscure important information by including it with a large amount of insignificant detail. Similarly, an entity shall not disclose information that is so aggregated that it obscures important differences between the different types of involvement or associated risks.

26. The disclosures in paragraph 28.g. of this statement apply to transfers accounted for as sales when the transferor has continuing involvement with transferred financial assets as a result of a securitization, asset-backed financing arrangement, or a similar transfer. If specific disclosures are required for a particular form of the transferor's continuing involvement by other SSAPs, the transferor shall provide the information required in paragraphs 28.f.i.(a) and 28.f.ii.(a) of this statement with a cross-reference to the separate notes to financial statements so a financial statement user can understand the risks retained in the transfer. The entity need not provide each specific disclosure required in paragraphs 28.f.i.(b), 28.f.ii.(a)(1)–(4), and 28.f.ii.(b)–(e) if the disclosure is not required by other SSAPs and the objectives of paragraph 23 are met. For example, if the transferor's only form of continuing involvement is a derivative, the entity shall provide the disclosures required in paragraphs 28.f.i.(a) and 28.f.ii.(a) of this statement and the disclosures about derivatives required by applicable SSAPs. In addition, the entity would evaluate whether the other disclosures in paragraph 28.g. are necessary for the entity to meet the objectives in paragraph 23.

27. To apply the disclosures in paragraph 28, an entity shall consider all involvements by the transferor or its agents to be involvements by the transferor.

28. A reporting entity shall disclose the following⁵:

a. For Repurchase and Reverse Repurchase Agreements:

- i. If the entity has entered into repurchase or reverse repurchase agreements, information regarding the company policy or strategies for engaging in repo programs, policy for requiring collateral, as well as whether transactions have been accounted for as secured borrowings or as sale transactions. This disclosure shall include the terms of reverse repurchase agreements whose amounts are included in borrowing money. The following information shall be disclosed by type of agreement:
 - (a) Whether repo agreements are bilateral and/or tri-party trades;
 - (b) Maturity time frame divided by the following categories: open or continuous term contracts for which no maturity date is specified, overnight, 2 days to 1 week, from 1 week to 1 month, greater than 1 month to 3 months, greater than 3 months to 1 year, and greater than 1 year⁶;
 - (c) Aggregate narrative disclosure of the fair value of securities sold and/or acquired that resulted in default. (This disclosure is not intended to capture “failed trades”, which are defined as instances in which the trade did not occur as a result of an error and was timely corrected. Rather, this shall capture situations in which the non-defaulting party exercised their right to terminate after the defaulting party failed to execute.)
- ii. For repurchase transactions accounted for as secured borrowings⁷, the maximum amount and end balance as of each reporting period (quarterly and annual) for the following:
 - (a) Fair value of securities sold. (Book adjusted carrying value shall be provided as an end balance only.) This information is required in the aggregate, and by type of security categorized by NAIC designation, with identification of nonadmitted assets. Although legally sold as a secured borrowing, these assets are still reported by the insurer and shall be coded as restricted pursuant to the annual statement instructions, disclosed in accordance with SSAP No. 1—*Accounting Policies, Risks & Uncertainties, and Other Disclosures*, reported in the general interrogatories, and

⁵ All repurchase and reverse repurchase transactions (collectively referred to as “repos”), and securities borrowing and securities lending transactions shall be reported gross for disclosure purposes and when detailed on the respective investment schedules. However, repurchase and reverse repurchase transactions, and securities borrowing and securities lending transactions may be reported net in the financial statements (pages 2 and 3 of the statutory financial statements) in accordance with SSAP No. 64—*Offsetting and Netting of Assets and Liabilities* when a valid right to offset exists. When these transactions are offset in accordance with SSAP No. 64 and reported net in the financial statements, the disclosure requirements in SSAP No. 64, paragraph 6, shall be followed.

⁶ Only short-term repo agreements (with a stated short-term maturity date) are allowed as admitted assets. Long-term repo agreements (agreements with maturity dates in excess of 365 days) are nonadmitted.

⁷ For secured borrowing repurchase transactions, the insurance reporting entity is selling a security, and receiving collateral (generally cash) in an exchange that does not qualify as a sale.

included in any other statutory schedules or disclosure requirements requesting information for restricted assets.

- (b) Cash collateral and the fair value of security collateral (if any) received. This information is required in the aggregate and by type of security categorized by NAIC designation with identification of collateral securities received that do not qualify as admitted assets.
 - (1) For collateral received, aggregate allocation of the collateral by the remaining contractual maturity of the repurchase agreements (gross): overnight and continuous, up to 30 days, 30-90 days, greater than 90 days. This disclosure shall also include a discussion of the potential risks associated with the agreements and related collateral received, including the impact arising changes in the fair value of the collateral received and/or the provided security and how those risks are managed.
 - (2) For cash collateral received that has been reinvested, the total reinvested cash and the aggregate amortized cost and fair value of the invested asset acquired with the cash collateral. This disclosure shall be reported by the maturity date of the invested asset: under 30 days, 60 days, 90 days, 120 days, 180 days, less than 1 year, 1-2 years, 2-3 years and greater than 3 years. To the extent that the maturity dates of the liability (collateral to be returned) does not match the invested assets, the reporting entity shall explain the additional sources of liquidity to manage those mismatches.
 - (c) Liability recognized to return cash collateral, and the liability recognized to return securities received as collateral as required pursuant to the terms of the secured borrowing transaction.
- iii. For reverse repurchase transactions accounted for as secured borrowings⁸, the maximum amount and end balance as of each reporting period (quarterly and annual) for the following:
- (a) Fair value of securities acquired. This information shall be reported in the aggregate, and by type of security categorized by NAIC designation, with identification of whether acquired assets would not qualify as admitted assets.
 - (b) Cash collateral and the fair value of security collateral (if any) provided. (If security collateral was provided, book adjusted carrying value shall be provided as an end balance only.) Disclosure shall identify the book adjusted carrying value of any nonadmitted securities provided as collateral. For collateral pledged, the aggregate allocation of the collateral by the remaining contractual maturity of the reverse-repurchase agreements (gross): overnight and continuous, up to 30 days, 30-90 days, greater than 90 days. This disclosure shall also include a discussion of the potential risks associated with the agreements and related collateral

⁸ For secured borrowing reverse repurchase transactions, the insurance reporting entity is buying a security and providing collateral (generally cash) in an exchange that does not qualify as a sale.

pledged, including obligations arising from a decline in the fair value of the collateral pledged and how those risks are managed.

- (c) Recognized receivable for the return of collateral. (Generally cash collateral, but including securities provided as collateral as applicable under the terms of the secured borrowing transaction. Receivables are not recognized for securities provided as collateral if those securities are still reported as assets of the reporting entity.)
 - (d) Recognized liability to return securities acquired under the reverse-repurchase agreement as required pursuant to the secured borrowing transaction. (Generally, a liability is required if the acquired securities are sold.)
- iv. For repurchase transactions accounted for as a sale⁹, the maximum amount and end balance as of each reporting period (quarterly and annual) for the following:
- (a) Fair value of securities sold (derecognized from the financial statements). (Book adjusted carrying value shall be provided as an end balance only, reflecting the amount derecognized from the sale transaction.) This information is required in the aggregate, and by type of security categorized by NAIC designation, with information on the book adjusted carrying value of nonadmitted assets sold.
 - (b) Cash and the fair value of securities (if any) received as proceeds and recognized in the financial statements. This information is required in the aggregate and by type of security categorized by NAIC designation, with identification of received assets nonadmitted in the financial statements. All securities received shall be coded as restricted pursuant to the annual statement instructions, disclosed in accordance with SSAP No. 1, reported in the general interrogatories, and included in any other statutory schedules or disclosure requirements requesting information for restricted assets.
 - (c) The forward repurchase commitment recognized to return the cash or securities received. Amount reported shall reflect the stated repurchase price under the repurchase transaction.
- v. For reverse repurchase transactions accounted for as sale¹⁰, the maximum amount and end balance as of each reporting period (quarterly and annual):
- (a) Fair value of securities acquired and recognized on the financial statements. (Book adjusted carrying value shall be provided as an end balance only.) This information shall be reported in the aggregate, and by type of security categorized by NAIC designation. The disclosure also requires the book adjusted carrying value of nonadmitted assets acquired.
 - (b) Cash collateral and the fair value of security collateral (if any) provided. (If security collateral was provided, book adjusted carrying value shall be

⁹ For sale repurchase transactions, the insurance reporting entity sold a security and received “proceeds” in exchange. With a sale transaction, the insurer removes the asset from their financial statements and recognizes the proceeds from the sale. This transaction requires recognition of a forward repurchase commitment.

¹⁰ For sale reverse repurchase transactions, the insurance reporting entity has purchased a security and provided “proceeds” in exchange. With a sale transaction, the insurer reports the acquired asset in their financial statements and removes the proceeds provided. This transaction requires recognition of a forward resale commitment.

provided as an end balance only.) Disclosure shall also identify whether any nonadmitted assets were provided as collateral (derecognized from the financial statements).

- (c) The forward resale commitment recognized (stated repurchase price) to sell the acquired securities.

b. Collateral:

- i. If the entity has entered into securities lending transactions, its policy for requiring collateral or other security and the fair value of the loaned security;
- ii. If the entity has pledged any of its assets as collateral that are not reclassified and separately reported in the statement of financial position pursuant to paragraph 19.a., the carrying amounts and classifications of both those assets and associated liabilities as of the date of the latest statement of financial position presented, including qualitative information about the relationship(s) between those assets and associated liabilities. For example, if assets are restricted solely to satisfy a specific obligation, the carrying amounts of those assets and associated liabilities, including a description of the nature of restrictions placed on the assets, shall be disclosed.
- iii. If the entity or its agent has accepted collateral that it is permitted by contract or custom to sell or repledge, the fair value as of the date of each statement of financial position presented of that collateral and of the portion of that collateral that it has sold or repledged, and information about the sources and uses of that collateral. Additionally, the reporting entity shall disclose the aggregate amount of contractually obligated open collateral positions (aggregate amount of securities at current fair value or cash received for which the borrower may request the return of on demand) and the aggregate amount of contractually obligated collateral positions under 30-day, 60-day, 90-day, and greater than 90-day terms.
- iv. If the entity has accepted collateral that it is not permitted by contract or custom to sell or repledge, provide detail on these transactions, including the terms of the contract, and the current fair value of the collateral.
- v. For all securities lending transactions, disclose collateral for transactions that extend beyond one year from the reporting date; and
- vi. For securities lending transactions administered by an affiliated agent in which “one-line” reporting (paragraph 89.a.) of the reinvested collateral per paragraph 89.c. is optional, at the discretion of the reporting entity, disclose the aggregate value of the reinvested collateral which is “one line” reported and the aggregate value of items which are reported in the investment schedules (paragraph 89.b.). Identify the rationale between the items which are one line reported and those that are investment schedule reported and if the treatment has changed from the prior period and
- vii. For securities lending transactions, include separately, the amount of any loaned securities within the separate account and if the policy and procedures for the separate account differ from the general account.

- c. The reporting entity shall provide the following information by type of program (securities lending or dollar repurchase agreement) with respect to the reinvestment of the cash

collateral and any securities which it or its agent receives as collateral that can be sold or repledged.

- i. The aggregate amount of the reinvested cash collateral (amortized cost and fair value). Reinvested cash collateral shall be broken down by the maturity date of the invested asset – under 30 days, 60 days, 90 days, 120 days, 180 days, less than 1 year, 1-2 years, 2-3 years and greater than 3 years.
 - ii. To the extent that the maturity dates of the liability (collateral to be returned) does not match the invested assets, the reporting entity shall explain the additional sources of liquidity to manage those mismatches.
- d. For in-substance defeasance of debt
 - i. If debt was considered to be extinguished by in-substance defeasance, a general description of the transaction and the amount of debt that is considered extinguished at the end of each the period so long as that debt remains outstanding.
- e. For all servicing assets and servicing liabilities:
 - i. A description of the risks inherent in servicing assets and servicing liabilities and, if applicable, the instruments used to mitigate the income statement effect of changes in fair value to the servicing assets and servicing liabilities. (Disclosure of quantitative information about the instruments used to manage the risks inherent in servicing assets and servicing liabilities is encouraged but not required.)
 - ii. The amount of contractually specified servicing fees, late fees and ancillary fees earned for each period for which results of operations are presented, including a description of where each amount is reported in the statement of income.
 - iii. Quantitative and qualitative information about the assumptions used to estimate the fair value (for example, discount rates, anticipated credit losses, and prepayment speeds). An entity that provides quantitative information about the instruments used to manage the risks inherent in the servicing assets and servicing liabilities, as encouraged by paragraph 28.e.i., also is encouraged, but not required to disclose the quantitative and qualitative information about the assumptions used to estimate the fair value of those instruments.
- f. When servicing assets and servicing liabilities are subsequently measured at fair value:
 - i. For each class of servicing assets and servicing liabilities, the activity in the balance of servicing assets and the activity in the balance of servicing liabilities (including a description of where changes in fair value are reported in the statement of income for each period for which results of operations are presented), including, but not limited to, the following:
 - (a) The beginning and ending balances
 - (b) Additions (through purchases of servicing assets, assumptions of servicing obligations, and recognition of servicing obligations that result from transfers of financial assets)
 - (c) Disposals

- (d) Changes in fair value during the period resulting from (i) changes in valuation inputs or assumptions used in the valuation model and (ii) other changes in fair value and a description of those changes
 - (e) Other changes that affect the balance and a description of those changes.
 - g. For securitizations, asset-backed financing arrangements, and similar transfers accounted for as sales when the transferor has continuing involvement (as defined in the glossary) with the transferred financial assets:
 - i. For each income statement presented:
 - (a) The characteristics of the transfer including a description of the transferor's continuing involvement with the transferred financial assets, the nature and initial fair value of the assets obtained as proceeds and the liabilities incurred in the transfer, and the gain or loss from sale of transferred financial assets. For initial fair value measurements of assets obtained and liabilities incurred in the transfer, the following information:
 - (1) The level within the fair value hierarchy in which the fair value measurements in their entirety fall, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3);
 - (2) The key inputs and assumptions¹¹ used in measuring the fair value of assets obtained and liabilities incurred as a result of the sale that relate to the transferor's continuing involvement (including, at a minimum, but not limited to, and if applicable, quantitative information about discount rates, expected prepayments including the expected weighted-average life of prepayable¹² financial assets, and anticipated credit losses, including expected static pool losses^{13, 14}).
 - (b) Cash flows between a transferor and transferee, including proceeds from new transfers, proceeds from collections reinvested in revolving-period transfers, purchases of previously transferred financial assets, servicing fees, and cash flows received from a transferor's beneficial interests.
 - ii. For each statement of financial position presented, regardless of when the transfer occurred:

¹¹ If an entity has aggregated multiple transfers during a period in accordance with paragraphs 24 and 25, it may disclose the range of assumptions.

¹² The weighted-average life of prepayable assets in periods (for example, months or years) can be calculated by multiplying the principal collections expected in each future period by the number of periods until that future period, summing those products, and dividing the sum by the initial principal balance.

¹³ Expected static pool losses can be calculated by summing the actual and projected future credit losses and dividing the sum by the original balance of the pool of assets.

¹⁴ The timing and amount of future cash flows for transferor's interests in transferred financial assets are commonly uncertain, especially if those interests are subordinate to more senior beneficial interests. Thus, estimates of future cash flows used for a fair value measurement depend heavily on assumptions about default and prepayment of all the financial assets transferred, because of the implicit credit or prepayment risk enhancement arising from the subordination.

- (a) Qualitative and quantitative information about the transferor's continuing involvement with transferred financial assets that provides financial statement users with sufficient information to assess the reasons for the continuing involvement and the risks related to the transferred financial assets to which the transferor continues to be exposed after the transfer and the extent that the transferor's risk profile has changed as a result of the transfer (including, but not limited to, credit risk, interest rate risk, and other risks), including:
- (1) The total principal amount outstanding (BACV), the amount that has been derecognized, and the amount that continues to be recognized in the statement of financial position. The amount recognized (allocated fair value) by the reporting entity for the acquired participation in the transferred assets. The reporting schedules of both the transferred and reacquired assets. The percentage of beneficial interests from the reporting entity's transferred assets acquired by affiliated entities.
 - (2) The terms of any arrangements that could require the transferor to provide financial support (for example, liquidity arrangements and obligations to purchase assets) to the transferee or its beneficial interest holders, including a description of any events or circumstances that could expose the transferor to loss and the amount of the maximum exposure to loss.
 - (3) Whether the transferor has provided financial or other support during the periods presented that it was not previously contractually required to provide to the transferee or its beneficial interest holders, including when the transferor assisted the transferee or its beneficial interest holders in obtaining support, including:
 - (i.) The type and amount of support
 - (ii.) The primary reasons for providing the support
 - (4) Information is encouraged about any liquidity arrangements, guarantees, and/or other commitments provided by third parties related to the transferred financial assets that may affect the transferor's exposure to loss or risk of the related transferor's interest.
- (b) The entity's accounting policies for subsequently measuring assets and liabilities that relate to the continuing involvement with the transferred financial assets;
- (c) The key inputs and assumptions used in measuring the fair value of assets or liabilities that relate to the transferor's continuing involvement (including, at a minimum, but not limited to, and if applicable, quantitative information about discount rates, expected prepayments including the expected weighted-average life of prepayable financial assets, and anticipated credit losses, including expected static pool losses);

- (d) For the transferor's interests in the transferred financial assets, a sensitivity analysis or stress test showing the hypothetical effect on the fair value of those interests (including any servicing assets or servicing liabilities) of two or more unfavorable variations from the expected levels for each key assumption that is reported under paragraph 28.g.ii.(c) independently from any change in another key assumption, and a description of the objectives, methodology, and limitations of the sensitivity analysis or stress test;
 - (e) Information about the asset quality of transferred financial assets and any other assets that it manages together with them. This information shall be separated between assets that have been derecognized and assets that continue to be recognized in the statement of financial position. This information is intended to provide financial statement users with an understanding of the risks inherent in the transferred financial assets as well as in other assets and liabilities that it manages together with transferred financial assets. For example, information for receivables shall include, but is not limited to:
 - (i.) Delinquencies at the end of the period; and
 - (ii.) Credit losses, net of recoveries, during the period.
- h. Disclosure requirements for transfers of financial assets accounted for as secured borrowing (excluding repurchase and reverse repurchase transactions disclosed under paragraph 28.a.):
 - i. The carrying amounts and classifications of both assets and associated liabilities recognized in the transferor's statement of financial position at the end of each period presented, including qualitative information about the relationship(s) between those assets and associated liabilities. For example, if assets are restricted solely to satisfy a specific obligation, the carrying amounts of those assets and associated liabilities, including a description of the nature of restrictions placed on the assets.
 - i. Description of any loaned securities, including the amount, a description of, and the policy for, requiring collateral, and whether or not the collateral is restricted;
 - j. A description of the securities underlying, dollar repurchase and dollar reverse repurchase agreements, including book values and fair values, and maturities for the following categories: (i) securities subject to dollar repurchase agreements; and (ii.) securities subject to dollar reverse repurchase agreements.
 - k. Disclose any transfers of receivables with recourse.
 - l. A reporting entity shall disclose the following information for wash sales, as defined in paragraph 12, for all affiliated investment transactions (including items originally classified as cash equivalents and short-term investments) and for non-affiliated investment transactions with an NAIC designation of 3 or below, or that do not have an NAIC designation. (For non-affiliated investments, all cash equivalents, derivative instruments and short-term investments with credit assessments equivalent to an NAIC 1-2 designation are excluded from this disclosure.) This disclosure shall be included in the financial statements for when the investment was initially sold and is only applicable for sales and purchases that cross quarter-end or year-end reporting periods. For example, if the investment was sold December 20, 2017, and reacquired on January 10, 2018, the

transaction shall be captured in the wash sale disclosure included in the year-end 2017 financial statements, while an investment sold on May 1, 2019, and reacquired on May 20, 2019, would not be required to be disclosed:

- i. A description of the reporting entity's objectives regarding these transactions;
 - ii. An aggregation of transactions by NAIC designation 3 or below, or that do not have an NAIC designation;
 - iii. The number of transactions involved during the reporting period;
 - iv. The book value of securities sold;
 - v. The cost of securities repurchased; and
 - vi. The realized gains/losses associated with the securities involved.
- m. For reporting entities that have sold securities short within the reporting period, provide the following disclosures:
- i. Unsettled Short Sale Transactions (outstanding at reporting date) – The amount of proceeds received and the fair value of the securities to deliver, with current unrealized gains and/or losses, and the expected settlement timeframe (number of days). This disclosure shall include the fair value of current transactions that were not settled within three days and the fair value of the short sales expected to be satisfied by a securities borrowing transaction. This disclosure shall be aggregated by security type. (For example, short sales of common stock shall be aggregated and reported together.)
 - ii. Settled Short Sale Transactions (settled during the reporting period) – The aggregate amount of proceeds received and the fair value of the security as of the settlement date with recognized gains and/or losses. This disclosure shall identify the aggregated fair value of settled transactions that were not settled within three days and the fair value of transactions that were settled through a securities borrowing transaction.

29. Refer to the Preamble for further discussion regarding disclosure requirements. The disclosures required by paragraph 28 shall be made for the current quarter in the quarterly statement and for the year in the annual statement.

Application Guidance

30. This application guidance describes certain provisions of this statement in more detail and describes how they apply to certain types of transactions. It also discusses generalized situations. Facts and circumstances and specific contracts need to be considered carefully in applying this statement. This application guidance is an integral part of the standards provided in this statement.

31. Paragraph 6 of this statement states that the objective of paragraph 8 and related implementation guidance is to determine whether a transferor has surrendered control over transferred financial assets.

Unit of Account

32. Paragraph 7 establishes the unit of account to which the sale accounting conditions in paragraph 8 shall be applied. Paragraph 7 states that paragraph 8 shall be applied to transfers of an entire financial asset, transfers of a group of entire financial assets, and transfers of a participating interest in an entire financial

asset. Inherent in that principle is that to be eligible for sale accounting an entire financial asset cannot be divided into components before a transfer unless all of the components meet the definition of a participating interest.

33. The legal form of the asset and what the asset conveys to its holders shall be considered in determining what constitutes an entire financial asset. The following examples illustrate the application of what constitutes an entire financial asset:

- a. A loan to one borrower in accordance with a single contract that is transferred to a securitization entity before securitization shall be considered an entire financial asset. Similarly, a beneficial interest in securitized financial assets after the securitization process has been completed shall be considered an entire financial asset. In contrast, a transferred interest in an individual loan shall not be considered an entire financial asset; however, if the transferred interest meets the definition of a participating interest, the participating interest would be eligible for sale accounting.
- b. In a transaction in which the transferor creates an interest-only strip from a loan and transfers the interest-only strip, the interest-only strip does not meet the definition of an entire financial asset (and an interest-only strip does not meet the definition of a participating interest; therefore, sale accounting would be precluded). In contrast, if an entire financial asset is transferred to a securitization entity and the transfer meets the conditions for sale accounting, the transferor may obtain an interest-only strip as proceeds from the sale. An interest-only strip received as proceeds of a sale is an entire financial asset for purposes of evaluating any future transfers that could then be eligible for sale accounting.
- c. If multiple advances are made to one borrower in accordance with a single contract (such as a line of credit, credit card loan, or a construction loan), an advance on that contract would be a separate unit of account if the advance retains its identity, does not become part of a larger loan balance, and is transferred in its entirety. However, if the transferor transfers an advance in its entirety and the advance loses its identity and becomes part of a larger loan balance, the transfer would be eligible for sale accounting only if the transfer of the advance does not result in the transferor retaining any interest in the larger balance or if the transfer results in the transferor's interest in the larger balance meeting the definition of a participating interest. Similarly, if the transferor transfers an interest in an advance that has lost its identity, the interest must be a participating interest in the larger balance to be eligible for sale accounting.

Participating Interests in an Entire Financial Asset

34. Paragraph 7.b. requires that all cash flows received from the entire financial asset be divided among the participating interest holders (including any interest retained by the transferor or its agents) in proportion to their share of ownership. That is, the participating interest definition does not allow for the allocation of specified cash flows unless each cash flow is proportionately allocated to the participating interest holders. For example, in the case of an individual loan in which the borrower is required to make a contractual payment that consists of a principal amount and interest amount on the loan, the transferor and transferee shall share in the principal and interest payments on the basis of their proportionate ownership interest in the loan. In contrast, if the transferor is entitled to receive an amount that represents the principal payments and the transferee is entitled to receive an amount that represents the interest payments on the loan, that arrangement would not be consistent with the participating interest definition because the transferor and transferee do not share proportionately in the cash flows received from the loan. In other cases, a transferor may transfer a portion of an individual loan that represents either a senior interest or a junior interest in an individual loan. In both of those cases, the transferor would account for the transfer as a secured borrowing

because the senior interest or junior interest in the loan does not meet the requirements to be participating interests (see paragraph 38).

35. Paragraph 7.b. states that cash flows allocated as compensation for services performed, if any, shall not be included in that determination provided that those cash flows are not subordinate to the proportionate cash flows of the participating interest and are not significantly above an amount that would fairly compensate a substitute service provider, should one be required, including any profit that would be demanded in the marketplace. Cash flows allocated as compensation for services performed that are significantly above an amount that would fairly compensate a substitute service provider would result in a disproportionate division of cash flows of the entire financial asset among the participating interest holders and, therefore, would preclude the portion of a transferred financial asset from meeting the definition of a participating interest. Examples of cash flows that are compensation for services performed include loan origination fees paid by the borrower to the transferor, fees necessary to arrange and complete the transfer paid by the transferee to the transferor, and fees for servicing the financial asset.

36. The transfer of a portion of an entire financial asset may result in a gain or loss on the transfer when the contractual interest rate on the entire financial asset differs from the market rate at the time of transfer. Paragraph 7.b. states that any cash flows received by the transferor as proceeds of a transfer of a participating interest shall be excluded from the determination of whether the cash flows of the participating interest are proportionate provided that the transfer does not result in the transferor receiving an ownership interest in the financial asset that permits it to receive disproportionate cash flows. For example, if the transferor transfers an interest in an entire financial asset and the transferee agrees to incorporate the excess interest (between the contractual interest rate on the financial asset and the market interest rate at the date of transfer) into the contractually specified servicing fee, the excess interest would likely result in the conveyance of an interest-only strip to the transferor from the transferee. An interest-only strip would result in a disproportionate division of cash flows of the financial asset among the participating interest holders and would preclude the portion from meeting the definition of a participating interest.

37. Paragraph 7.c. requires that the rights of each participating interest holder (including the transferor in its role as participating interest holder) have the same priority and that no participating interest holder's interest is subordinated to the interest of another participating interest holder. In certain transfers, recourse is provided to the transferee that requires the transferor to reimburse any premium paid by the transferee if the underlying financial asset is prepaid within a defined timeframe of the transfer date. Such recourse would preclude the transferred portion from meeting the definition of a participating interest. However, once the recourse provision expires, the transferred portion shall be reevaluated to determine if it meets the participating interest definition.

38. Paragraph 7.c. also requires that participating interest holders have no recourse to the transferor (or its agents) or to each other, other than standard representations and warranties, ongoing contractual obligations to service the entire financial asset and administer the transfer contract, and contractual obligations to share in any set-off benefits. Recourse in the form of an independent third-party guarantee shall be excluded from the evaluation of whether the participating interest definition is met. Similarly, cash flows allocated to a third-party guarantor for the guarantee fee shall be excluded from the determination of whether the cash flows are divided proportionately among the participating interest holders.

Isolation Beyond the Reach of the Transferor and Its Creditors

39. The nature and extent of supporting evidence required for an assertion in financial statements that an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset (which are referred to collectively in this statement as transferred financial assets) have been isolated—put presumptively beyond the reach of the transferor and its creditors, either by a single transaction or a series of transactions taken as a whole—depend on the facts and circumstances. All available evidence that either supports or questions an assertion shall be considered, including whether the contract or circumstances permit the transferor to revoke the transfer. It also may include consideration of

the legal consequences of the transfer in the jurisdiction in which bankruptcy or other receivership would take place, whether a transfer of financial assets would likely be deemed a true sale at law (as described in paragraph 40.a.) or otherwise isolated (as described in paragraph 40.b.), whether the transferor is affiliated with the transferee, and other factors pertinent under applicable law. Derecognition of transferred financial assets is appropriate only if the available evidence provides reasonable assurance that the transferred financial assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor and its creditors (paragraph 74.c.). Transactions between related parties or affiliates are accounted for in accordance with SSAP No. 25.

40. In the context of U.S. bankruptcy laws, a true sale opinion from an attorney is often required to support a conclusion that transferred financial assets are isolated from the transferor, and its creditors. In addition, a nonconsolidation opinion is often required if the transfer is to an affiliated entity. In the context of U.S. bankruptcy laws:

- a. A true sale opinion is an attorney's conclusion that the transferred financial assets have been sold and are beyond the reach of the transferor's creditors and that a court would conclude that the transferred financial assets would not be included in the transferor's bankruptcy estate.
- b. A nonconsolidation opinion is an attorney's conclusion that a court would recognize that an entity holding the transferred financial assets exists separately from the transferor. Additionally, a nonconsolidation opinion is an attorney's conclusion that a court would not order the substantive consolidation of the assets and liabilities of the entity holding the transferred financial assets and the assets and liabilities of the transferor in the event of the transferor's bankruptcy or receivership.

A legal opinion may not be required if a transferor has a reasonable basis to conclude that the appropriate legal opinion(s) would be given if requested. For example, the transferor might reach a conclusion without consulting an attorney if (1) the transfer is a routine transfer of financial assets that does not result in any continuing involvement by the transferor or (2) the transferor had experience with other transfers with similar facts and circumstances under the same applicable laws and regulations.

41. For insurers that are subject to conservatorship, or other receivership procedures, judgments about whether transferred financial assets have been isolated need to be made in relation to the powers of conservators or receivers in those jurisdictions.

42. Whether securitizations isolate transferred financial assets may depend on such factors as whether the securitization is accomplished in one step or multiple step transfers (paragraphs 71-76). Some common financial transactions, for example, typical repurchase agreements and securities lending transactions, may isolate transferred financial assets from the transferor, although they may not meet the other conditions for surrender of control (paragraph 8).

Conditions That Constrain a Transferee

43. Sale accounting is allowed under paragraph 8.b. only if each transferee (or, if the transferee is an entity whose sole purpose is to engage in securitization or asset-backed financing arrangements and that entity is constrained from pledging or exchanging the assets it receives, each third-party holder of its beneficial interests) has the right to pledge or exchange the assets or beneficial interests it received, and no condition both constrains the transferee (or third-party holder of its beneficial interests) from taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the transferor. Many transferor-imposed or other conditions on a transferee's right to pledge or exchange both constrain a transferee from pledging or exchanging and, through that constraint, provide more than a trivial benefit to the transferor. Judgment is required to assess whether a particular condition results in a constraint. Judgment also is required to assess whether a constraint provides a more-than-trivial benefit to the transferor. If the

transferee is an entity whose sole purpose is to engage in securitization or asset-backed financing activities, that entity may be constrained from pledging or exchanging the transferred financial assets to protect the rights of beneficial interest holders in the financial assets of the entity. Paragraph 8.b. requires that the transferor look through the constrained entity to determine whether each third-party holder of its beneficial interests has the right to pledge or exchange the beneficial interests that it holds. The considerations in paragraphs 47-49 apply to the transferee or the third-party holders of its beneficial interests in an entity that is constrained from pledging or exchanging the assets it receives and whose sole purpose is to engage in securitization or asset-backed financing activities

44. Some conditions may constrain a transferee from pledging or exchanging the financial asset and may provide the transferor with more than a trivial benefit. For example, a provision that prohibits selling or pledging a transferred loan receivable not only constrains the transferee but also provides the transferor with the more-than-trivial benefit of knowing who holds the financial asset (a prerequisite to repurchasing the financial asset) and of being able to block the financial asset from being transferred to a competitor for the loan customer's business. Transferor-imposed contractual constraints that narrowly limit timing or terms, for example, allowing a transferee to pledge only on the day assets are obtained or only on terms agreed to with the transferor, also constrain the transferee and presumptively provide the transferor with more-than-trivial benefits. In some circumstances in which the transferor has no continuing involvement with the transferred financial assets, some conditions may constrain a transferee from pledging or exchanging the financial assets. If the transferor and its agents have no continuing involvement with the transferred financial assets, the condition under paragraph 8.b. is met. For example, if a transferor receives only cash in return for the transferred financial assets and the transferor and its agents have no continuing involvement with the transferred financial assets, sale accounting is allowed under paragraph 8.b. even if the transferee entity is significantly limited in its ability to pledge or exchange the transferred assets.

45. However, some conditions may not constrain a transferee from pledging or exchanging the transferred financial asset. For example, a transferor's right of first refusal on the occurrence of a bona fide offer to the transferee from a third party presumptively would not constrain a transferee. This is because the right in itself does not enable the transferor to compel the transferee to sell the financial asset and the transferee would be in a position to receive the sum offered by exchanging the financial asset, albeit possibly from the transferor rather than the third party. Further examples of conditions that presumptively would not constrain a transferee for purposes of this statement include (a) a requirement to obtain the transferor's permission to sell or pledge that is not to be unreasonably withheld, (b) a prohibition on sale to the transferor's competitor if other potential willing buyers exist, (c) a regulatory limitation such as on the number or nature of eligible transferees (as in the case of securities issued under Securities Act Rule 144A or debt placed privately), and (d) illiquidity, for example, the absence of an active market. However, judgment is required to assess the significance of some conditions. For example, a prohibition on sale to the transferor's competitor would be a constraint if that competitor were the only potential willing buyer other than the transferor.

46. A condition imposed by a transferor that constrains the transferee presumptively provides more than a trivial benefit to the transferor. A condition not imposed by the transferor that constrains the transferee may or may not provide more than a trivial benefit to the transferor. For example, if the transferor refrains from imposing its usual contractual constraint on a specific transfer because it knows an equivalent constraint is already imposed on the transferee by a third party, it presumptively benefits more than trivially from that constraint. However, the transferor cannot benefit from a constraint if it is unaware at the time of the transfer that the transferee is constrained.

Transferor's Rights or Obligations to Reacquire Transferred Assets or Beneficial Interests

47. Some rights or obligations to reacquire transferred financial assets or beneficial interests both constrain the transferee and provide more than a trivial benefit to the transferor, thus precluding sale accounting under paragraph 8.b. A freestanding call option written by a transferee to the transferor may benefit the transferor and, if the transferred financial assets are not readily obtainable in the marketplace, is

likely to constrain a transferee because the transferee might have to default if the call was exercised and the transferee had pledged or exchanged the financial assets. For example, if a transferor in a securitization transaction has a call option to repurchase third-party beneficial interests at the price paid plus a stated return, that arrangement conveys more than a trivial benefit to the transferor (paragraphs 53 and 54). If the third-party holders of its beneficial interests are constrained from pledging or exchanging their beneficial interests due to that call option, the transferor would be precluded from accounting for the transfer of financial assets to the securitization entity as a sale. Similarly, a freestanding forward purchase-sale contract between the transferor and the transferee on transferred financial assets not readily obtainable in the marketplace would benefit the transferor and is likely to constrain a transferee in much the same manner. Alternatively, freestanding rights to reacquire transferred assets that are readily obtainable presumptively do not constrain the transferee from pledging or exchanging them and thus do not preclude sale accounting under paragraph 8.b.

48. Other rights or obligations to reacquire transferred financial assets, regardless of whether they constrain the transferee, may result in the transferor's maintaining effective control over the transferred financial assets, as discussed in paragraphs 50-58, thus precluding sale accounting under paragraph 8.c. For example, an attached call in itself would not constrain a transferee who is able, by exchanging or pledging the asset subject to that call, to obtain substantially all of its economic benefits. However, an attached call could result in the transferor's maintaining effective control over the transferred asset(s) because the attached call gives the transferor the unilateral ability to cause whoever holds that specific asset to return it.

49. The concept of qualified special-purpose entities (QSPEs) was previously included within SSAP No. 91R. With the issuance of this statement, this concept is no longer included within statutory accounting guidance. Although this concept has been eliminated and is no longer a factor in determining whether a transfer of assets qualifies for sale accounting, reporting entities may continue to form, conduct transfers between, or have investments in trusts or other such legal vehicles that may have previously met the conditions to be considered a QSPE. Accounting for transfers of assets between the insurer and such trusts or other legal vehicles, including whether such transfers qualify for sale accounting, are subject to the provisions of this statement. As noted within paragraph 4, SSAP No. 25 shall be followed for accounting and disclosure requirements for all related party transactions.

Effective Control Over Transferred Financial Assets or Beneficial Interests

50. Judgment is required to assess whether the transferor maintains effective control over transferred financial assets or third-party beneficial interests. The transferor must evaluate whether a combination of multiple arrangements maintains effective control of transferred financial assets. When the transferee issues beneficial interests in the transferred financial assets, the evaluation of whether the transferor maintains effective control over the transferred financial assets also shall consider whether the transferor maintains effective control over the transferred financial assets through its control over the third-party beneficial interests. To assess whether the transferor maintains effective control over the transferred financial assets, all continuing involvement by the transferor or its agents shall be considered continuing involvement by the transferor. When assessing effective control, the transferor only considers the involvements of an agent when the agent acts for and on behalf of the transferor. In other words, if the transferor and transferee have the same agent, the agent's activities on behalf of the transferee would not be considered in the transferor's evaluation of whether it has effective control over a transferred financial asset. For example, an investment manager may act as a fiduciary (agent) for both the transferor and the transferee; therefore, the transferor need only consider the involvements of the investment manager when it is acting on its behalf.

Agreement to Repurchase or Redeem Transferred Financial Assets

51. An agreement that both entitles and obligates the transferor to repurchase or redeem transferred financial assets from the transferee maintains the transferor's effective control over those assets as described in paragraph 8.c.(1) when all of the following conditions are met:

- a. The financial assets to be repurchased or redeemed are the same or substantially the same as those transferred (paragraph 52).
- b. The agreement is to repurchase or redeem them before maturity, at a fixed or determinable price.
- c. The agreement is entered into contemporaneously with, or in contemplation of, the transfer.

52. To be substantially the same, the financial asset that was transferred and the financial asset that is to be repurchased or redeemed need to have all of the following characteristics:

- a. The same primary obligor (except for debt guaranteed by a sovereign government, central bank, government-sponsored enterprise or agency thereof, in which case the guarantor and the terms of the guarantee must be the same);
- b. Identical form and type so as to provide the same risks and rights;
- c. The same maturity (or in the case of mortgage-backed pass-through and pay-through securities similar remaining weighted-average maturities that result in approximately the same market yield);
- d. Identical contractual interest rates;
- e. Similar assets as collateral; and
- f. The same aggregate unpaid principal amount or principal amounts within accepted "good delivery" standards for the type of security involved.

Unilateral Ability to Cause the Return of Specific Transferred Financial Assets

53. A transferor maintains effective control over transferred financial assets when the transferor has the unilateral ability to cause the holder to return specific financial assets and that ability provides more than a trivial benefit to the transferor. A cleanup call, however, is permitted as an exception to that general principle. A call on a transferred financial asset provides the transferor with effective control over that financial asset if, under its price and other terms, the call provides the transferor with the unilateral ability to reclaim the transferred financial asset and conveys more than a trivial benefit to the transferor. A call or other right conveys more than a trivial benefit if the price to be paid is fixed, determinable, or otherwise potentially advantageous, unless because that price is so far out of the money or for other reasons it is probable when the option is written that the transferor will not exercise it. A transferor's unilateral ability to cause a securitization entity to return to the transferor or otherwise dispose of specific transferred financial assets, for example, in response to its decision to exit a market or a particular activity, would provide the transferor with effective control over the transferred financial assets if it provides more than a trivial benefit to the transferor. However, a call on readily obtainable assets at fair value may not provide the transferor with more than a trivial benefit. (Paragraph 56 provides an example in which, due to the combination of arrangements, the transferor would maintain effective control.)

54. Effective control over transferred financial assets can be present even if the right to reclaim is indirect. For example, if a call allows a transferor to buy back the beneficial interests at a fixed price, the transferor may maintain effective control of the financial assets underlying those beneficial interests. If the transferee is an entity whose sole purpose is to engage in securitization or asset-backed financing activities, that entity may be constrained from choosing to pledge or exchange the transferred financial assets. In that circumstance, any call held by the transferor on third-party beneficial interests is effectively an attached call on the transferred financial assets. Depending on the price and other terms of the call, the transferor may maintain effective control over the transferred financial assets.

55. An embedded call would not result in the transferor's maintaining effective control because it is the issuer rather than the transferor who holds the call and the call does not provide more than a trivial benefit to the transferor. For example, a call embedded by the issuer of a callable bond or the borrower of a prepayable mortgage loan would not provide the transferor with effective control over the transferred financial asset.

56. A right to reclaim specific transferred financial assets by paying their fair value when reclaimed generally does not maintain effective control when it does not convey a more than trivial benefit to the transferor. However, a transferor has maintained effective control if it has such a right and also holds the residual interest in the transferred financial assets. For example, if a transferor holds the residual interest in securitized financial assets and can reclaim the transferred financial assets at termination of the securitization entity by purchasing them in an auction, and thus at what might appear to be fair value, then sale accounting for the transfer of those financial assets it can reclaim would be precluded. Such circumstances provide the transferor with a more than trivial benefit and effective control over the financial assets because it can pay any price it chooses in the auction and recover any excess paid over fair value through its residual interest in the transferred financial assets.

57. Removal-of-account provisions do not result in the transferor's maintaining effective control, and are thus precluded from being accounted for as sales under statutory accounting as discussed in paragraph 78.

Arrangements to Reacquire Transferred Financial Assets

58. A transferor maintains effective control over the transferred financial asset as described in paragraph 8.c.(3) through an agreement that permits the transferee to require the transferor to repurchase the transferred financial asset at a price that is so favorable to the transferee at the date of the transfer that it is probable that the transferee will require the transferor to repurchase the transferred financial asset. For example, a put option written to the transferee generally does not provide the transferor with effective control over the transferred financial asset. However, a put option that is sufficiently deep in the money when it is written would provide the transferor effective control over the transferred financial asset because it is probable that the transferee will exercise the option and the transferor will be required to repurchase the transferred financial asset. In contrast, a sufficiently out-of-the-money put option held by the transferee would not provide the transferor with effective control over the transferred financial asset if it is probable when the option is written that the option will not be exercised. Likewise, a put option held by the transferee at fair value would not provide the transferor with effective control over the transferred financial asset.

Changes That Result in the Transferor's Regaining Control of Financial Assets Sold

59. A change in law or other circumstance may result in a transferred portion of an entire financial asset no longer meeting the conditions of a participating interest (paragraph 7) or the transferor's regaining control of transferred financial assets after a transfer that was previously accounted for as a sale, because one or more of the conditions in paragraph 8 are no longer met. Such changes, unless they arise solely from the initial application of this statement or from a change in market prices (for example, an increase in price that moves into-the-money a freestanding call on a non-readily-obtainable transferred financial asset that was originally sufficiently out-of-the-money that it was judged not to constrain the transferee), are accounted for in the same manner as a purchase of the transferred financial assets from the former transferee(s) in exchange for liabilities assumed (paragraph 9 or 11). (This "re-purchase" premise is consistent with *INT 04-21: EITF 02-09: Accounting for Changes that Result in a Transferor Regaining Control of Financial Assets Sold*.) After that change, the transferor recognizes in its financial statements those transferred financial assets together with liabilities to the former transferee(s) or beneficial interest holders of the former transferee(s). The transferor initially measures those transferred financial assets and liabilities at fair value on the date of the change, as if the transferor purchased the transferred financial assets and assumed the liabilities on that date. The former transferee would derecognize the transferred

financial assets on that date, as if it had sold the transferred financial assets in exchange for a receivable from the transferor.

Measurement of Interests Held after a Transfer of Financial Assets

Assets Obtained and Liabilities Incurred as Proceeds

60. The proceeds from a sale of financial assets consist of the cash and any other assets obtained, including beneficial interests and separately recognized servicing assets, in the transfer less any liabilities incurred, including separately recognized servicing liabilities. Any asset obtained is part of the proceeds from the sale. Any liability incurred, even if it is related to the transferred financial assets, is a reduction of the proceeds. Any derivative financial instrument entered into concurrently with a transfer of financial assets is either an asset obtained, or a liability incurred and part of the proceeds received in the transfer. All proceeds and reductions of proceeds from a sale shall be initially measured at fair value.

Participating Interests in Financial Assets That Continue to be Held by a Transferor

61. Participating interests in financial assets that continue to be held by a transferor are not part of the proceeds of the transfer, and the carrying amount of those participating interests shall be measured at the date of the 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 a transferor, based on their relative fair values.

Servicing Assets and Liabilities

62. Servicing of mortgage loans, credit card receivables, or other financial assets commonly includes, but is not limited to, collecting principal, interest, and escrow payments from borrowers; paying taxes and insurance from escrowed funds; monitoring delinquencies; executing foreclosure if necessary; temporarily investing funds pending distribution; remitting fees to guarantors, trustees, and others providing services; and accounting for and remitting principal and interest payments to the holders of beneficial interests or participating interests in the financial assets. Servicing is inherent in all financial assets; it becomes a distinct asset or liability for accounting purposes only in the circumstances described in paragraph 63. If a transferor sells a participating interest in an entire financial asset, it will recognize a servicing asset or a servicing liability only related to the participating interest sold.

63. An entity that undertakes a contract to service financial assets shall recognize either a servicing asset or a servicing liability, each time it undertakes an obligation to service a financial asset that (a) results from a servicer's transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset that meets the requirements for sale accounting, or (b) is acquired or assumed and the servicing obligation does not relate to financial assets of the servicer. However, if the transferor transfers the assets to an entity in a transfer that qualifies as a sale in which the transferor obtains the resulting securities, and classifies them as debt securities, the servicing asset or servicing liability may be reported together with the asset being serviced and not recognized separately. A servicer of financial assets commonly receives the benefits of servicing—revenues from contractually specified servicing fees, a portion of the interest from the financial assets, late charges, and other ancillary sources, including “float,” all of which it is entitled to receive only if it performs the servicing—and incurs the costs of servicing the financial assets. Typically, the benefits of servicing are expected to be more than adequate compensation to a servicer for performing the servicing, and the contract results in a servicing asset. However, if the benefits of servicing are not expected to adequately compensate a servicer for performing the servicing, the contract results in a servicing liability. (A servicing asset may become a servicing liability, or vice versa, if circumstances change, and the initial measure for servicing may be zero if the benefits of servicing are just adequate to compensate the servicer for its servicing responsibilities.) A servicer would account for its servicing contract that qualifies for separate recognition as a servicing asset or a servicing liability initially measured at its fair value regardless of whether explicit consideration was exchanged.

64. A servicer that transfers or securitizes financial assets in a transaction that does not meet the requirements for sale accounting and is accounted for as a secured borrowing with the underlying financial assets remaining on the transferor's balance sheet shall not recognize a servicing asset or a servicing liability.

65. A servicer that recognizes a servicing asset or servicing liability shall account for the contract to service financial assets separately from those financial assets, as follows:

- a. Report servicing assets separately from servicing liabilities as a nonadmitted asset in the statement of financial position.
- b. Initially measure servicing assets and servicing liabilities at fair value, (paragraph 15).
- c. Account separately for rights to future interest income from the serviced assets that exceed contractually specified servicing fees. Those rights are not servicing assets; they are financial assets, effectively interest-only strips to be accounted for in accordance with paragraph 18 of this statement. (Interest-only strips preclude a portion of a financial asset from meeting the definition of a participating interest; see paragraph 36.)
- d. Identify classes of servicing assets and servicing liabilities based on (1) the availability of market inputs used in determining the fair value of servicing assets and servicing liabilities, (2) an entity's method for managing the risks of its servicing assets and servicing liabilities, or (3) both.
- e. Subsequently measure each class of separately recognized servicing assets and servicing liabilities at fair value. Changes in fair value should be reported as unrealized gains and losses (paragraph 17). Declines in fair value which are determined to be other-than-temporary shall be recorded as realized losses.

66. As indicated above, transferors sometimes agree to take on servicing responsibilities when the future benefits of servicing are not expected to adequately compensate them for performing that servicing. In that circumstance, the result is a servicing liability rather than a servicing asset. For example, if in the transaction illustrated in Exhibit B – Illustration 3 the transferor had agreed to service the loans without explicit compensation and it estimated the fair value of that servicing obligation at \$50, net proceeds would be reduced to \$980, gain on sale would become a loss on sale of \$20, and the transferor would report a servicing liability of \$50.

Securitizations

67. Financial assets, such as mortgage loans, are commonly transferred in securitizations. Securitizations of mortgage loans may include pools of single-family residential mortgages or other types of real estate mortgage loans, for example, multifamily residential mortgages and commercial property mortgages. Both financial and nonfinancial assets can be securitized; life insurance policy loans, patent and copyright royalties, and even taxi medallions also have been securitized. But securitizations of nonfinancial assets are outside the scope of this statement.

68. An originator of a typical securitization (the transferor) transfers a portfolio of financial assets to a securitization entity, commonly a trust. In "pass-through" and "pay-through" securitizations, receivables are transferred to the entity at the inception of the securitization, and no further transfers are made; all cash collections are paid to the holders of beneficial interests in the entity.

69. Beneficial interests in the securitization entity are sold to investors and the proceeds are used to pay the transferor for the assets transferred financial assets. Those beneficial interests may comprise either a single class having equity characteristics or multiple classes of interests, some having debt characteristics

and others having equity characteristics. The cash collected from the portfolio is distributed to the investors and others as specified by the legal documents that established the entity.

70. Pass-through and pay-through securitizations that meet the conditions in paragraph 8 qualify for sale accounting under this statement. All financial assets obtained and liabilities incurred by the transferor of a securitization that qualifies as a sale shall be recognized and measured as provided in paragraphs 9 and 11; that includes the implicit forward contract to sell additional financial assets during a revolving period, which may become valuable or onerous to the transferor as interest rates and other market conditions change.

Isolation of Transferred Financial Assets in Securitizations

71. A securitization carried out in one transfer or a series of transfers may or may not isolate the transferred financial assets beyond the reach of the transferor and its creditors. Whether it does depends on the structure of the securitization transaction taken as a whole, considering such factors as the type and extent of further involvement in arrangements to protect investors from credit, and interest rate, and other risks, the availability of other financial assets, and the powers of bankruptcy courts or other receivers. The discussion in paragraphs 72-74 relates only to the isolation condition in paragraph 8.a. The conditions in paragraphs 8.b. and 8.c. also must be considered to determine whether a transferor has surrendered control over the transferred financial assets.

72. In certain securitizations, a corporation that, if it failed, would be subject to the U.S. Bankruptcy Code transfers financial assets to a securitization entity exchange for cash. The entity raises that cash by issuing to investors beneficial interests that pass through all cash received from the financial assets, and the transferor has no further involvement with the trust or the transferred financial assets. The Board understands that those securitizations generally would be judged as having isolated the assets, because, in the absence of any continuing involvement, there would be reasonable assurance that the transfer would be found to be a true sale at law that places the assets beyond the reach of the transferor, and its creditors, even in bankruptcy or other receivership.

73. In other securitizations, a similar corporation transfers financial assets to a securitization entity in exchange for cash and beneficial interests in the transferred financial assets. That entity raises the cash by issuing to investors commercial paper that gives them a senior beneficial interest in cash received from the financial assets. The beneficial interests obtained by the transferring corporation represent a junior interest to be reduced by any credit losses on the financial assets in the entity. The senior beneficial interests (commercial paper) are highly rated by credit rating agencies only if both (a) the credit enhancement from the junior interest is sufficient and (b) the transferor is highly rated. Depending on facts and circumstances, the Board understands that those “single-step” securitizations often would be judged in the United States as not having isolated the financial assets, because the nature of the continuing involvement may make it difficult to obtain reasonable assurance that the transfer would be found to be a true sale at law that places the financial assets beyond the reach of the transferor and its creditors in U.S. bankruptcy (paragraph 39). If the transferor fell into bankruptcy and the transfer was found not to be a true sale at law, investors in the transferred financial assets might be subjected to an automatic stay that would delay payments due them, and they might have to share in bankruptcy expenses and suffer further losses if the transfer was recharacterized as a secured loan.

74. Still other securitizations use multiple transfers intended to isolate transferred financial assets beyond the reach of the transferor and its creditors, even in bankruptcy. For example, in “two-step” structures:

- a. First, the corporation transfers a group of financial assets to a special-purpose corporation that, although wholly owned, is so designed that the possibility is remote that the transferor or its creditors could reclaim the financial assets. This first transfer is designed to be judged to be a true sale at law, in part because the transferor does not provide “excessive” credit

or yield protection to the special-purpose corporation, and the Board understands that transferred financial assets are likely to be judged beyond the reach of the transferor or the transferor's creditors even in bankruptcy or other receivership.

- b. Second, the special-purpose corporation transfers a group of financial assets to a trust or other legal vehicle with a sufficient increase in the credit or yield protection on the second transfer (provided by a transferor's junior beneficial interest or other means) to merit the high credit rating sought by third-party investors who buy senior beneficial interests in the trust. Because of that aspect of its design, that second transfer might not be judged to be a true sale at law and, thus, the transferred financial assets could at least in theory be reached by a bankruptcy trustee for the special-purpose corporation.
- c. However, the special-purpose corporation is designed to make remote the possibility that it would enter bankruptcy. For example, its charter forbids it from undertaking any other business or incurring any liabilities, so that there can be no creditors to petition to place it in bankruptcy. Furthermore, its dedication to a single purpose is intended to make it extremely unlikely, even if it somehow entered bankruptcy, that a receiver under the U.S. Bankruptcy Code could reclaim the transferred financial assets because it has no other assets to substitute for the transferred financial assets.

75. The Board understands that the "two-step" securitizations described above, taken as a whole, generally would be judged under present U.S. law as having isolated the financial assets beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership. However, each entity involved in a transfer must be evaluated under the applicable accounting guidance.

76. The powers of receivers vary considerably by state of domicile, and therefore some receivers may be able to reach financial assets transferred under a particular arrangement and others may not. A securitization may isolate transferred financial assets from a transferor subject to such a receiver and its creditors even though it is accomplished by only one transfer directly to a securitization entity that issues beneficial interests to investors and the transferor provides credit or yield protection.

Sales of Future Revenues

77. In addition to securitization of assets, some reporting entities have entered into transactions characterized as a sale of future revenues. These transactions are sometimes referred to as securitizations and are sometimes characterized as selling deferred acquisition costs. A sale of future revenues by a reporting entity shall not result in the immediate recognition of income or surplus. The proceeds of any such sale shall be established as a liability and shall be reduced as the proceeds are repaid.

Removal-of-Accounts Provisions

78. Many transfers of financial assets that involve transfers of a group of entire financial assets to an entity whose sole purpose is to engage in securitization or asset-backed financing activities empower the transferor to reclaim assets subject to certain restrictions. Such a power is sometimes called a removal-of-accounts provision (ROAP). Transfers of assets that include ROAP provisions are precluded from being accounted for as sales under statutory accounting and shall follow the guidance in paragraph 14 for secured borrowing.

Short Sales

79. A short sale, as defined for statutory accounting, is the sale of a security that a selling reporting entity (seller) does not own at the time of sale or a sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller. Short sales are normally settled by the delivery of a security borrowed by or on behalf of the seller. The seller later closes out the position by returning the borrowed

security to the lender, typically by purchasing securities on the open market. If the price of the security rises, short sellers who buy it at the higher price will incur a loss.

80. In a “naked” short sale, the seller does not borrow or arrange to borrow the securities in time to make delivery to the buyer within the standard three-day settlement period (T+3). As a result, the seller fails to deliver securities to the buyer when delivery is due (known as a “failure to deliver” or “fail”).

81. Consistent with U.S. GAAP guidance, short sales generally do not meet the definition of a derivative unless a forward purchase or forward sale is involved. Even if a forward purchase or forward sale element is included, if the contract meets the regular-way security trade exception, it would not be subject to the derivative guidance.

82. State statutes or state laws may have restrictions regarding whether a reporting entity is permitted to sell securities short. In situations in which state regulations do not prohibit, or otherwise provide specific guidance, short-sale transactions shall be accounted for in accordance with this statement.

83. Selling a security short is an action by a reporting entity, which results with the reporting entity recognizing proceeds from the sale and an obligation to deliver the sold security. For statutory accounting purposes, obligations to deliver securities resulting from short sales shall be reported as contra-assets (negative assets) in the respective investment schedule for the type of asset sold, with an investment code detailing the item as a short sale. The obligation (negative asset) shall be initially reflected at fair value, with changes in fair value recognized as unrealized gains and losses. These unrealized gains and losses shall be realized upon settlement of the short sale obligation. Interest on short sale positions shall be accrued periodically and reported as interest expense.

84. If short sales are supported by a securities borrowing transaction, the accounting and reporting guidelines in paragraphs 93-95 shall also be followed.

Securities Lending Transactions

85. Securities lending transactions are generally initiated by broker-dealers and other financial institutions that need specific securities to cover a short sale or a customer’s failure to deliver securities sold. Securities lending transactions typically extend less than one year. Transferees (borrowers) of securities generally are required to provide collateral to the transferor (lender) of securities, commonly cash but sometimes other securities or standby letters of credit, with a value slightly higher than that of the securities borrowed. If the collateral is cash, the transferor typically earns a return by investing that cash at rates higher than the rate paid or rebated to the transferee. If the collateral is other than cash, the transferor typically receives a fee. Securities custodians or other agents commonly carry out securities lending activities on behalf of clients. Because of the protection of collateral (typically valued daily and adjusted frequently for changes in the market price of the securities transferred) and the short terms of the transactions, most securities lending transactions in themselves do not impose significant credit risks on either party. Other risks arise from what the parties to the transaction do with the assets they receive. For example, investments made with cash collateral impose market and credit risks on the transferor.

86. If the criteria conditions in paragraph 8 (sales criteria) are met, securities lending transactions shall be accounted for:

- a. By the transferor as a sale of the “loaned” securities for proceeds consisting of the cash collateral¹⁵ and a forward repurchase commitment.

¹⁵ If the “collateral” in a transaction that meets the criteria in paragraph 8 is a financial asset that the holder or its agent is permitted by contract or custom to sell or repledge, that financial asset is proceeds of the sale of the “loaned” securities. To the extent that the “collateral” consists of letters of credit or other financial instruments that the holder or its agent is not permitted by contract or custom to sell or repledge, a securities lending transaction does not satisfy the sale criteria and is accounted for as a loan of securities by the transferor to the transferee.

- b. By the transferee as a purchase of the “borrowed” securities in exchange for the collateral and a forward resale commitment. During the term of that agreement, the transferor has surrendered control over the securities transferred and the transferee has obtained control over those securities with the ability to sell or transfer them at will. In that case, creditors of the transferor have a claim only to the “collateral” and the forward repurchase commitment.

87. Many securities lending transactions are accompanied by an agreement that entitles and obligates the transferor to repurchase or redeem the transferred financial assets before their maturity under which the transferor maintains effective control over those financial assets (paragraphs 51-52). Those transactions shall be accounted for as secured borrowings, in which cash (or securities that the holder or its agent is permitted by contract or custom to sell or repledge) received as collateral is considered the amount borrowed, the securities loaned are considered pledged as collateral against the cash or securities borrowed and reclassified as set forth in paragraph 19.a., and any rebate paid to the transferee of securities is interest on the cash or securities the transferor is considered to have borrowed.

88. The transferor of securities being “loaned” accounts for cash received in the same way whether the transfer is accounted for as a sale or a secured borrowing. The cash received shall be recognized as the transferor’s asset – as shall investments made with that cash, even if made by agents or in pools with other securities lenders – along with the obligation to return the cash. If securities that may be sold or repledged are received, the transferor of the securities being “loaned” accounts for those securities in the same way as it would account for cash received.

89. The transferor of securities being “loaned” accounts for collateral received in the same way whether the transfer is accounted for as a sale or a secured borrowing. The collateral received shall be recognized as the transferor’s asset – as shall investments made with that collateral, even if made by agents or in pools with other securities lenders – along with the obligation to return the collateral. If securities that may be sold or repledged are received by the transferor or its agent, the transferor of the securities being “loaned” accounts for those securities in the same way as it would account for collateral received. Collateral which may be sold or repledged by the transferor or its agent is reflected on balance sheet, along with the obligation to return the asset¹⁶. Collateral received which may not be sold or repledged by the transferor or its agent is off balance sheet¹⁷. For collateral on the balance sheet, the reporting is determined by the administration of the program.

- a. Securities lending programs where the collateral received by the reporting entity’s unaffiliated agent that can be sold or repledged is reported on the balance sheet. The collateral received and reinvestment of that collateral by the reporting entity’s unaffiliated agent shall be reflected as a one-line entry on the balance sheet (Securities Lending Collateral) and a detailed schedule will be required each quarter and at year-end to list the description of the collateral asset. This description shall include the NAIC designation, fair value; book adjusted carrying value and maturity date. A separate liability shall also be established to record the obligation to return the collateral (Collateral from Securities Lending Activities).
- b. Securities lending programs where the collateral received by the reporting entity that can be sold or repledged is reported on the balance sheet. If the reporting entity is the administrator of the program, then, the collateral received and any reinvestment of that

¹⁶ If cash is received by the transferor or its agent and reinvested or repledged it is reported on balance sheet. It is explicitly intended that when the lender bears reinvestment risk, that collateral is on balance sheet.

¹⁷ An example of collateral which is off balance sheet is when securities are received by the transferor or its agent in which the collateral must be held and returned, without the ability to transfer or repledge the collateral. This would involve limited situations in which the transferor or agent is prohibited from reinvesting the collateral.

collateral is reported with the invested assets of the reporting entity based on the type of investment (i.e. bond, common stock, etc.). A separate liability shall also be established to record the obligation to return the collateral (Collateral from Securities Lending Activities).

- c. Securities lending programs where the collateral received by the reporting entity's affiliated agent can report using either one-line reporting (paragraph 89.a.) or investment schedule reporting (paragraph 89.b.).

90. Reinvestment of the collateral by the reporting entity or its agent shall follow the same impairment guidance as other similar invested assets reported on the balance sheet. Any fees received by the transferor for loaning the securities shall be recorded as miscellaneous investment income.

Securities Lending Transactions – Collateral Requirements¹⁸

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.

Securities Borrowing Transactions – Sale Criteria is Not Met (Secured Borrowing)

93. In addition to being the transferor of securities being loaned and receiving collateral under a securities lending arrangement, reporting entities may be a transferee of borrowed securities, and provide collateral under a securities borrowing arrangement.

94. A transferee that sells borrowed securities shall recognize the proceeds from the sale of the securities and an obligation, at fair value, to return the borrowed securities to the transferor. If cash proceeds from the sale of borrowed securities are invested into other assets, or if non-cash proceeds are received from the sale, the assets acquired shall be shown as assets on the reporting entity's (transferee's) financial statements and accounted and reported in accordance with the SSAP for the type of assets acquired. For all instances in which the transferee sells borrowed securities, the reporting entity shall designate restricted assets equivalent to the fair value of the obligation to return the borrowed securities to the transferor.

95. A reporting entity transferee that borrows securities captured under this section (sale criteria is not met) and uses the borrowed securities to settle a short sale transaction shall eliminate the contra-asset recognized under the short sale (paragraph 83) and establish a liability to return the borrowed security. The

¹⁸ The collateral requirements are required for determining admitted assets under statutory accounting, but the receipt of collateral is not a factor in determining whether the transferor has effective control over the loaned assets in accordance with paragraph 51.

liability to return the borrowed security shall remain on the books until the reporting entity acquires the security to return to the transferor. The accounting/reporting for the short sale and the secured borrowing transaction shall be separately reflected within the financial statements. As such, use of the borrowed asset for the short sale would be similar to recognizing "proceeds" from selling a borrowed asset, as such, if the borrowed asset is used to settle a short sale, the reporting entity shall recognize the borrowed asset and the obligation to return the asset under the secured borrowing agreement until the asset has been returned under the secured borrowing transaction. and recognize an obligation, at fair value, to return the borrowed securities.

Repurchase Agreements and "Wash Sales"

96. Government securities dealers, banks, other financial institutions, and corporate investors commonly use repurchase agreements to obtain or use short-term funds. Under those agreements, the transferor ("repo party") transfers a security to a transferee ("repo counterparty" or "reverse party") in exchange for cash¹⁹ and concurrently agrees to reacquire that security at a future date for an amount equal to the cash exchanged plus a stipulated "interest" factor. Repurchase agreements, reverse repurchase agreements and dollar repurchase agreements 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.

97. Repurchase agreements can be affected in a variety of ways. Some repurchase agreements are similar to securities lending transactions in that the transferee or its agent has the right to sell or repledge the securities to a third party during the term of the repurchase agreement. In other repurchase agreements, the transferee does not have the right to sell or repledge the securities during the term of the repurchase agreement. For example, in a tri-party repurchase agreement, the transferor transfers securities to an independent third-party custodian that holds the securities during the term of the repurchase agreement. Also, many repurchase agreements are for short terms, often overnight, or have indefinite terms that allow either party to terminate the arrangement on short notice. However, other repurchase agreements are for longer terms, sometimes until the maturity of the transferred financial asset. Some repurchase agreements call for repurchase of securities that need not be identical to the securities transferred.

98. If the conditions in paragraph 8 are met, the transferor shall account for the repurchase agreement as a sale of financial assets and a forward repurchase commitment, and the transferee shall account for the agreement as a purchase of financial assets and a forward resale commitment. Other transfers that are accompanied by an agreement to repurchase the transferred financial assets that may be accounted for as sales include transfers with agreements to repurchase at maturity. (Repurchase financing is addressed in paragraphs 105-110.)

99. Furthermore, "wash sales" that previously were not recognized if the same financial asset was purchased within 30 days before or after the sale shall be accounted for as sales under this statement. Unless there is a concurrent contract to repurchase or redeem the transferred financial assets from the transferee, the transferor does not maintain effective control over the transferred financial assets.

100. As with securities lending transactions, under many agreements to repurchase transferred financial assets before their maturity the transferor maintains effective control over those financial assets. Repurchase agreements that do not meet all the conditions in paragraph 8 shall be treated as secured borrowings. Fixed-coupon and dollar-roll repurchase agreements, and other contracts under which the securities to be repurchased need not be the same as the securities sold, qualify as borrowings if the return of substantially the same (paragraph 52) securities as those concurrently transferred is assured. Therefore, those transactions shall be accounted for as secured borrowings by both parties to the transfer.

¹⁹ Instead of cash, other securities or letters of credit sometimes are exchanged. Those transactions are accounted for in the same manner as securities lending transactions (paragraphs 85-92).

101. If a transferor has transferred securities to an independent third-party custodian, or to a transferee, under conditions that preclude the transferee from selling or repledging the assets during the term of the repurchase agreement (as in most tri-party repurchase agreements), the transferor has not surrendered control over those assets.

Repurchase Agreements

102. Repurchase agreements are defined as agreements under which a reporting entity sells securities and simultaneously agrees to repurchase the same or substantially the same securities at a stated price on a specified date. For securities to be substantially the same, the criteria defined in paragraph 52 must be met, and for mortgage-backed securities excluding mortgage pass-through securities, the projected cash flows of the securities must be substantially the same under multiple scenario prepayment assumptions.

103. For repurchase agreements that are accounted for as collateralized borrowings in accordance with paragraph 100 of this statement, the underlying securities shall continue to be accounted for as an investment owned by the reporting entity. The proceeds from the sale of the securities shall be recorded as a liability, and the difference between the proceeds and the amount at which the securities will be subsequently reacquired shall be reported as interest expense, calculated on the straight-line method or the scientific interest (constant yield) method, over the term of the agreement.

104. Reporting entities generally take possession of the underlying collateral under repurchase agreements and in many cases may obtain additional collateral when the estimated fair value of such securities falls below their current contract value. However, to the extent that the current fair value of the collateral is less than the recorded amount, the shortfall shall reduce the admitted asset value of the repurchase agreement.

Repurchase Financing

105. Repurchase financing is a repurchase agreement that relates to a previously transferred financial asset between the same counterparties (or affiliates of either counterparty) that is entered into contemporaneously with, or in contemplation of, the initial transfer.

106. A repurchase financing involves the transfer of a previously transferred financial asset back to the initial transferor as collateral for a financing between the initial transferee (the borrower) and the initial transferor (the lender). A repurchase financing also typically involves the initial transferor returning the transferred financial asset (or substantially the same asset) to the initial transferee when the financing is repaid on a stated date. A repurchase financing is entered into in contemplation of the initial transfer if both transactions are considered together at the execution of the initial transfer.

107. When the transferor transfers a financial asset and also enters into a repurchase financing with the transferee, there are typically three transfers of the financial assets:

- a. Initial transfer – An initial transferor transfers a financial asset to an initial transferee.
- b. Repurchase financing – The initial transferee (the borrower) transfer the previously transferred financial asset back to the initial transferor (the lender) as collateral for a financing between the initial transferor and initial transferee.
- c. Settlement – The initial transferor (the lender) returns the financial asset (or substantially the same asset) to the initial transferee (the borrower) upon receipt of payment from the initial transferee.

108. Repurchase financing that is entered into contemporaneously with, or in contemplation of, an initial transfer of financial asset between the same counterparties (or affiliates of either counterparty) shall not be separately accounted for as a transfer of a financial asset and a related repurchase financing unless (a) the

two transactions have a valid and distinct business or economic purpose for being entered into separately and (b) the repurchase financing does not result in the initial transferor regaining control over the financial asset. Unless the provisions in paragraph 109 are met, the initial transfer and repurchase financing shall be evaluated as a linked transaction. The linked transaction shall be evaluated to determine whether it meets the requirements for sale accounting per paragraph 8. If the linked transaction does not meet the requirements for sale accounting, the linked transaction shall be accounted for based on the economics of the combined transactions, which generally represent a forward contract. SSAP No. 86 shall be used to evaluate whether the linked transaction shall be accounted for as a derivative.

109. An initial transfer of a financial asset and repurchase financing that are entered into contemporaneously with, or in contemplation of, one another shall be considered linked unless all of the following criteria are met at the inception of the transaction:

- a. The initial transfer and the repurchase financing are not contractually contingent on one another. Even if no contractual relationship exists, the pricing and performance of either the initial transfer or the repurchase financing must not be dependent on the terms and execution of the other transaction.
- b. The repurchase financing provides the initial transferor with recourse to the initial transferee upon default. That recourse must expose the initial transferor to the credit risk of the initial transferee, or its affiliates, and not solely to the market risk of the transferred financial asset. The initial transferee's agreement to repurchase the previously transferred financial asset (or substantially the same asset) for a fixed price and not fair value.
- c. The financial asset subject to the initial transfer and repurchase financing is readily obtainable in the marketplace. In addition, the initial transfer of a financial asset and the repurchase financing are executed at market rates. This criterion may not be circumvented by embedding off-market terms in a separate transaction contemplated with the initial transfer or the repurchase financing.
- d. The financial asset and repurchase agreement are not coterminous (the maturity of the repurchase financing must be before the maturity of the financial asset).

110. In accordance with paragraph 108, an initial transfer of assets and a repurchase financing shall not be considered separate transactions unless the provisions of paragraph 109 are met. If the provisions of paragraph 109 are met, the initial transfer shall be evaluated to determine whether it meets the requirements for sale accounting without taking into consideration the repurchase financing. In such situations, the repurchase financing shall then be separately analyzed as a repurchase agreement.

Reverse Repurchase Agreements

111. Reverse repurchase agreements are defined as agreements under which a reporting entity purchases securities and simultaneously agrees to resell the same or substantially the same securities at a stated price on a specified date. For securities to be substantially the same, the criteria defined in paragraph 52 must be met, and for mortgage-backed securities excluding mortgage pass-through securities, the projected cash flows of the securities must be substantially the same under multiple scenario prepayment assumptions.

112. For reverse repurchase agreements that are accounted for as collateralized lendings in accordance with paragraph 100 of this statement, the underlying securities shall not be accounted for as investments owned by the reporting entity. The amount paid for the securities shall be reported as a short-term investment, and the difference between the amount paid and the amount at which the securities will be subsequently resold shall be reported as interest income, calculated on the straight-line method or the scientific interest (constant yield) method, over the term of the agreement.

Collateral Requirements – Repurchase and Reverse Repurchase Agreements²⁰

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.

Dollar Repurchase Agreements

114. Dollar repurchase and dollar reverse repurchase agreements are defined as repurchase and reverse repurchase agreements involving debt instruments that are pay-through securities collateralized with Government National Mortgage Association (GNMA), Federal Home Loan Mortgage Corporation (FHLMC) and Federal National Mortgage Association (FNMA) collateral, and pass-through certificates sponsored by GNMA, mortgage participation certificates issued by the FHLMC or similar securities issued by the FNMA. Dollar repurchase agreements are also commonly referred to as dollar roll transactions. To meet the definition of dollar repurchase and dollar reverse repurchase agreements, the securities underlying the agreements must meet the criteria defined in paragraph 52, and for mortgage-backed securities excluding mortgage pass-through securities, the projected cash flows of the securities must be substantially the same under multiple scenario prepayment assumptions.

115. For the seller in a dollar repurchase agreement accounted for as collateralized borrowing in accordance with paragraph 100 of this statement, a liability is recorded for the amount of proceeds of the sale and the sold mortgage-backed securities are not removed from the accounting records. During the period of the agreement, interest income is recorded as if the mortgage-backed security had been held during the term of the agreement. This is offset by an equal amount of interest expense related to the proceeds received from the sale. Additional interest expense is recorded representing the difference between the sales price and the repurchase price of the mortgage-backed securities sold.

116. When the mortgage-backed securities are repurchased under the agreement, the original mortgage-backed securities sold are removed from the accounting records and the purchased mortgage-backed securities are recorded. The principal amount of the mortgage-backed securities repurchased must be in good delivery form consistent with paragraph 52.

²⁰ The collateral requirements are required for determining admitted assets under statutory accounting, but the receipt of collateral is not a factor in determining whether the transferor has effective control over the loaned assets in accordance with paragraph 50.

117. If the principal amount repurchased is greater than the amount sold, the cash paid is recorded as an additional investment in the newly acquired certificates. If the principal amount repurchased is less than the amount sold, a gain or loss relating to the original certificates held is recorded.

118. For the purchaser in a dollar reverse repurchase agreement accounted for as collateralized lending in accordance with paragraph 100 of this statement, an asset is recorded for the amount of the purchase. Upon completion of the reverse repurchase agreement, cash is received in exchange for a “substantially the same” security. The difference between the purchase and reselling price represents interest income for the lending of short-term funds.

Separate Transactions

119. Agreements to repurchase and resell securities that do not meet the definitions in paragraphs 85-101 of this statement shall be accounted for as two separate transactions, that is, as a sale and purchase or as a purchase and sale, in accordance with the relevant statutory accounting guidance. For example, sales of bonds would result in recognition of realized gains or losses.

Offsetting

120. Reporting entities may operate on both sides of the repurchase agreement market resulting in recording of liabilities and assets representing repurchase and reverse repurchase agreements, respectively.

121. Reporting entities shall offset such liabilities and assets only to the extent that a legal right to offset exists as defined in SSAP No. 64, paragraph 2. Otherwise, separate assets and liabilities shall be recognized.

Loan Syndications

122. Borrowers often borrow amounts greater than any one lender is willing to lend. Therefore, it is common for groups of lenders to jointly fund those loans. That may be accomplished by a syndication under which several lenders share in lending to a single borrower, but each lender loans a specific amount to the borrower and has the right to repayment from the borrower.

123. A loan syndication is not a transfer of financial assets. Each lender in the syndication shall account for the amounts it is owed by the borrower. Repayments by the borrower may be made to a lead lender who then distributes the collections to the other lenders of the syndicate. In those circumstances, the lead lender is also functioning as a servicer and, therefore, shall only recognize its portion of the loan as a financial asset.

Loan Participations

124. Groups of banks or other entities also may jointly fund large borrowings through loan participations in which a single lender makes a large loan to a borrower and subsequently transfers interests in the loan to other entities.

125. 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 transferor (originating lender) continues to service the loan. The transferee (participating entity) may or may not have the right to sell or transfer its participation during the term of the loan, depending upon the terms of the participation agreement.

126. If the loan participation agreement transfers a participating interest in an entire financial asset (as described in paragraph 7 of this statement) and the conditions in paragraph 8 are met, the transfer shall be accounted for by the transferor as a sale of a participating interest. A transferor’s right of first refusal on a bona fide offer from a third party, a requirement to obtain the transferor’s permission that shall not be unreasonably withheld, or a prohibition on sale to the transferor’s competitor is a limitation on the transferee’s rights but presumptively does not constrain a transferee from exercising its right to pledge or

exchange. However, if the loan participation agreement constrains the transferees from pledging or exchanging its participating interest and that constraint provides a more-than-trivial benefit to the transferor, the transferor has not relinquished control and shall account for the transfer as a secured borrowing.

Factoring Arrangements

127. Factoring arrangements are a means of discounting accounts receivable on a nonrecourse, notification basis. Accounts receivable in their entirety are sold outright, usually to a transferee (the factor) that assumes the full risk of collection, without recourse to the transferor in the event of a loss. Debtors are directed to send payments to the transferee. Factoring arrangements that meet the conditions in paragraph 8 shall be accounted for as sales of financial assets because the transferor surrenders control over the receivables to the factor.

Transfers of Receivables with Recourse

128. In a transfer of an entire receivable, a group of entire receivables, or a portion of an entire receivable with recourse, the transferor provides the transferee with full or limited recourse. The transferor is obligated under the terms of the recourse provision to make payments to the transferee or to repurchase receivables sold under certain circumstances, typically for defaults up to a specified percentage. A transfer of receivables with recourse shall not be recognized as a sale, but rather as secured borrowing. (This provision is applied regardless if the transfer was comprised of the entire receivable, a group of the entire receivable, or a portion of the entire receivable.) A transfer of receivables without recourse shall only be recognized if the transferor receives cash for the receivables. The sale shall be recognized when cash is received. Sales of premium receivables are addressed in *SSAP No. 42—Sale of Premium Receivables*.

Extinguishments of Liabilities

129. If a creditor releases a debtor from primary obligation on the condition that a third party assumes the obligation and that the original debtor becomes secondarily liable, that release extinguishes the original debtor's liability. However, in those circumstances, whether or not explicit consideration was paid for that guarantee, the original debtor becomes a guarantor. As a guarantor, it shall recognize a guarantee obligation in the same manner as would a guarantor that had never been primarily liable to that creditor, with due regard for the likelihood that the third party will carry out its obligations. The guarantee obligation shall be initially measured at fair value, and that amount reduces the gain or increases the loss recognized on extinguishment.

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 considered substantially different and/or more than minor.

Relevant Literature

131. The accounting guidance in this statement adopts with modification *FAS 166, Accounting for the Transfers of Financial Assets, an Amendment to FAS 140* (FAS 166), *FAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FAS 140), as amended by FAS 166, and *FAS 156, Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140*, as amended by FAS 166. Statutory modifications from these adoptions include:

- a. Rejects the GAAP consideration for “consolidated affiliates” as the concept of consolidation has not been adopted for statutory accounting.
- b. Rejects reference to GAAP standards and GAAP methods not adopted for statutory as well as concepts that are not pertinent for insurers. For example, references to investments

“held-to-maturity”, “available for sale” or “trading” and reference to FASB standards are replaced with statutory terms and references to statutory standards.

- c. Rejects GAAP reference and guidance regarding “Revolving-Period Securitizations” as this GAAP guidance is not applicable to statutory accounting. This concept was also deemed not applicable to statutory accounting under SSAP No. 91R.
- d. Rejects GAAP guidance for “Sale-Type and Direct-Financing Lease Receivables” as leases shall be accounted for in accordance with *SSAP No. 22R—Leases*. This conclusion is consistent with SSAP No. 91R.
- e. Rejects GAAP guidance for “Banker’s Acceptances and Risk Participations in Them,” as not applicable for statutory accounting. This GAAP guidance was also deemed not applicable to statutory accounting under SSAP No. 91R.
- f. Rejects GAAP guidance for “Removal of Account Provisions” that allows recognition of sale accounting. For statutory, transfers that would empower the transferor to reclaim assets under certain conditions (considered “removal-of-accounts provisions”) are precluded from being accounted for as sales. This conclusion is consistent with SSAP No. 91R.
- g. Rejects GAAP guidance for “Transfers of Receivables with Recourse” that allows transfers of receivables in their entirety with recourse to be accounted for as sales. For statutory, a transfer of receivables with recourse shall be accounted for as a secured borrowing. This conclusion is consistent with SSAP No. 91R.
- h. Rejects illustrations for transactions involving transfers of lease financing receivables with residual values and banker’s acceptances with a risk participation as the GAAP guidance in FAS 166 related to these topics has been rejected for statutory accounting.
- i. Rejects the optionality provided within FAS 156 for subsequent measurement of servicing assets and servicing liabilities using either fair value or an amortization method. This statement requires application of a fair value method for subsequent measurement.
- j. Incorporates guidance previously included in SSAP No. 91R specific to insurance entities, and guidance that was adopted from GAAP guidance not revised through the issuance of FAS 166. Items incorporated include:
 - i. Clarification that transfers of financial assets that are in substance real estate shall be accounted for in accordance with *SSAP No. 40R—Real Estate Investments* (paragraph 2).
 - ii. Clarification that transactions between related parties or affiliates are accounted for in accordance with *SSAP No. 25—Affiliates and Other Related Parties* (paragraph 4).
 - iii. Clarification that the guidance does not address the securitization of mortality or morbidity risk (paragraph 5).
 - iv. Guidance on the accounting of sale transactions for entities required to maintain an interest maintenance reserve (IMR). This guidance requires such entities to account for realized and unrealized capital gains and losses per the guidance in the SSAP for the specific type of investment, or if not specifically stated in the related SSAP, in accordance with SSAP No. 7 (paragraph 11.c.).

- v. Clarification of when servicing assets and servicing liabilities shall be recognized as well as measurement of these items. Continues prior statutory decision that servicing rights assets shall be nonadmitted (paragraphs 15-17).
- vi. Guidance on the accounting for transactions that require the granting of a security interest in certain assets to another party to serve as collateral for their performance under a contract (paragraph 20).
- vii. Disclosures on security lending transactions, loaned securities; securities underlying repurchase and reverse repurchase agreements, dollar repurchase and dollar reverse repurchase agreements; receivables with recourse; and wash sales (paragraphs 28.a., 28.b., and 28.h.-28.l.).
- viii. Guidance on the sales of future revenues (paragraph 77).
- ix. Guidance on collateral requirements for securities lending transactions (paragraph 91).
- x. Clarification that repurchase agreements, reverse repurchase agreements and dollar repurchase agreements 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 guidance (paragraph 96).
- xi. Guidance on Repurchase Agreements (paragraphs 96-110).
- xii. Guidance on Reverse Repurchase Agreements (paragraphs 111-112).
- xiii. Guidance on Collateral for Reverse and Repurchase Agreements (paragraph 113).
- xiv. Guidance on Dollar Repurchase Agreements (paragraph 114-118).
- xv. Guidance for Separate Transactions (paragraph 119).
- xvi. Guidance for Offsetting (paragraph 121). (This guidance was revised in November 2012 to only allow offsetting when a valid right to offset exists in accordance with SSAP No. 64. This is different from previous guidance reflected in SSAP No. 91R.)
- xvii. Guidance for Transfers of Receivables with Recourse (paragraph 129).

132. This statement also adopts *FASB Staff Position 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions* (FSP FAS 140-3), *ASU 2011-03, Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements* and *AICPA Statement of Position 90-3, Definition of the Term Substantially the Same for Holders of Debt Instruments, as used In Certain Audit Guides and a Statement of Position*. This statement adopts *FASB Emerging Issues Task Force (EITF) No. 87-34, Sale of Mortgage Servicing Rights with a Subservicing Agreement*, *FASB EITF No. 88-11, Allocation of Recorded Investment When a Loan as Part of a Loan is Sold*, *FASB EITF No. 88-18, Sales of Future Revenues*, *FASB EITF No. 88-22, Securitization of Credit Card and Other Receivable Portfolios*, *FASB EITF No. 90-21, Balance Sheet Treatment of a Sale of Mortgage Servicing Rights with a Subservicing Agreement*, *FASB EITF No. 95-5, Determination of What Risks and Rewards, If Any, Can Be Retained and Whether Any Unresolved Contingencies May Exist in a Sale of Mortgage Loan Servicing Rights*, *FASB EITF No. 96-19, Debtor's Accounting for a Modification or Exchange of Debt Instruments*, as amended by FAS 166, and *FASB EITF No. 01-7, Creditor's Accounting for a Modification or Exchange of Debt Instruments*. This statement adopts ASC guidance for short sales with modification to require the short sale obligation to be reflected as a contra-asset rather than a liability. Also, the recognition of unrealized gains

and losses is consistent with statutory accounting recognition, rather than directly to net income under U.S. GAAP. (The adopted ASC guidance includes guidance reflected in 942-405-25-1 through 25-2, 942-405-35-1, and 942-405-45-1. Additionally, the guidance in ASC 815-10-55-57 through 59 and 815-10-15-15 through 17, which addresses whether short sales are within the scope of SSAP No. 86, and the definition of a regular-way security trade is also adopted.)

133. This statement rejects FASB EITF No. 84-5, *Sale of Marketable Securities with a Put Option*, and FASB EITF No. 92-2, *Measuring Loss Accruals by Transferors of Receivables with Recourse* and FTB 01-1: *Effective Date for Certain Financial Institutions of Certain Provisions of Statement 140 related to Isolation of Transferred Financial Assets*. This statement rejects FIN 41, *Offsetting Amounts Related to Certain Repurchase and Reverse Repurchase Agreements*. This rejection, as it is a reversal of the prior adoption of this guidance in SSAP No. 45, and the revisions to paragraphs 121-122 adopted November 2012, are effective January 1, 2013. This guidance has been rejected as it permits optionality as to whether offsetting and net reporting occurs for repurchase and reverse purchase agreements under master netting agreements. The provisions of SSAP No. 64 shall be used in determining whether assets and liabilities shall be offset and reported net.

134. Effective December 31, 2023, this statement rejects ASU 2016-13 *Financial Instruments—Credit Losses (Topic 326)*, *Measurement of Credit Losses on Financial Instruments*, ASU 2018-19 *Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, ASU 2019-04 *Codification Improvements to Topics 326, 815, 825*, ASU 2019-10 *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815)*, and *Leases (Topic 842)*, ASU 2019-11 *Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, and ASU 2020-03 *Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB’s issuance of ASU 2016-13 and other related ASUs.

Effective Date and Transition

~~134.~~ 135. This standard shall be effective for years beginning on and after January 1, 2013 (effective date) and shall be applied prospectively. This statement must be applied as of the beginning of the reporting entity’s first annual reporting period after the effective date, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. This statement must be applied to transfers occurring on or after the effective date. On and after the effective date, the concept of a qualifying special purpose entity is no longer relevant for statutory accounting purposes. The disclosure provisions of this statement shall be applied to transfers that occurred both before and after the effective date of this statement. Guidance reflected in paragraph 22 added from INT 03-05, EITF 01-7: *Creditor’s Accounting for a Modification or Exchange of Debt Instruments* has been in effect since June 22, 2003. Guidance in paragraphs 22 and 121 was originally contained in INT 99-14: EITF No. 96-19, *Debtor’s Accounting for a Modification or Exchange of Debt Instruments*, as amended by FAS 166 and was effective October 4, 1999. Revisions to incorporate guidance for short sales, detailed in *Issue Paper No. 152—Short Sales*, are effective on a prospective basis for transactions occurring on or after January 1, 2017, unless a reporting entity has previously been following an approach similar to the adopted guidance. Reporting entities that have previously been following a similar approach shall not deviate from that approach prior to the effective date of the adopted guidance. Revisions to paragraph 28.a. of this statement to incorporate enhanced disclosures on repurchase and reverse repurchase transactions are effective December 31, 2017.

REFERENCES**Other**

- *SSAP No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
- *SSAP No. 33—Securitization*
- *SSAP No. 45—Repurchase Agreements, Reverse Repurchase Agreements and Dollar Repurchase Agreements*
- *SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
- *Purposes and Procedures Manual of the NAIC Investment Analysis Office*

Relevant Issue Papers

- *Issue Paper No. 122—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
- *Issue Paper No. 134—Servicing Assets/Liabilities, An Amendment of SSAP No. 91*
- *Issue Paper No. 141—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
- *Issue Paper No. 144—Substantive Revisions to SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities – Revised*
- *Issue Paper No. 152—Short Sales*

EXHIBIT A - GLOSSARY**Adequate Compensation**

The amount of benefits of servicing that would fairly compensate a substitute servicer should one be required, which includes the profit that would be demanded in the marketplace.

Agent

A party that acts for and on behalf of another party. For example, a third-party intermediary is an agent of the transferor if it acts on behalf of the transferor.

Attached Call

A call option held by the transferor of a financial asset that becomes part of and is traded with the underlying instrument. Rather than being an obligation of the transferee, an attached call is traded with and diminishes the value of the underlying instrument transferred subject to that call.

Beneficial Interests

Rights to receive all or portions of specified cash inflows received by a trust or other entity, including, but not limited to, senior and subordinated shares of interest, principal, or other cash inflows to be “passed-through” or “paid-through,” premiums due to guarantors, commercial paper obligations, and residual interests, whether in the form of debt or equity.

Benefits of Servicing

Revenues from contractually specified servicing fees, late charges, and other ancillary sources, including “float.”

Cleanup Call

An option held by the servicer or its affiliate, which may be the transferor, to purchase the remaining transferred financial assets, or the remaining beneficial interests not held by the transferor, its affiliates, or its agents in an entity (or in a series of beneficial interests in transferred financial assets within an entity), if the amount of outstanding financial assets or beneficial interests falls to a level at which the cost of servicing those assets or beneficial interests becomes burdensome in relation to the benefits of servicing.

Collateral

Personal or real property in which a security interest has been given.

Continuing Involvement

Any involvement with the transferred financial assets that permits the transferor to receive cash flows or other benefits that arise from the transferred financial assets or that obligates the transferor to provide additional cash flows or other assets to any party related to the transfer. All available evidence shall be considered, including, but not limited to, explicit written arrangements, communications between the transferor and the transferee or its beneficial interest holders, and unwritten arrangements customary to similar transfers. Examples of continuing involvement with the transferred financial assets include, but are not limited to, servicing arrangements, recourse or guarantee arrangements, agreements to purchase or redeem transferred financial assets, options written or held, derivative financial instruments that are entered into contemporaneously with, or in contemplation of, the transfer, arrangements to provide financial support, pledges of collateral, and the transferor’s beneficial interests in the transferred financial assets.

Contractually Specified Servicing Fees

All amounts that, per contract, are due to the servicer in exchange for servicing the financial asset and would no longer be received by a servicer if the beneficial owners of the serviced assets (or their trustees or agents) were to exercise their actual or potential authority under the contract to shift the servicing to another servicer. Depending on the servicing contract, those fees may include some or all of the difference between the interest rate collectible on the financial asset being serviced and the rate to be paid to the beneficial owners of those financial assets.

Derecognize

Remove previously recognized assets or liabilities from the statement of financial position.

Derivative Financial Instrument

A derivative instrument (as defined in *SSAP No. 86—Derivatives*) that is a financial instrument (refer to *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures*, paragraph 2).

Embedded Call

A call option held by the issuer of a financial instrument that is part of and trades with the underlying instrument. For example, a bond may allow the issuer to call it by posting a public notice well before its stated maturity that asks the current holder to submit it for early redemption and provides that interest ceases to accrue on the bond after the early redemption date. Rather than being an obligation of the initial purchaser of the bond, an embedded call trades with and diminishes the value of the underlying bond.

Financial Asset

Cash, evidence of an ownership interest in an entity, or a contract that conveys to a 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.

Financial Liability

A contract that imposes on one entity an obligation (a) to deliver cash or another financial instrument to a second entity or (b) to exchange other financial instruments on potentially unfavorable terms with the second entity.

Freestanding Call

A call that is neither embedded in nor attached to an asset subject to that call.

Interest-Only Strip

A contractual right to receive some or all of the interest due on a bond, mortgage loan, collateralized mortgage obligation, or other interest-bearing financial asset.

Naked Short Sale

A short sale in which the seller does not borrow or arrange to borrow the securities in time to make delivery to the buyer within the standard three-day settlement period (T+3). As a result, the seller fails to deliver securities to the buyer when delivery is due (known as a "failure to deliver" or "fail").

Participating Interest

A participating interest has the following characteristics:

- a. From the date of the transfer, it represents a proportionate (pro rata) ownership interest in an entire financial asset. The percentage of ownership interests held by the transferor in the entire financial asset may vary over time, while the entire financial asset remains outstanding as long as the resulting portions held by the transferor or its agents) and the transferee(s) meet the other characteristics of a participating interest. For example, if the transferor's interest in an entire financial asset changes because it subsequently sells another interest in the entire financial asset, the interest held initially and subsequently by the transferor must meet the definition of a participating interest.
- b. From the date of the transfer, all cash flows received from the entire financial asset are divided proportionately among the participating interest holders in an amount equal to their share of ownership. Cash flows allocated as compensation for services performed, if any, shall not be included in that determination provided those cash flows are not subordinate to the proportionate cash flows of the participating interest and are not significantly above an amount that would fairly compensate a substitute service provider, should one be required, which includes the profit that would be demanded in the marketplace. In addition, any cash flows received by the transferor as proceeds of the transfer of the participating interest shall be excluded from the determination of proportionate cash flows provided that the transfer does not result in the transferor receiving an ownership interest in the financial asset that permits it to receive disproportionate cash flows.
- c. The rights of each participating interest holder (including the transferor in its role as a participating interest holder) have the same priority, and no participating interest holder's interest is subordinated to the interest of another participating interest holder. That priority does not change in the event of bankruptcy or other receivership of the transferor, the original debtor, or any other participating interest holder. Participating interest holders have no recourse to the transferor, its agents or to each other, other than standard representations and warranties, ongoing contractual obligations to service the entire financial asset and administer the transfer contract, and contractual obligations to share in any set-off benefits received by any participating interest holder. That is, no participating interest holder is entitled to receive cash before any other participating interest holder under its contractual rights as a participating interest holder. For example, if a participating interest holder also is the servicer of the entire financial asset and receives cash in its role as servicer, that arrangement would not violate this requirement.
- d. No party has the right to pledge or exchange the entire financial asset unless all participating interest holders agree to pledge or exchange the entire financial asset.

Proceeds

Cash, beneficial interests, servicing assets, derivatives, or other assets that are obtained in a transfer of financial assets, less any liabilities incurred.

Recourse

The right of a transferee of receivables to receive payment from the transferor of those receivables for (a) failure of debtors to pay when due, (b) the effects of prepayments, or (c) adjustments resulting from defects in the eligibility of the transferred receivables.

Regular-Way Security Trade

Contracts that provide for delivery of a security within a period of time after the trade date generally established by regulations or conventions in the marketplace or exchange in which it is being executed.

Securitization

The process by which financial assets are transformed into securities.

Security Interest

A form of interest in property that provides that upon default of the obligation for which the security interest is given, the property may be sold in order to satisfy that obligation.

Seller

A transferor that relinquishes control over financial assets by transferring them to a transferee in exchange for consideration.

Servicing Asset

A contract to service financial assets under which the estimated future revenues from contractually specified servicing fees, late charges, and other ancillary revenues are expected to more than adequately compensate the servicer for performing the servicing. A servicing contract is either (a) undertaken in conjunction with selling or securitizing the financial assets being serviced or (b) purchased or assumed separately.

Short Sale

A short sale, as defined for statutory accounting, is the sale of a security that a selling reporting entity (seller) does not own at the time of sale or a sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller.

Servicing Liability

A contract to service financial assets under which the estimated future revenues from contractually specified servicing fees, late charges, and other ancillary revenues are not expected to adequately compensate the servicer for performing the servicing.

Standard Representations and Warranties

Representations and warranties that assert the financial asset being transferred is what it is purported to be at the transfer date. Examples include representations and warranties about (a) the characteristics, nature, and quality of the underlying financial asset, including characteristics of the underlying borrower and the type and nature of the collateral securing the underlying financial asset, (b) the quality, accuracy, and delivery of documentation relating to the transfer and the underlying financial asset, and (c) the accuracy of the transferor's representations in relation to the underlying financial asset.

Transfer

The conveyance of a noncash financial asset by and to someone other than the issuer of that financial asset. Thus, a transfer includes selling a receivable, putting it into a securitization trust, or posting it as collateral but excludes the origination of that receivable, the settlement of that receivable, or the restructuring of that receivable into a security in a troubled debt restructuring.

Transferee

An entity that receives a financial asset, an interest in a financial asset, or a group of financial assets from a transferor.

Transferor

An entity that transfers a financial asset, an interest in a financial asset, or a group of financial assets that it controls to another entity.

Unilateral Ability (See paragraphs 53 and 54)

A capacity for action not dependent on the actions (or failure to act) of any other party.

Not for Distribution

EXHIBIT B - ILLUSTRATIONS**Illustration—Recording Transfers with Proceeds of Cash, Derivatives, and Other Liabilities**

1. Company A transfers entire loans with a carrying amount of \$1,000 to a subsidiary and receives proceeds with a fair value of \$1,030 and the transfer is accounted for as a sale. Company A undertakes no servicing responsibilities and assumes a limited recourse obligation to repurchase delinquent loans.

Company A agrees to provide the transferee a return at a floating rate of interest even though the contractual terms of the loan are fixed rate in nature (that provision is effectively an interest rate swap).

Fair Values

Cash proceeds	\$1,050
Interest rate swap asset	40
Recourse obligation	60

Net Proceeds

Cash received	\$1,050
Plus: Interest rate swap asset	40
Less: Recourse obligation	(60)
Net proceeds	<u>\$1,030</u>

Gain on Sale

Net proceeds	\$1,030
	<u>1,000</u>
Carrying amount of loans sold	<u>\$30</u>
Gain on sale	

Journal Entry

Cash	1,050	
Interest rate swap asset	40	
Loans		1,000
Recourse obligation		60
Gain on sale		30
<i>To record transfer</i>		

Illustration—Recording Transfers of Participating Interests

2. Company B transfers a nine-tenths participating interest in a loan with a fair value of \$1,100 and a carrying amount of \$1,000, and the transfer is accounted for as a sale. The servicing contract has a fair value of zero because Company B estimates that the benefits of servicing are just adequate to compensate it for its servicing responsibilities.

Fair Values

Cash proceeds for nine-tenths sold ($\$1,100 \times 9/10$)	\$990
One-tenth interest continued to be held by the transferor ($\$1,100 \times 1/10$)	110

Allocated Carrying Amount Based on Relative Fair Values

	<u>Fair Value</u>	<u>Percentage Of Total Fair Value</u>	<u>Allocated Carrying Amount</u>
Nine-tenths participating interest sold ($\$1,100 \times 9/10$)	\$990	90	\$900
One-tenth participating interest continued to be held by the transferor ($\$1,100 \times 1/10$)	<u>110</u>	<u>10</u>	<u>100</u>
Total	<u>\$ 1,100</u>	<u>100</u>	<u>\$1,000</u>

Gain on Sale

Net proceeds	\$ 990
Less: Carrying amount of loans sold	(900)
Gain on sale	<u>\$90</u>

Journal Entry

Cash	990	
Loans		900
Gain on sale		90

To record transfer

Illustration—Sale of Receivables with Servicing Obtained

3. Company C originates \$1,000 of loans that yield 10% 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% on the contractual interest on the loans (an interest-only strip receivable), and an additional 1% 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.

Fair Values

Cash proceeds	\$1,000
Servicing asset	40
Interest-only strip receivable	60

Net Proceeds

Cash proceeds	\$1,000
Servicing Asset	40
Interest-only strip receivable	60
Net Proceeds	<u>\$1,100</u>

Gain on Sale

Net proceeds	\$1,100
Less: Carrying amount of loans sold	<u>(1,000)</u>
Gain on sale	<u>\$ 100</u>

Journal Entries

Cash	1,000	
Interest-only strip receivable	60	
Servicing Asset	40	
Loans		1,000
Gain on sale		100

To record transfer and to recognize interest-only strip receivable and servicing asset

Illustration—Securities Lending Transaction Treated as a Secured Borrowing

4. The following example illustrates the accounting for a securities lending transaction treated as a secured borrowing, in which the securities borrower sells the securities upon receipt and later buys similar securities to return to the securities lender:

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

For simplicity, the fair value of the security is assumed not to change during the 35-day term of the transaction.

Journal Entries for the Transferor

At inception:

Cash	1,020	
Payable under securities loan agreements		1,020

To record the receipt of cash collateral

Securities pledged to creditors	1,000	
Securities		1,000

To reclassify loaned securities that the secured party has the right to sell or repledge

Money market instrument	1,020	
Cash		1,020

To record investment of cash collateral

At conclusion:

Cash	1,025	
Interest		5
Money market instrument		1,020

To record results of investment

Securities	1,000	
Securities pledged to creditors		1,000

To record return of security

Payable under securities loan agreements	1,020	
Interest ("rebate")	4	
Cash		1,024

To record repayment of cash collateral plus interest

Journal Entries for the Transferee

At inception:

Receivable under securities loan agreements	1,020	
Cash		1,020

To record transfer of cash collateral

Cash	1,000	
Obligation to return borrowed securities		1,000
<i>To record sale of borrowed securities to a third party and the resulting obligation to return securities that it no longer holds</i>		
<i>At conclusion:</i>		
Obligation to return borrowed securities	1,000	
Cash		1,000
<i>To record the repurchase of securities borrowed</i>		
Cash	1,024	
Receivable under securities loan agreements		1,020
Interest revenue ("rebate")		4
<i>To record the receipt of cash collateral and rebate interest</i>		

Not for Distribution

Illustration—Short Sale Settled with Securities Borrowed Under a Secured Borrowing Agreement

5. The following example illustrates the accounting for a securities borrowing transaction treated as a secured borrowing, in which the insurer borrows securities and delivers the borrowed securities to a different counterparty to settle a short sale transaction.

Cash

Contra-Asset – Securities Sold Short

To recognize the cash received and the obligation to delivery securities under a short sale.

Receivable Under Securities Loan Agreement (Borrow Securities)

Cash

To recognize transfer of cash under the security borrowing agreement, with recognition of a receivable for the return. The actual securities borrowed under the agreement (as sale accounting criteria is not met) shall not be recognized on the financial statements.

Borrowed Asset (“Proceeds” of selling asset)

Obligation to return Securities Borrowed

To recognize the use of the borrowed security to settle a short-sale transaction. This transaction would be similar to receiving “proceeds” from the sale of a borrowed security – but instead of “cash” recognition of the actual borrowed asset, with an obligation to return the borrowed securities.

Contra-Asset – Securities Sold Short

Borrowed Asset

Close out the short sale by delivering the asset to the counterparty.

Obligation to Return Securities Borrowed

Cash

Eliminate the liability to return the borrowed asset by purchasing the asset and re-establishing it as off-balance sheet collateral for the securities borrowing transaction.

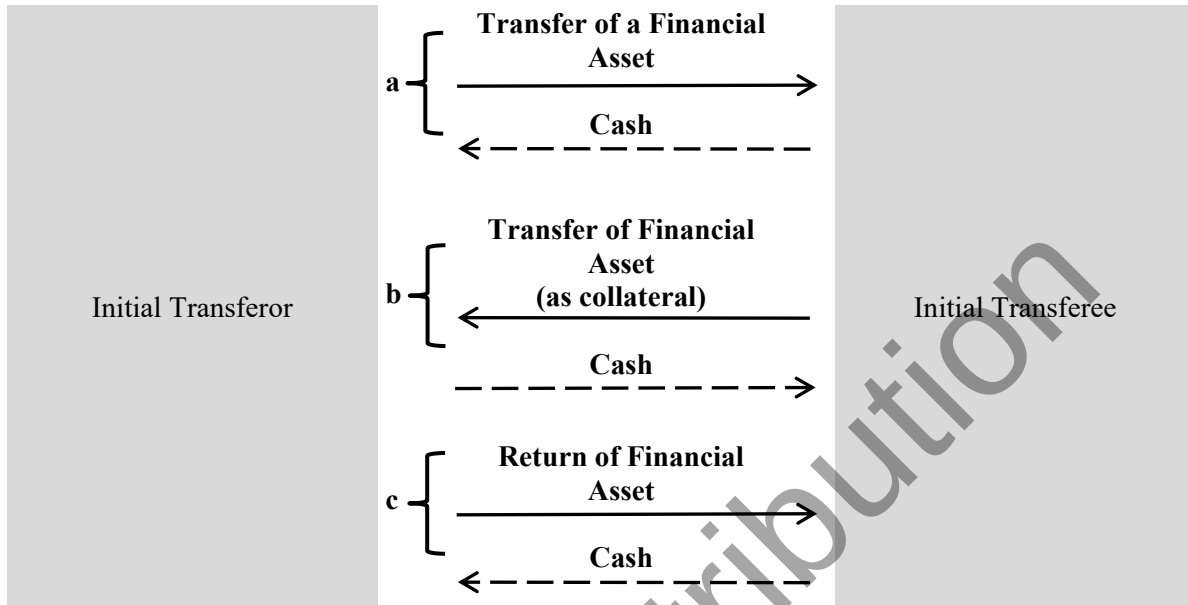
Cash

Receivable Under Securities Loan Agreement

To recognize the return of cash collateral from the transferor and the unwinding of the securities borrowing agreement.

Illustration—Initial Transfer and Repurchase Financing

6. The following diagram is an example of an initial transfer of a financial asset and a subsequent repurchase financing, as described in paragraphs 105-110.



Statement of Statutory Accounting Principles No. 104 – Revised

Share-Based Payments

STATUS

Type of Issue	Common Area
Issued	August 11, 2012; Substantively revised December 15, 2013
Effective Date	January 1, 2013
Affects	Supersedes SSAP No. 13; Nullifies and incorporates INT 99-17, INT 00-06, INT 00-32 and INT 01-14
Affected by	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS	1
SCOPE OF STATEMENT	1
SUMMARY OF ISSUE	2
Scope and Scope Exceptions	2
Recognition	3
Initial Measurement	7
Subsequent Measurement	12
Subsequent Measurement - Awards Classified as Equity	16
Subsequent Measurement - Awards Classified as Liabilities	18
Accounting for Tax Effects of Share-Based Arrangements	19
Accounting for Rabbi Trusts	20
Disclosures	21
Employee Share Purchase Plans	22
Consolidated / Holding Company Plans	23
Relevant Literature	24
Effective Date and Transition	26
REFERENCES	27
Other	27
Relevant Issue Papers	27
EXHIBIT A – CLASSIFICATION CRITERIA: LIABILITY OR EQUITY	28
Classification Criteria	28
Distinguishing Liability from Equity – Scope and Scope Exclusions	30

SCOPE OF STATEMENT

1. This statement provides statutory accounting principles for transactions in which an entity exchanges its equity instruments to employees and non-employees¹ in share-based payment transactions, including employee share purchase plans and deferred compensation obligations held in a rabbi trust. This

¹ Guidance referencing grantees is intended to be applicable to recipients of both employee and nonemployee awards, and guidance referencing employees or nonemployees is only applicable to those specific types of awards.

statement does not provide statutory accounting principles for employee share ownership plans; those transactions are addressed in *SSAP No. 12—Employee Stock Ownership Plans*.

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.

3. This statement requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. This statement establishes fair value as the measurement objective in accounting for share-based payment arrangements and requires all entities to apply a fair-value-based measurement method² in accounting for share-based payment transactions .

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 part³, 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.

² Accounting pronouncements that require fair value measurements but that are excluded from *SSAP No. 100R—Fair Value* is limited to this statement addressing share-based payment transactions. The fair value measurement objective in this statement is generally consistent with the fair value measurement objective in SSAP No. 100R. However, for certain share-based payment transactions, the measurements at the grant date are fair-value-based measurements, not fair value measurements. Although some measurements in this statement are fair value measurements, for practical reasons this statement is excluded in its entirety from SSAP No. 100R. To be consistent with GAAP guidance on share-based payment transactions, the definition of fair value for use in this statement is: “the amount at which the asset (or liability) could be bought (or incurred) or sold (settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale.” Observable market prices of identical or similar equity or liability instruments in active markets are the best estimate of fair value and, if available, should be used as the basis for the measurement of equity and liability instruments awarded in a share-based payment transaction with employees.

³ The phrase “at least in part” is used because an award of share-based compensation may be indexed to both the price of an entity’s shares and something else that is neither the price of the entity’s shares nor a market, performance, or service condition.

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.
7. Paragraphs 116-123 apply to all entities that use employee share purchase plans. This is a separate and distinct scope from share-based payment transactions captured in paragraph 4.

Recognition

8. An entity shall recognize the goods acquired or services received in a share-based payment transaction when it obtains the goods or as services are received, as further described in paragraphs 9-10. The entity shall recognize either a corresponding increase in equity or a liability, depending on whether the instruments granted satisfy the equity or liability classification criteria (see paragraphs 15-29).
9. Employee services themselves are not recognized before they are received. As the services are consumed, the entity shall recognize the related cost. For example, as services are consumed, the cost usually is recognized in determining net income of that period, for example, as expenses incurred for employee services. In some circumstances, the cost of services may be initially capitalized as part of the cost to acquire or construct another asset, such as inventory, and later recognized in the income statement when that asset is disposed of or consumed. This statement refers to recognizing compensation cost rather than compensation expense because any compensation cost that is capitalized as part of the cost to acquire or construct an asset would not be recognized as compensation expense in the income statement.
10. Transactions with nonemployees in which share-based payment awards are granted in exchange for the receipt of goods or services may involve a contemporaneous exchange of the share-based payment awards for goods or services or may involve an exchange that spans several financial reporting periods. Furthermore, by virtue of the terms of the exchange with the grantee, the quantity and terms of the share-based payment awards to be granted may be known or not known when the transaction arrangement is established because of specific conditions dictated by the agreement (for example, performance conditions). Judgment is required in determining the period over which to recognize cost, otherwise known as the nonemployee's vesting period.
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.
12. The accounting for all share-based payment transactions shall reflect the rights conveyed to the holder of the instruments and the obligations imposed on the issuer of the instruments, regardless of how those transactions are structured. For example, the rights and obligations embodied in a transfer of equity shares for a note that provides no recourse to other assets of the grantee (that is, other than the shares) are

substantially the same as those embodied in a grant of equity share options. Thus, that transaction shall be accounted for as a substantive grant of equity share options.

13. Assessment of both the rights and obligations in a share-based payment award and any related arrangement and how those rights and obligations affect the fair value of an award requires the exercise of judgment in considering the relevant facts and circumstances.

Determining the Grant Date

14. As a practical accommodation, in determining the grant date of an award subject to this statement, assuming all other criteria in the grant date definition have been met, a mutual understanding of the key terms and conditions of an award to an individual grantee shall be presumed to exist at the date the award is approved in accordance with the relevant corporate governance requirements (that is, by the Board or management with the relevant authority) if both of the following conditions are met:

- a. The award is a unilateral grant and, therefore, the recipient does not have the ability to negotiate the key terms and conditions of the award with the grantee.
- b. The key terms and conditions of the award are expected to be communicated to an individual recipient within a relatively short time period from the date of approval. A relatively short time period is that period in which an entity could reasonably complete all actions necessary to communicate the awards to the recipients in accordance with the entity's customary practices.

Determining Whether to Classify a Financial Instrument as a Liability or As Equity

15. Paragraphs 15-29 provide guidance for determining whether certain financial instruments awarded in share-based payment transactions are liabilities. In determining whether an instrument not specifically discussed in those paragraphs shall be classified as a liability or as equity, an entity shall apply statutory accounting principles applicable to financial instruments issued in transactions not involving share-based payment.

16. Unless paragraphs 17-29 require otherwise, an entity shall apply the classification criteria in Exhibit A in determining whether to classify as a liability a freestanding financial instrument given to a grantee in a share-based payment transaction. Paragraphs 78-83 provide criteria for determining when instruments subject to this statement subsequently become subject to other applicable statutory accounting principles.

17. In determining the classification of an instrument, an entity shall take into account the classification requirements as established by Exhibit A. In addition, a call option written on an instrument that is not classified as a liability under those classification requirements also shall be classified as equity so long as those equity classification requirements for the entity continue to be met, unless liability classification is required under the provisions of paragraphs 20-21.

18. Exhibit A does not apply to outstanding shares embodying a conditional obligation to transfer assets, for example, shares that give the grantee the right to require the grantor to repurchase them for cash equal to their fair value (puttable shares). A put right may be granted to the grantee in a transaction that is related to a share-based compensation arrangement. If exercise of such a put right would require the entity to repurchase shares issued under the share-based compensation arrangement, the shares shall be accounted for as puttable shares. A puttable (or callable) share awarded to an grantee as compensation shall be classified as a liability if either of the following conditions is met:

- a. The repurchase feature permits the grantee to avoid bearing the risks and rewards normally associated with equity share ownership for a reasonable period of time from the date the good is delivered or the service is rendered, and the share is issued. A grantee begins to bear the risks and rewards normally associated with equity share ownership when all the

goods are delivered, or all the service has been rendered and the share is issued. A repurchase feature that can be exercised only upon the occurrence of a contingent event that is outside the grantee's control (such as an initial public offering) would not meet this condition until it becomes probable that the event will occur within the reasonable period of time.

- b. It is probable that the grantor would prevent the grantee from bearing those risks and rewards for a reasonable period of time from the date the share is issued.

For this purpose, a period of six months or more is a reasonable period of time.

19. A puttable (or callable) share that does not meet either of those conditions shall be classified as equity.

20. Options or similar instruments on shares shall be classified as liabilities if either of the following conditions is met:

- a. The underlying shares are classified as liabilities.
- b. The entity can be required under any circumstances to settle the option or similar instrument by transferring cash or other assets. A cash settlement feature that can be exercised only upon the occurrence of a contingent event that is outside the grantee's control (such as an initial public offering) would not meet this condition until it becomes probable that event will occur.

21. For example, a reporting entity that is a Securities and Exchange Commission (SEC) registrant may grant an option to a grantee that, upon exercise, would be settled by issuing a mandatorily redeemable share. Because the mandatorily redeemable share would be classified as a liability under Exhibit A (as well as under *SSAP No. 72—Surplus and Quasi-Reorganizations*), the option also would be classified as a liability.

22. An award may be indexed to a factor in addition to the entity's share price. If that additional factor is not a market, performance, or service condition, the award shall be classified as a liability for purposes of this statement, and the additional factor shall be reflected in estimating the fair value of the award.

23. For this purpose, an award of equity share options granted to a grantee of an entity's foreign operation that provides for a fixed exercise price denominated either in the foreign operation's functional currency or in the currency in which the foreign operation's employee's pay is denominated shall not be considered to contain a condition that is not a market, performance, or service condition. Therefore, such an award is not required to be classified as a liability if it otherwise qualifies as equity. For example, equity share options with an exercise price denominated in euros granted to employees or nonemployees of a U.S. entity's foreign operation whose functional currency is the euro are not required to be classified as liabilities if those options otherwise qualify as equity. In addition, options granted to employees and nonemployees are not required to be classified as liabilities even if the functional currency of the foreign operation is the U.S. dollar, provided that the foreign operation's employees are paid in euros.

24. For purposes of applying paragraph 22, a share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades shall not be considered to contain a condition that is not a market, performance, or service condition. Therefore, in accordance with that paragraph, such an award shall not be classified as a liability if it otherwise qualifies for equity classification. For example, a parent entity whose functional currency is the Canadian dollar grants equity share options with an exercise price denominated in U.S. dollars to grantees of a Canadian entity with the functional and payroll currency of the Canadian dollar. If a substantial portion of the parent entity's equity securities trades on a U.S. dollar denominated exchange, the options are not precluded from equity classification.

25. The accounting for an award of a share-based payment shall reflect the substantive terms of the award and any related arrangement. Generally, the written terms provide the best evidence of the substantive terms of an award. However, an entity's past practice may indicate that the substantive terms of an award differ from its written terms. For example, an entity that grants a tandem award under which a grantee receives either a stock option or a cash-settled stock appreciation right is obligated to pay cash on demand if the choice is the grantee's, and the entity thus incurs a liability to the grantee. In contrast, if the choice is the entities, it can avoid transferring its assets by choosing to settle in stock, and the award qualifies as an equity instrument. However, if an entity that nominally has the choice of settling awards by issuing stock predominately settles in cash or if the entity usually settles in cash whenever a grantee asks for cash settlement, the entity is settling a substantive liability rather than repurchasing an equity instrument. In determining whether an entity that has the choice of settling an award by issuing equity shares has a substantive liability, the entity also shall consider whether:

- a. It has the ability to deliver the shares. Requirements to deliver registered shares do not, by themselves, imply that an entity does not have the ability to deliver shares and thus do not require an award that otherwise qualifies as equity to be classified as a liability.)
- b. It is required to pay cash if a contingent event occurs (see paragraphs 20-21).

26. A provision that permits grantees to effect a broker-assisted cashless exercise of part or all of an award of share options through a broker does not result in liability classification for instruments that otherwise would be classified as equity if both of the following criteria are satisfied:

- a. The cashless exercise requires a valid exercise of the share options.
- b. The grantee is the legal owner of the shares subject to the option (even though the grantee has not paid the exercise price before the sale of the shares subject to the option).

27. A broker that is a related party of the entity must sell the shares in the open market within a normal settlement period, which generally is three days, for the award to qualify as equity.

28. Similarly, a provision for either direct or indirect (through a net-settlement feature) repurchase of shares issued upon exercise of options (or the vesting of nonvested shares), with any payment due employees withheld to meet the employer's statutory withholding requirements resulting from the exercise, does not, by itself, result in liability classification of instruments that otherwise would be classified as equity. However, if the amount that is withheld, or may be withheld at the employer's discretion, is in excess of the maximum statutory tax rates in the employee's applicable jurisdictions, the entire award shall be classified and accounted for as a liability. That is, to qualify for equity classification, the employer must have a statutory obligation to withhold taxes on the employee's behalf, and the amount withheld cannot exceed the maximum statutory tax rates in the employees' applicable jurisdictions. The maximum statutory tax rates are based on the applicable rates of the relevant tax authorities (for example, federal, state, and local), including the employee's share of payroll or similar taxes, as provided in tax law, regulations, or the authority's administrative practices, not to exceed the highest statutory rate in that jurisdiction, even if that rate exceeds the highest rate that may be applicable to the specific award grantee.

29. Cash paid to a tax authority by an grantor when withholding shares from a grantee's award for tax withholding purposes shall be considered cash flows from financing activities in the Statement of Cash Flows as it represents an outlay to reacquire the entity's equity instruments.

Market, Performance, and Service Conditions

30. Accruals of compensation cost for an award with a performance condition shall be based on the probable outcome of that performance condition—compensation cost shall be accrued if it is probable that the performance condition will be achieved and shall not be accrued if it is not probable that the performance condition will be achieved. If an award has multiple performance conditions (for example, if the number of

options or shares a grantee earns varies depending on which, if any, of two or more performance conditions is satisfied), compensation cost shall be accrued if it is probable that a performance condition will be satisfied. In making that assessment, it may be necessary to take into account the interrelationship of those performance conditions.

31. If an award requires satisfaction of one or more market, performance, or service conditions (or any combination thereof), compensation cost shall be recognized if the good is delivered or the service is rendered, and no compensation cost shall be recognized if the good is not delivered or the service is not rendered.

Payroll Taxes

32. A liability for employee payroll taxes on employee stock compensation shall be recognized on the date of the event triggering the measurement and payment of the tax to the taxing authority (for a nonqualified option in the United States, generally the exercise date). Payroll taxes, even though directly related to the appreciation on stock options, are operating expenses and shall be reflected as such in the statement of operations.

Initial Measurement

33. While some of the material in paragraphs 33-63 was written in terms of awards classified as equity, it applies equally to awards classified as liabilities.

34. A share-based payment transaction shall be measured based on the fair value (or in certain situations specified in this statement, a calculated value or intrinsic value) of the equity instruments issued.

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.

36. However, this statement provides certain exceptions (paragraph 56) to that measurement method if it is not possible to reasonably estimate the fair value of an award at the grant date. A reporting entity that is not able to reasonably estimate the fair value of its equity options and similar instruments may measure its liabilities under share-based payment arrangements at intrinsic value (see paragraphs 38.b. and 52).

37. The terms of a share-based payment award and any related arrangement affect its value and, except for certain explicitly excluded features, such as a reload feature, shall be reflected in determining the fair value of the equity or liability instruments granted. For example, the fair value of a substantive option structured as the exchange of equity shares for a nonrecourse note will differ depending on whether the grantee is required to pay nonrefundable interest on the note.

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.

39. The fair value of an equity share option or similar instrument shall be measured based on the observable market price of an option with the same or similar terms and conditions, if one is available.

40. Such market prices for equity share options and similar instruments granted in share-based payment transactions are frequently not available; however, they may become so in the future. As such, the fair value of an equity share option or similar instrument shall be estimated using a valuation technique such as an option-pricing model. For this purpose, a similar instrument is one whose fair value differs from its intrinsic value, that is, an instrument that has time value. For example, a share appreciation right that requires net settlement in equity shares has time value; an equity share does not.

41. To satisfy the measurement objective in paragraph 38, the restrictions and conditions inherent in equity instruments awarded are treated differently depending on whether they continue in effect after the requisite service period or the nonemployee's vesting period. A restriction that continues in effect after an entity has issued awards, such as the inability to transfer vested equity share options to third parties or the inability to sell vested shares for a period of time, is considered in estimating the fair value of the instruments at the grant date. For equity share options and similar instruments, the effect of nontransferability (and nonhedgeability, which has a similar effect) is taken into account by reflecting the effects of grantees' expected exercise and postvesting termination behavior in estimating fair value (referred to as an option's expected term).

42. On an award-by-award basis, an entity may elect to use the contractual term as the expected term when estimating the fair value of a nonemployee award to satisfy the measurement objective in paragraph 38. Otherwise, an entity shall apply the guidance in this statement in estimating the expected term of a nonemployee award, which may result in a term less than the contractual term of the award.

43. When a reporting entity chooses to measure a nonemployee share-based payment award by estimating its expected term and applies the practical expedient in paragraph 53, it must apply the practical expedient to all nonemployee awards that meet the condition in paragraph 54. However, a reporting entity may still elect, on an award-by-award basis, to use the contractual term as the expected term as described in paragraph 42.

44. A restriction that stems from the forfeitability of instruments to which grantees have not yet earned the right, such as the inability either to exercise a nonvested equity share option or to sell nonvested shares, is not reflected in estimating the fair value of the related instruments at the grant date. Instead, those restrictions are taken into account by recognizing compensation cost only for awards for which grantees deliver the good or render the service.

45. Awards of share-based compensation ordinarily specify a performance condition or a service condition (or both) that must be satisfied for a grantee to earn the right to benefit from the award. No compensation cost is recognized for instruments forfeited because a service condition or a performance condition is not satisfied (for example, instruments for which the good is not delivered or service is not rendered).

46. The fair-value-based method described in paragraphs 38 and 41-47 uses fair value measurement techniques, and the grant-date share price and other pertinent factors are used in applying those techniques. However, the effects on the grant-date fair value of service and performance conditions that apply only during the employee's requisite service period or a nonemployee's vesting period are reflected based on the outcomes of those conditions. This statement refers to the required measure as fair value.

47. Some awards contain a market condition. The effect of a market condition is reflected in the grant-date fair value of an award. (Valuation techniques have been developed to value path-dependent options as well as other options with complex terms. Awards with market conditions, as defined in this statement, are path-dependent options.) Compensation cost thus is recognized for an award with a market condition provided that the good is delivered or the service is rendered, regardless of when, if ever, the market condition is satisfied.

48. Market, performance, and service conditions (or any combination thereof) may affect an award's exercise price, contractual term, quantity, conversion ratio, or other factors that are considered in measuring an award's grant-date fair value. A grant-date fair value shall be estimated for each possible outcome of such a performance or service condition, and the final measure of compensation cost shall be based on the amount estimated at the grant date for the condition or outcome that is actually satisfied.

49. A nonvested equity share or nonvested equity share unit shall be measured at its fair value as if it were vested and issued on the grant date.

50. Nonvested shares granted in share-based payment transactions usually are referred to as restricted shares, but this statement reserves that term for fully vested and outstanding shares whose sale is contractually or governmentally prohibited for a specified period of time.

51. A restricted share awarded to a grantee, that is, a share that will be restricted after the grantee has a vested right to it, shall be measured at its fair value, which is the same amount for which a similarly restricted share would be issued to third parties.

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.

53. For an award that meets the conditions in paragraph 54, a reporting entity may make an entity-wide accounting policy election to estimate the expected term using the following practical expedient:

- a. If vesting is only dependent upon a service condition, a reporting entity shall estimate the expected term as the midpoint between the employee's requisite service period or the nonemployee's vesting period and the contractual term of the award.
- b. If vesting is dependent upon satisfying a performance condition, an entity first would determine whether the performance condition is probable of being achieved.

- i. If the reporting entity concludes that the performance condition is probable of being achieved, the entity shall estimate the expected term as the midpoint between the employee's requisite service period or the nonemployee's vesting period and the contractual term.
- ii. If the reporting entity concludes that the performance condition is not probable of being achieved, the reporting entity shall estimate the expected term as either:
 - (a) The contractual term if the service period is implied (that is, the requisite service period or the nonemployee's vesting period is not explicitly stated but inferred based on the achievement of the performance condition at some undetermined point in the future).
 - (b) The midpoint between the employee's requisite service period or the nonemployee's vesting period and the contractual term if the requisite service period is stated explicitly.

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.

A reporting entity that elects to apply the practical expedient in paragraph 53 may always elect to use the contractual term as the expected term when estimating the fair value of a nonemployee award as described in paragraph 42. However, a reporting entity must apply the practical expedient in paragraph 53 for all nonemployee awards that have all the characteristics listed in this paragraph if that reporting entity does not elect to use the contractual term as the expected term and that reporting entity elects the accounting policy election to apply the practical expedient in paragraph 53.

55. If a reporting entity is not able to reasonably estimate the current share price (fair value) as a practical expedient, a reporting entity may use a value determined by the reasonable application of a reasonable valuation method as the current price of its underlying share for purposes of determining the fair value of an award that is classified as equity at grant date or upon a modification. The determination of whether a valuation method is reasonable, or whether an application of a valuation method is reasonable, shall be made on the facts and circumstances as of the measurement date. Factors to be considered under a reasonable valuation method include, as applicable:

- a. The value of tangible and intangible assets.
- b. The present value of anticipated future cash flows.
- c. The market value of stock or equity interests in similar corporations and other entities engaged in trades or businesses substantially similar to those engaged by the entity for which the stock is to be valued, the value of which can be readily determined through nondiscretionary, objective means (such as through trading prices on an established securities market or an amount in an arm's length transaction).

- d. Recent arm's length transactions involving the sale or transfer of stock or equity interest.
- e. Other relevant factors such as control premiums or discounts for lack of marketability and whether the valuation method is used for other purposes that have a material economic effect on the entity, its stockholders, or its creditors.
- f. The entity's consistent use of a valuation method to determine the value of its stock or assets for other purposes, including purposes unrelated to compensation of service providers.

56. It should be possible to reasonably estimate the fair value of most equity share options and other equity instruments at the date they are granted. However, in rare circumstances, it may not be possible to reasonably estimate the fair value of an equity share option or other equity instrument at the grant date because of the complexity of its terms.

57. An equity instrument for which it is not possible to reasonably estimate fair value at the grant date shall be accounted for based on its intrinsic value (paragraph 85) for measurement after issue date.

58. The fair value of each award of equity instruments, including an award of options with a reload feature (reload options), shall be measured separately based on its terms and the share price and other pertinent factors at the grant date. The effect of a reload feature in the terms of an award shall not be included in estimating the grant-date fair value of the award. Rather, a subsequent grant of reload options pursuant to that provision shall be accounted for as a separate award when the reload options are granted.

59. A contingent feature of an award that might cause a grantee to return to the entity either equity instruments earned or realized gains from the sale of equity instruments earned for consideration that is less than fair value on the date of transfer (including no consideration), such as a clawback feature shall not be reflected in estimating the grant-date fair value of an equity instrument.

60. An entity shall make its initial best estimate of the requisite service period at the grant date (or at the service inception date, if that date precedes the grant date) and shall base accruals of compensation cost on that period.

61. The initial best estimate and any subsequent adjustment to that estimate of the requisite service period for an award with a combination of market, performance, or service conditions shall be based on an analysis of all of the following:

- a. All vesting and exercisability conditions
- b. All explicit, implicit, and derived service periods
- c. The probability that performance or service conditions will be satisfied.

62. Performance or service conditions that affect vesting are not reflected in estimating the fair value of an award at the grant date because those conditions are restrictions that stem from the forfeitability of instruments to which grantees have not yet earned the right. However, the effect of a market condition is reflected in estimating the fair value of an award at the grant date (paragraph 47). For purposes of this statement, a market condition is not considered to be a vesting condition, and an award is not deemed to be forfeited solely because a market condition is not satisfied.

63. In some cases, the terms of an award may provide that a performance target that affects vesting could be achieved after an employee completes the requisite service period or a nonemployee satisfies a vesting period. That is, the grantee would be eligible to vest in the award regardless of whether the grantee is rendering service or delivering goods on the date the performance target is achieved. A performance target that affects vesting and that could be achieved after an employee's requisite service period or a

nonemployee's vesting period shall be accounted for as a performance condition. As such, the performance target shall not be reflected in estimating the fair value of the award at the grant date. Compensation cost shall be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the service or goods already have been provided. If the performance target becomes probable of being achieved before the end of the employee's requisite service period or the nonemployee's vesting period, the remaining unrecognized compensation cost for which service or goods have not yet been provided shall be recognized prospectively over the remaining employee's requisite service period or the nonemployee's vesting period. The total amount of compensation cost recognized during and after the employee's requisite service period or the nonemployee's vesting period shall reflect the number of awards that are expected to vest based on the performance target and shall be adjusted to reflect those awards that ultimately vest. An entity that has an accounting policy to account for forfeitures when they occur in accordance with paragraph 68 or paragraph 72 shall reverse compensation cost previously recognized, in the period the award is forfeited, for an award that is forfeited before completion of the employee's requisite service period or the nonemployee's vesting period. The employee's requisite service period and the nonemployee's vesting period end when the grantee can cease rendering service or delivering goods and still be eligible to vest in the award if the performance target is achieved. The stated vesting period (which includes the period in which the performance target could be achieved) may differ from the employee's requisite service period or the nonemployee's vesting period.

Subsequent Measurement

64. Guidance that equally applies to both liabilities and equity is generally found in paragraphs 64-84. Paragraphs 85-95 provide additional subsequent measurement guidance for awards classified as equity and paragraphs 96-99 provide additional subsequent measurement guidance for awards classified as liabilities.

Recognition of Nonemployee Compensation Costs

65. A grantor shall recognize the goods acquired or services received in a share-based payment transaction with nonemployees when it obtains the goods or as services are received. A grantor may need to recognize a nonadmitted prepaid asset before it actually receives goods or services if it first exchanges a share-based payment for an enforceable right to receive those goods or services. Nonetheless, the goods or services shall not be recognized before they are received. (The nonadmitted asset recognized prior to the goods and services would be eliminated upon receipt of the goods and services that are recognized.)

66. If fully vested, nonforfeitable equity instruments are granted at the date the grantor and nonemployee enter into an agreement for goods or services (no specific performance is required by the nonemployee to retain those equity instruments), then, because of the elimination of any obligation on the part of the nonemployee to earn the equity instruments, a grantor shall recognize the equity instruments when they are granted (in most cases, when the agreement is entered into). Whether the corresponding cost is an immediate expense or a nonadmitted prepaid asset depends on the specific facts and circumstances. A grantor may conclude that an asset (other than a note or a receivable) has been received in return for fully-vested, nonforfeitable nonemployee share-based payment awards that are issued at the date the grantor and nonemployee enter into an agreement for goods or services (and no specific performance is required by the nonemployee in order to retain those equity instruments). Such an asset shall not be displayed as contra-equity by the grantor of the. The transferability (or lack thereof) of the awards shall not affect the balance sheet display of this nonadmitted prepaid asset. This guidance is limited to transactions in which awards are transferred to nonemployees in exchange for goods or services.

67. An entity may grant fully vested, nonforfeitable equity instruments that are exercisable by the nonemployee only after a specified period of time if the terms of the agreement provide for earlier exercisability if the nonemployee achieves specified performance conditions. Any measured cost of the transaction shall be recognized in the same period(s) and in the same manner as if the entity had paid cash for the goods or services instead of paying with, or using, the share-based payment awards.

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.

69. A recognized nonadmitted prepaid asset or expense shall not be reversed if a stock option that the nonemployee has the right to exercise expires unexercised.

70. A grantor shall recognize either a corresponding increase in equity or a liability, depending on whether the instruments granted satisfy the equity or liability classification criteria established in paragraphs 15-29. As the goods or services are disposed of or consumed, the grantor shall recognize the related cost, unless other statutory accounting principles require costs to be expensed when incurred. In these instances, when the goods or services are received, the grantor shall recognize the related cost.

Recognition of Employee Compensation Costs

71. The compensation cost for an award of share-based employee compensation classified as equity shall be recognized over the requisite service period, with a corresponding credit to equity (generally, paid-in capital). The requisite service period is the period during which an employee is required to provide service in exchange for an award, which often is the vesting period. The requisite service period is estimated based on an analysis of the terms of the share-based payment award.

72. The total amount of compensation cost recognized at the end of the requisite service period for an award of share-based compensation shall be based on the number of instruments for which the requisite service has been rendered (that is, for which the requisite service period has been completed). Previously recognized compensation cost shall not be reversed if an employee share option (or share unit) for which the requisite service has been rendered expires unexercised (or unconverted). 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 employee share-based payment awards to do either of the following:

- a. Estimate the number of awards for which the requisite service will not be rendered (that is, estimate the number of forfeitures expected to occur). The entity shall base initial accruals of compensation cost on the estimated number of instruments for which the requisite 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 estimated number of instruments for which the requisite service is expected to be or has been rendered shall be recognized in compensation cost in the period of the change.
- b. Recognize the effect of awards for which the requisite service is not rendered when the award is forfeited (that is, recognize the effect of forfeitures in compensation cost when

they occur). Previously recognized compensation cost for an award shall be reversed in the period that the award is forfeited.

73. An entity shall reverse previously recognized compensation cost for an award with a market condition only if the requisite service is not rendered.

74. The requisite service period for employee awards may be explicit or it may be implicit, being inferred from an analysis of other terms in the award, including other explicit service or performance conditions. The requisite service period for an award that contains a market condition can be derived from certain valuation techniques that may be used to estimate grant-date fair value. An award may have one or more explicit, implicit, or derived service periods; however, an award may have only one requisite service period for accounting purposes unless it is accounted for as in-substance multiple awards. An award with a graded vesting schedule that is accounted for as in-substance multiple awards is an example of an award that has more than one requisite service period (paragraph 77).

75. The service inception date is the beginning of the requisite service period. If the service inception date precedes the grant date, accrual of compensation cost for periods before the grant date shall be based on the fair value of the award at the reporting date. In the period in which the grant date occurs, cumulative compensation cost shall be adjusted to reflect the cumulative effect of measuring compensation cost based on fair value at the grant date rather than the fair value previously used at the service inception date (or any subsequent reporting date).

76. An entity shall adjust that initial best estimate in light of changes in facts and circumstances. Whether and how the initial best estimate of the requisite service period is adjusted depends on both the nature of the conditions identified in paragraph 61 and the manner in which they are combined, for example, whether an award vests or becomes exercisable when either a market or a performance condition is satisfied or whether both conditions must be satisfied.

77. An entity shall make a policy decision about whether to recognize compensation cost for an employee award with only service conditions that has a graded vesting schedule in either of the following ways:

- a. On a straight-line basis over the requisite service period for each separately vesting portion of the award as if the award was, in-substance, multiple awards.
- b. On a straight-line basis over the requisite service period for the entire award (that is, over the requisite service period of the last separately vesting portion of the award).

However, the amount of compensation cost recognized at any date must at least equal the portion of the grant-date value of the award that is vested at that date.

Awards May Become Subject to Other Guidance

78. Paragraphs 80-83 are intended to apply to those instruments issued in share-based payment transactions with employees and nonemployees accounted for under this statement, and to instruments exchanged in a business combination for share-based payment awards of the acquired business that were originally granted to grantees of the acquired business and are outstanding as of the date of the business combination..

79. A convertible instrument award granted to a nonemployee in exchange for goods or services to be used or consumed in a grantor's own operations is subject to recognition and measurement guidance in this statement until the award is fully vested. Once vested, a convertible instrument award that is equity in form, or debt in form, that can be converted into equity instruments of the grantor, shall follow recognition and measurement through reference to other applicable statutory accounting guidance.

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.

82. Once the classification of an instrument is determined, the recognition and measurement provisions of this statement shall be applied until the instrument ceases to be subject to the requirements discussed in paragraph 80. Other applicable statutory accounting principles apply to a freestanding financial instrument that was issued under a share-based payment arrangement but that is no longer subject to this statement. This guidance is not intended to suggest that all freestanding financial instruments shall be accounted for as liabilities, but rather that freestanding financial instruments issued in share-based payment transactions may become subject to other applicable statutory accounting principles depending on their substantive characteristics and when certain criteria are met.

83. An entity may modify (including cancel and replace) or settle a fully vested, freestanding financial instrument after it becomes subject to other applicable statutory accounting principles. Such a modification or settlement shall be accounted for under the provisions of this statement unless it applies equally to all financial instruments of the same class regardless of the holder of the financial instrument. Following the modification, the instrument continues to be accounted for under other applicable statutory accounting principles. A modification or settlement of a class of financial instrument that is designed exclusively for and held only by grantees (or their beneficiaries) may stem from the employment or vendor relationship depending on the terms of the modification or settlement. Thus, such a modification or settlement may be subject to the requirements of this statement. See paragraph 80 for a discussion of changes to awards made solely to reflect an equity restructuring.

84. An option or similar instrument that is classified as equity, but subsequently becomes a liability because the contingent cash settlement event is probable of occurring, shall be accounted for similar to a modification from an equity to liability award. That is, on the date the contingent event becomes probable of occurring (and therefore the award must be recognized as a liability), the entity recognizes a share-based liability equal to the portion of the award attributed to past performance (which reflects any provision for acceleration of vesting) multiplied by the award's fair value on that date. To the extent the liability equals or is less than the amount previously recognized in equity, the offsetting debit is a charge to equity. To the extent that the liability exceeds the amount previously recognized in equity, the excess is recognized as compensation cost. The total recognized compensation cost for an award with a contingent cash settlement feature shall at least equal the fair value of the award at the grant date. The guidance in this paragraph is applicable only for options or similar instruments issued as part of compensation arrangements. That is, the

guidance included in this paragraph is not applicable, by analogy or otherwise, to instruments outside share-based payment arrangements.

Subsequent Measurement - Awards Classified as Equity

85. An equity instrument for which it is not possible to reasonably estimate fair value at the grant date shall be remeasured at each reporting date through the date of exercise or other settlement. The final measure of compensation cost shall be the intrinsic value of the instrument at the date it is settled. Compensation cost 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 or services instead of paying with a nonemployee award at the reporting date) in the intrinsic value of the instrument in each reporting period. The entity shall continue to use the intrinsic value method for those instruments even if it subsequently concludes that it is possible to reasonably estimate their fair value.

86. A contingent feature of an award that might cause a grantee to return to the entity either equity instruments earned or realized gains from the sale of equity instruments earned for consideration that is less than fair value on the date of transfer (including no consideration), such as a clawback feature, shall be accounted for if and when the contingent event occurs.

Modification of An Award

87. An entity shall account for the effects of a modification as described in paragraphs 88-95, unless all of the following are met:

- a. The fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the original award immediately before the original award is modified. If the modification does not affect any of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification.
- b. The vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified.
- c. The classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified.

The disclosure requirements in paragraph 114 apply regardless of whether an entity is required to apply modification accounting.

88. Except as described in paragraph 87, a modification of the terms or conditions of an equity award shall be treated as an exchange of the original award for a new award. In substance, the entity repurchases the original instrument by issuing a new instrument of equal or greater value, incurring additional compensation cost for any incremental value. The effects of a modification shall be measured as follows:

- a. Incremental compensation cost shall be measured as the excess, if any, of the fair value of the modified award determined in accordance with the provisions of this statement over the fair value of the original award immediately before its terms are modified, measured based on the share price and other pertinent factors at that date. As indicated in paragraph 52, references to fair value throughout this statement shall be read also to encompass calculated value. The effect of the modification on the number of instruments expected to vest also shall be reflected in determining incremental compensation cost. The estimate at

the modification date of the portion of the award expected to vest shall be subsequently adjusted, if necessary, in accordance with paragraph 68 or 72.

- b. Total recognized compensation cost for an equity award shall at least equal the fair value of the award at the grant date unless at the date of the modification the performance or service conditions of the original award are not expected to be satisfied. Thus, the total compensation cost measured at the date of a modification shall be the sum of the following:
 - i. The portion of the grant-date fair value of the original award for which the promised good is expected to be delivered (or has already been delivered) or the service is expected to be rendered (or has already been rendered) at that date, and
 - ii. The incremental cost resulting from the modification.

Compensation cost shall be subsequently adjusted, if necessary, in accordance with paragraph 68 or 72.

- c. A change in compensation cost for an equity award measured at intrinsic value in accordance with paragraph 85 shall be measured by comparing the intrinsic value of the modified award, if any, with the intrinsic value of the original award, if any, immediately before the modification.

89. An entity that has an accounting policy to account for forfeitures when they occur in accordance with paragraph 68 or 72 shall assess at the date of the modification whether the performance or service conditions of the original award are expected to be satisfied when measuring the effects of the modification in accordance with paragraph 87. However, the entity shall apply its accounting policy to account for forfeitures when they occur when subsequently accounting for the modified award.

90. Paragraphs 78-83 provide additional guidance on accounting for modifications of certain freestanding financial instruments that initially were subject to this statement but subsequently became subject to other applicable statutory accounting principles.

Short-Term Inducements

91. Except as described in paragraph 87, a short-term inducement shall be accounted for as a modification of the terms of only the awards of grantees who accept the inducement, and other inducements shall be accounted for as modifications of the terms of all awards subject to them.

Equity Restructuring or Business Combination

92. Exchanges of share options or other equity instruments or changes to their terms in conjunction with an equity restructuring or a business combination are modifications for purposes of this statement. An entity shall apply the guidance in paragraph 87 to those exchanges or changes to determine whether it shall account for the effects of those modifications. See paragraph 80 for an exception.

Repurchase or Cancellation

93. The amount of cash or other assets transferred (or liabilities incurred) to repurchase an equity award shall be charged to equity, to the extent that the amount paid does not exceed the fair value of the equity instruments repurchased at the repurchase date. Any excess of the repurchase price over the fair value of the instruments repurchased shall be recognized as additional compensation cost. An entity that repurchases an award for which the promised goods have not been delivered or the service has not been rendered has, in effect, modified the employee's requisite service period or nonemployee's vesting period to the period for which goods have already been delivered or service already has been rendered, and thus the amount of

compensation cost measured at the grant date but not yet recognized shall be recognized at the repurchase date.

Cancellation and Replacement

94. Except as described in paragraph 87, cancellation of an award accompanied by the concurrent grant of (or offer to grant) a replacement award or other valuable consideration shall be accounted for as a modification of the terms of the cancelled award. (The phrase *offer to grant* is intended to cover situations in which the service inception date precedes the grant date.) Therefore, incremental compensation cost shall be measured as the excess of the fair value of the replacement award or other valuable consideration over the fair value of the cancelled award at the cancellation date in accordance with paragraph 88. Thus, the total compensation cost measured at the date of a cancellation and replacement shall be the portion of the grant-date fair value of the original award for which the promised good is expected to be delivered (or has already been delivered) or the service is expected to be rendered (or has already been rendered) at that date plus the incremental cost resulting from the cancellation and replacement.

95. A cancellation of an award that is not accompanied by the concurrent grant of (or offer to grant) a replacement award or other valuable consideration shall be accounted for as a repurchase for no consideration. Accordingly, any previously unrecognized compensation cost shall be recognized at the cancellation date.

Subsequent Measurement - Awards Classified as Liabilities

96. The fair value of liabilities incurred in share-based payment transactions shall be remeasured at the end of each reporting period through settlement.

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.](#)

99. A modification of a liability award is accounted for as the exchange of the original award for a new award. However, because liability awards are remeasured at their fair value (or calculated value for an entity subject to paragraph 52) at each reporting date, no special guidance is necessary in accounting for a modification of a liability award that remains a liability after the modification.

Accounting for Tax Effects of Share-Based Arrangements

100. Income tax regulations specify allowable tax deductions for instruments issued under share-based payment arrangements in determining an entity's income tax liability. For example, under tax law, allowable tax deductions may be measured as the intrinsic value of an instrument on a specified date. The time value component, if any, of the fair value of an instrument generally may not be tax deductible. Therefore, tax deductions may arise in different amounts and in different periods from compensation costs recognized in financial statements. Similarly, the amount of expense reported for an employee stock ownership plan during a period may differ from the amount of the related income tax deduction prescribed by income tax rules and regulations.

101. This guidance addresses how temporary differences are recognized for share-based payment arrangement awards that are classified either as equity or as liabilities under the requirements of paragraphs 16-29. Incremental guidance is also provided for issues related to employee stock ownership plans.

Tax Effects for Instruments Classified as Equity

102. The cumulative amount of compensation cost recognized for instruments classified as equity that ordinarily would result in a future tax deduction under existing tax law shall be considered to be a deductible temporary difference in applying the requirements of *SSAP No. 101—Income Taxes*. The deductible temporary difference shall be based on the compensation cost recognized for financial reporting purposes. Compensation cost that is capitalized as part of the cost of an asset, such as inventory, shall be considered to be part of the tax basis of that asset for financial reporting purposes.

103. Recognition of compensation cost for instruments that ordinarily do not result in tax deductions under existing tax law shall not be considered to result in a deductible temporary difference. A future event can give rise to a tax deduction for instruments that ordinarily do not result in a tax deduction. The tax effects of such an event shall be recognized only when it occurs. An example of a future event that would be recognized only when it occurs is an employee's sale of shares obtained from an award before meeting a tax law's holding period requirement, sometimes referred to as a disqualifying disposition, which results in a tax deduction not ordinarily available for such an award.

Tax Effects for Instruments Classified as Liability

104. The cumulative amount of compensation cost recognized for instruments classified as liabilities that ordinarily would result in a future tax deduction under existing tax law also shall be considered to be a deductible temporary difference. The deductible temporary difference shall be based on the compensation costs recognized for financial reporting purposes.

Accounting for Tax Effects

105. The deferred tax benefit (expense) that results from increases (or decreases) in the recognized share-based payment temporary difference, for example, an increase that results as additional service is rendered and the related cost is recognized or a decrease that results from forfeiture of an award, shall be recognized in the income statement.

106. SSAP No. 101 requires a deferred tax asset to be evaluated for future realization and to be reduced by a statutory valuation allowance if, based on the weight of the available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized. Differences between the deductible temporary difference computed pursuant to paragraphs 102-103 and the tax deduction that would result based on the current fair value of the entity's shares shall not be considered in measuring the gross deferred tax asset or determining the need for a valuation allowance for a deferred tax asset recognized under these requirements.

107. The tax effect of the difference, if any, between the cumulative compensation cost of an award recognized for financial reporting purposes and the deduction for an award for tax purposes shall be

recognized as income tax expense or benefit in the income statement. The tax effect shall be recognized in the period in which the amount of the deduction is determined, which is typically when an award is exercised, or expired, in the case of share options, or vests in the case of nonvested stock awards. The appropriate period depends on the type of award and the guidance in SSAP No. 101.

Tax Benefits of Dividends on Share-Based Payment Awards

108. An income tax benefit from dividends or dividend equivalents that are charged to unassigned-funds (surplus) and are paid to employees for any of the following equity classified awards shall be recognized as an income tax expense or benefit in the income statement:

- a. Nonvested equity shares
- b. Nonvested equity share units
- c. Outstanding equity share options.

Accounting for Rabbi Trusts

109. This section addresses the accounting for deferred compensation arrangements where amounts earned by an employee are invested in the stock of the employer and placed in a rabbi trust. Certain of these plans allow the employee to immediately diversify into nonemployer securities or to diversify after a holding period (for example, six months); other plans do not allow for diversification. The deferred compensation obligation of some plans may be settled in any of the following:

- a. Cash, by having the trust sell the employer stock (or the diversified assets) in the open market
- b. Shares of employer's stock
- c. Diversified assets

In other plans, the deferred compensation obligation may be settled only by the delivery of the shares of the employer stock.

110. The guidance in this section addresses the accounting for deferred compensation that have characteristics in paragraphs 110.a. or 110.b. This section does not address the accounting for stock appreciation rights, even if they are funded through a rabbi trust.

- a. If amounts earned by an employee are invested in the stock of the employer and placed in a rabbi trust.
- b. Where the employee elects to diversify the assets held by the rabbi trust into nonemployer securities.

111. Rabbi trusts are grantor trusts generally set up to fund compensation for a select group of management or highly paid executives. To qualify as a rabbi trust for income tax purposes, the terms of the trust agreement must explicitly state that the assets of the trust are available to satisfy the claims of general creditors in the event of bankruptcy of the employer.

112. The following are the four types of deferred compensation arrangements involving rabbi trusts covered in this guidance:

- Plan A: The plan does not permit diversification and must be settled by the delivery of a fixed number of shares of employer stock.

- Plan B: The plan does not permit diversification and may be settled by the delivery of cash or shares of employer stock.
- Plan C: The plan permits diversification; however, the employee has not diversified (the plan may be settled in cash, shares of employer stock, or diversified assets).
- Plan D: The plan permits diversification and the employee has diversified (the plan may be settled in cash, shares of employer stock, or diversified assets).

113. The accounts of the rabbi trust should be consolidated with the accounts of the employer in the financial statements of the employer.

- a. For Plan A, employer stock held by the rabbi trust should be classified in equity in a manner similar to the manner in which treasury stock is accounted for. Subsequent changes in the fair value of the employer's stock should not be recognized. The deferred compensation obligation should be classified as an equity instrument and changes in the fair value of the amount owed to the employee should not be recognized.
- b. For Plans B and C, employer stock held by the rabbi trust should be classified in equity in a manner similar to the manner in which treasury stock is accounted for. Subsequent changes in the fair value of the employer's stock should not be recognized. The deferred compensation obligation should be classified as a liability and adjusted with a corresponding charge (or credit) to compensation cost, to reflect the changes in the fair value of the amount owed to the employee.
- c. For Plan D, assets held by the rabbi trust should be accounted for in accordance with statutory accounting principles for the particular asset (for example, if the diversified asset is an unaffiliated common stock security, that security would be accounted for in accordance with *SSAP No. 30R—Unaffiliated Common Stock*. The deferred compensation obligation should be classified as a liability and adjusted, with a corresponding charge (or credit) to compensation cost, to reflect changes in the fair value of the amount owed to the employee. Changes in the fair value of the deferred compensation obligation should not be recorded in unrealized gains or losses, even if changes in the fair value of the assets held by the rabbi trust are recorded in surplus pursuant to SSAP No. 30R.

Disclosures

114. An entity with one or more share-based payment arrangements shall disclose information that enables users of the financial statements to understand all of the following:

- a. The nature and terms of such arrangements that existed during the period and the potential effects of those arrangements on shareholders;
- b. The effect of compensation costs arising from share-based payment arrangements on the income statement;
- c. The method of estimating the fair value of the goods or services received, or the fair value of the equity instruments granted (or offered to grant), during the period; and
- d. The cash flow effects resulting from share-based payment arrangements.

115. The disclosures in paragraph 114 are for annual audited statutory financial statements only. This statement adopts FASB Codification 718-10-50-2 for the minimum disclosure information needed to

achieve the objective in paragraph 114 of this statement, noting that a reporting entity may need to disclose additional information to achieve the objectives.

Employee Share Purchase Plans

Overview and Background

116. This section provides guidance to all entities that use employee share purchase plans. The entity must first determine whether the plan is compensatory or noncompensatory. This is determined by the terms of the plan (paragraphs 117-118). A plan with an option feature, for example a look-back feature, is considered compensatory. (This section on employee share purchase plans has its own discrete scope, which is separate and distinct from the pervasive scope.)

Recognition

117. An employee share purchase plan that satisfies all of the following criteria does not give rise to recognizable compensation costs (that is, the plan is noncompensatory):

- a. The plan satisfies either of the following conditions:
 - i. The terms of the plan are no more favorable than those available to all holders of the same class of shares. Note that a transaction subject to an employee share purchase plan that involves a class of equity shares designed exclusively for and held only by current or former employees or their beneficiaries may be compensatory depending on the terms of the arrangement.
 - 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.
- b. Substantially all employees that meet limited employment qualifications may participate on an equitable basis.
- c. The plan incorporates no option features, other than the following:
 - i. Employees are permitted a short period of time—not exceeding 31 days—after the purchase price has been fixed to enroll in the plan.
 - ii. The purchase price is based solely on the market price of the shares at the date of purchase, and employees are permitted to cancel participation before the purchase date and obtain a refund of amounts previously paid (such as those paid by payroll withholdings).

118. A plan provision that establishes the purchase price as an amount based on the lesser of the equity share's market price at date of grant or its market price at date of purchase, commonly called a look-back plan, is an example of an option feature that causes the plan to be compensatory. Similarly, a plan in which the purchase price is based on the share's market price at date of grant and that permits a participating

employee to cancel participation before the purchase date and obtain a refund of amounts previously paid contains an option feature that causes the plan to be compensatory.

119. The requisite service period for any compensation cost resulting from an employee share purchase plan is the period over which the employee participates in the plan and pays for the shares.

Initial Measurement

120. Paragraph 38 states that the objective of the fair value measurement method is to estimate the fair value of the equity instruments, based on the share price and other measurement assumptions at the grant date, that are issued in exchange for providing goods or rendering services. Estimating the fair value of equity instruments at the grant date, which are issued in exchange for employee services also applies to the fair value measurements associated with grants under a compensatory employee share purchase plan.

Look-Back Plans

121. Many employee share purchase plans with a look-back option have differing features. For example, some plans contain multiple purchase periods, others contain reset mechanisms, and still others allow changes in the withholding amounts or percentages after the grant date. In some circumstances, applying the measurement approaches described in this section may not be practicable for certain types of employee share purchase plans. Paragraph 85 provides guidance on the measurement requirements if it is not possible to reasonably estimate fair value at the grant date.

Subsequent Measurement

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).

123. Any decreases in the withholding amounts (or percentages) shall be disregarded for purposes of recognizing compensation cost unless the employee services that were valued at the grant date will no longer be provided to the employer due to a termination. However, no compensation cost shall be recognized for awards that an employee forfeits because of failure to satisfy a service requirement for vesting. The accounting for decreases in withholdings is consistent with the requirement in paragraph 63 that the total amount of compensation cost that must be recognized for an award be based on the number of instruments for which the requisite service has been rendered (that is, for which the requisite service period has been completed).

Consolidated / Holding Company Plans

124. Except for the disclosure requirement in paragraph 125, the provisions of this statement do not apply to a reporting entity, as long as:

- a. The reporting entity is not directly liable for obligations under the share-based payment plan.
- b. Compensation costs associated with share-based payments provided by a related party or holder of an economic interest in the reporting entity, equal to the required contribution to the plan for the period, are included in allocated expenses to the reporting entity. A liability shall be established for any such contributions due and unpaid.

125. The reporting entity shall disclose in the financial statements that its employees participate in a plan sponsored by the holding company for which the reporting entity has no legal obligation. The amount of the expense incurred and the allocation methodology utilized by the provider of such benefits shall also be disclosed.

126. If the reporting entity is directly liable for the share-based payment plan, then the other provisions of this statement apply.

Relevant Literature

127. This statement adopts with modification the U.S. GAAP guidance for share-based payment transactions reflected in FASB *Accounting Standards Codification (ASC) Topic 718, Compensation – Stock Compensation*, as modified by the ASUs listed in paragraphs 127.a. through 127.e., excluding the guidance in *ASC Subtopic 718-40, Employee Stock Ownership Plans (ESOPs)*. Statutory accounting guidance for ESOPs is addressed in *SSAP No. 12—Employee Stock Ownership Plans*. This adoption with modification includes the related implementation guidance reflected within the FASB Codification Topic 718 not reflected within this standard. The U.S. GAAP guidance adopted with modification reflects the adoption with modification of the following ASUs:

- a. [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.](#)
- ~~a.b.~~ [ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting.](#) The revisions from ASU 2018-07 expand the scope of ASC 718 to include share-based payment transactions for acquiring goods and services from nonemployees. With ASU 2018-17, *ASC 505-50, Equity—Equity Payments to Nonemployees* was superseded.
- ~~b.c.~~ [ASU 2017-09, Scope of Modification Accounting](#)
- ~~c.d.~~ [ASU 2016-09, Improvements to Employee Share-Based Payment Accounting](#)
- ~~d.e.~~ [ASU 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period](#)
- ~~e.f.~~ [ASU 2010-13, Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Current of the Market in Which the Underlying Equity Security Trades](#)

128. The statutory accounting guidance for share-based payments is intended to be consistent with U.S. GAAP. Adopted modifications to U.S. GAAP guidance are as follows:

- a. GAAP references to “public and nonpublic” guidance have been eliminated. However, entities that report share-payment transactions under U.S. GAAP as “public” entities shall not report different amounts between U.S. GAAP and SAP. (For example, if a reporting entity reports “fair value” under U.S. GAAP, that entity shall not utilize a “calculated or intrinsic” amount under statutory accounting.

- b. Prepaid assets are nonadmitted.
- c. GAAP references are revised to reference applicable statutory accounting guidance.
- d. GAAP reporting line items (either explicitly provided in the statement or adopted by reference – such as the GAAP implementation guidance) shall be replaced to reference applicable statutory annual statement line items. (For example, GAAP references to “other comprehensive income” shall be reflected within “Surplus - Unassigned Funds”).
- e. GAAP guidance to calculate earnings per share is not applicable to statutory accounting and has not been included within the statement.
- f. GAAP effective date and transition, and transition disclosures have not been incorporated. Reporting entities shall follow the effective date and transition elements provided within this statement.
- g. Inclusion of guidance specific to statutory for consolidated/holding company plans.

129. The adoption with modification of FASB Codification Topic 718 detailed in paragraph 127 of this statement reflects adoption with modification of the following pre-codification GAAP standards:

- a. *FAS 123R, Share-Based Payment* (FAS 123R);
- b. *FAS 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* (FAS 150) – (Adopted only to the extent referenced in FAS 123R for classifying instruments as equity or liability for application in this statement. Adopted guidance is reflected in Exhibit A);
- c. *FASB Staff Position FAS 123(R)-1: Classification and Measurement of Freestanding Financial Instruments Originally issued in Exchange for Employee Services under FASB Statement No. 123(R)* (FAS 123R-1);
- d. *FASB Staff Position (FSP) FAS 123(R)-2: Practical Accommodation to the Application of Grant Date as Defined in FASB Statement No. 123(R)* (FSP FAS 123R-2);
- e. *FASB Staff Position (FSP) FAS 123(R)-4: Classification of Options and Similar Instruments Issued as Employee Compensation That Allow for Cash Settlement upon the Occurrence of a Contingent Event* (FSP FAS 123R-4);
- f. *FASB Staff Position (FSP) FAS 123(R)-5: Amendment of FASB Staff Position FAS 123R-1* (FSP FAS 123R-5);
- g. *FASB Staff Position (FSP) FAS 123(R)-6: Technical Corrections of FASB Statement No. 123(R)* (FSP FAS 123R-6);
- h. *FASB Emerging Issues Task Force 97-14: Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested* (EITF 97-14);
- i. *FASB Emerging Issues Task Force 00-16: Recognition and Measurement of Employer Payroll Taxes on Employee Stock-Based Compensation* (EITF 00-16);
- j. *FASB Technical Bulletin 97-01, Accounting under Statement 123 for Certain Employee Stock Purchase Plans with a Look-Back Option* (TB 97-01)

130. The adoption with modification of FASB Codification Topic 718 in this statement reflects rejection of the following pre-codification GAAP standards:

- a. *FASB Staff Position (FSP) FAS 123(R)-3: Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards* (FSP FAS 123R-3); and
- b. *FASB Staff Position (FSP) EITF 03-6-1; Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (FSP EITF 03-6-1).

Effective Date and Transition

131. This statement was effective January 1, 2013, with interim and annual financial reporting thereafter. Early adoption was permitted for December 31, 2012, financial statements with interim and annual reporting thereafter. At the time of initial adoption of this statement, reporting entities with existing share-based payment instruments that applied the guidance in *SSAP No. 13—Stock Options and Stock Purchase Plans* were to apply the requirements of SSAP No. 104 prospectively to new awards and to awards modified, repurchased or cancelled after the required effective date. Those reporting entities were to continue to account for any portion of awards outstanding at the date of initial application using the statutory accounting principles originally applied to those awards (e.g., SSAP No. 13).

132. Since the initial adoption of SSAP No. 104, subsequent revisions were effective as follows:

- a. *ASU 2021-07, Compensation – Stock Compensation, Determining the Current Price of an Underlying Share for Equity-Classified Share-Based Awards*. This SAP clarification effective August 10, 2022.
- b. *ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting*: Nonsubstantive revisions effective January 1, 2020, with early application permitted.
- c. *ASU 2017-09, Scope of Modification Accounting*: Nonsubstantive revisions effective January 1, 2018, applicable to modifications that occur on or after the effective date, with early application permitted.
- d. *ASU 2016-09, Improvements to Employee Share-Based Payment Accounting*: Nonsubstantive revisions effective December 31, 2017, with early adoption permitted. The adoption included the transition provisions from ASU 2016-19, although not duplicated within this statement.
- e. *ASU 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period*: Nonsubstantive revisions effective January 1, 2016, with early adoption permitted.
- f. *ASU 2010-13, Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Current of the Market in Which the Underlying Equity Security Trades*: Captured in the original adoption of SSAP No. 104, effective January 1, 2013.

133. After initial adoption of SSAP No. 104, substantive revisions, detailed in Issue Paper No. 146, were adopted to incorporate guidance for share-based payment transaction with nonemployees. These substantive revisions adopted with modification U.S. GAAP guidance reflected in *ASC 505-50, Equity Payments to Nonemployees*. Pursuant to the adoption with modification of ASU 2018-07, statutory accounting guidance previously adopted from ASC 505-50 has been superseded. As such, the following pre-codification standards have also been superseded and are no longer considered adopted for statutory accounting:

- a. *FASB Emerging Issues Task Force 96-18: Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services;*
- b. *FASB Emerging Issues Task Force 00-08: Accounting by a Grantee for an Equity Instrument to Be Received in Conjunction with Providing Goods or Services; and*
- c. *FASB Emerging Issues Task Force 00-18: Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other Than Employees.*

REFERENCES

Other

- *SSAP No. 12—Employee Stock Ownership Plans*

Relevant Issue Papers

- *Issue Paper No. 129—Share-Based Payment, A Replacement of SSAP No. 13*

Not for Distribution

EXHIBIT A – Classification Criteria: Liability or Equity**Classification Criteria**

1. As detailed in paragraph 16 of this statement, unless paragraphs 17-29 require otherwise, an entity shall apply the classification criteria in this Exhibit in determining whether to classify a freestanding financial instrument given to a grantee as a liability

2. The guidance in this Exhibit shall be applied to a freestanding financial instrument in its entirety. Any nonsubstantive or minimal features shall be disregarded in applying the classification provisions of this Exhibit. Judgment, based on consideration of all the terms of an instrument and other relevant facts and circumstances, is necessary to distinguish substantive, nonminimal features from nonsubstantive or minimal features.

Mandatorily Redeemable Financial Instruments

3. A mandatorily redeemable financial instrument shall be classified as a liability unless the redemption is required to occur only upon the liquidation or termination of the reporting entity.

4. A financial instrument that embodies a conditional obligation to redeem the instrument by transferring assets upon an event not certain to occur becomes mandatorily redeemable if that event occurs, the condition is resolved, or the event becomes certain to occur.

5. In determining if an instrument is mandatorily redeemable, all terms within a redeemable instrument shall be considered. The following items do not affect the classification of a mandatorily redeemable financial instrument as a liability:

- a. A term extension option
- b. A provision that defers redemption until a specified liquidity level is reached
- c. A similar provision that may delay or accelerate the timing of a mandatory redemption.

6. If a financial instrument will be redeemed only upon the occurrence of a conditional event, redemption of that instrument is conditional and, therefore, the instrument does not meet the definition of mandatorily redeemable financial instrument in this statement. However, that financial instrument would be assessed at each reporting period to determine whether circumstances have changed such that the instrument now meets the definition of a mandatorily redeemable instrument (that is, the event is no longer conditional). If the event has occurred, the condition is resolved, or the event has become certain to occur, the financial instrument is reclassified as a liability.

Obligations to Repurchase Issuer's Equity Shares by Transferring Assets

7. An entity shall classify as a liability (or an asset in some circumstances) any financial instrument, other than an outstanding share, that, at inception, has both of the following characteristics:

- a. It embodies an obligation to repurchase the issuer's equity shares, or is indexed to such an obligation, and
- b. It requires or may require the issuer to settle the obligation by transferring assets.

8. In this statement, "indexed to" is used interchangeably with "based on variations in the fair value of." The phrase "requires or may require" encompasses instruments that either conditionally or unconditionally obligate the issuer to transfer assets. If the obligation is conditional, the number of conditions leading up to the transfer of assets is irrelevant.

9. Examples of financial instruments that meet the criteria in paragraph 7 of this Exhibit include forward purchase contracts or written put options on the issuer's equity shares that are to be physically settled or net cash settled.

10. All obligations that permit the holder to require the issuer to transfer assets result in liabilities, regardless of whether the settlement alternatives have the potential to differ.

11. Certain financial instruments that embody obligations that are liabilities within the scope of this statement also may contain characteristics of assets but be reported as single items. Some examples include the following:

- a. Net-cash-settled or net-share-settled forward purchase contracts.
- b. Certain combined options to repurchase the issuer's shares.

Those instruments are classified as assets or liabilities initially or subsequently depending on the instrument's fair value on the reporting date.

12. An instrument that requires the issuer to settle its obligation by issuing another instrument (for example, a note payable in cash) ultimately requires settlement by a transfer of assets, accordingly:

- a. When applying paragraphs 7-11 of this Exhibit, this also would apply for an instrument settled with another instrument that ultimately may require settlement by a transfer of assets (warrants for puttable shares).
- b. It is clear that a warrant for mandatorily redeemable shares would be a liability under this statement.

Certain Obligations to Issue a Variable Number of Shares

13. A financial instrument that embodies an unconditional obligation, or a financial instrument other than an outstanding share that embodies a conditional obligation, that the issuer must or may settle by issuing a variable number of its equity shares shall be classified as a liability (or an asset in some circumstances) if, at inception, the monetary value of the obligation is based solely or predominantly on any one of the following:

- a. A fixed monetary amount known at inception (for example, a payable settleable with a variable number of the issuer's equity shares),
- b. Variations in something other than the fair value of the issuer's equity shares (for example, a financial instrument indexed to the Standard and Poor's S&P 500 Index and settleable with a variable number of the issuer's equity shares), or
- c. Variations inversely related to changes in the fair value of the issuer's equity shares (for example, a written put option that could be net share settled).

Prohibition on Combining Freestanding Financial Instruments

14. A freestanding financial instrument that is within the scope of this statement shall not be combined with another freestanding financial instrument in applying paragraphs 3-13 of this Exhibit. For example, a freestanding written put option that is classified as a liability under this statement shall not be combined with an outstanding equity share.

Distinguishing Liability from Equity – Scope and Scope Exclusions

15. The guidance in paragraphs 15-29 of this statement applies to any freestanding financial instrument, including one that has any of the following attributes:

- a. Comprises more than one option or forward contract, or
- b. Has characteristics of both a liability and equity and, in some circumstances, also has characteristics of an asset (for example, a forward contract to purchase the issuer's equity shares that is to be net cash settled). Accordingly, this statement does not address an instrument that has only characteristics of an asset.

16. For example, an instrument that consists of a written put option for an issuer's equity shares and a purchased call option and nothing else is a freestanding financial instrument. That freestanding financial instrument embodies an obligation to repurchase the issuer's equity shares and is subject to the requirements of this statement.

Not for Distribution

Statement of Statutory Accounting Principles No. 105 – Revised

Working Capital Finance Investments

STATUS

Type of Issue.....	Common Area
Issued	December 15, 2013; Substantively revised May 20, 2020
Effective Date	January 1, 2014; Substantive revisions detailed in Issue Paper No. 163 effective June 30, 2020.
Affects.....	No other pronouncements
Affected by	No other pronouncements
Interpreted by	INT 06-07
Relevant Appendix A Guidance	None

STATUS	1
SCOPE OF STATEMENT	1
SUMMARY CONCLUSION	1
Working Capital Finance Program - Definitions and Conditions	2
Confirmation Process	3
Program Requirements	4
Exclusions	4
Accounting and Reporting	5
Default	6
Impairment	6
Disclosures	6
Relevant Literature	7
Effective Date and Transition	7
REFERENCES	7
Relevant Issue Papers	7

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for working capital finance investments held by reporting entities. This statement amends *SSAP No. 20—Nonadmitted Assets* (SSAP No. 20) to allow working capital finance investments as admitted assets to the extent they conform to the requirements of this statement.

SUMMARY CONCLUSION

2. Working capital finance investments represent a confirmed short-term obligation¹ to pay a specified amount owed by one party (the obligor) to another (typically a supplier of goods), generated as a part of a working capital finance investment program currently designated by the NAIC Securities Valuation Office.

¹ All references to short-term obligations in this statement to refer to obligations not exceeding one year.

Pursuant to the working capital finance investment program, this short-term obligation has been transferred by the entity entitled to payment (typically a supplier of goods) to a third party investor.

3. Working capital finance investments held by a reporting entity represent a right of the reporting entity to receive future payment. This statement provides accounting and reporting guidelines for the right to receive payment under working capital finance programs that meet particular criteria.

Working Capital Finance Program - Definitions and Conditions

4. A “working capital finance program” is an open account program under which an investor may purchase interests, or evidence thereof, in commercial non-insurance receivables. A working capital finance program is created for the benefit of a commercial investment-grade obligor and its suppliers of goods or services, and facilitated by a finance agent.

5. A working capital finance program transfers a right to payment to an investor from a short term obligation and arises from transactions among:

- a. a buyer of goods or services that becomes an obligor to the supplier of goods or services,
- b. the supplier(s) of those goods or services,
- c. a finance agent, and
- d. an investor.

6. A “working capital finance investment” is an interest in payment(s) from a confirmed supplier receivable issued pursuant to a working capital finance program. The payment (maturity) date must not exceed one year from the date of invoice from the supplier to the obligor. This investment is created when the investor purchases from a working capital finance program that is currently designated as NAIC “1” or “2” by the NAIC Securities Valuation Office, any of the following:

- a. One or more confirmed supplier receivables;
- b. in case of a participation, a participation interest in one or more confirmed supplier receivables issued by the finance agent or lead lender holding confirmed supplier receivables; or
- c. a certificate, note or other interest manifestation, documented in a way that is verifiable, representing a legally enforceable interest in a right to payment either directly to the investor or from a trust, other special purpose entity or pool holding confirmed supplier receivables.

7. “Obligor” is the party that purchases the goods or services that generates the original supplier receivable (which is the payable for that Obligor). The obligor must have an NAIC designation of “1” or “2” or a Credit Rating Provider equivalent. The obligor must confirm the supplier receivable described in paragraph 11 as described in the confirmation process in paragraphs 12 and 13.

8. “Supplier” is the party that sells the goods or services to the obligor. The supplier sells the confirmed supplier receivable in accordance with the terms of the working capital finance program designated by the NAIC Securities Valuation Office at a price agreed to by the finance agent and/or investor.

9. “Investor” is the party purchasing a working capital finance investment in accordance with the terms of the working capital finance program designated by the NAIC Securities Valuation Office.

10. The “finance agent” is a bank, financial institution, other financial intermediary, or service provider that facilitates the working capital finance program, arranges the sale, assignment or transfer of the confirmed supplier receivable to the investor for a fee and administers the payment mechanism. In the case of participation, the finance agent must inform the reporting entity investor of a default or event of default as soon as it becomes aware of such default or event of default. For the working capital finance program to qualify under this SSAP, the finance agent must meet the requirements of either paragraph 10.a. or 10.b.:

- a. The finance agent is directly regulated by, or falls under the supervision of, a financial regulator of its domiciliary country provided that such country appears on the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* List of Jurisdictions Eligible for Netting; or
- b. Payments from the obligor must be paid directly to the reporting entity (investor) or into an account maintained by a regulated financial institution for the benefit of investors in the working capital finance program and, in either case, the finance agent cannot be the beneficiary of such payment.

11. A “confirmed supplier receivable” is a first priority perfected security interest 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 has been confirmed by the obligor committing and stating that the obligations under the agreement and any payment shall not be affected by the invalidity, unenforceability, existence, performance or non-performance of the underlying commercial trade transaction or any related contract or undertaking nor that it will not protest, delay, or deny, nor offer nor assert any defenses, personal or otherwise, against payment to the supplier or any party taking claims, interests, or rights to payments made by the supplier.

- a. The confirmed supplier receivable must be sold, assigned or otherwise transferred in a manner that results in an absolute, irrevocable and legally enforceable obligation that has been confirmed by the Obligor.
- b. In the case of a participation, the certificates or other evidence of participation provide an absolute, irrevocable, and legally enforceable obligation of the finance agent or holder of the confirmed supplier receivable to pay to the reporting entity investor all of the amounts due to it under the confirmed supplier receivable, without reduction or delay arising from any claims that the finance agent may have against the reporting entity investor. The reporting entity investor’s ability to exercise its rights as creditor, or to direct the finance agent to exercise the rights of a creditor on its behalf, shall not be subject to, other than during a cure period not to exceed thirty days, the discretion of the finance agent or other lenders or investors.

Confirmation Process

12. In the case of a purchase, the investor shall verify, prior to the sale that the obligor has confirmed the respective amounts, payment dates and related invoice numbers’ specified dates and has waived all defenses to payment. In the case of a participation, the finance agent must verify that the obligor has confirmed the respective amounts, payment dates and related invoice reference numbers’ specified due dates, and has waived all defenses to payment in accordance with the confirmation process.

13. The obligor must commit and state that upon confirmation of a supplier receivable it is obligated to pay to the investor, the finance agent, or any third party acting as agent or trustee for the investor, a sum equal to the full amount of that confirmed supplier receivable(s) on a date certain stated in the confirmation and that it waives any right of setoff or other defenses to avoid or delay the full and timely payment of that Confirmed Supplier Receivable. The documents establishing the working capital finance program or the confirmation must state and confirm that the obligation to pay must be independent of any other contracts

or claims that might be raised in defense arising from any transaction financed in connection with the WCFI program, the confirmed supplier receivable, or any other courses of performance or courses of dealing with the supplier.

Program Requirements

14. The working capital finance program investor must provide in its annual filing with the NAIC Securities Valuation Office one of the following:

- a. An annual independent report according to Statement on Standards for Attestation Engagements (SSAE) No. 16 (or functional equivalent), reporting on controls at a service organization related to the administration of the investment; or
- b. An annual audit of the financial statements and internal controls of the consolidated group of which the finance agent is part, which does not note any material weaknesses related to servicing working capital financial investments.

The NAIC Securities Valuation Office would review the materiality of the report findings in making their determination of the assignment of a designation.

15. If the credit rating of the working capital finance program or obligor falls to non-investment grade (below the equivalent of NAIC designation “1” or “2”), the reporting entity shall nonadmit, the working capital finance investments obtained under the related working capital finance program and/or the related obligor. Due to the short-term nature of these investments, once an investment is nonadmitted due to the credit rating of the working capital finance program or the obligor, those investments will continue to be nonadmitted.

16. Reporting entity investors must have the ability to monitor the working capital finance program and the credit-related activities of the obligor. Reporting entity investors must provide information as requested to the state of domicile indicating that they have the ability to monitor on an ongoing basis the activities of the working capital finance program.

17. All contracts or agreements that are a part of or that together constitute a working capital finance program must provide that if a dispute arises among any of the parties under any of the contracts or agreements that are a part of or that together constitute the working capital finance program, each party agrees that the dispute will be submitted to a court of competent jurisdiction in the United States or a constituent state thereof or of an alternative dispute resolution process recognized thereby. All contracts or agreements that are a part of or that together constitute a working capital finance program must provide that any dispute arising under any of the contracts or agreements that are a part of or that together constitute the working capital finance program must be resolved pursuant to the laws of the United States or a constituent state thereof that address the substance of the dispute but excluding those laws addressing conflicts of law.

Exclusions

18. A working capital finance investment excludes any receivables financed through:

- a. Factoring: the purchase of receivables in bulk from a supplier where the receivables represent the payment obligations of potentially thousands of buyers to a single supplier, in which the buyers have no relationship with or contractual obligation to pay the factor and retain all legal defenses to payment they may have against the supplier;
- b. Forfaiting: the purchase of one or a series of receivables from exporters by a forfaiter to enable the exporter (seller) to finance a commercial transaction with a buyer in which the Obligor has no relationship with or contractual obligation to pay the forfaiter and retains all legal defenses to pay it may have against the seller; or

- c. Invoice discounting: the advancement of funds by a finance company to a business entity with the funds advanced limited to a defined percentage of the business entity's eligible and outstanding receivables.
19. Eligible Confirmed Supplier Receivables must not:
- a. Include insurance or insurance related assets;
 - b. Be impaired or in default at the time of purchase;
 - c. Have a payment (maturity) date longer than one year from the date of the invoice from the Supplier to the Obligor giving rise to the confirmed supplier receivable, and the maturity date must not be subject to change or rolling; nor
 - d. Include any receivable of any parent or affiliate of the reporting entity investor, and neither the Obligor nor any Supplier may be affiliated with the reporting entity investor. Working Capital Finance Investments that have obligors or vendors that are affiliated with the investor are ineligible, and therefore, nonadmitted assets.

Accounting and Reporting

20. The right to receive payment generated by a working capital finance investment issued under a working capital finance program is considered to meet the definition of an asset as defined in *SSAP No. 4—Assets and Nonadmitted Assets*, and is an admitted asset to the extent the investment conforms to the requirements set forth in this statement and the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. For programs that comply with all of these elements, working capital finance investments 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. Programs that do not comply with the elements set forth in this statement, or the provisions set forth in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* are nonadmitted. Working capital finance investments are reported as other invested assets in the financial statements.

21. A working capital finance investment shall be recorded on the trade date. At acquisition, the Working Capital Finance Investment shall be initially reported at cost, excluding brokerage and other related fees, and all other costs (internal costs, or costs paid for origination, purchase or commitment to purchase such investments), which shall be expensed as incurred.

22. After initial acquisition, the Working Capital Finance Investment shall be reported at amortized cost until the specified maturity date, unless the investment, or a portion thereof, is deemed uncollectible or when an other-than-temporary impairment has occurred. In the event that a working capital finance investment is purchased by a reporting entity investor at a premium (amount to be received by the entity under the confirmed supplier receivable is less than the price paid for the investment), the excess paid by the reporting entity investor in comparison to the amount receivable under the confirmed supplier receivable must be immediately expensed.

23. For reporting entities required to maintain an Interest Maintenance Reserve (IMR), the accounting for realized capital gains and losses from working capital finance investments shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. For reporting entities not required to maintain an IMR, realized gains and losses from working capital finance investments 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).

24. A Working Capital Finance Investment may provide for a prepayment penalty or acceleration fee in the event the working capital finance investment is liquidated prior to its scheduled termination date. Such fees shall be reported as investment income when received.

25. *SSAP No. 34—Investment Income Due and Accrued* shall be followed for determining and recording investment income earned on working capital finance investments acquired at a discount. In accordance with *SSAP No. 34—Investment Income Due and Accrued*, investment income shall be reduced for amounts that have been determined to be uncollectible, however amounts more than 15 days overdue are nonadmitted.

Default

26. A working capital finance investment payment that is uncollected by the reporting entity within 30 days after the due date shall be considered in default and nonadmitted. If the reporting entity has any other working capital finance investment assets from the same defaulting counterparty, all other working capital finance investments from that counterparty shall be nonadmitted. All working capital finance investments from a counterparty identified in default shall be evaluated for impairment.

Impairment

27. An other-than-temporary impairment^(INT 06-07) 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 confirmed supplier receivable including the payment on the established due date. Pursuant to this guidance, assessment of other-than-temporary impairment shall include an evaluation of the financial condition and short-term prospects of the obligor. If it is determined that a decline in the fair value of a working capital finance investment below book/adjusted carrying value is due to an other-than-temporary impairment, an impairment loss shall be recognized as a realized loss equal to the entire difference between the working capital finance investment's carrying value and fair value as of the reporting period for which the assessment is made. Fair value shall be determined in accordance with *SSAP No. 100R—Fair Value*, and reflect the price to sell the asset in an orderly market between market participants. As such, the fair value shall reflect the assumptions market participants will use in pricing the asset, including assumptions about risk.

28. For reporting entities required to maintain an AVR/IMR, the entire amount of the realized loss from the other-than-temporary impairment shall be recorded through the AVR, in accordance with *SSAP No. 7*.

29. Upon recognition of an other-than-temporary impairment, the fair value of the working capital finance investment on the measurement date shall become the new cost basis of the working capital finance investment and the new cost basis shall not be adjusted for subsequent recoveries in fair value. Once an investment is determined to be other-than-temporarily impaired, until all expected payments are received, the reporting entity must re-evaluate the investment quarterly and reassess fair value, with recognized realized losses for the difference between the book/adjusted carrying value and the current fair value. This process shall continue until either all expected payments are received, or the entity has recognized a realized loss for the entire uncollected carrying value.

Disclosures

30. The financial statements shall include the following disclosures:

- a. Fair value in accordance with *SSAP No. 100R*.
- b. Concentrations of credit risk in accordance with *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures* in the annual audited statutory financial reports only.

- c. Information regarding the aggregate book/adjusted carrying value of working capital finance investment by designation including gross assets with nonadmitted and net admitted amounts annually. (Note that programs designated 3-6 are nonadmitted.)

	Gross Asset CY	Non-Admitted Asset CY	Net Admitted Asset CY
WCFI Designation 1			
WCFI Designation 2			
WCFI Designation 3			
WCFI Designation 4			
WCFI Designation 5			
WCFI Designation 6			
Total			

- d. Annual and quarterly information regarding the aggregate book/adjusted carrying value maturity distribution on the underlying working capital finance investments by the categories of maturities up to 180 days and 181 to 365 days.
- e. Any events of default of working capital finance investments during the reporting period.
31. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

32. [*ASU 2022-04, Disclosure of Supplier Finance Program Obligations is rejected.*](#)

33. [*Effective December 31, 2023, this statement rejects ASU 2016-13, Financial Instruments—Credit Losses \(Topic 326\), Measurement of Credit Losses on Financial Instruments; ASU 2018-19, Codification Improvements to Topic 326, Financial Instruments—Credit Losses; ASU 2019-04, Codification Improvements to Topics 326, 815, 825; ASU 2019-10 Financial Instruments—Credit Losses \(Topic 326\), Derivatives and Hedging \(Topic 815\), and Leases \(Topic 842\); ASU 2019-11, Codification Improvements to Topic 326, Financial Instruments—Credit Losses; and ASU 2020-03, Codification Improvements to Financial Instruments. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB’s issuance of ASU 2016-13 and other related ASUs.*](#)

Effective Date and Transition

~~32~~³⁴. This statement is effective for years on or after January 1, 2014. Substantive revisions documented in *Issue Paper No. 163—Working Capital Finance Investment Updates* are effective for financial reporting periods on or after June 30, 2020. 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. 147—Working Capital Finance Investments*
- *Issue Paper No. 163—Working Capital Finance Investment Updates*

Statement of Statutory Accounting Principles No. 107

Risk-Sharing Provisions of the Affordable Care Act

STATUS

Type of Issue.....	Common Area
Issued	December 12, 2014
Effective Date	December 15, 2014
Affects.....	Nullifies INT 13-04
Affected by.....	No other pronouncements
Interpreted by	INT 15-01
Relevant Appendix A Guidance	A-791

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	2
Risk Adjustment Program – Description and Overview.....	2
Risk Adjustment Program – Accounting Treatment.....	3
Risk Adjustment Program – High-Cost Risk Pool – Accounting Treatment.....	5
Transitional Reinsurance Program – Description and Overview.....	5
Transitional Reinsurance Program – Accounting Treatment.....	7
Subject Individual Insured Health Products.....	7
Other Insured Health Products	9
Self-Insured Health Products	9
Risk Corridors – Description and Overview	10
Risk Corridors – Accounting Treatment ^(INT 15-01)	11
Disclosures.....	12
Relevant Literature.....	14
Effective Date and Transition	14
REFERENCES.....	14
Relevant Issue Papers	14
EXHIBIT A – GLOSSARY.....	15
EXHIBIT B – ACA RISK-SHARING PROVISIONS ROLL-FORWARD ILLUSTRATION	17

SCOPE OF STATEMENT

1. The Affordable Care Act (ACA) imposes fees and premium stabilization provisions on health insurance issuers offering commercial health insurance. This statement provides accounting for three programs known as risk adjustment, reinsurance and risk corridors that take effect in 2014. Risk adjustment is a permanent risk-spreading program (ACA Section 1343). The temporary transitional reinsurance program (ACA Section 1341) and temporary risk corridors program (ACA Section 1342) are for years 2014 through 2016.

SUMMARY CONCLUSION

2. Specific terms included in Exhibit A are unique to these programs and should not be applied to other aspects of statutory accounting. The required payments to the programs by reporting entities are described as “contributions” in the program literature but are referred to in this guidance as assessments for clarity. Amounts redistributed by the programs back to reporting entities are termed “payments” by the programs. These “payments” are recoverables / receivables for the reporting entity and are termed program distributions or receivables (to the reporting entity) in this guidance. The reporting of payable or receivable amounts in this guidance is from the perspective of the reporting entity. This statement nullifies *INT 13-04: Accounting for the Risk-Sharing Provisions of the Affordable Care Act*.

3. This statement establishes statutory accounting principles for the risk-sharing provisions of the ACA. The manner in which these provisions are applied in the determination of the medical loss ratios (MLR) and rebates may be different from these as the MLR calculations are based on the ACA Section 2718(b).

Risk Adjustment Program – Description and Overview

4. The risk adjustment program based on Section 1343 of the ACA is effective beginning in the 2014 benefit year and continues as a permanent program.

5. The risk adjustment program includes health plans (except certain exempt and grandfathered plans) in the individual or small group markets both on and off the exchange. All covered risk adjustment plans are required to participate in the risk adjustment program.

6. The purpose of the risk adjustment program is to transfer funds from lower risk plans to higher risk plans within similar plans in the same state in order to adjust premiums for adverse selection among carriers caused by membership shifts due to guarantee issue and community rating mandates. States may set up their own risk adjustment programs, or they may permit the U.S. Department of Health and Human Services (HHS) to develop and manage the program in the state. In addition to the risk adjustment amount, HHS determines the user fee. In states operating their own risk adjustment program, the state will determine the fee.

7. Risk adjustment assessments and distributions will be computed based on the reporting entity’s risk score versus the overall market risk score after applying adjustments. Effective for 2018 benefit plan years, the risk adjustments and distributions are calculated including the high-cost risk pool aspect of this program (see high-cost risk pool in paragraphs 10-11, paragraph 15 and paragraph 16). Risk adjustment assessments will be made if the plan average actuarial risk of all of their enrollees in a market and state is lower than the plan average risk of all enrollees in fully insured plans in that market and state risk pool. Risk adjustment distributions will be made to health plan issuers whose plans have an average actuarial risk that is greater than the plan average actuarial risk scores in that market and state risk pool. The reinsurance program is not considered in the computation.

8. HHS will collect a user fee to support the administration of the HHS-operated risk adjustment program. This fee applies to issuers of risk adjustment covered plans in states in which HHS is operating the risk adjustment program. For example, HHS projects that the per capita risk adjustment user fee for 2014 is approximately \$1 per enrollee per year. Similar terms will apply for the user fees of state operated programs.

9. All risk adjustment distributions made to issuers are completely funded through the amounts assessed to other issuers within the same market in the same state to ensure equality between program distributions and assessments. Consequently, risk adjustment assessments will be invoiced prior to processing program distributions to issuers. Once applicable risk adjustment assessments by issuers are received by HHS or the state, funds will be redistributed to the higher risk plans. Each issuer that offers a

risk adjustment covered plan will be notified of risk adjustment distributions or assessments by June 30 of the year following the benefit year to align with the program distributions and assessment processing. Risk adjustment assessments owed by an issuer to HHS or the state are required to be remitted within 30 days of notification of the assessment. Once applicable assessments are received by HHS or the state, funds will be redistributed to the higher risk plans.

10. In December 2016, the HHS adopted a new regulation that changed how the ACA risk adjustment program would function, beginning with the 2018 benefit year. Specifically, the ACA risk adjustment methodology will incorporate a high-cost risk pool calculation. This adds a reinsurance-like element to the risk adjustment program, which is referred to as high-cost risk pooling. The operation of the high-cost risk pools will exclude a percentage of costs above a threshold level in the calculation of enrollee-level plan liability risk scores so that risk adjustment factors in the risk adjustment program described in paragraphs 4-9 would be calculated for risk excluding these extreme costs as determined by federal regulations. The program will operate two national high-cost risk pools, one for individuals and one for small groups. An overview of the new high-cost risk pool aspect of ACA risk adjustment is as follows:

- a. HHS will establish two new high-cost risk pool parameters: a threshold and a coinsurance rate. For 2018, the threshold has been set at \$1 million, and the coinsurance rate has been set at 60%. For 2018, the high-cost risk pools for high-cost enrollees would fund 60% of an issuer's costs for individual enrollees with claims above \$1 million.
- b. In the calculation of each issuer's annual risk adjustment transfer amount, the issuer will be reimbursed for a portion (specifically, the coinsurance rate) of actual enrollee-level claims above the threshold. Conforming changes will be made to how each issuer's enrollee-level plan liability risk scores are calculated. For example, in 2018, claims in excess of \$1 million per enrollee will be reimbursed from the respective high-cost risk pool at a 60% coinsurance rate. This payment is referred to hereafter as the high-cost risk pool claims reimbursement.
- c. In order to maintain the zero-sum nature of risk adjustment across each market in light of the new high-cost risk pool claims reimbursements detailed in paragraph 10.b., each issuer's risk adjustment transfer amount payable to HHS will include an assessment to all risk adjustment entities, which will be calculated as a percentage of the issuer's total premiums in the applicable market. The sum of the assessments across all issuers is intended to equal the sum of the high-cost risk pool claims reimbursements across all issuers.
- d. HHS will report the high-cost risk pool amounts as part of the risk adjustment payment transfer formula including all components as a single amount, which should be reported on a net basis.

11. Conceptually, high-cost risk pool can be thought of as an involuntary reinsurance pool or as an aspect of the risk adjustment program. Combining the estimates of the various parts of the risk adjustment program reduces the potential impact of misestimating each element.

Risk Adjustment Program – Accounting Treatment

12. The accounting elements of the ACA permanent risk adjustment program, which are considered separately, include the user fee and the risk adjustment assessments and distributions.

13. The user fee is paid to HHS in states where the risk adjustment program is being operated by HHS and to the state program if operated by the state. Risk adjustment user fees shall be treated as government assessments. These fees are treated the same as other non-income-based governmental taxes

and fees in that they are recognized as an expense and liability when the premium subject to the assessment is written.

14. Premium adjustments pursuant to the risk adjustment program will be based upon the risk scores (health status) of enrollees, participating in risk adjustment covered plans rather than the actual loss experience of the insured. This program bears some similarities to the Medicare Advantage risk adjustment program¹ under which the plan receives additional funding (or pays additional amounts) based on adjustments to risk scores of enrollees (see *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage*).

15. The risk adjustment payables and receivables shall be accounted for as premium adjustments subject to redetermination as specified in this statement. Effective beginning with 2018 benefit plan years, the risk adjustment assessments and distributions are calculated including the high-cost risk pool aspect of this program and should be reported on a net basis.

- a. Risk adjustment payables meet the definition of liabilities as set forth in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*. Risk adjustment receivables meet the definition of an asset and are admissible to the extent that they meet all of the criteria in this statement.
- b. Risk adjustment payables and receivables shall be estimated based on experience to date. The method used to estimate the payables and receivables shall be reasonable and consistent between reporting periods. Reporting entities shall be aware of the significant uncertainties involved in preparing estimates and be both diligent and conservative in their estimations. In exercising the judgment required to prepare reasonable estimates for the financial reporting of risk adjustment program payables and receivables, the statutory accounting concept of conservatism shall be followed. In addition, reporting entities are required to have sufficient data to determine a reasonable estimate. Ensuring sufficient data requires that the reporting entity's estimate is based on demonstrated knowledge of the marketplace and annual information which includes patient encounter and diagnosis code data to determine the differences in the actuarial risk profile of the reporting entity's insureds versus the market participants in the particular market and state risk pool. Sufficient data shall incorporate patient default scores, if applicable, under the terms of the risk adjustment program. In addition, the estimates shall be consistent with other financial statement assertions and the pricing scenarios used by the reporting entity.
- c. Premium revenue adjustments for the risk adjustment program are estimated for the portion of the policy period that has expired and shall be reported as an immediate adjustment to premium. Accrued risk adjustment receivables shall be recorded in premium and considerations receivable, with a corresponding entry to written premiums. Accrued risk adjustment payables shall be recorded as a liability² with a corresponding entry to written premiums. Reporting entities shall record additions or reductions to revenue resulting from the risk adjustment program in the period in which the changes in risk scores of enrollees result in reasonably estimable additions or reductions. The risk adjustment program receivables shall be reported gross of payables.

¹ The ACA program also has significant differences from the Medicare Advantage risk adjustment program, which is retrospective, administered as a single national program, with most enrollees administered by the federal government. By contrast, the ACA risk adjustment is not retrospective, and is administered by each entity by state and by plan.

² The annual statement liability lines will vary by the type of annual statement the reporting entity files. Managed care/accident and health reporting entities report as aggregate health policy reserves; life and accident and health reporting entities report as aggregate reserves for accident and health contracts; and property and casualty reporting entities report as aggregate write-ins for liabilities.

- d. The risk adjustment receivables are administered through a federal governmental program. Once amounts are collected by the governmental entity, there is an obligation to distribute the funds. Amounts over 90 days due shall not cause the receivable to be treated as a nonadmitted asset based solely on aging.
- e. Provided that the risk adjustment receivables due the reporting entity are determined in a manner that is consistent with the requirements of this statement, the receivables are admitted assets until determination of impairment or payment denial is received from the governmental entity or government-sponsored entity administering the program. Upon notification that payments to be paid to the reporting entity will be less than the recorded receivables, any amount in excess of the confirmed amount shall be written off and charged to income, except for amounts that are under appeal. Any receivable for risk adjustment amounts under appeal shall be reflected as a nonadmitted asset.
- f. Evaluation of the collectibility of all amounts receivable from the risk adjustment program shall be made for each reporting period. If, in accordance with SSAP No. 5R, it is probable that the risk adjustment receivables are uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. If it is reasonably possible that a portion of the balance determined in accordance with this paragraph is not anticipated to be collected and is therefore not written off, the disclosure requirements outlined in SSAP No. 5R shall be followed.

Risk Adjustment Program – High-Cost Risk Pool – Accounting Treatment

16. The individual and small group high-cost risk pools of the ACA risk adjustment program shall be accounted for consistent with the rest of the ACA risk adjustment program. Reporting entity issuers in the individual or small group markets need to account for the following risk adjustment payables and receivables including the impairment and aging guidance reflected in paragraph 15 and paragraph 16:

- a. The high-cost risk pool assessment payable by the reporting entity, which is the percent-of-premium charge to the issuer in order to fund reimbursements across all issuers of claims above the high cost risk pool threshold, shall be accounted for as decreases to written premium subject to redetermination.
- b. High-cost risk pool distributions, which represent proportionate reimbursement for the issuer's claims above the high cost risk pool threshold, would be accounted for as increases to written premium subject to redetermination.
- c. As the risk adjustments and distributions described in paragraphs 4-9 are calculated after excluding the percentage of costs above the threshold specified in the high-cost risk pool aspect of this program, the payments described in paragraphs 4-9 will continue to be accounted for consistent with guidance in paragraph 15 and paragraph 16 (i.e., as a premium adjustment subject to redetermination).

Transitional Reinsurance Program – Description and Overview

17. The transitional reinsurance program based on Section 1341 of the ACA is effective for plan years 2014 through 2016. Reinsurance assessments will be collected and distributions will be issued during the three-year term.

18. All issuers of major medical commercial products and third party administrators (TPAs) on behalf of uninsured group health plans are required to contribute funding at the national contribution rate to HHS. States establishing reinsurance programs may collect additional funding. Non-grandfathered individual plans are eligible to receive benefit program distributions via an excess-of-loss reinsurance

system. Grandfathered plans are ineligible. Group plans are required to contribute funding, but are not eligible to receive reinsurance program distributions.

19. In general, this transitional reinsurance program provides funding to issuers in the individual market that incur high claims costs for enrollees. The program requires assessments from all issuers and TPAs on behalf of group health plans based on a per member annual fee established by HHS. The reinsurance assessment will fund reinsurance program distributions plus disbursements to the U.S. Treasury, in addition to covering administrative expenses of the program.

20. Consequently, the term “reinsurance” does not represent actual reinsurance between licensed insurers as defined by *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*. This program is similar to an involuntary pool in *SSAP No. 63—Underwriting Pools* for the individual insured health products subject to the 2014 ACA market reforms. For the group plans, which are required to contribute funding but are not eligible to receive program distributions, the program is an assessment payable by the reporting entity and not a pool.

21. The national transitional reinsurance program assessment rate for all issuers and TPAs will be established by HHS and will be designed to collect more than \$12 billion in 2014 to cover the required \$10 billion for the reinsurance program, the \$2 billion contribution to the U.S. Treasury, and additional amounts to cover the administrative costs of the federal government entity and applicable reinsurance entities. States electing to operate their own reinsurance program have the option to increase the reinsurance assessment rate to provide additional funding for the reinsurance program or to fund the administrative expenses of the applicable reinsurance entity. Assessments for the reinsurance program must fund the reinsurance program of \$10 billion in 2014, \$6 billion in 2015 and \$4 billion in 2016, plus disbursements to the U.S. Treasury of \$2 billion, \$2 billion and \$1 billion for years 2014 through 2016, in addition to covering administrative expenses of the applicable reinsurance entity or HHS.

22. Reinsurance program distributions will be processed either by the applicable reinsurance entity or by HHS and will be made to issuers of non-grandfathered individual market plans for high claim costs of enrollees. Distributions from the applicable reinsurance entity to insurers providing individual coverage will be calculated as a coinsurance rate multiplied by the eligible claims submitted for an individual enrollee’s covered benefits between an attachment point and the reinsurance cap for each benefit year. The coinsurance rate, attachment point and reinsurance cap are initially determined by HHS, but may be modified by the state, if the state chooses to establish its own reinsurance program.

23. Each state is eligible to establish a reinsurance program, regardless of whether the state establishes a Marketplace Exchange. If a state establishes a reinsurance program, the state must enter into a contract with an applicable reinsurance entity or entities or establish a reinsurance entity to carry out the program. If a state does not elect to establish its own reinsurance program, HHS will administer the reinsurance program on behalf of that state. HHS establishes the annual administrative portion of the fee. (For example, the 2014 fee will be \$0.11 per-member per-year resulting in \$20.3 million of administrative expense funding).

24. Reinsurance assessments to fund the program are made on an annual basis with billing beginning December 15, 2014. An insurer may submit claims for reimbursement when an enrollee of the reinsurance-eligible plan has met the applicable criteria as determined by either the state or HHS. Claims may be submitted through April 30 of the year following the benefit year. HHS will distribute reinsurance program funds among issuers nationally based on submitted claims. Issuers will be notified of pending reinsurance distributions by June 30 following the benefit year. If the requests for distributions exceed the actual assessments collected, HHS will reduce reinsurance distributions on a pro-rata basis. If the requests for distributions are less than actual assessments collected, HHS will increase reinsurance distributions on a pro-rata basis.

Transitional Reinsurance Program – Accounting Treatment

25. Due to the diverse elements of the transitional reinsurance program, which includes characteristics of traditional reinsurance, involuntary pools and governmental assessments, a hybrid accounting approach is required. The accounting treatment for the transitional reinsurance program outlined below is discussed in terms of the payables and receivables and the impact to the health insurance products subject to the program.

26. The following are the broad groupings of the health insurance products subject to the transitional reinsurance program:

- a. Individual insured health products subject to the 2014 ACA market reforms. This excludes grandfathered and non-grandfathered 2013 products (referred to as subject individual insured products);
- b. Other insured health products. This encompasses products which are not subject to the ACA market reforms including individual grandfathered and non-grandfathered (referred to as other insured health products);
- c. Self-insured health products.

27. The guidance in this section will provide treatment for each of the assessments payable and program distribution receivable elements of the program listed below for the health insurance products listed in paragraph 26.

- a. Assessments for reinsurance
- b. Administrative costs assessments
- c. Additional U.S. Treasury assessment
- d. Reinsurance distributions

Subject Individual Insured Health Products**Subject Individual Insured Issuers - Assessments Payable for Reinsurance**

28. Transitional reinsurance assessments attributable to enrollees in individual plans are treated as ceded reinsurance premium. This applies both to assessments made at the national assessment rate and to any state-elected additional assessments that will fund reinsurance program distributions. Ceded premiums would be reported as a reinsurance cession and follow reinsurance accounting in accordance with SSAP No. 61R, paragraph 17 and paragraphs 25-27.

29. For the individual coverage issuers, this is an involuntary pool and under the terms of the transitional reinsurance program, the transfer of risk and timely reimbursement requirements of SSAP No. 61R are deemed to be met.

30. With regard to individual coverage issuers, the transitional reinsurance program is more similar to traditional reinsurance than it is to an assessment, because program assessments are made to and program distributions are received from the government or government-sponsored entity. Accordingly, the program is accounted for as reinsurance for individual insured products subject to the transitional reinsurance program.

31. The provisions of SSAP No. 63, paragraph 3, define involuntary pools.

32. The transitional reinsurance program differs from an involuntary pool, in that there is not a proportionate sharing of the entire results of a pool. However, the purpose is very similar: to address the additional costs associated with high-risk individuals. Furthermore, HHS has noted, “*the Affordable Care Act ... requires that states eliminate or modify high-risk pools to the extent necessary to carry out the reinsurance program,*” which likewise highlights the similar purposes of the two mechanisms. Therefore, SSAP No. 63, paragraph 8, provides additional relevant guidance. As the transitional reinsurance program is a mechanism for sharing the additional costs associated with high-risk individuals, it is accounted for as traditional reinsurance.

Subject Individual Insured Issuers - Reinsurance Administrative Expense Assessments

33. The assessment payable by the reporting entity for administrative expenses attributable to individual coverage is reflected as ceded premium. This applies both to assessments made at the national assessment rate and to any state-required assessments that will provide additional funding for administrative expenses.

34. Normally reinsurance premiums are set at a level intended to cover anticipated claim costs and include an administrative charge component. Therefore, as a matter of consistency, it is appropriate to include the administrative charge component for the transitional reinsurance program in ceded premium for individual insured products.

Subject Individual Insured Issuers - U.S. Treasury Assessment

35. Because this portion of the assessment is earmarked for the U.S. Treasury and not for the reimbursement of claims or to cover the operating costs of the reinsurance program, it is a federal assessment not based on income. This portion of the assessment is not treated as ceded premium, but as an assessment under SSAP No. 35R and is reflected in the same expense category as taxes, licenses and fees. This is also consistent with annual statement expense reporting categories.

Subject Individual Insured Issuers - Reinsurance Program Distributions

36. Program distributions received from the ACA transitional reinsurance program for individual insurance is reflected as ceded claim benefit recoveries. This applies both to distributions received pursuant to the uniform federal reinsurance parameters and to any state distribution received.

37. In keeping with the rationale for reinsurance assessments above, distributions receivable from the transitional reinsurance program for individual insurance products is reflected the same as traditional reinsurance recoveries as described in SSAP No. 61R, paragraph 27.

38. Therefore, recoveries received are reported in the summary of operations and will reduce the ceding entity's reported benefits paid.

39. HHS and all applicable reinsurance entities shall be reported consistent with providers to an involuntary pool and will be treated as authorized reinsurers for the purposes of financial reporting for subject individual health products.

40. All receivables from the transitional reinsurance program are subject to the 90-day nonadmission rule beginning from when program receivables are due to be disbursed by the government or a government-sponsored entity. That is, the 90-day rule begins when governmental receivables are due, not from the date of initial accrual. The announced governmental or government-sponsored entity distribution date shall be the contractual due date similar to Appendix A-791, paragraph 2.h., which requires that payments due from the reinsurer are made in cash within ninety (90) days of the settlement date. The receivable is also subject to impairment analysis.

Other Insured Health Products

Other Insured Health Products – Assessments Payable for Reinsurance

41. Transitional reinsurance program reinsurance assessments made for enrollees in fully insured plans other than individual plans are treated as an assessment payable by the reporting entity and charged to taxes, licenses and fees. This applies both to assessments made at the national assessment rate and to any state assessments that will fund reinsurance program distributions. In this case, for fully insured non-individual plans, the entity cannot, under the terms of the program, be deemed to be “participating,” as funds for claim recoveries will not be re-distributed back to the issuer for the coverage that is being assessed. Therefore, issuers of other insured health products that are not for individuals are paying an involuntary fee but are not participating in an involuntary pool.

42. The treatment of the transitional reinsurance program reinsurance assessments for non-individual fully insured plans differs from the treatment for individual plans. Since the non-individual plans are not eligible for reimbursement, they are not participating in a reinsurance arrangement, and thus, the assessments are not treated as ceded premium. As an involuntary assessment, the transitional reinsurance program reinsurance assessments, consistent with SSAP No. 35R are treated as an assessment payable by the reporting entity and charged to taxes, licenses and fees expense. The expense is accrued in proportion to the other insured health enrollees base that will be used to determine the assessments payable as the premium subject to the assessment is written.

Other Insured Health Products - Reinsurance Administrative Expense Assessments

43. The reinsurance program administrative costs for other insured health products are an assessment payable by the reporting entity. This applies both to assessments made at the national assessment rate and to any state assessment that will fund administrative expenses and is reflected in the same expense category as taxes, licenses and fees.

Other Insured Health Products - U.S. Treasury Assessment

44. The additional U.S. Treasury assessment for other insured health products is a federal assessment payable by the reporting entity which is not based on income and is reflected in the same expense category as taxes, licenses and fees.

Other Insured Health Products - Reinsurance Program Distributions (not applicable)

45. Reinsurance recoveries will not occur for insured health products other than individual. Other insured health products will pay the transitional reinsurance program assessments payable but not receive program distributions for claims.

Self-Insured Health Products

Self-Insured Health Products - Assessments Payable for Reinsurance

46. Assessments made on behalf of self-insured plans which are administered by the reporting entity are uninsured plans and are excluded from the reporting entity's statement of operations, with respect to both monies received from the plans and assessments disbursed by the reporting entity. Any resulting liabilities or receivables shall be reported as liabilities and receivables held in connection with uninsured plans. This treatment is consistent with SSAP No. 47—*Uninsured Plans*, paragraphs 5 and 8-11.

47. The self-insured plan, not the reporting entity, is legally liable for assessments for the transitional reinsurance program. The funds are a bona fide pass-through by the reporting entity, which is merely

providing a service for the self-insured (uninsured) plan. Therefore, the reporting entity will not report revenues or expenses for the assessments for the transitional reinsurance program.

48. The reporting entity may have received funds from the self-insured plans in advance of making disbursements. In that event, a liability is established for funds held in connection with self-insured plans.

49. The reporting entity, depending on its arrangement with the (uninsured) plan, may make a disbursement before receiving full funding from the plan. In that event, an asset is established for amounts receivable in connection with uninsured plans. The asset would be subject to the rules for admissibility and impairment as prescribed in SSAP No. 47, paragraphs 9-10.

Self-Insured Health Products - Reinsurance Administrative Expense Assessments Payable and U.S. Treasury Assessment

50. A reporting entity providing a service for a self-insured plan that is uninsured shall apply the pass-through treatment for the transitional reinsurance program's administrative cost assessments and additional U.S. Treasury contribution amounts. The uninsured plan, not the reporting entity, is legally liable. Therefore, the reporting entity will not report revenues or expenses with respect to the transitional reinsurance program's administrative cost assessments and additional U.S. Treasury contribution amounts.

Self-Insured Health Products - Reinsurance Payments (not applicable)

51. Reinsurance recoveries will not occur for self-insured health products, as these products will pay fees but not receive claims reimbursements.

Risk Corridors – Description and Overview

52. The risk corridors program based on Section 1342 of the ACA is effective for benefit years beginning in 2014 through 2016. The risk corridors program applies to Qualified Health Plans (QHPs) in the individual and small group markets whether sold on or outside of an exchange.

53. The purpose of the risk corridors program is to provide limitations on issuer losses and gains for QHPs through additional protection against initial pricing risk. The program creates a mechanism for sharing the risk for Allowable Costs between the federal government and the QHP issuers. The program is applied at the QHP level, not the issuer or market segment level. Although the risk corridors program provides protection against extreme bounds of experience, there is a substantial corridor in which all variance in experience directly affects the financial return of the reporting entity.

54. To determine whether an issuer pays into (contributes), or receives distributions from, the risk corridors program, HHS will compare Allowable Costs³ and the Target Amount⁴ based on a formula that compares Allowable Costs. Below is an example (before transition requirements) for a QHP.

- a. When a QHP's Allowable Costs for any benefit year are more than 103% but not more than 108% of the Target Amount, HHS will pay the QHP issuer an amount equal to 50% of the Allowable Costs in excess of 103% of the Target Amount.

³ With respect to a QHP, Allowable Costs is an amount equal to the sum of incurred claims of the QHP issuer, adjusted to include qualifying expenditures by the QHP for activities that improve health care quality, expenditures for health information technology and meaningful use requirements and other required adjustments.

⁴ With respect to a QHP, the Target Amount is an amount equal to the total premiums earned with respect to a QHP, including any premium tax credit under any governmental program, reduced by the allowable administrative costs of the plan.

- b. When a QHP's Allowable Costs for any benefit year are more than 108% of the Target Amount, HHS will pay the QHP issuer an amount equal to 2.5% of the Target Amount plus 80% of the Allowable Costs in excess of 108% of the Target Amount.
- c. If a QHP's Allowable Costs for any benefit year are less than 97% but not less than 92% of the Target Amount, the QHP issuer must remit assessments payable to HHS in an amount equal to 50% of the difference between 97% of the Target Amount and the Allowable Costs.
- d. When a QHP's Allowable Costs for any benefit year are less than 92% of the Target Amount, the QHP issuer must remit assessments payable to HHS in an amount equal to the sum of 2.5% of the Target Amount plus 80% of the difference between 92% of the Target Amount and the Allowable Costs.

55. The risk corridors program creates a mechanism for sharing risk for Allowable Costs between the federal government and QHP issuers. The ACA establishes the risk corridors program as a federal program; consequently, HHS will operate the risk corridors program under federal rules without state variations. The risk corridors program is intended to protect against inaccurate rate setting in the early years of the exchanges by limiting the extent of issuer losses and gains. In the event that risk corridors program collections are not sufficient to cover all the required distributions, the ACA requires the use of other sources of federal funding for the required distributions, subject to the availability of appropriations.

56. The final risk corridors settlement calculation will be communicated by HHS after the end of the benefit year and after premium and loss adjustments related to the reinsurance and risk adjustment programs have been determined.

Risk Corridors – Accounting Treatment^(INT 15-01)

57. This program is similar to the risk corridors program established for the Medicare Part D prescription drug coverage⁵. However, due to the asymmetrical nature of the risk corridors calculation, an overstatement of expense in one cell, which is theoretically offset by the understatement of expense in another cell, does not necessarily result in zero financial impact.

58. Payables and receivables pursuant to the temporary risk corridors program shall be accounted for as specified in this statement.

59. Risk corridors assessments meet the definition of liabilities as set forth in SSAP No. 5R. Risk corridors receivables due to the reporting entity meet the definition of an asset and are admissible to the extent that they meet all of the criteria in this statement.

- a. Assumptions used in estimating retrospective premium adjustments shall be consistent with the assumptions made in recording other assets and liabilities necessary to reflect the underwriting results of the reporting entity such as claim and loss reserves (including IBNR) and contingent commissions. Contingent commissions and other related expenses shall be adjusted in the same period the additional or return retrospective premiums are recorded.
- b. The additions or reductions to premium revenue resulting from the risk corridors program are recognized over the contractual period of coverage, to the extent that such additions or reductions are reasonably estimable. Reporting entities shall be aware of the significant uncertainties involved in preparing estimates and be both diligent and

⁵ The ACA risk corridors program also has significant differences between the Medicare risk corridors program. The ACA risk corridors program is performed at a significantly more granular plan specific level with a pro-rata allocation of the issuer's overall claim costs for the plan's state/market cell.

conservative in their estimations. Risk corridors payables and receivables shall be estimated based on experience to date. The method used to estimate the payables and receivables shall be reasonable and consistent between reporting periods. In exercising the judgment required to prepare reasonable estimates for the financial reporting of risk corridors program payables and receivables, the statutory accounting concept of conservatism shall be followed. In addition, reporting entities are required to have sufficient information to determine a reasonable estimate. Part of ensuring sufficient information requires that the reporting entity's estimate is based on demonstrated knowledge of the impacts of the other risk-sharing programs on the risk corridors program and the terms of the risk corridors program. In addition, the estimates shall be consistent with other financial statement assertions and the pricing scenarios used by the reporting entity.

- c. The risk corridors receivables are from a federal governmental program. Amounts over 90 days due shall not cause the receivable to be treated as a nonadmitted asset based solely on aging.
- d. Provided that the risk corridors receivables due the reporting entity are determined in a manner that is consistent with the requirements of this statement, the receivables are admitted assets until determination of impairment or payment denial is received from the governmental entity or government-sponsored entity administering the program. Upon notification that payments to be paid to the reporting entity will be less than the recorded receivables, any amount in excess of the confirmed amount shall be written off and charged to income, except for amounts that are under appeal. Any receivable for risk corridors amounts under appeal shall be reflected as a nonadmitted asset.
- e. Evaluation of the collectibility of all amounts receivable from the risk corridors program shall be made for each reporting period. If, in accordance with SSAP No. 5R, it is probable that the risk corridors receivables are uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. If it is reasonably possible, that a portion of the balance determined in accordance with this paragraph is not anticipated to be collected and is therefore not written off, the disclosure requirements outlined in SSAP No. 5R shall be followed.
- f. Reporting shall be consistent with *SSAP No. 66—Retrospectively Rated Contracts*, paragraph 9 guidance on reporting for retrospective premium.

Disclosures

60. The financial statements shall disclose on an annual and quarterly basis beginning in the first quarter of 2014, the assets, liabilities and revenue elements by program regarding the risk-sharing provisions of the Affordable Care Act for the reporting periods which are impacted by the programs including the listing in paragraphs 60.a. through 60.c. Reporting entities shall also indicate if they wrote any accident and health insurance premium, which is subject to the Affordable Care Act risk-sharing provisions. In the event that the balances are zero, the reporting entity should provide context to explain the reasons for the zero balances, including insufficient data to make an estimate, no balances or premium was excluded from the program, etc. Asset balances shall reflect admitted asset balances. The disclosure shall include the following:

- a. ACA Permanent Risk Adjustment Program
 - i. Premium adjustments receivable due to ACA Risk Adjustment (including high-cost risk pool payments)

- ii. Risk adjustment user fees payable for ACA Risk Adjustment
- iii. Premium adjustments payable due to ACA Risk Adjustment (including high-cost risk pool ceded premium)
- iv. Reported as revenue in premium for accident and health contracts (written/collected) due to ACA Risk Adjustment
- v. Reported in expenses as ACA risk adjustment user fees (incurred/paid)
- b. ACA Transitional Reinsurance Program
 - i. Amounts recoverable for claims paid due to ACA Reinsurance
 - ii. Amounts recoverable for claims unpaid due to ACA Reinsurance (contra-liability)
 - iii. Amounts receivable relating to uninsured plans for contributions for ACA Reinsurance
 - iv. Liabilities for contributions payable due to ACA Reinsurance - not reported as ceded premium
 - v. Ceded reinsurance premiums payable due to ACA Reinsurance
 - vi. Liability for amounts held under uninsured plans contributions for ACA Reinsurance
 - vii. Ceded reinsurance premiums due to ACA Reinsurance
 - viii. Reinsurance recoveries (income statement) due to ACA Reinsurance payments or expected payments
 - ix. ACA Reinsurance Contributions – not reported as ceded premium
- c. ACA Temporary Risk Corridors Program
 - i. Accrued retrospective premium due from ACA Risk Corridors
 - ii. Reserve for rate credits or policy experience rating refunds due to ACA Risk Corridors
 - iii. Effect of ACA Risk Corridors on net premium income (paid/received)
 - iv. Effect of ACA Risk Corridors on change in reserves for rate credits

61. In addition, beginning in annual 2014 and both quarterly and annual thereafter, a roll forward of prior year ACA risk-sharing provisions specified asset and liability balances shall be disclosed in the annual statutory Notes to Financial Statements, as illustrated in Exhibit B. Note for the roll forward illustration, assets shall be reflected gross of any nonadmission. The reasons for adjustments to prior year balances (i.e. federal audits, revised participant counts, information which impacted risk score projections, etc.) shall also be disclosed. For year-end 2014, all columns and rows are expected to be zero since 2014 is the first year that a receivable or liability will be recorded. For reporting periods on or after March 31, 2016, the risk corridors roll forward is amended to require disclosure of the risk corridors asset

and liability balances and subsequent adjustments by program benefit year. The beginning receivable or payable in the roll forward will reflect the prior year-end balance for the specified benefit.

62. For reporting periods ending on or after March 31, 2016, for both quarterly and annual reporting, the following information is required for risk corridors balances by program benefit year:

- a. Estimated amount to be filed or final amounts filed with federal agency
- b. Amounts impaired or amounts not accrued for other reasons (not withstanding collectability concerns)
- c. Amounts received from federal agency
- d. Asset balance gross of nonadmission
- e. Nonadmitted amounts
- f. Net admitted assets

Relevant Literature

Generally Accepted Accounting Principles

63. U.S. GAAP did not issue additional guidance to address the risk-sharing provisions of the ACA.

Effective Date and Transition

64. This statement is effective for years ending on or after December 15, 2014. 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*. Risk-sharing provisions guidance was previously reflected within *INT 13-04: Accounting for the Risk-Sharing Provisions of the Affordable Care Act* and was effective January 1, 2014. Upon adoption of this statement, INT 13-04 was nullified. Disclosures in paragraphs 60 and 61 were adopted in *SSAP No. 35R—Guaranty Fund and Other Assessments*, but were incorporated into this statement prior to publication. Statement revisions in paragraphs 10-11 and paragraphs 15-16 for risk adjustment high-cost risk pools and related disclosure changes are effective for reporting periods beginning on or after January 1, 2018.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 150—Accounting for the Risk-Sharing Provisions of the Affordable Care Act*

EXHIBIT A – GLOSSARY

The terms included in this exhibit are specific to the risk-sharing provisions of the ACA; accordingly, they are not intended to be applied to other topics.

Affordable Care Act (ACA) – The Patient Protection and Affordable Care Act (PPACA), commonly called the Affordable Care Act (ACA), is a United States federal statute signed into law on March 23, 2010.

Applicable Reinsurance Entity – A tax-exempt not-for-profit organization, the duties of which shall be to carry out the transitional reinsurance program by coordinating the funding and operation of the risk-spreading mechanisms designed to stabilize the individual markets during the implementation of health reform.

Cell – The risk corridor calculation is done at the QHP (Qualified Health Plan) level – the cell is state, market (individual or small group), QHP.

Assessment – Required payments into the applicable reinsurance entity by all issuers of major medical commercial products and third-party administrators to fund the transitional reinsurance program.

Exchange – Health insurance marketplaces, also called Health Exchanges, are organizations set up to facilitate the purchase of health insurance in every state of the United States in accordance with the Patient Protection and Affordable Care Act. The exchanges are regulated, online marketplaces, administered by either federal or state government, where individuals, families and small businesses can purchase qualified health insurance plans starting October 1, 2013, with coverage beginning January 1, 2014. Exchanges will also determine who qualifies for subsidies and make subsidy payments to insurers on behalf of individuals receiving them. They will also accept applications for other health coverage programs such as Medicaid and Children's Health Insurance Program (CHIP).

Exempt Plans – Certain health plans that are determined not to be a risk adjustment covered plan in the applicable federally certified risk adjustment methodology (45 C.F.R. § 153.20), grandfathered health plans, group health insurance coverage benefits that are not an integral part of a group health plan, are limited scope, or supplemental benefits (45 C.F.R. § 146.145(c)), and individual health insurance coverage excepted benefits (45 C.F.R. § 148.220).

Grandfathered Plans – A group health plan that was created or an individual health insurance policy that was purchased on or before March 23, 2010. Grandfathered plans are exempted from many changes required under the ACA. Plans or policies may lose their “grandfathered” status if they make certain significant changes that reduce benefits or increase costs to consumers. New employees and new family members may be added to grandfathered group plans after March 23, 2010.

Health and Human Services (HHS) – The Department of Health and Human Services (HHS) is the United States government's principal agency that oversees CMS, which administers programs for protecting the health of all Americans and providing essential human services.

Market Segment – Subset of consumers with its own set of demographic and other assumptions such as individual, state/federal, small group, group, Medicaid or Medicare.

Program Distribution – Amounts payable to or redistributed by the applicable reinsurance entity or the HHS to issuers of non-grandfathered individual market plans that incur high claims costs for enrollees and are eligible to receive benefit payments (recoveries).

Qualified Health Plan (QHP) – Under the Affordable Care Act, starting in 2014, an insurance plan that is certified by the Health Insurance Marketplace, provides essential health benefits and follows established limits on cost-sharing (such as deductibles, copayments, and out-of-pocket maximum amounts).

Risk Score – Individual risk score means a relative measure of predicted health care costs for a particular enrollee that is the result of a risk adjustment model. Claims-based risk-assessment models use data, typically from a 12-month period, to identify underlying conditions and assign a risk score for each individual based on an algorithm.

Not for Distribution

EXHIBIT B – ACA RISK-SHARING PROVISIONS ROLL-FORWARD ILLUSTRATION

Receivables are reflected gross of any nonadmission for this illustration.

	Accrued During the Prior Year on Business Written Before December 31 of the Prior Year		Received or Paid as of the Current Year on Business Written Before December 31 of the Prior Year		Differences		Adjustments			Unsettled Balances as of the Reporting Date	
					Prior Year Accrued Less Payments (Col 1 – 3)	Prior Year Accrued Less Payments (Col 2 – 4)	To Prior Year Balances	To Prior Year Balances		Cumulative Balance from Prior Years (Col 1 – 3 + 7)	Cumulative Balance from Prior Years (Col 2 – 4 + 8)
					1	2	3	4	5	6	7
	Receivable	(Payable)	Receivable	(Payable)	Receivable	(Payable)	Receivable	(Payable)	Ref	Receivable	(Payable)
a. Permanent ACA Risk Adjustment Program											
1. Premium adjustments receivable	4,000,000		3,000,000		1,000,000		-800,000		A	200,000	0
2. Premium adjustments (payable)		8,000,000		9,000,000		-1,000,000		1,000,000	B		0
3. Subtotal ACA Permanent Risk Adjustment Program	4,000,000	8,000,000	3,000,000	9,000,000	1,000,000	-1,000,000	-800,000	1,000,000		200,000	0
b. Transitional ACA Reinsurance Program											
1. Amounts recoverable for claims paid	22,000,000		15,000,000		7,000,000		-7,000,000		C	0	
2. Amounts recoverable for claims unpaid (contra liability)	8,000,000		9,000,000		-1,000,000		990,000		D	-10,000	
3. Amounts receivable relating to uninsured plans	3,000,000		2,800,000		200,000		-100,000		E	100,000	
4. Liabilities for contributions payable due to ACA Reinsurance – not reported as ceded premium		90,000		75,000		15,000		-14,000	F		1,000
5. Ceded reinsurance premiums payable		100		200		-100		100	G		0
6. Liability for amounts held under uninsured plans		125,000		15,000		110,000		90,000	H		200,000
7. Subtotal ACA Transitional Reinsurance Program	33,000,000	215,100	26,800,000	90,200	6,200,000	124,900	-6,110,000	76,100		90,000	201,000
c. Temporary ACA Risk Corridors Program											
1. Accrued retrospective premium	12,000,000		14,000,000		-2,000,000		1,750,000		I	-250,000	
2. Reserve for rate credits or policy experience rating refunds		150,000		250,000		-100,000		100,000	J		0
3. Subtotal ACA Risk Corridors Program	12,000,000	150,000	14,000,000	250,000	-2,000,000	-100,000	1,750,000	100,000		-250,000	0
d. Total for ACA Risk- Sharing Provisions	49,000,000	8,365,100	43,800,000	9,340,200	5,200,000	-975,100	-5,160,000	1,176,100		40,000	201,000

Explanation of adjustments:

- A. Adjusted due to federal audit.
- B. Adjusted because of revised participant count.
- C. Adjusted due to poor experience of other participants in the reinsurance pool.
- D. Revised risk score information in the state of substantially impacted risk scores.

Statement of Statutory Accounting Principles No. 108

Derivatives Hedging Variable Annuity Guarantees

STATUS

Type of Issue	Common Area
Issued	November 15, 2018
Effective Date.....	January 1, 2020, with early adoption permitted January 1, 2019
Affects	None
Affected by	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance.....	None

STATUS.....	1
SCOPE OF STATEMENT.....	1
SUMMARY CONCLUSION	1
Terms/Concepts (for purposes of this statement)	2
Special Accounting Provision.....	2
Assessing Hedge Effectiveness.....	5
Measurement/Recognition of Gains and Losses of Outstanding (Open) Instruments	5
Measurement/Recognition of Realized Gains or Losses of Expired Derivatives	8
Derivative Income.....	9
Disclosures.....	9
Effective Date and Transition	11
REFERENCES.....	11
Relevant Issue Papers	11
EXHIBIT A – CALCULATION OF DEFERRED ASSET OR DEFERRED LIABILITY.....	12

SCOPE OF STATEMENT

1. Current statutory accounting guidance for derivatives qualifying for hedging effectiveness is in *SSAP No. 86—Derivatives*. Pursuant to the direction from the Financial Condition (E) Committee, this statement allows special accounting treatment for limited derivatives hedging variable annuity guarantee benefits subject to fluctuations as a result of interest rate sensitivity. The provisions within this statement are separate and distinct from the guidance in SSAP No. 86, as the items subject to the scope of this guidance, and the provisions within, would not qualify for hedge effectiveness under SSAP No. 86. The provisions provided within this statement are only permitted if all of the components of the statement are met and shall not be inferred as an acceptable statutory accounting approach for derivative transactions that do not meet the stated qualifications or that are not specifically addressed within this guidance.

SUMMARY CONCLUSION

2. This statement establishes statutory accounting principles to address certain, limited derivative transactions hedging variable annuity guarantees subject to fluctuations as a result of interest rate sensitivity. Eligibility for the special accounting provision within this standard is strictly limited to variable annuity contracts and other contracts involving certain guaranteed benefits similar to those offered with

variable annuities that are reserved for in accordance with Valuation Manual 21: Requirements for Principal-Based Reserves for Variable Annuities (VM-21)¹. The statutory accounting guidance within this statement is considered a special accounting provision, only permitted if all the components in the standard are met, and shall not be inferred as an acceptable statutory accounting approach for situations that do not meet the stated qualifications or that are not specifically addressed within this guidance.

Terms/Concepts (for purposes of this statement)

3. The following terms reflect concepts specific to this statement. (This listing only details the key concepts. Specific guidelines are reflected throughout the guidance.)

- a. **Derivative Instrument:** An agreement, option, instrument or series or combination thereof: (1) To make or take delivery of, or assume or relinquish, a specified amount of one or more underlying interests, or to make a cash settlement in lieu thereof; or (2) That has a price, performance, value or cash flow based primarily upon the actual or expected price, level, performance, value or cash flow of one or more underlying interests.
- b. **Dynamic Hedging Approach:** A dynamic hedging strategy allows for the portfolio of derivatives comprising the hedging instrument to be rebalanced in accordance with changes to the hedged item in order to adhere to the specified, documented hedging strategy.
- c. **Hedged Item:** The hedged item shall consist of declared guarantee benefits on a pool, or portion thereof, of variable annuity contracts exposed to interest rate risk. The hedged item may relate to an open or flexible portfolio (e.g., group of variable annuity contracts with different characteristics and liability durations) that allows for addition of newly issued contracts, subtraction of surrenders and fluctuations in balances. The portfolio of variable annuity contracts may consist of an entire book of business or declared components thereof.
- d. **Hedging Instrument:** The hedging instrument shall reflect a specified derivative, or a portfolio of specified derivatives, that hedges the interest rate sensitivity of the designated hedged item. The hedging instrument may reflect a dynamic hedging strategy in which a portfolio of derivatives comprising the hedging instrument is rebalanced in accordance with changes to the hedged item.

Special Accounting Provision

4. The special accounting provision within this statement permits reporting entities to utilize a form of “macro-hedging” in which a portfolio of variable annuity policies, which could include the entire book of business or subsections thereof, are jointly designated as the host contracts containing the hedged item, in a fair value hedge², pursuant to a Clearly Defined Hedging Strategy (throughout this issue paper also referred to as “CDHS” or “hedging strategy”). This is considered a macro-hedge, as the designated hedged item (rate sensitive guarantee benefits) may be attached to a portfolio of variable annuity contracts with different characteristics and liability durations. Under this special accounting provision, the portfolio of contracts giving rise to the hedged item is not required to be static, but can be revised to remove policies and/or include new policies to allow for continuous risk management (hedging) of the variable annuity guarantees in accordance with the specific risks being hedged and the hedge objectives of the specified, documented hedging strategy. In designating the hedged item, reporting entities are permitted to exclude specific components of the variable annuity contracts, but such exclusions must apply collectively to all

¹ Actuarial Guideline XLIII, CARVM for Variable Annuities (AG 43) shall apply in states that have not adopted the Valuation Manual.

² As detailed in paragraph 10, these hedges are required to be highly effective in achieving offsetting changes in fair value attributed to the hedged risk between the derivative hedging instruments and the hedged item during the period that the hedge is designated.

policies included within the portfolio. For example, reporting entities may elect to only hedge the interest rate risk of rider cash flows, and if making this election, would define the hedged item as the “fair value of rider claims net of rider fees” for the portfolio of policies designated as giving rise to the hedged item.

5. This special accounting provision permits reporting entities to utilize a specified derivative, or a portfolio of specified derivatives, as the hedging instrument within a fair value hedge to hedge the interest rate sensitivity, or a specific percentage³ of the interest rate sensitivity, of the designated hedged item. The hedging instrument may reflect a dynamic hedging strategy in which a portfolio of derivatives comprising the hedging instrument is rebalanced in accordance with changes to the hedged item in order to adhere to the specified, documented hedging strategy. Although the hedging instruments must address interest rate risk, this guidance does not preclude use of derivative instruments that may offset risks other than interest rate risk from being designated as the hedging instruments. For derivative instruments that are affected by multiple risk factors, including interest rate risk, reporting entities shall apply this special accounting treatment to the change in fair value due to interest rate risk. Reporting entities shall bifurcate the change in fair value due to the various risk factors - e.g., fair value volatility due to interest rates (ρ), and other risk factors, such as equity level (δ) or volatility (ν). Pursuant to paragraphs 10 and 13, fair value fluctuations not attributed to the hedged risk, including fair value changes from excluded open components, shall be recognized as unrealized gains or losses.

6. With the provisions in this standard to allow for flexibility in the hedged item (changes to variable annuity contracts within a portfolio) coupled with a dynamic hedging approach (rebalancing of derivative hedging instruments), there is a greater risk of misrepresentation of successful risk management and achievement of a highly effective hedging relationship. Although this risk cannot be eliminated, the following provisions intend to ensure governance of the program and provide sufficient tools to allow for regulator review:

- a. Prior to implementing a hedging program for application within scope of this standard, the reporting entity must obtain explicit approval from the domiciliary state commissioner allowing use of this special accounting provision. The domiciliary state commissioner may subsequently disallow use of this special accounting provision at their discretion. Although this guidance does not restrict the state domiciliary commissioner on when to prohibit future use, disallowance should be considered upon finding that the reporting entity’s documentation, controls, measurement, prior execution of strategy or historical results are not adequate to support future use.
- b. Actuarial certifications of VM-21 reserves, consistent with Valuation Manual requirements, which explicitly include the following:
 - i. Certification as to whether the hedging strategy is incorporated within the establishment of VM-21 reserves, and the impact of the hedging strategy within the VM-21 Conditional Tail Expectation Amount.
 - ii. Certification by a financial officer of the company (CFO, treasurer, CIO, or designated person with authority over the actual trading of assets and derivatives) that the hedging strategy meets the definition of a Clearly Defined Hedging Strategy within VM-21 and that the Clearly Defined Hedging Strategy is the hedging strategy being used by the company in its actual day-to-day risk mitigation efforts. This provision does not require reporting entities to use a hedging strategy in determining VM-21 reserves, nor does it require entities to use the special accounting provision within this standard. However, it does require reporting entities that use the special accounting provisions within this standard to certify

³ In identifying the hedged risk, reporting entities must identify whether they are hedging the full, or a portion of (e.g., 40%), the interest rate sensitivity.

that the hedging strategy within scope of this standard is a Clearly Defined Hedging Strategy and is reflected in the establishment of VM-21 reserves.

7. As identified in paragraph 2, eligibility for the special accounting provision within this standard is strictly limited to variable annuity contracts and other contracts involving certain guaranteed benefits similar to those offered with variable annuities that are reserved for in accordance with VM-21. This special accounting provision requires the reporting entity to engage in highly effective fair value hedges that follow a Clearly Defined Hedging Strategy, as defined in VM-21, meeting all required provisions of VM-21 allowing the reporting entity to reduce the amount of the Conditional Tail Expectation (CTE) Amount. In order to qualify as a Clearly Defined Hedging Strategy (which may be dynamic, static, or a combination thereof), the strategy must meet the principles outlined in VM-21, be in place (implemented) for at least three months⁴, and shall at a minimum, identify:

- a. Specific risks being hedged⁵,
- b. Hedge objectives,
- c. Risks not being hedged,
- d. Financial instruments that will be used to hedge the risks,
- e. Hedge trading rules, including permitted tolerances from hedging objectives,
- f. Metric(s) used for measuring hedging effectiveness,
- g. Criteria that will be used to measure effectiveness,
- h. Frequency of measuring hedging effectiveness,
- i. Conditions under which hedging will not take place, and
- j. The individuals responsible for implementing the hedging strategy.

8. While an initially documented hedging strategy may subsequently change, any change in hedging strategy, which includes a change in hedge target, shall be documented, with notification to the domiciliary state commissioner, and include an effective date of the change in strategy. Reporting entities that elect to change a documented hedging strategy prior to the end of the three-month minimum implementation timeframe shall identify the hedging strategy, and all hedging instruments executed under the strategy, as ineffective. The three-month timeframe begins with the stated effective date of the hedging strategy regardless if any hedging instruments have been executed under the hedging strategy. Changes in a documented hedging strategy that occur after the three-month implementation timeframe do not necessitate an ineffective determination as long as hedged items and hedging instruments under the revised/new strategy continue to meet the requirements of a highly effective fair value hedge. Reporting entities are permitted to have more than one hedging strategy implemented, but all implemented strategies must qualify as a component of a Clearly Defined Hedging Strategy pursuant to paragraph 7.

⁴ As detailed in VM-21, before a new or revised hedging strategy can be used to reduce the amount of the Conditional Tail Expectation (CTE) otherwise calculated, the hedging strategy should be in place (effectively implemented) for at least three months. As detailed in VM-21, the reporting entity may meet the time requirement by having evaluated the effective implementation of the hedging strategy for at least three months without actually having executed the trades indicated by the hedging strategy (e.g., mock testing or by having effectively implemented the strategy with similar annuity products for at least three months.)

⁵ The specific risk being hedged shall include a measure of the hedge coverage (e.g., percentage of interest rate sensitivity being hedged).

Assessing Hedge Effectiveness

9. The provisions within this standard require the entity to use a specific method, as detailed in paragraph 10, to assess hedge effectiveness at inception and on an ongoing basis. At a minimum, hedge effectiveness assessment is required whenever financial statements are reported, at least every three months. Documentation requires prospective and retrospective⁶ hedge effectiveness assessments, with on-going assessment consistent with the originally documented risk management strategy.

10. Both at inception, and on an ongoing basis, the hedging relationship must be highly effective in achieving offsetting changes in fair value attributed to the hedged risk during the period that the hedge is designated. Reporting entities electing to use this special accounting provision must calculate the fair value of the hedged item at inception and on an ongoing basis, and compare the fair value change of the hedged item to the fair value change of the hedging instruments in assessing whether the relationship is highly effective on a cumulative basis. This comparison is specific to the designated hedged risks and exposures, therefore, if only a portion of the interest rate risk is hedged or if the designated hedge only include specific components of the variable annuity policies (e.g., riders), for determining hedge effectiveness, the fair value comparisons is limited to those designated items. If an entity's defined risk management strategy for a particular hedging relationship excludes specific components of the hedging derivative from the assessment of hedge effectiveness, the excluded open components shall be reported at fair value with gains or losses recognized as unrealized gains or losses.

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.

Measurement/Recognition of Gains and Losses of Outstanding (Open) Instruments

12. All designated hedging instruments (all derivatives, including those reflected in portfolios) shall be reported in the financial statements at fair value.

13. Fair value fluctuations in the measurement of outstanding (non-expired) derivatives within a highly effective hedging strategy shall be reflected as follows:

- a. Fair value fluctuations in the hedging instruments attributable to the hedged risk that offset the current period change in the designated portion of the VM-21 reserve liability⁷ shall be recognized as a realized⁸ gain or loss.

⁶ For situations in which there has been a change in hedging strategy pursuant to paragraph 8, when conducting retrospective hedge effectiveness assessments, reporting entities shall assess effectiveness based on the hedge target that was actually in effect during the retrospective time periods.

⁷ Hedge effectiveness is determined by comparing fair value fluctuations between the hedging instruments and the hedged item. However, in determining recognition in the financial statements, the fair value fluctuation of the hedging instruments is compared to the change in the reported value of the designated portion of the VM-21 liability. The designated portion of the VM-21 liability is not reported at fair value in the statutory financial statements, as such, the offset reported as realized gains and losses is the portion of the fair value change in hedging instruments offset by the change in the reported value of the designated portion of the VM-21 reserve. In accordance with the documented hedging strategy, reporting entities shall compare the fair value fluctuations to the change in the designated portion of the reserve liability, after considering recognized derivative returns (including recognized derivative income), when determining the recognition of fair value fluctuations.

⁸ Recognizing the fair value change for open derivative positions that offset the VM-21 change as a realized gain/loss (instead of an unrealized gain or loss) directly offsets the VM-21 reserve change in the income statement.

- b. Fair value fluctuations in the hedging instruments attributable to the hedged risk⁹ that do not offset the current period change in the designated portion of the VM-21 reserve liability shall be recognized as deferred assets (admitted) and deferred liabilities. The ability to recognize a deferred asset and deferred liability is limited to only the portion of the fair value fluctuation in the hedging instruments that is attributed to the hedged risk and does not immediately offset changes in the designated portion of the VM-21 reserve liability.
- c. An amount equal to the net deferred asset and deferred liability (net amount from all hedging strategies/programs captured within this guidance) shall be allocated from unassigned funds to special surplus. Upon domestic regulator request, reporting entities shall provide estimations of RBC as if the special accounting provisions had not been applied. This estimation shall reflect the removal of deferred assets or deferred liabilities and reflect the impact to unassigned funds as if the derivative gains and losses had been recognized.
- d. As detailed in paragraph 10, fair value fluctuations in the hedging instruments that are not attributable to the hedged risk, shall be recognized as unrealized gains or unrealized losses.
- e. Reporting entities shall utilize the following calculation for establishing the deferred asset (also illustrated in Exhibit A) unless a different method has been approved by the domiciliary state commissioner:
 - i. Calculate the fair value gain or loss in the hedged item attributable to the hedged risk.
 - ii. Express the quantity calculated in paragraph 13.e.i. as a percentage of the change in the full-contract fair value (i.e., with all product cash flows) attributed to interest rate movements¹⁰.
 - iii. Calculate the VM-21 liability change attributed to the hedged risk as the quantity calculated in paragraph 13.e.ii. multiplied by the VM-21 liability change attributable to interest rate.
 - iv. Establish the deferred asset or deferred liability in the amount of the fair value loss or (gain) of the designated hedging instruments attributed to the hedged risk less the VM-21 liability decrease or (increase) attributed to the hedged risk as calculated in paragraph 13.e.iii.
 - v. Allocate an amount equal to the net deferred asset and deferred liability (net amount from all hedging strategies/programs captured within this guidance) to special surplus.

⁹ The change in fair value of the hedging instruments and hedged item is limited to changes driven by market factors. For example, periodic recognition of a cost owed to acquire the derivative from a counterparty (financing cost) shall not be captured as a change in the derivative instrument's fair value. The fair value of the instrument shall be determined based on the underlying derivative without inclusion of acquisition costs (or other such contractual elements that may exist with the counterparty) that do not change based on the underlying derivative interests or market factors.

¹⁰ The result of this calculation (the coverage ratio) should not exceed 100% nor drop below zero.

14. Deferred assets and deferred liabilities recognized under paragraph 13.b. shall be amortized using a straight-line method into realized gains or realized losses over a finite amortization period. The amortization timeframe shall equal the Macaulay duration of the guarantee benefit cash flows based on the VM-21 Standard Projection¹¹, but shall not exceed a period of 10 years.

- a. Future recognition of deferred assets or liabilities (fair value fluctuations attributed to the hedged risk that are not offset by the reserve liability change) do not extend the amortization timeframe for previously recognized deferred assets or deferred liabilities. Reporting entities are required to separately track, with a schedule to show the initial deferred amount and amortization schedule, of the deferred assets and deferred liabilities recognized and outstanding at each reporting date.
- b. The amount reported on the financial statement at each reporting date shall reflect the net amount (net as either a deferred asset or deferred liability) for each hedging strategy captured within scope of this guidance. (Reporting entities that have more than one hedging strategy could have both deferred assets and deferred liabilities in the financial statements based on the net position of the separate hedging strategies.)
- c. Reporting entities are permitted to amortize a greater portion of the deferred assets and/or deferred liabilities into realized gains or realized losses at any time in advance of the scheduled amortization period.
 - i. If electing to accelerate amortization, reporting entities are required to accelerate amortization equally between deferred assets and deferred liabilities within a single hedging strategy. For example, a reporting entity is not permitted to accelerate amortization of the deferred liabilities (recognizing the gains from fair value changes) and not accelerate amortization of the deferred assets (continuing to defer losses from fair value changes). If a reporting entity only has a single hedging strategy which only reflects deferred assets or deferred liabilities, the reporting entity is permitted to accelerate amortization without restrictions.
 - ii. If a reporting entity has more than one hedging strategy, and the strategies have offsetting net positions (both deferred assets and deferred liabilities are recognized in the financial statements), a reporting entity's election to accelerate amortization must be applied equally to programs with offsetting net positions. (For example, a decision to accelerate amortization of a program with a net deferred liability must be applied equally to a program with a deferred asset that best corresponds to the deferred liability¹².) In these situations, the guidance in paragraph 14.c.i. is also applicable, whereas, the accelerated amortization must also apply equally to the deferred assets and deferred liabilities within each individual hedging program. If a reporting entity with more than one hedging strategy only has net deferred assets or net deferred liabilities recognized, the reporting entity is permitted to accelerate

¹¹ The VM-21 Standard Projection benefit cash flows shall be based on the prescribed assumptions run for the scenario that produces the scenario reserve closest to conditional tail expectation (CTE) 70 (adjusted). The VM-21 Standard Projection with prescribed assumptions run is determined using the method (company specific market path (CSMP) or conditional tail expectations with prescribed assumptions (CTEPA)) applied by the reporting entity to calculate the prescribed projections amount. For the CSMP method, the economic scenario is Path A, with the guarantee benefit cash flows from the run to calculate Prescribed Amount A. For the CTEPA method, the economic scenario is the scenario that produces the scenario reserve closest to the CTE70 (adjusted) from the stochastic reserve calculation, with the guarantee benefit cash flows from the VM-21 Standard Projection with prescribed assumptions run for this economic scenario. The discount rate for the Macaulay duration calculation shall be equal to the valuation interest rate specified by the Standard Valuation Law for annuities valued on an issue year basis, using Plan Type A and a Guarantee Duration greater than 10 years but not more than 20 years.

¹² The intent of this guidance is to ensure that the ability to accelerate amortization does not result with elections that simply result in favorable financial statement presentation.

amortization to a single program in a manner consistent with the guidelines in paragraphs 14.c.i.

15. For outstanding (non-expired) derivative instruments that were removed from a highly effective hedging strategy (rebalanced), subsequent gains and losses from fair value fluctuations shall not impact the previously recognized deferred assets or deferred liabilities. The deferred assets and deferred liabilities for these derivative instruments shall be “locked” and amortized under the remaining schedule unless the reporting entity elects to terminate or accelerate amortization. Subsequent to the removal from a highly effective strategy, all fair value fluctuations from the outstanding derivative instruments would be subject to the guidance in SSAP No. 86, and recognized as unrealized gains and/or unrealized losses. If the derivative is re-designated as part of a highly effective hedging strategy qualifying under this standard, subsequent fair value fluctuations (after the re-designation) may be accounted for under the special accounting provision detailed in this statement.

16. For outstanding (non-expired) derivative instruments in a hedging strategy that no longer qualifies within scope of this standard (e.g., VM-21 requirements are not met) or is no longer a highly effective hedge, any non-amortized deferred assets or deferred liabilities shall be amortized to unrealized gains or unrealized losses over the remaining amortization timeframe, not to exceed five-years. If the deferred assets/deferred liabilities have a remaining amortization period that is less than the shortened timeframe, amortization shall continue over the remaining period. If the remaining amortization period is greater than 5-years at the time of the program no longer qualifies, or is no longer highly effective, the amortization schedule shall be revised to require full amortization within the shortened 5-year timeframe. If elected by the reporting entity, deferred assets and deferred liabilities may be immediately recognized as unrealized gains and/or unrealized losses or have accelerated amortization (less than 5-years) as unrealized gains and/or unrealized losses. (An election to immediately eliminate or accelerate amortization must follow the provisions in paragraph 14.c.) All future fair value fluctuations for these derivative instruments would be subject to the guidance in SSAP No. 86, and shall be recognized as unrealized gains or unrealized losses unless the instrument is subsequently designated as part of a highly effective hedging strategy within scope of this statement. If the derivative is re-designated as part of a highly effective hedging strategy qualifying under this standard, subsequent fair value fluctuations (after the re-designation) may be accounted for under the special accounting provision detailed in this statement.

17. Reporting entities may elect to terminate use of this special accounting provision at any time. In those instances, if the derivative instruments are outstanding, all deferred assets and deferred liabilities shall be amortized to unrealized gains or unrealized losses over the remaining amortization timeframe, not to exceed five-years. If the deferred assets/deferred liabilities have an amortization period that is less than the shortened 5-year timeframe, amortization shall continue over the established period. If the remaining amortization period is greater than 5-years at the time of termination, the amortization schedule shall be revised to require full amortization within the shortened 5-year timeframe. If elected by the reporting entity, deferred assets and deferred liabilities may be immediately eliminated or have accelerated amortization (less than 5-years) with recognition as unrealized gains and/or unrealized losses. (An election to immediately eliminate or accelerate amortization must follow the provisions in paragraph 14.c.) Once the special accounting provision is terminated, unless re-designated by the reporting entity, subsequent accounting of the derivatives in a hedging strategy that would be captured within this statement shall follow the fair value accounting approach in SSAP No. 86¹³.

Measurement/Recognition of Realized Gains or Losses of Expired Derivatives

18. With the ability to rebalance the hedging instrument, this guidance allows for individual derivative instruments to expire and/or be removed from the portfolio of the hedging instrument, and not immediately

¹³ Macro-hedges and the ability to rebalance hedging instruments are not provisions permitted within “effective” hedges in scope of SSAP No. 86. As such, hedging strategies with these components accounted for under SSAP No. 86 shall follow the fair value accounting approach detailed in that standard.

trigger an assessment that the overall hedging strategy is no longer highly effective. Furthermore, special allowances are included to consider the tenure differences between a hedging instrument and VM-21 liability duration. These allowances permit expired¹⁴ derivative instruments that were part of a highly effective hedging strategy at the time of expiration to continue amortizing the deferred gains and deferred losses over the previously established amortization timeframe even if the overall hedging strategy is subsequently terminated or subsequently identified as no longer qualifying as a highly effective hedge.

19. Pursuant to the provisions in paragraph 14.c., reporting entities are permitted to amortize a greater portion of the deferred assets and/or deferred liabilities from expired derivatives into realized gains or realized losses in advance of the scheduled amortization period.

20. Consistent with the guidance in paragraph 17, reporting entities may elect to terminate use of this special accounting provision at any time. In those instances, if the derivative instruments have expired, all deferred assets and deferred liabilities shall be amortized to realized gains or realized losses over the remaining amortization timeframe, not to exceed 5-years. If the deferred assets/deferred liabilities had an amortization period that was less than the shortened timeframe, amortization shall continue over the established period. If the amortization period was greater than 5-years at the time of termination, the amortization schedule would be revised to require full amortization within the shortened timeframe. If elected by the reporting entity, the deferred assets and deferred liabilities may be immediately eliminated, or have accelerated amortization, with recognition as realized gains and/or realized losses. An election to immediately eliminate or accelerate amortization (less than 5 years) must follow the provisions in paragraph 14.c.)

Derivative Income

21. Derivative income shall be recognized when earned.

22. Pursuant to the documented hedging strategy as a fair value hedge, derivative income shall be considered as part of the overall hedging strategy and included in the assessments on whether the strategy is highly effective.

Disclosures

23. A reporting entity that has any outstanding derivatives accounted for under this special accounting provision, or that has unamortized deferred assets and/or deferred liabilities (representing previously unrecognized qualifying fair value fluctuations) from expired derivatives under the special accounting provision shall disclose the following within the financial statements:

- a. Discussion of hedged item, including information on the guarantees sensitive to interest rate risk, along with information on the designated hedging instruments being used to hedge the risk. Discussion of the hedging instruments shall identify whether a hedging instrument is a single instrument or portfolio, as well as information on the hedging strategy (including whether there have been changes in strategy from the prior reporting period, along with detailed information on the changes), and assessment of hedging effectiveness and compliance with the “Clearly Defined Hedging Strategy” of VM-21. Identification shall occur on whether the hedged item is intended to be fully hedged under the hedging strategy, or if the strategy is only focused on a portion of the liability characteristics or a portion of the interest rate sensitivity. Hedging strategies shall be identified as highly effective or not highly effective. If the strategy for a particular hedging relationship excludes a specific component of the gain or loss, or related cash flows, from the assessment of hedge effectiveness, details on the excluded components shall be disclosed.

¹⁴ Throughout this standard the use of the word “expire” is intended to capture all instances in which the derivative is no longer outstanding. It includes maturities, terminations, sales, and/or other closing transactions of a derivative.

- b. Aggregate disclosure of the original cost and fair value of hedging instruments (including all instruments within a portfolio), including any net investment income, realized and unrealized gains and losses during the reporting period. Additionally, disclose the fair value of the hedged item, the change in fair value from the prior reporting period, and the portion of the fair value change attributed to the hedged risk.
- c. Schedule showing the aggregate fair value change from the prior reporting period for the designated components for all hedging instruments, with identification of the fair value change reflected in realized gains, realized losses, deferred assets, and deferred liabilities. This schedule shall also show the current period amortization, including any accelerated amortization elected by the reporting entity, and the future scheduled amortization of the deferred assets and deferred liabilities. This schedule shall identify the fair value of the excluded components of the hedging instruments, and the fair value change for those components reflected in unrealized gain and unrealized loss.
- d. For hedging strategies no longer identified as highly effective previously captured within scope of this standard, information on the determination of ineffectiveness, including variations from prior assessments resulting in the change from classification as a highly effective hedge. This disclosure shall also include:
 - i. Identification of outstanding hedging instruments previously captured within scope of this standard and subsequently identified as no longer part of a highly effective hedging strategy. This disclosure shall identify the date in which the domiciliary state was notified that the hedging strategy had been identified by the reporting entity as no longer highly effective.
 - ii. Deferred assets and deferred liabilities previously recognized when the program was highly effective, with a schedule that shows the amortization that would have occurred if the program had remained highly effective, the amount of original amortization as well as a schedule that details the amortization that will occur as the program is no longer highly effective (maximum five-year timeframe).
 - iii. Disclosure on whether the reporting entity is electing to accelerate amortization (in advance of the remaining scheduled amortization or the maximum five-year timeframe), along with amounts immediately recognized to unrealized gains/losses, and how the election impacts the scheduled amortization.
- e. For situations in which the reporting entity has elected to terminate the hedging strategy and/or discontinue the special accounting provisions permitted within this SSAP, the reporting entity shall disclose the key elements in the reporting entity's decision to terminate, identifying changes in the reporting entity's objectives or perspectives from initial application. This disclosure shall also include:
 - i. Identification of outstanding hedging instruments previously captured within scope of this standard and the accounting impact as a result of the termination/discontinuation. (Open derivative transactions no longer captured within the special accounting provision would be subject to the accounting and reporting guidance within SSAP No. 86.) This disclosure shall identify the date in which the domiciliary state was notified that the hedging strategy or the election to use the special accounting provision in this SSAP had been terminated.
 - ii. Deferred assets and deferred liabilities previously recognized under the hedging strategy and/or program, with a schedule that shows the amortization that would have occurred if the strategy and/or program had remained highly effective, as well

as a schedule that details the amortization that will occur with the termination of the strategy and/or program (maximum five-year timeframe).

- iii. Disclosure on whether the reporting entity is electing to accelerate amortization (in advance of the remaining scheduled amortization or the maximum five-year timeframe), along with amounts immediately recognized to unrealized gains/losses, and the resulting impact to the scheduled amortization.

Effective Date and Transition

24. This statement is effective January 1, 2020, with early adoption permitted January 1, 2019. The guidance in this SSAP is required to be applied on a prospective basis for qualifying hedge programs in place on or after the effective date. This prospective application prohibits deferred asset and deferred liability recognition from fair value fluctuations previously recognized as unrealized gains or losses that occurred prior to the effective date of the guidance.

25. Reporting entities that have previously received permitted or prescribed practices for qualifying hedge programs, resulting with the recognition of deferred assets/deferred liabilities from unrecognized fair value fluctuations, shall work with their domiciliary state regulator to determine the appropriate method in transitioning from previously approved permitted practices. The reporting entity shall include disclosure of the transition approach approved by the domiciliary state in their financial statements in the first year of application. The approved transition approach is not considered a permitted practice as long as the reporting entity is fully compliant with the provisions of this statement after implementation. After the effective date of this statement, domiciliary state provisions that differ from this statement must be disclosed as a permitted or prescribed practice pursuant to *SSAP No. 1—Accounting Policies, Risks & Uncertainties and Other Disclosures*.

REFERENCES

RELEVANT ISSUE PAPERS

- *Issue Paper No. 159—Special Accounting Treatment for Limited Derivatives*

EXHIBIT A – CALCULATION OF DEFERRED ASSET OR DEFERRED LIABILITY

Under the special accounting provisions within this issue paper, as detailed in paragraph 13.e., fair value fluctuations in the hedging instruments attributable to the hedged risk that do not offset the current period change in the hedged item (the change in the VM-21 reserve liability) can be recognized as deferred assets (admitted) and deferred liabilities.

The ability to recognize a deferred asset and deferred liability is limited to only the portion of the fair value fluctuation in the hedging instruments that is attributed to the hedged risk and does not immediately offset changes in the hedged item. As detailed in the standard, the hedged risk may be designated as a specific component of the hedged item. For example, if the variable annuity reserve benefits are matched to bonds, the hedged risk could only be the portion of interest rate risk remaining after the natural hedge based on the asset-liability matching.

Unless a different method has been approved by the domiciliary state commissioner, reporting entities shall utilize the following calculation (detailed in paragraph 13) for establishing the deferred asset:

- 13.e.i. Calculate the fair value gain or loss in the hedged item attributable to the hedged risk (Step 1);
- 13.e.ii. Express the fair value gain or loss calculated (Step 1) as a percentage of the change in the full-contract fair value (i.e., with all product cash flows) attributed to interest rate movements (Step 2)¹⁵.
- 13.e.iii. Calculate the VM-21 liability change attributed to the hedged risk as the quantity calculated in Step 2 multiplied by the VM-21 liability change attributable to interest rate (Step 3).
- 13.e.iv. Establish the deferred asset or deferred liability in the amount of the fair value loss or (gain) of the designated hedging instruments attributed to the hedged risk less the VM-21 liability decrease or (increase) attributed to the hedged risk as calculated in Step 3.
- 13.e.v. Allocate an amount equal to the net deferred asset and deferred liability (net amount from all hedging strategies/programs captured within this guidance) to special surplus.

To illustrate the above calculation:

Clearly Defined Hedging Strategy (CDHS) characteristics

Hedged item	Rider claims less rider fees
Hedged risk	50% of the rho (first-order IR level sensitivity)

Calculation of the deferred asset or liability

Note: positive values = increase in liability

Fair value gain (loss) in hedged item attributable to interest rate movement	(500)
13.e.i. – Fair value gain (loss) in hedged item attributable to hedged risk	(250)

¹⁵ The result of this calculation (the coverage ratio) should not exceed 100% nor drop below zero.

Hence, if the insurer were hedging per the CDHS perfectly, then the insurer should see a 250 fair value loss in the designated IR hedge instruments. To determine how much of that loss should be deferred:

Fair value gain (loss) in full-contract cash flows attributable to IR movement	(700)
13.e.ii. – Quantity calculated in 13.b.i. as a % of the (700) above	36%
VM-21 liability increase (decrease) from beginning of period to end of period	400
VM-21 liability increase (decrease) attributable to interest rate movements	(100)
13.e.iii. – VM-21 liability increase (decrease) attributable to the hedged risk	(36)

In this example, even though the VM-21 liability increased by 400 during the reporting period, interest rate movements actually contributed to a 100 *decrease*. The hedged risk (50% of the interest rate sensitivity of rider cash flows) accounts for 36% of this, or \$36 of the liability decrease. As such, \$36 of the fair value loss on the interest rate hedge instruments should be reflected immediately and the remainder deferred via a deferred asset equal in amount to $250 - 36 = 214$.

13.e.iv. – Deferred asset (13.b.i less 13.b.iii) attributable to hedged risk	(214)
<i>(This is shown as a negative – to be consistent with the decrease in VM-21 liability – but represents a deferred asset. Deferred assets reflect fair value losses.)</i>	

INDEX to the Statements of Statutory Accounting Principles

This index is a compilation of topics listed in the table of contents found at the beginning of each statement of statutory accounting principle (SSAP). Refer to the referenced SSAP table of contents for specific page location. Also included in this index are topics and terms deemed significant that are not specifically listed in a SSAP table of contents but are referenced within the content of the statement(s).

	<u>SSAP</u> <u>Reference</u>
ACA (Affordable Care Act).....	107
Accelerated Benefits - Life Contracts	51R
Accident and Health Claim Reserve	54R
Accident and Health Contracts	50; 54R
Accidental Death and Dismemberment	50
Accounting and Reporting of Reinsurance	61R
Accounting Policies and Practices	1
Accrued Interest – Mortgage Loans	37
Acquisition, Development and Construction (ADC) Arrangements	38
Acquisitions and Sales:	
Bonds	26R
Common Stock	30R
Loan-Backed and Structured Securities	43R
Preferred Stock	32R
State Tax Credits - Transferable and Non-Transferable	94R
Acting as an Agent for Collection and Remittance of Fees and Assessments	35R
Additional Reserves Not Included Elsewhere:	
Deposit-Type Contracts	52
Individual and Group Accident and Health Contracts	54R
Life Contracts	51R
Adjustable Features/Retrospective Rating – Property and Casualty Reinsurance	62R
Administrative Expense Payment - Multiple Peril Crop Insurance	78
Administrative Service Contract Plan (ASC)	47
Administrative Service Only Plan (ASO)	47
Admissibility of Income Tax Assets	101
Admissibility Requirements of Investments in Downstream Holding Companies	97
Admitted Asset	4; 20; 21R
Advance Premiums:	
Life Contracts	51R
Property Casualty Contracts	53
Advances to Providers — Health Care and Government Insured Plans	84
Affiliate	25; 97
Affordable Care Act (ACA):	
Risk-Sharing Provisions	107
Agents' Balances – Uncollected Amounts Due	6
Aggregate Excess of Loss Reinsurance	62R
Agreement to Repurchase or Redeem Transferred Financial Assets	103R
Airplanes	20; 22R
Allocation of Expenses:	
General	70
Title Insurance	57
Alternative Minimum Tax	101
Amortization:	
Bonds	26R

Index to the Statements of Statutory Accounting Principles

	<u>SSAP</u> <u>Reference</u>
Investments in Preferred Stock	32R
Loan-Backed and Structured Securities	43R
Mortgage Loans	37
Amortized Cost – Bonds	26R
Amount That Could Be Realized on Life Insurance Where the Reporting Entity is Owner and Beneficiary or Has Otherwise Obtained Rights to Control the Policy	21R
Amounts Due From Agents and Brokers	6
Amounts Receivable (Payable):	
Government Insured Plans	84
Multi-Peril Crop Insurance	78
Uninsured Plans	47
Amounts Withheld or Retained by Company as Agent or Trustee	67
Annual and Quarterly Disclosure Requirements	Preamble
Annuity	50; 51R; 52; 56; 65
Annuity Contract(s)	50; 92; 102
Applying the Market Valuation, Statutory Equity and Audited GAAP Equity Methods	97
Application of Yield-to-Worst	26R
Applying the Recognition Criteria - Guaranty Funds and Assessments	35R
Arm's-Length Transaction	25
Arrangements to Reacquire Transferred Financial Assets	103R
Asbestos and Environmental Exposures	65
Asbestos and Pollution Contracts – Counterparty Reporting Exception	62R
Asset Securitization	103R
Asset Valuation Reserve (AVR)	7
Assets	4
Assets Obtained and Liabilities Incurred as Proceeds	103R
Assets Pledged as Collateral or Otherwise Restricted	1; 4
Assumed Reinsurance	62R
Assumption Reinsurance Transactions	61R
Attached Call	103R
Audit Premium	6; 53
Authorized Reinsurer	61R
Automatic Maximum Limit - Life, Deposit-Type and A&H Reinsurance	61R
Automatic Reinsurance - Life Deposit-Type and A&H Reinsurance	61R
Automobiles	20
Balance Sheet Amount:	
Bonds	26R
Common Stock	30R
Preferred Stock	32R
Bank Loans	26R
Beneficial Interests	43R; 103R
Benefits of Servicing	103R
Bills Receivable for Premiums	6
Bills Receivable Not for Premium and Loans Unsecured or Secured by Assets that Do Not Qualify as Investment	20
Binding Authority - Life Deposit-Type and A&H Reinsurance	61R
Bonds, Excluding Loan-Backed and Structured Securities	26R

Index to the Statements of Statutory Accounting Principles

	<u>SSAP Reference</u>
Business Combinations	68
Pensions	102
Postretirement Benefits Other Than Pensions	92
Business Interruption Insurance Recoveries	24
Call Option	86
Cap	86
Capital Notes	41R
Capital Stock	72
Capitalization of Interest	44
Capitalization Policy - EDP Equipment and Software	16R
Capitation Arrangement	84
Capitation Arrangement Receivables	84
Carryback - Taxes	101
Cash	2R
Cash Advances	20
Cash Flow Hedges	86
Cash Value of Structured Settlements	21R
Catastrophe Reinsurance	61R
Ceded Premiums and Losses - Multiple Peril Crop Insurance	78
Ceded Reinsurance:	
Life, Deposit-Type and Accident and Health Reinsurance	61R
Property/Casualty	62R
Certified Reinsurer:	
Ceded – Life, Deposit-Type and Accident and Health Reinsurance	61R
Ceded – Property/Casualty	62R
Cession	61R; 62R; 63
Change in Accounting Estimate	3
Change in Accounting Principle	3
Change In Valuation Basis:	
Credit Life and Accident and Health Insurance Contracts	59
Deposit-Type Contracts	52
Individual and Group Accident and Health Contracts	54R
Life Contracts	51R
Changes in Statutory Surplus	72
Changes That Result in the Transferor's Regaining Control of Financial Assets	
Sold	103R
Characteristics of Reinsurance Agreements – Property & Casualty	62R
Claim Overpayment Receivables	84
Claim Reserves – Accident and Health Contracts	54R
Claims Adjustment Expense:	
Accident and Health Contracts	55
Life Entity	55
Managed Care Contracts	55
Property/Casualty	55
Claims-Made Policies	65
Classifications of Insurance or Managed Care Contracts	50
Cleanup Call	103R
Coinurance With Funds Withheld Arrangements	61R

Index to the Statements of Statutory Accounting Principles

	<u>SSAP Reference</u>
Co-Lender in Mortgage Loan Agreement	37
Collar	86
Collateral (Specific to transfers and servicing of financial assets. Refer to individual SSAPs for specific guidance.)	103R
Collateral Assignment	49
Collateral Loan on Stock	20
Collateral Loans	21R
Collateral Risk - Reverse Mortgages.....	39
Collection of All Contractual Cashflows is Not Probable - LB&SS.....	43R
Collection of All Contractual Cashflows is Probable - LB&SS.....	43R
Combination Plan - Uninsured Plan.....	47
Commercial Mortgage Backed Securities (CMBS)	43R
Commercial Substance	95
Commissioners Annuity Reserve Valuation Method (CARVM)	51R; 56; 97
Commissions:	
Life, Deposit-Type and Accident and Health Reinsurance	61R
Policy Acquisition Costs and Commissions	71
Property and Casualty Reinsurance	62R
Commitment Fees:	
Bonds	26R
Loan-Backed and Structured Securities	43R
Mortgage Loans	37
Common Stock	30R
Commutations:	
Life, Deposit-Type and Accident and Health Reinsurance	61R
Property and Casualty Reinsurance	62R
Company Stock as Collateral	20
Comparison of GAAP and SAP	Preamble
Compensated Absences	11
Compensatory Employee Share-Based Payment Plans	104R
Computer Software (Cost of Software to be Sold)	16R
Conditions That Constrain a Transferee	103R
Conservatism - Statutory Accounting Concept	Preamble
Consistency - Statutory Accounting Concept	Preamble
Consolidated/Holding Company:	
Pension Plans	102
Postretirement Benefits Other Than Pensions	11; 92
Share-Based Payments	104R
Consolidation	3; 97
Construction Loans	37
Contingency Reserve:	
Financial Guaranty Insurance	60
Mortgage Guaranty Insurance	58
Continuing Involvement – Leases	22R
Continuing Involvement – Transfers and Servicing of Financial Assets and Extinguishments of Liabilities	103R
Contract Loans	49
Contracts Subject to Redetermination - Accident and Health Contracts.....	54R
Contractually Specified Servicing Fees	103R
Contractual Termination Features – Property & Casualty Reinsurance.....	62R
Convertible Bond	26R

Index to the Statements of Statutory Accounting Principles

	<u>SSAP</u> <u>Reference</u>
Convertible Debt Securities with Beneficial Conversion Features	15
Convertible Instrument Granted or Issued to a Nonemployee for Goods or Services, or Services and Cash (in Combination or Individually), or as Consideration Payable to a Customer	95
Corporate Joint Venture	48
Correction of an Error	3
Cost Containment:	
Accident and Health Contracts and Managed Care Contracts	55
Property/Casualty	55
Cost Recognition – Deposit-Type Contracts	52
Costs of Computer Software:	
Developed or Obtained for Internal Use and Web Site Development Costs	16R
Non-Software Deliverables in Arrangements Containing More-Than- Incidental Software	16R
To be Sold	16R
Coupons - Life Contracts	51R
Credit Derivatives	86
Credit Life and Accident and Health Insurance Contracts	59
Credits for Ceded Reinsurance	61R
Criteria to Meet Substantially the Same	43R; 103R
Critical Terms Match Method – Derivatives	86
Current Income Taxes	101
Curtailment:	
Pension Plans	102
OPEB Plans	92
Cut Through Endorsement	61R
Debt	15
Changes in Line-of-Credit or Revolving-Debt Arrangements	15
Settlement of the Equity-Settled Portion of a Convertible Debt Instrument That Permits or Requires the Conversion Spread to Be Settled in Stock	15
Troubled Debt	36
Debt Issuance Cost	15
Deferred Annuity	50
Deferred Assets – Derivatives	108
Deferred Compensation Arrangements Accounted for Individually	11
Deferred Income Taxes	101
Deferred Liabilities – Derivatives	108
Deferred Tax Assets (DTAs)	101
Deferred Tax Liabilities (DTLs)	101
Defined Benefit Pension Plans	102
Defined Benefit Plans – Settlements and Curtailments	102
Defined Contribution Plans:	
Pensions	102
Postretirement Benefits Other Than Pensions	92
Demutualizations	72
Deposit Accounting:	
Life, Deposit-Type and Accident and Health Reinsurance	61R
Property and Casualty Reinsurance	62R
Deposits in Suspended Depositories	20

Index to the Statements of Statutory Accounting Principles

	<u>SSAP</u> <u>Reference</u>
Deposit-Type Contracts:	
Classifications and Definitions	50
General	52
Depreciation:	
Depreciable Assets – Furniture, Fixtures and Leasehold Improvements	19
Nonoperating System Software	16R
Operating System Software	16R
Derecognize	103R
Derivative Instruments	86; 103R; 108
Used to Hedge Variable Annuity Guarantees	108
Used in Hedging Transactions	86
Used in Income Generation Transactions	86
Used in Replication (Synthetic Asset) Transactions	86
Derivative Premiums.....	86
Designation Guidance – LB&SS.....	43R
Determination of Due Date – Premiums	6
Determining Whether a Creditor Has Granted a Concession	36
Determining Whether a Debtor Is Experiencing Financial Difficulties	36
Disclosure by Creditors – Troubled Debt Restructuring	36
Disclosure by Debtors – Troubled Debt Restructuring	36
Disclosure of Concentrations of Credit Risk of All Financial Instruments	27
Disclosure of Credit Risk of Financial Instruments with Off-Balance-Sheet Credit Risk	27
Disclosure of Extent, Nature, and Terms of Financial Instruments with Off- Balance-Sheet Risk	27
Disclosures about Fair Value of Financial Instruments	100R
Discontinued Operations	24; 90
Discounting:	
Non-Tabular Basis – Permitted & Prescribed Practices.....	65
Property and Casualty Contracts	65
Liabilities and Assets Related to Long-Term Care Assessments.....	35R
Disposal:	
Long-Lived Assets to Be Disposed Of Other Than By Sale	90
Long-Lived Assets to Be Disposed Of By Sale	90
Reporting Long-Lived Assets and Disposal Groups to Be Disposed Of	90
Disputed Items – Property and Casualty Reinsurance	62R
Documentation Guidance – Derivatives	86
Dollar Repurchase Agreements	103R
Drafts	2R
Due and Unpaid Claims	55
Durable Medical Equipment	73
Dynamic Hedging Approach	108
Earned but Unbilled Premium – Property & Casualty	53
Earned but Uncollected Premium – Property & Casualty.....	53
Economic Transaction	25
EDP Equipment and Operating / Nonoperating System Software	16R
Effective Control Over Transferred Financial Assets or Beneficial Interests	103R
Electronic Data Processing Equipment and Software	16R
Embedded Call	103R
Embedded Derivative Instruments	86

Index to the Statements of Statutory Accounting Principles

	<u>SSAP Reference</u>
Employee Share-Based Payments:	
Consolidated/Holding Company Plans	104R
Employee Stock Ownership Plans	12
Employers with Two or More Plans:	
Pensions	102
Postretirement Benefits Other Than Pensions	92
Encumbrance	40R; 57; 90
Endowment Contract	50
Equity Method of Accounting	48; 97
Equity Securities Subject to Contractual Sale Restrictions	100R
Escrow Account – Multiple Peril Crop Insurance	78
Escrow Payments	37
Evaluating Whether a Restructuring Results in a Delay in Payment That is	
Insignificant	36
Excess Liability	50
Excess of Loss	62R
Excess Per Risk Reinsurance	62R
Excess Statutory Reserve – Property & Casualty	65
Exchange, Health	107
Exchange of Nonmonetary Assets	95
Exchange Traded Fund (ETF)	30R
SVO-Identified Bond ETF	26R
SVO-Identified Preferred Stock ETF	32R
Exchanges and Conversions:	
Bonds	26R
Preferred Stock	32R
Exempt Plans – Affordable Care Act	107
Expenses – Life, Deposit-Type and Accident and Health Reinsurance	61R
Experience Refunds	61R
Extended Reporting Endorsement	65
Extinguishments of Liabilities	103R
Factoring Arrangements	103R
Facultative Reinsurance Contracts	61R; 62R
Fair Access to Insurance Requirements (FAIR) Plans	50
Fair Value – Definition, Hierarchy, Valuation	100R
Fair Value Hedges	86; 108
Fair Value Accounting – Derivatives	86; 108
Federal Employees' Group Life Insurance	21R
Federal Crop Insurance Receivables	21R; 78
Federal Home Loan Bank (FHLB):	
Capital Stock	30R
Debt/Borrowings	15
Funding Agreements	52
Fidelity Bond	50
Finance Agent – Working Capital Finance Investments	105R
Financial Assets Subject to Prepayment	103R
Financial Guaranty Insurance	60
Financial Instruments With:	
Characteristics of Both Liabilities and Equity	5R
Concentrations of Credit Risk	27
Off-Balance-Sheet Risk	27

Index to the Statements of Statutory Accounting Principles

	<u>SSAP Reference</u>
Financial Liability	103R
Financial Modeling – RMBS/CMBS	43R
Employee Share Purchase Plans.....	104R
Financing Premiums – Derivatives	86
Fire and Allied Lines	50
Flexible Premium Universal Life-Type Contract	51R
Floor	86
Foreign Currency Hedges	86
Foreign Currency Transactions	23
Foreign Currency Translations	23
Foreign Operations – Hedges of Foreign Currency Exposure of Net Investment	86
Forward Contract	86
Franchise Life Contract	50
Freestanding Call.....	103R
Fronting Arrangement	61R
Functional Currency	23
Funds Held Under Reinsurance Treaties with Unauthorized or Certified Reinsurers:	
Life, Deposit-Type and Accident and Health Reinsurance	61R
Property/Casualty Reinsurance	62R
Fully Funded – Protected Cell.....	74
Furniture – Health Care Delivery Assets	73
Furniture, Fixtures, Equipment and Leasehold Improvements	19
Future	86
Future Settled Premiums – Derivatives.....	86
Gain Contingencies	5R
Gains and Losses on Indemnity Reinsurance	61R
General Account Reporting:	
Protected Cell	74
Separate Accounts	56
General Partnership	48
Giantization/Megatization of FHLMC or FNMA Mortgage Backed Securities	43R
Goodwill	68; 97
Government Insured Plans – Receivables	84
Grandfathered Plans – Affordable Care Act	107
Gross Paid-In and Contributed Surplus	72
Gross Premium – Life Contracts.....	51R
Group Life Contract	50
Guaranteed Investment Contracts	21R; 56
Guarantees	5R
Guaranty Fund Assessments	35R
Health Care Delivery Assets	73
Health Care Receivables	84
Health Exchange	107
Hedge Accounting	86; 108
Hedge Designations	86; 108
Hedging Effectiveness.....	86; 108
Hedge Transaction	86; 108
Cash Flow Hedges	86
Documentation Guidance	86
Fair Value Hedges	86; 108
Foreign Currency Hedges	86

Index to the Statements of Statutory Accounting Principles

	<u>SSAP Reference</u>
Hedge Effectiveness	86; 108
Hedging Forecasted Transactions	86
High Deductible Policies	65
High Inflationary Environment	23
High Risk Cost Pool – ACA Risk Adjustment Program	107
History of Codification	Preamble
Holders of Capital or Surplus Notes	41R
Holding Company Obligations	15
Hybrid	26R
Identification of Discontinued Operations	24
Impact on Historical Schedules	3
Impairment:	
Bonds	26R
Derivatives	86
Goodwill	68; 97
Interest Capitalization	44
Investment Income Due and Accrued	34
Investments in Preferred Stock	32R
Investments in Subsidiary, Controlled, and Affiliated Entities	97
Joint Ventures, Partnerships and LLCs	48
Loan-Backed and Structured Securities	43R
Low-Income Housing Tax Credits	93
Mortgage Loans	37
Perpetual Preferred Stock.....	32R
Premium Receivables	6
Real Estate	90
Redeemable Preferred Stock	32R
Reverse Mortgages.....	39
Surplus Notes	41R
Transferable and Non-Transferable State Tax Credits	94R
Unaffiliated Common Stock.....	30R
Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers	6
Working Capital Finance Investments	105R
Income Generation Transactions	86
Income – Investments:	
Bonds	26R
Common Stock	30R
Loan-Backed and Structured Securities	43R
Mortgage Loans	37
Preferred Stock	32R
Income Recognition:	
Credit Life and Accident and Health Insurance Contracts	59
Deposit-Type Contracts	52
Income Statement Treatment – State Tax Credits.....	94R
Income – Surplus Notes	41R
Income Taxes – Employee Stock Ownership Plans	12
Income Taxes	101
Income, Expenses, and Capital Improvements – Real Estate Investments	40R
Incurred But Not Reported (IBNR):	
Claims (Life and Accident and Health)	55

Index to the Statements of Statutory Accounting Principles

	<u>SSAP</u> <u>Reference</u>
Managed Care	55
Losses (P/C)	55
Indemnity Reinsurance	61R
Indemnity Trigger – Protected Cell.....	74
Individual and Group Accident and Health Contracts	54R
Inflation Indexed Securities (U.S. TIPS)	26R
Initial Transfer and Repurchase Financing	103R
Inland Marine	50
Inputs to Valuation Techniques	100R
Insolvency Clause	62R
Insulation.....	56
Insurance-Linked Securities Issued Through a Protected Cell.....	74
Insurance Contracts – Postretirement Benefits Other Than Pensions	92
Insurance-Linked Securities.....	1
Insured Risk – Mortgage Guaranty	58
Intangible Assets:	
Goodwill	68; 97
Other Intangibles Assets	20
Intercompany Income Tax Transactions	101
Intercompany Pools	63
Intercompany Transactions	25
Interest Income – Mortgage Loans	37
Interest Maintenance Reserve:	
General	7
Life, Deposit-Type and Accident and Health Reinsurance	61R
Interest-Only Strip.....	103R
Interest Payable	67
Interest Rate Risk – Reverse Mortgages	39
Interest Rate Swap	86
Interim Financial Disclosures.....	Preamble
Interim Tax Periods	101
Intraperiod Tax Allocation	101
Investment Expense:	
Real Estate	40R
Reverse Mortgages	39
Title	57
Investment Income Due and Accrued	34
Investments in:	
Bonds	26R
Common Stock	30R
Loan-Backed and Structured Securities	43R
Preferred Stock	32R
Preferred Stock or Surplus Notes of a Subsidiary, Controlled and Affiliated Entity	97
Subsidiary, Controlled, and Affiliated Entities	97
Working Capital Finance Investments	105R
Involuntary Pool	63
Isolation Beyond the Reach of the Transferor and Its Creditors	103R
Isolation of Transferred Financial Assets in Securitizations	103R
Issuers of Surplus Notes	41R
Joint and Several Liabilities	5R

Index to the Statements of Statutory Accounting Principles

	<u>SSAP Reference</u>
Joint and Survivorship Annuity	50
Joint Ventures, Partnerships and Limited Liability Companies	48
Leasehold Improvements:	
General	19
Health Care Delivery Assets	73
Paid by Reporting Entity as Lessee	19
Leases:	
Accounting and Reporting by Lessees	22R
Accounting and Reporting by Lessors	22R
Leveraged Leases for Lessors	22R
Related Party Leases	22R
Sale-Leaseback Transactions	22R
Leveraged ESOPs	12
Liabilities:	
General	5R
Uninsured Plans	43R
Life Annuity	50
Life Contracts:	
Classifications and Definitions.....	50
Defined	50
General	51R
Reserving	51R
Life, Deposit-Type and Accident and Health Reinsurance	61R
Limited Exceptions to the Audit Requirements for Downstream Noninsurance	
Holding Companies	97
Limited Liability Company	48
Limited Partnership	48
Limited-Payment Contract	50
Line-of-Credit or Revolving-Debt Arrangements	15
Loading – Life Contracts.....	51R
Loan Origination Fees – Mortgage Loan	37
Loan Origination, Acquisition, and Commitment Costs – Mortgage Loan	37
Loan Participations	103R
Loan Syndications	103R
Loan-Backed and Structured Securities	43R
Loans and Advances to Providers	84
Loans to State Guaranty Associations	21R
Loans on Personal Security	20
Loans Unsecured or Secured by Assets that Do Not Qualify as Investment	20
Long Lived Assets:	
Categories for Real Estate Investments.....	90
Long-Lived Assets to Be Abandoned	90
Long-Lived Assets to Be Disposed.....	90
Long-Lived Assets to Be Exchanged or to Be Distributed to Owners in a Spinoff	90
Long Term Care Contract	50
Loss Adjustment Expenses:	
Financial Guaranty	60
General	55
Life, Accident and Health	55
Managed Care	55

Index to the Statements of Statutory Accounting Principles

	<u>SSAP</u> <u>Reference</u>
Mortgage Guaranty	58
Property/Casualty	55
Title	57
Loss Contingencies or Impairments of Assets	5R
Loss Portfolio Transaction	62R
Loss Reserve Recognition – Title Insurance	57
Low-Income Housing Tax Credit Property Investments	93
Macro-Hedging	108
Maintenance Costs Incurred by Lessee	22R
Maintenance Costs Paid by Lessee	19
Managed Care Coverage	50
Mandatory Convertible Bond.....	26R
Mandatory Sinking Fund – Preferred Stock	32R
Materiality	Preamble
Mean Reserve Method	51R
Measurement and Reporting of Discontinued Operations	24
Measurement Date – OPEB Plans.....	92
Measurement of Cost and Obligations:	
Pensions	102
Postretirement Benefits Other Than Pensions	92
Measurement of Interests Held After a Transfer of Financial Assets	103R
Measurement of Plan Assets:	
Pensions	102
Postretirement Benefits Other Than Pensions	92
Medical Equipment and Fixtures	73
Medicare Part D	47; 54R; 66
Mergers	3; 68
Mezzanine Real Estate Loans	83
Mid-Terminal Method	51R
Miscellaneous Liability	50
Mod-Co Reserve Adjustment.....	61R
Modified Coinsurance Arrangements	61R
Monetary Asset	95
Mortality Risk – Reverse Mortgages	39
Mortgage Guaranty Insurance	50; 58
Mortgage Loans	37
Mortgage Pass-Through Certificate	58
Mortgage Revenue Bond	58
Multiemployer Plans:	
Pensions	102
Postretirement Benefits Other Than Pensions	92
Multiple Element Arrangements That Contain a Lease	22R
Multiple–Employer Plans:	
Pensions	102
Postretirement Benefits Other Than Pensions	92
Multiple Peril	50
Multiple Peril Crop Insurance	78
Multiple-Year Retrospectively Rated Contracts	62R
Naked Short Sale.....	103R
National Flood Insurance Program	62R
Negative Goodwill	68

Index to the Statements of Statutory Accounting Principles

	<u>SSAP Reference</u>
Net Amount at Risk.....	61R
Net Asset Value Per Share (NAV)	100R
Net Premium - Life Contracts	51R
Non-Bankable Checks	20
Non-Economic Assumption Reinsurance Transactions	61R
Non-Economic Transaction	25
Non-Proportional Reinsurance	61R
Non-Software Deliverables in Arrangements Containing More-Than-Incidental Software	16R
Non-Sufficient Funds Checks	20
Non-Transferable State Tax Credits	94R
Non-U.S. Pension Plans	102
Nonadmittance of Premium Receivables	6
Nonadmitted Assets	4; 20
Noncompensatory Employee Share Based Plans	104R
Nonleveraged ESOPs	12
Nonmonetary Transactions	95
Nonoperating Software	16R
Notional.....	86
Novation	61R; 62R
Objectives of Statutory Financial Reporting	Preamble
Obligatory Retrospective Rating Provision.....	62R
Ocean Marine	50
Off-Balance Sheet Risk.....	27
Offsetting and Netting of Assets and Liabilities	62R; 64; 103R
Operating Lease	22R
Operating Software	16R
Option	86
Origination Fees:	
Bonds	26R
Loan-Backed and Structured Securities	43R
Origination, Acquisition, and Commitment Costs:	
Bonds	26R
Loan-Backed and Structured Securities	43R
Other Admitted Assets	21R
Other Amounts Receivable Under Reinsurance Contracts	21R
Other Assessments	35R
Other Claims In Course Of Settlement	55
Other Contracts with Insurance Companies – Pensions.....	102
Other Considerations Received – Life Contracts	51R
Other Disclosures	1
Other Liabilities:	
General	67
Separate Accounts	56
Other-Than-Special Surplus Funds	72
Other-Than-Temporary Impairment (OTTI):	
Bonds.....	26R
Business Combinations and Goodwill	68
Investments in Subsidiary, Controlled and Affiliated Entities.....	97
Joint Ventures, Partnerships and Limited Liability Companies.....	48
Loan-Backed and Structured Securities	43R

Index to the Statements of Statutory Accounting Principles

	<u>SSAP Reference</u>
Low-Income Housing Tax Credit Property Investments.....	93
Mortgage Loans.....	37
Preferred Stock.....	32R
Reverse Mortgages.....	39
Surplus Notes.....	41R
Unaffiliated Common Stock.....	30R
Working Capital Finance Investments.....	105R
Owner and Beneficiary of Life Insurance Contract.....	21R
Overfunded Plan with Prepaid Benefit Cost.....	102
P&C Runoff Reinsurance Transactions.....	62R
Parent.....	97
Participant in Mortgage Loan.....	37
Participating Interests in an Entire Financial Asset.....	103R
Participating Interests in Financial Assets That Continue to be Held by a Transferor	103R
Participating Mortgage Loans.....	40R
Payable to Parent, Subsidiaries and Affiliates – Other Liabilities.....	67
Payment-In-Kind (PIK).....	32R
Pension Reversion ESOPs.....	12
Pensions.....	102
Permitted Accounting Practices.....	Preamble
Perpetual Fire Deposits.....	53
Perpetual Preferred Stock.....	32R
Pharmaceutical Rebate Receivables.....	84
Pharmaceuticals – Health Care Delivery Assets.....	73
Plan Curtailment:	
Pensions.....	102
Postretirement Benefits Other Than Pensions – OPEB.....	92
Policies with Coverage Periods Equal to or in Excess of Thirteen Months.....	65
Policy Acquisition Costs.....	71
Policy Commissions.....	71
Policy Loans.....	49
Policy Reserves:	
Credit Life and Accident and Health Insurance Contracts.....	59
Deposit-Type Contracts.....	52
Individual and Group Accident and Health Contracts.....	54R
Life Contracts.....	51R
Separate Accounts.....	56
Policyholder Dividend Liability – Life Contracts.....	51R
Policyholder Dividends.....	65
Pool – Life, Accident and Health Reinsurance.....	61R
Pool Insurance – Mortgage Guaranty Insurance.....	58
Portfolio Reinsurance – Property and Casualty Reinsurance.....	62R
Portfolio Layer Method.....	86
Positive Goodwill.....	68; 97
Postemployment Benefits and Compensated Absences.....	11
Postretirement Benefits Other Than Pensions – OPEB.....	92
Postretirement Benefit Plans Outside the United States.....	92
Preferred Stock.....	32R; 97
Prefunded Insurance-Linked Securities – Protected Cell.....	74
Premium Adjustments – Life Contracts.....	51R

Index to the Statements of Statutory Accounting Principles

	<u>SSAP Reference</u>
Premium Deficiency Reserve:	
Accident and Health Contracts	54R
Credit Insurance	59
Financial Guaranty	60
Mortgage Guaranty Insurance	58
Property Casualty Contracts	53, 65
Premium Deposits on Perpetual Fire Deposits.....	53
Premium Income Recognition:	
Individual and Group Accident and Health Contracts	54R
Life Contracts	51R
Multi-Peril Crop	78
Premium Receivable – Sale.....	42
Premium Revenue Recognition:	
Financial Guaranty Insurance	60
Mortgage Guaranty Insurance	58
Multiple Peril Crop Insurance	78
Title Insurance	57
Preoperating Costs	17
Prepaid Expenses	29
Prepayment Risk – LB&SS	43R
Prepayments – Mortgage Loans	37
Presumption of Control	25; 48; 97
Private Placement Life Insurance – Insurer Issuer	56
Private Placement Variable Annuities – Insurer Issuer.....	56
Professional Liability	50
Program Requirements – Working Capital Finance Investments	105R
Property and Casualty Contracts:	
Classification	50
Defined	50
General	65
Premiums	53
Property and Casualty Reinsurance	62R
Property and Casualty Run-Off Agreements.....	62R
Proportional Reinsurance	61R
Pro Rata – Property and Casualty Reinsurance	62R
Prospective Reinsurance Agreements	62R
Protected Cell	74
Provision for Reinsurance – Property and Casualty.....	62R
Purpose of Codification	Preamble
Put Option	86
Qualified Health Plan (QHP) – Risk-Sharing Provisions of ACA	107
Qualified Versus Unqualified Opinions	97
Quasi-Reorganizations	72
Quota Share Reinsurance	62R
Rabbi Trusts	104R
Real Estate Investments	40R
Real Estate Impairment	90
Real Estate Mezzanine Loans	83
Real Estate Projects Under Development	40R
Real Estate Sales	40R; 90
Realization of Tax Benefits and Tax-Planning Strategies	101

Index to the Statements of Statutory Accounting Principles

	<u>SSAP Reference</u>
Realization Threshold Limitation Table – RBC Reporting Entities	101
Realization Threshold Limitation Table – Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entities	101
Realization Threshold Limitation Table – Other Non-RBC Reporting Entities	101
Recaptures and Commutations	61R
Receivables for Securities	21R
Receivables Under Government Insured Plans	84
Recognition – Statutory Accounting Concept	Preamble
Recognition:	
and Measurement of an Impairment Loss	90
and Measurement of Servicing Assets and Liabilities	103R
Guidance – Subsequent Events	9
of Compensatory Share-Based Payment Transactions	104R
Of Derivatives	86
of Liabilities and Assets	92; 102
of Net Periodic Pension Benefit Cost	102
of Net Periodic Postretirement Benefit Cost	92
of Noncompensatory Share-Based Payment Transactions	104R
of Nonemployee Share-Based Payment Transactions	104R
of Servicing Rights	103R
Recording Transfers of Participating Interests	103R
Recording Transfers with Proceeds of Cash, Derivatives and Other Liabilities	103R
Recourse	103R
Recoverability Testing	90
Redeemable Preferred Stock	32R
Refund Annuity	50
Regular-Way Security Trade	103R
Reinsurance Agreements with Multiple Cedents – Property and Casualty	62R
Reinsurance Arrangements – Life Contracts	61R
Reinsurance Benefit Payments – Life Contracts	61R
Reinsurance Contract that is Accounted for as a Deposit Using the Interest Method.....	62R
Reinsurance Contracts Must Include Transfer of Risk – Property and Casualty	62R
Reinsurance Premiums – Life Contracts	61R
Reinsurance:	
Accounting and Reporting – Life	61R
Accounting – Property and Casualty	62R
Ceded to a Certified Reinsurer – Life	61R
Ceded to a Certified Reinsurer – Property/Casualty	62R
Deposit Accounting	61R; 62R
Deposit-Type Contracts	61R
Life, Deposit-Type and Accident and Health Reinsurance	61R
Property and Casualty Reinsurance	62R
Title Insurance	57
Related Party:	
Debt Forgiveness	72
Leases	22R; 25
Loans	25
Services	25
Transactions	25
Relationship of Settlements and Curtailments to Other Events – Pensions	102
Relationship to GAAP	Preamble

Index to the Statements of Statutory Accounting Principles

	<u>SSAP Reference</u>
Remittances and Items Not Allocated – Other Liabilities	67
Removal of Accounts Provisions	103R
Reported Losses	55
Reporting Assets for Premium Tax Offsets and Policy Surcharges	35R
Reporting Guidance for All Loan-Backed and Structured Securities	43R
Repurchase Agreements (and Wash Sales)	103R
Repurchase Financing	103R
Required Terms for Reinsurance Agreements – Property and Casualty	62R
Research and Development Costs	17
Incurred to Obtain or Develop Computer Software	16R; 17
Reserve Adequacy – Accident and Health	54R
Reserve Recognition:	
Individual and Group Accident and Health Contracts	54R
Life Contracts	51R
Reverse Repurchase Agreements	103R
Reserve Requirements – Health	54R
Reserves for Reinsurance Assumed – Life, Deposit-Type and Accident and Health	61R
Residential Mortgage Backed Securities (RMBS)	43R
Residual Interests and Reporting	48
Residual Tranches or Interests	43R
Resisted Claims in Course of Settlement	55
Restricted Cash / Cash Equivalent	1; 69
Restricted Preferred Stock	32R
Retained Asset	52
Retention – Life, Deposit-Type and Accident and Health	61R
Retroactive Reinsurance Agreements – Property and Casualty	62R
Retrocession	61R; 62R
Retrospectively Rated Contracts	66
Return of Capital Distribution	72
Revenue/Expense Recognition – Uninsured Plans	47
Reverse Mortgages	39
Reverse Repurchase Agreements	103R
Collateral Requirements	103R
Risk Adjustment Program – High-Cost Risk Pool	107
Risk Charge	56
Risk-Sharing Provisions of the Affordable Care Act (ACA):	
High-Cost Risk Pool	107
Risk Adjustment Program	107
Risk Corridors	107
Risk Score	107
Other Insured Health Products	107
Self-Insured Health Products	107
Subject Individual Insured Health Products	107
Transitional Reinsurance Program	107
Risk-Sharing Receivables – Health Care and Government Insured Receivables	84
Risks and Uncertainties	1
Run-Off Agreements – Property/Casualty Reinsurance	62R
Sabbatical Leave and Other Similar Benefits	11
Sale of Premium Receivables	42
Sale of Real Estate	40R
Sale of Receivables with Servicing Obtained	103R

Index to the Statements of Statutory Accounting Principles

	<u>SSAP Reference</u>
Sale-Leaseback Transactions	22R
Continuing Involvement	22R
Sales of Future Revenues	103R
Salvage:	
Furniture and Equipment	19
Salvage and Subrogation:	
Contracts with Coverage in Excess of Thirteen Months	65
Losses and Unpaid Loss Adjusting Expenses	55
Title Insurance	57
SCAs (Subsidiaries, Controlled and Affiliated Entities)	97
SCA Reporting Process	97
Secured Borrowings	103R
Secured Borrowings and Collateral	103R
Securities Borrowing Transactions	103R
Securities Lending Transaction Treated as a Secured Borrowing.....	103R
Securities Lending Transactions	103R
Collateral Requirements	103R
Securitizations	103R
Security –Defined.....	26R, 37
Security 5GI Disclosure	1
Security Interest	103R
Seed Money	56
Self-Insurance	67
Seller	103R
Separate Accounts:	
AVR and IMR Reporting	56
General Account Reporting	56
Policy Loans.....	49; 56
Policy Reserves	56
Separate Account Reporting	56
Separate Transactions	103R
Serviceman’s Group Life Insurance	21R
Servicing Assets and Liabilities	103R
Settlement:	
Pension Obligation	102
Postretirement Benefit Obligation – OPEB	92
Settlement of the Equity-Settled Portion of a Convertible Debt Instrument That Permits or Requires the Conversion Spread to Be Settled in Stock	15
Share-Based Compensation Awards	104R
Share-Based Payments	104R
Shares of SEC Registered Investment Companies.....	30R
Short-Cut Method – Derivatives	86
Short-Term Investments	2R
Short Sales.....	103R
Sick-Pay Benefits	11
Single-Employer Defined Benefit Pension Plans	102
Single-Employer Defined Benefit Postretirement Plans	92
Sinking Fund Preferred Stock	32R
Sliding Scale Discounting of SCA Entities Using the Market Valuation Approach.....	97

Index to the Statements of Statutory Accounting Principles

	<u>SSAP Reference</u>
Software:	
Developed or Obtained for Internal Use	16R
Revenue Recognition	16R
Special Surplus Funds	72
Special Accounting Provisions for Limited Derivatives	108
Specific Interim Reporting Guidance Financially Modeled Securities	43R
Stable Currency	23
Standard Representations and Warranties	103R
Start-Up Costs	76
State Guaranty Association Loan Agreements	21R
Statement of Cash Flow	69
Statement of Concepts	Preamble
States Who Prescribe or Permit Discounting on a Non-Tabular Basis	62R
Statutory Accounting Principles, Defined	Preamble
Statutory Hierarchy	Preamble
Statutory Mergers	3; 68
Statutory Policy Reserve – Life Contracts	51R
Statutory Purchases of SCA Investments	68
Statutory Surplus	72
Stock as Collateral for a Loan	20
Stock Splits, Stock Dividends, Payment in Kind Dividends, and Stock Exchanges	30R
Stop Loss Reinsurance	61R
Stress Liquidity Risks	1
Structured Securities Acquired for a Specified Investment Strategy	43R
Structured Securities	43R
Structured Settlements – Investments	21R
Structured Settlements – Reporting Entity Payee:	
Deposit-Type Contracts	52
Property and Casualty Contracts	65
Subprime Mortgage Related Risk Exposure	1
Subsequent Events	9
Subsequent Measurement – Share-Based Payments	104R
Awards Classified as Equity	104R
Awards Classified as Liabilities	104R
Subsidiary	97
Subsidiary, Controlled and Affiliated Entities (SCAs)	97
Supplemental Benefits:	
Individual and Group Accident and Health Contracts	54R
Life Contracts	51R
Supplemental Investment Disclosure	1
Supplementary Contract	50; 51R
Supplies – Health Care Delivery Assets.....	73
Surety Bond	50
Surgical Supplies	73
Surplus	72
Surplus Line	50
Surplus Notes:	
Double-Counting.....	41R; 97
General	41R
Included in Surplus	72
Surplus Share Reinsurance	62R

Index to the Statements of Statutory Accounting Principles

	<u>SSAP Reference</u>
SVO-Identified Investments.....	26R
Swaps	86
Syndicated Letters of Credit:	
Life, Deposit-Type and Accident and Health Reinsurance	61R
Property/Casualty Reinsurance	62R
Systematic Value.....	26R
Tax Contingencies	5R
Tax Credits:	
Guaranty Funds	35R
Income Tax	101
Low-Income Housing	93
Non-Transferable State Tax Credits	94R
Transferable State Tax Credits	94R
Tax Effects of Share-Based Compensation Awards	104R
Temporary Differences – Income Taxes	101
Term Life Contract	50
Terminal Reserve – Life Contracts	51R
Termination Benefits – Pensions.....	102
Terms/Concepts.....	108
Title Insurance	57
Title Plant	57
Total Maximum Guarantee – Separate Accounts.....	56
Trade Names and Other Intangible Assets	20
Transactions Involving Services – Related Parties	25
Transactions Involving the Exchange of Assets or Liabilities – Related Parties	25
Transactions with Affiliates and Other Related Parties	25
Transfer	103R
Transfer of Property and Casualty Run-Off Agreements.....	62R
Transfer of Risk – Life, Deposit-Type and A&H Reinsurance.....	61R
Transferable State Tax Credits	94R
Transferee.....	103R
Transferred Assets	103R
Ability to Unilaterally Cause the Return of	103R
Regaining Control of	103R
Transferor:	
Changes That Result in the Transferor’s Regaining Control of Financial Assets Sold	103R
Participating Interests That Continue to be Held by a Transferor	103R
Transferor’s Rights or Obligations to Reacquire Transferred Assets or Beneficial Interests	103R
Transfers and Servicing of Financial Assets and Extinguishments of Liabilities	103R
Transfers of an Entire Financial Asset or Group of Entire Financial Assets	103R
Transfers of Participating Interests	103R
Transfers of Receivables with Recourse	103R
Travel Advances	20
Treasury Stock	72
Treatment of Goodwill When Previously Purchased or Merged Entity Ceases to Exist	68
Treatment of Negative Cash Balances	2R
Treaty Reinsurance	62R

Index to the Statements of Statutory Accounting Principles

	<u>SSAP Reference</u>
Troubled Debt Restructuring:	
Accounting & Disclosure by Creditors	36
Accounting & Disclosure by Debtors	36
Determining Whether a Creditor Has Granted a Concession	36
Determining Whether a Debtor is Experiencing Financial Difficulties	36
Evaluating Whether Delay in Payment is Insignificant	36
General	36
Trust Preferred Securities.....	26R
Trustee Sales Guarantees (TSGs)	6
Types of Premiums – Life	51R
Types of Reinsurance Arrangements – Life, Deposit-Type and Accident and Health	61R
U.S. Mortgage Guaranty Tax and Loss Bonds	58
Unaffiliated Common Stock.....	30R
Unallocated Loss Adjustment Expense (ULAE) – Title Insurance.....	57
Unamortized Goodwill	68
Unassigned Funds (Surplus)	72
Unauthorized Reinsurance:	
Life, Deposit-Type and Accident and Health Reinsurance	61R
Property/Casualty Reinsurance	62R
Uncollected Premium Balances:	
General	6
Life Contracts	51R
Uncollectible Reinsurance:	
Life, Deposit-Type and Accident and Health Reinsurance	61R
Property/Casualty Reinsurance	62R
Underfunded Plan – Pensions:	
With Accrued Benefit Cost	102
With Accrued Benefit Cost with Surplus Deferral Elected.....	102
With Prepaid Benefit Cost – No Surplus Deferral Elected	102
With Prepaid Benefit Cost – Surplus Deferral, Funded ABO.....	102
With Prepaid Benefit Cost – Surplus Deferral, Unfunded ABO.....	102
Underwriting Pools and Associations	63
Unearned Income:	
Deposit-Type Contracts	52
Life Contracts	51R
Unilateral Ability to Cause the Return of Specific Transferred Financial Assets	103R
Uninsured Plans	47
Unit of Account	103R
Universal Life Contract	50
Unpaid Claims	55
Unpaid Losses	55
Unpaid Losses and Loss Adjustment Expense Recognition:	
Financial Guaranty Insurance	60
General	55
Life, Accident and Health	55
Managed Care, Managed Care and Accident and Health	55
Mortgage Guaranty Insurance	58
Multiple Peril Crop Insurance	78
Property	55
Unsecured Loans or Secured by Assets that Do Not Qualify as Investment	20
Unusual or Infrequently Occurring Items	24

Index to the Statements of Statutory Accounting Principles

	<u>SSAP Reference</u>
Valuation and Reporting:	
Bonds	26R
Common Stock	30R
Loan-Backed and Structured Securities	43R
Preferred Stock	32R
Reverse Mortgages	39
Working Capital Finance Investments	105R
Valuation (Reserve) Method and Deferred Premiums	51R
Valuation and Impairment – Reverse Mortgages	39
Valuation of Investments in Downstream Holding Companies	97
Valuation Techniques (Fair Value)	100R
Variable Annuity	50
Variable Life Contract	50; 56
Variation Margin – Derivatives	86
Vehicles	20
Voluntary Pool	63
Waiver of Monthly Deductions for Flexible Premium Universal Life Insurance Policies	51R
Warrants:	
Privately Traded	86
Publicly Traded	30R
Wash Transactions	6; 103R
Web Site Development Costs	16R
Whole Life Contract	50
Workers' Compensation	50; 53
Working Capital Finance Investment	105R
Working Capital Finance Program	105R
Written Covered Put Options	86
Written Fixed Income Caps and Floors	86
Written Fixed Income Covered Call Options	86
Written Premium:	
Health (Premium Income)	54
Life (Premium Income)	51
Property and Casualty	53
Yankee Bonds	26R
Yearly Renewable Term (YRT)	50; 61R
Zero Coupon Bond	26R

GLOSSARY to the Statements of Statutory Accounting Principles

The terms in this Glossary are common in most SSAPs. Some SSAPs may have terminology that is topic-specific and not intended to be applied to other topics.

Adjusted Carrying Value – Carrying value amount adjusted to remove any accrued interest and to add back any of the following amounts: individual nonadmitted amounts, individual valuation allowances (if applicable), and aggregate valuation allowance (if applicable). In effect, this is equivalent to the SAP Book Value. (Not to be confused with the old “book value” reported in the annual statement blanks for data years 2000 and prior.)

Amortized Cost – See SAP Book Value.

Call Provision – Option to buy an asset at a specified price within a specified period. (Also applicable to Call and Call Option.)

Capitation Arrangement – A compensation plan used in connection with some managed care contracts in which a physician or other medical provider is paid a flat amount, usually on a monthly basis, for each subscriber who has elected to use that physician or medical provider.

Credit Rating Provider – CRP stands for Credit Rating Provider and refers to the nationally recognized statistical rating organizations (NRSROs) on the NAIC Credit Rating Provider List discussed in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*.

Deferred Tax Asset – The deferred tax consequences attributable to deductible temporary differences and carryforwards. A deferred tax asset is measured using the applicable enacted tax rate and provisions of the enacted tax law. Deferred tax assets are subject to the admissibility criteria as outlined in *SSAP No. 101—Income Taxes*, paragraph 11.

Deferred Tax Liability – The deferred tax consequences attributable to taxable temporary differences. A deferred tax liability is measured using the applicable enacted tax rate and provisions of the enacted tax law.

Equity Method – Accounting valuation approach used in which the initial investment is adjusted in accordance with the ownership of another entity. Guidance for using the equity method, and for determining adjustments to the investment under the equity method is detailed in *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).

Fair Value – Fair value is defined in *SSAP No. 100R—Fair Value*.

Guaranteed Investment Contract or Guaranteed Interest Contract (GIC) – An insurer-issued funding vehicle, typically issued to retirement plans, under which the insurer accepts a deposit (or, less frequently, a series of deposits) from the purchaser and guarantees to pay a specified interest rate of return on the funds deposited during a specified period of time.

Morbidity Risk – The potential for a person to experience illness, injury, or other physical or psychological impairment, whether temporary or permanent. Morbidity risk excludes the potential for an individual’s death, but includes the potential for an illness or injury that results in death.

Mortality Risk – The potential for loss of life, with respect to a specified person or group of people. For reverse mortgages (SSAP No. 39), mortality risk is defined as the risk of loan payments extending beyond the borrower’s original projected life expectancy.

Nonforfeiture – The principle that some types of insurance contract have an economic value to which the contract owner is entitled even upon lapsation or surrender of the contract. A *nonforfeiture value* is the economic value that must be provided to the contract owner upon lapsation or surrender; it can take various forms, such as a lump-sum cash payment, an amount of paid-up insurance, an amount of term insurance, etc.

Nonoperating System Software – Application systems software such as language processors, library routines and debugging aides and other computer software are not considered operating system software.

Operating System Software – The operating system is a program or a series of programs controlling the data job and task management operations of a computer or a computer network through executive scheduling and monitoring. It increases the productivity of a computer installation by managing the allocation of all available computer resources including the control processing unit, main storage and input/output devices.

Original Cost – See SAP Book Value.

Par Value – The nominal (or face value) of a stock or bond.

Recorded Investment – The SAP Book Value (Adjusted Carrying Value) plus Accrued Interest.

SAP Book Value – Original cost, including capitalized acquisition costs and accumulated depreciation, unamortized premium and discount, deferred origination and commitment fees, direct write-downs, and increase/decrease by adjustment.

SAP Carrying Value (Amount) – The SAP book value plus accrued interest and reduced by any valuation allowance (if applicable) and any nonadmitted adjustment applied to the individual investment. Carrying value is used in the determination of impairment.

Statement Value – The SAP book value reduced by any valuation allowance and nonadmitted adjustment applied to an individual investment or a similar group of investments, e.g., bonds, mortgage loans, common stock.

Appendix A

Excerpts of NAIC Model Laws

Introduction

The following appendices are an integral part of the NAIC *Accounting Practices and Procedures Manual*. The guidance herein is referred to by specific statements of statutory accounting principles (SSAPs).

Some appendices define certain terms. Such definitions are not intended to change the meaning of any terms used elsewhere in the NAIC *Accounting Practices and Procedures Manual* and should only be used in the context of the appendix in which it appears and the SSAP that refers to that appendix.

Certain appendices contain requirements regarding reserves, which are effective with new business written after the effective date of the related SSAP. Transition guidance is provided in the related SSAPs.

Table of Contents

No.	Title	Page
A-001	Investments of Reporting Entities	A001-1
A-010	Minimum Reserve Standards for Individual and Group Health Insurance Contracts.....	A010-1
A-200	Separate Accounts Funding Guaranteed Minimum Benefits Under Group Contracts	A200-1
A-205	Illustrative Disclosure of Differences Between NAIC Statutory Accounting Practices and Procedures and Accounting Practices Prescribed or Permitted by the State of Domicile	A205-1
A-225	Managing General Agents	A225-1
A-235	Interest-Indexed Annuity Contracts	A235-1
A-250	Variable Annuities	A250-1
A-255	Modified Guaranteed Annuities	A255-1
A-270	Variable Life Insurance	A270-1
A-440	Insurance Holding Companies	A440-1
A-585	Universal Life Insurance	A585-1
A-588	Modified Guaranteed Life Insurance	A588-1
A-620	Accelerated Benefits	A620-1
A-628	Title Insurance	A628-1
A-630	Mortgage Guaranty Insurance	A630-1
A-641	Long-Term Care Insurance	A641-1
A-695	Synthetic Guaranteed Investment Contracts	A695-1
A-785	Credit for Reinsurance	A785-1
A-791	Life and Health Reinsurance Agreements	A791-1
A-812	Smoker/Nonsmoker Mortality Tables for Use in Determining Minimum Reserve Liabilities	A812-1
A-815	Recognition of Preferred Mortality Tables for Use in Determining Minimum Reserve Liabilities	A815-1
A-817	Preneed Life Insurance Minimum Standards for Determining Reserve Liabilities and Nonforfeiture Values	A817-1
A-818	Determining Reserve Liabilities for Credit Life Insurance Model Regulation	A818-1
A-820	Minimum Life and Annuity Reserve Standards	A820-1
A-821	Annuity Mortality Table for Use in Determining Reserve Liabilities for Annuities	A821-1
A-822	Asset Adequacy Analysis Requirements	A822-1
A-830	Valuation of Life Insurance Policies (Including the Introduction and Use of New Select Mortality Factors)	A830-1

Appendix A-001

Investments of Reporting Entities

Relevant SSAPs:

SSAP No. 1—Accounting Policies, Risks & Uncertainties and Other Disclosures

SSAP No. 21R—Other Admitted Assets

SSAP No. 83—Mezzanine Real Estate Loans

Introduction

- Section 1. Reporting Requirements
- Section 2. Investment Risk Interrogatories
- Section 3. Summary Investment Schedule

Introduction

A reporting entity may acquire, hold or invest in investments or engage in investment practices as set forth in the laws and regulations of its domiciliary state. The disclosure required by this appendix is not intended to preempt such state authority. The financial information disclosed herein is intended solely for the use of state regulators for solvency analysis and should not be used for any other purpose.

Section 1. Reporting Requirements

The following reporting requirements apply to the provisions of this appendix:

- 1. Annual Statement – Section 3
- 2. Supplement to Annual Statement filed by April 1 – Section 2
- 3. Audited Statutory Financial Statements – Sections 2 and 3

Section 2. Investment Risks Interrogatories

Of The..... Insurance Company
 Address (City, State, Zip Code)
 NAIC Group Code..... NAIC Company Code..... Employer's ID Number.....

The Investment Risks Interrogatories are to be filed by April 1. They are also to be included with the Audited Statutory Financial Statements.

Answer the following interrogatories by reporting the applicable U.S. dollar amounts and percentages of the reporting entity's total admitted assets held in that category of investments.

1. Reporting entity's total admitted assets as reported on Page 2 of this annual statement:
 \$ _____

2. Ten largest exposures to a single issuer/borrower/investment:

	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>
	<u>Issuer</u>	<u>Description of Exposure</u>	<u>Amount</u>	<u>Percentage of Total Admitted Assets</u>
2.01		a.	\$.....	%
2.02		b.	\$.....	%
2.03		c.	\$.....	%
2.04		d.	\$.....	%
2.05		e.	\$.....	%
2.06		f.	\$.....	%
2.07		g.	\$.....	%
2.08		h.	\$.....	%
2.09		i.	\$.....	%
2.10		j.	\$.....	%

3. Amounts and percentages of the reporting entity's total admitted assets held in bonds and preferred stocks by NAIC designation:

Bonds		<u>1</u>	<u>2</u>	Preferred Stocks		<u>3</u>	<u>4</u>
3.01	NAIC – 1	\$.....	%	3.07	NAIC – 1	\$.....	%
3.02	NAIC – 2	\$.....	%	3.08	NAIC – 2	\$.....	%
3.03	NAIC – 3	\$.....	%	3.09	NAIC – 3	\$.....	%
3.04	NAIC – 4	\$.....	%	3.10	NAIC – 4	\$.....	%
3.05	NAIC – 5	\$.....	%	3.11	NAIC – 5	\$.....	%
3.06	NAIC – 6	\$.....	%	3.12	NAIC – 6	\$.....	%

4. Assets held in foreign investments:

4.01 Are assets held in foreign investments less than 2.5% of the reporting entity's total admitted assets? Yes [] No []

If response, to 4.01 above is yes, responses are not required for interrogatories 5 – 10.

4.02 Total admitted assets held in foreign investments \$..... %
 4.03 Foreign-currency-denominated investments \$..... %
 4.04 Insurance liabilities denominated in that same foreign currency \$..... %

5. Aggregate foreign investment exposure categorized by NAIC sovereign designation:

	<u>1</u>	<u>2</u>
5.01 Countries designated NAIC – 1	\$	 %
5.02 Countries designated NAIC – 2	\$	 %
5.03 Countries designated NAIC – 3 or below	\$	 %

6. Two largest foreign investment exposures to a single country, categorized by the country's NAIC sovereign designation:

	<u>1</u>	<u>2</u>
Countries designated NAIC – 1:		
6.01 Country:	\$	 %
6.02 Country:	\$	 %
Countries designated NAIC – 2:		
6.03 Country:	\$	 %
6.04 Country:	\$	 %
Countries designated NAIC – 3 or below:		
6.05 Country:	\$	 %
6.06 Country:	\$	 %

7. Aggregate unhedged foreign currency exposure: \$..... %

8. Aggregate unhedged foreign currency exposure categorized by NAIC sovereign designation:

	<u>1</u>	<u>2</u>
8.01 Countries designated NAIC – 1	\$	 %
8.02 Countries designated NAIC – 2	\$	 %
8.03 Countries designated NAIC – 3 or below	\$	 %

9. Two largest unhedged foreign currency exposures to a single country, categorized by the country's NAIC sovereign designation:

	<u>1</u>	<u>2</u>
Countries designated NAIC – 1:		
9.01 Country:	\$	 %
9.02 Country:	\$	 %
Countries designated NAIC – 2:		
9.03 Country:	\$	 %
9.04 Country:	\$	 %
Countries designated NAIC – 3 or below:		
9.05 Country:	\$	 %
9.06 Country:	\$	 %

10. Ten largest non-sovereign (i.e., non-governmental) foreign issues:

	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>
	<u>Issuer</u>	<u>NAIC Designation</u>		
10.01			\$	 %
10.02			\$	 %
10.03			\$	 %
10.04			\$	 %
10.05			\$	 %
10.06			\$	 %
10.07			\$	 %
10.08			\$	 %
10.09			\$	 %
10.10			\$	 %

11. Amounts and percentages of the reporting entity's total admitted assets held in Canadian investments and unhedged Canadian currency exposure:

11.01 Are assets held in Canadian investments less than 2.5% of the reporting entity's total admitted assets? Yes [] No []

If response to 11.01 is yes, detail is not required for the remainder of Interrogatory 11.

	<u>1</u>	<u>2</u>
11.02 Total admitted assets held in Canadian Investments	\$.....	%
11.03 Canadian-currency-denominated investments	\$.....	%
11.04 Canadian-denominated insurance liabilities	\$.....	%
11.05 Unhedged Canadian currency exposure	\$.....	%

12. Report aggregate amounts and percentages of the reporting entity's total admitted assets held in investments with contractual sales restrictions:

12.01 Are assets held in investments with contractual sales restrictions less than 2.5% of the Reporting entity's total admitted assets. Yes [] No []

If response to 12.01 is yes, responses are not required for the remainder of Interrogatory 12.

	<u>1</u>	<u>2</u>	<u>3</u>
12.02 Aggregate statement value of investments with contractual sales restrictions:	\$		%
Largest 3 investments with contractual sales restrictions:			
12.03	\$		%
12.04	\$		%
12.05	\$		%

13. Amounts and percentages of admitted assets held in the ten largest equity interests:

13.01 Are assets held in equity interest less than 2.5% of the reporting entity's total admitted assets? Yes [] No []

If response to 13.01 is yes, responses are not required for the remainder of Interrogatory 13.

	<u>1</u>	<u>2</u>	<u>3</u>
	<u>Issuer</u>		
13.02	\$		%
13.03	\$		%
13.04	\$		%
13.05	\$		%
13.06	\$		%
13.07	\$		%
13.08	\$		%
13.09	\$		%
13.10	\$		%
13.11	\$		%

14. Amounts and percentages of the reporting entity's total admitted assets held in nonaffiliated, privately placed equities:

14.01 Are assets held in nonaffiliated, privately placed equities less than 2.5% of the reporting entity's total admitted assets? Yes [] No []

If response to 14.01 above is yes, responses are not required for the remainder of Interrogatory 14.

	<u>1</u>	<u>2</u>	<u>3</u>
14.02 Aggregate statement value of investments held in nonaffiliated, privately placed equities:		\$	 %

Largest 3 investments held in nonaffiliated, privately placed equities:

14.03	\$	 %
14.04	\$	 %
14.05	\$	 %

15. Amounts and percentages of the reporting entity's total admitted assets held in general partnership interests:

15.01 Are assets held in general partnership interests less than 2.5% of the reporting entity's total admitted assets? Yes [] No []

If response to 15.01 above is yes, responses are not required for the remainder of Interrogatory 15.

	<u>1</u>	<u>2</u>	<u>3</u>
15.02 Aggregate statement value of investments held in general partnership interests:		\$	 %

Largest 3 investments in general partnership interests:

15.03	\$	 %
15.04	\$	 %
15.05	\$	 %

16. Amounts and percentages of the reporting entity's total admitted assets held in mortgage loans:

16.01 Are mortgage loans reported in Schedule B less than 2.5% of the reporting entity's total admitted assets? Yes [] No []

If response to 16.01 above is yes, responses are not required for the remainder of Interrogatory 16 and Interrogatory 17.

	<u>1</u>	<u>2</u>	<u>3</u>
(Type (Residential, Commercial, Agricultural))			
16.02	\$	 %	
16.03	\$	 %	
16.04	\$	 %	
16.05	\$	 %	
16.06	\$	 %	
16.07	\$	 %	
16.08	\$	 %	
16.09	\$	 %	
16.10	\$	 %	
16.11	\$	 %	

Amount and percentage of the reporting entity's total admitted assets held in the following categories of mortgage loans:

			<u>Loans</u>	
16.12	Construction loans	\$		%
16.13	Mortgage loans over 90 days past due	\$		%
16.14	Mortgage loans in the process of foreclosure	\$		%
16.15	Mortgage loans foreclosed	\$		%
16.16	Restructured mortgage loans	\$		%

17. Aggregate mortgage loans having the following loan-to-value ratios as determined from the most current appraisal as of the annual statement date:

	<u>Loan-to-Value</u>	<u>Residential</u>		<u>Commercial</u>		<u>Agricultural</u>	
		<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>
17.01	above 95%	\$	%	\$	%	\$	%
17.02	91% to 95%	\$	%	\$	%	\$	%
17.03	81% to 90%	\$	%	\$	%	\$	%
17.04	71% to 80%	\$	%	\$	%	\$	%
17.05	below 70%	\$	%	\$	%	\$	%

18. Amounts and percentages of the reporting entity's total admitted assets held in each of the five largest investments in real estate:

18.01 Are assets held in real estate reported in less than 2.5% of the reporting entity's total admitted assets? Yes [] No []

If response to 18.01 above is yes, responses are not required for the remainder of Interrogatory 18.

Largest five investments in any one parcel or group of contiguous parcels of real estate:

	<u>Description</u>	<u>1</u>	<u>2</u>	<u>3</u>
18.02		\$		%
18.03		\$		%
18.04		\$		%
18.05		\$		%
18.06		\$		%

19. Report aggregate amounts and percentages of the reporting entity's total admitted assets held in investments held in mezzanine real estate loans:

19.01 Are assets held in investments held in mezzanine real estate loans less than 2.5% of the Reporting entity's total admitted assets. Yes [] No []

If response to 19.01 is yes, responses are not required for the remainder of Interrogatory 19.

19.02 Aggregate statement value of investments held in mezzanine real estate loans: 1 2 3
\$%

Largest 3 investments held in mezzanine real estate loans:

19.03 \$%

19.04 \$%

19.05 \$%

20. Amounts and percentages of the reporting entity's total admitted assets subject to the following types of agreements:

	<u>At Year-end</u>		<u>At End of Each Quarter</u>		
	<u>1</u>	<u>2</u>	<u>1st Qtr</u> <u>3</u>	<u>2nd Qtr</u> <u>4</u>	<u>3rd Qtr</u> <u>5</u>
20.01 Securities lending agreements (do not include assets held as collateral for such transactions)	\$	 %	\$	\$	\$
20.02 Repurchase agreements	\$	 %	\$	\$	\$
20.03 Reverse repurchase agreements	\$	 %	\$	\$	\$
20.04 Dollar repurchase agreements	\$	 %	\$	\$	\$
20.05 Dollar reverse repurchase agreements	\$	 %	\$	\$	\$

21. Amounts and percentages of the reporting entity's total admitted assets for warrants not attached to other financial instruments, options, caps, and floors:

	<u>Owned</u>		<u>Written</u>	
	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>
21.01 Hedging	\$	 %	\$	 %
21.02 Income generation	\$	 %	\$	 %
21.03 Other	\$	 %	\$	 %

22. Amounts and percentages of the reporting entity's total admitted assets of potential exposure for collars, swaps, and forwards:

	<u>At Year-end</u>		<u>At End of Each Quarter</u>		
	<u>1</u>	<u>2</u>	<u>1st Qtr</u> <u>3</u>	<u>2nd Qtr</u> <u>4</u>	<u>3rd Qtr</u> <u>5</u>
22.01 Hedging	\$	 %	\$	\$	\$
22.02 Income generation	\$	 %	\$	\$	\$
22.03 Replications	\$	 %	\$	\$	\$
22.04 Other	\$	 %	\$	\$	\$

23. Amounts and percentages of the reporting entity's total admitted assets of potential exposure for futures contracts:

	<u>At Year-end</u>		<u>At End of Each Quarter</u>		
	<u>1</u>	<u>2</u>	<u>1st Qtr</u> <u>3</u>	<u>2nd Qtr</u> <u>4</u>	<u>3rd Qtr</u> <u>5</u>
23.01 Hedging	\$	 %	\$	\$	\$
23.02 Income generation	\$	 %	\$	\$	\$
23.03 Replications	\$	 %	\$	\$	\$
23.04 Other	\$	 %	\$	\$	\$

Section 3. Summary Investment Schedule (Revised for reporting periods effective January 1, 2019)

Investment Categories	Gross Investment Holdings		Admitted Assets as Reported in the Annual Statement			
	1	2	3	4	5	6
	Amount	Percentage	Amount	Securities Lending Reinvested Collateral Amount	Total (Col. 3+4) Amount	Percentage
1. Bonds (Schedule D, Part 1)						
1.1 U.S. Governments						
1.2 All Other Government						
1.3 U.S. States, Territories and Possessions, etc., Guaranteed						
1.4 U.S. Political Subdivisions of States, Territories and Possessions, Guaranteed						
1.5 U.S. Special Revenue & Special Assessment Obligations, etc., Non-Guaranteed						
1.6 Industrial and Miscellaneous						
1.7 Hybrid Securities						
1.8 Parent, Subsidiaries and Affiliates						
1.9 SVO Identified Funds						
1.10 Bank Loans						
1.11 Total Long-Term Bonds						
2. Preferred Stock (Schedule D, part 2, Section 1)						
2.1 Industrial and Miscellaneous (Unaffiliated)						
2.2 Parent Subsidiaries and Affiliates						
3. Common Stocks (Schedule D, Part 2, Section 2)						
3.1 Industrial and Miscellaneous (Unaffiliated) Publicly Traded						
3.2 Industrial and Miscellaneous (Unaffiliated) Other						
3.3 Parent, Subsidiaries and Affiliates Publicly Traded						
3.4 Parent, Subsidiaries and Affiliates Other						
3.5 Mutual Funds						
3.6 Total Common Stocks						
4. Mortgage Loans (Schedule B)						
4.1 Farm Mortgages						
4.2 Residential Mortgages						
4.3 Commercial Loans						
4.4 Mezzanine Real Estate Loans						
4.5 Total Valuation Allowance						
4.6 Total Mortgages						
5. Real Estate Investments (Schedule A)						
5.1 Property occupied by company						
5.2 Property held for production of income						
5.3 Property held for sale						

Investment Categories	Gross Investment Holdings		Admitted Assets as Reported in the Annual Statement			
	1	2	3	4	5	6
	Amount	Percentage	Amount	Securities Lending Reinvested Collateral Amount	Total (Col. 3+4) Amount	Percentage
6. Cash, Cash Equivalents and Short-Term Investments						
6.1 Cash (Schedule E, Part 1)						
6.2 Cash Equivalents (Schedule E, Part 2)						
6.3 Short-Term Investments (Schedule DA)						
6.4 Total Cash, Cash Equivalents and Short-Term Investments						
7. Contract Loans						
8. Derivatives (Schedule DB)						
9. Other Invested Assets (Schedule BA)						
10. Receivables for Securities						
11. Securities Lending (Schedule DL, Part1)						
12. Aggregate Write-Ins for Invested Assets						
13. Total Invested Assets						

Appendix A-010

Minimum Reserve Standards for Individual and Group Health Insurance Contracts

Relevant SSAPs:

SSAP No. 35R—Guaranty Fund and Other Assessments

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

SSAP No. 59—Credit Life and Accident and Health Insurance Contracts

Relevant NAIC Model Laws/Regulations:

Standard Valuation Law (#820)

Definitions

1. “Annual claim cost” is the net annual cost per unit of benefit before the addition of expenses, including claim settlement expenses, and a margin for profit or contingencies. For example, the annual claim cost for a \$100 monthly disability benefit, for a maximum disability benefit period of one year, with an elimination period of one week, with respect to a male at age 35, in a certain occupation might be \$12, while the gross premium for this benefit might be \$18. The additional \$6 would cover expenses and profit or contingencies.
2. “Claims accrued” is that portion of claims incurred on or prior to the valuation date that result in liability of the insurer for the payment of benefits for medical services that have been rendered on or prior to the valuation date, and for the payment of benefits for days of hospitalization and days of disability that have occurred on or prior to the valuation date, that the insurer has not paid as of the valuation date, but for which it is liable and will have to pay after the valuation date. This liability is sometimes referred to as a liability for “accrued” benefits. A claim reserve, which represents an estimate of this accrued claim liability, must be established. *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses defines this as a Claim Liability and not a Claim Reserve.*
3. “Claims reported” are considered as a reported claim for annual statement purposes when an insurer has been informed that a claim has been incurred, if the date reported is on or prior to the valuation date.
4. “Claims unaccrued” represent that portion of claims incurred on or prior to the valuation date which result in liability of the insurer for the payment of benefits for medical services expected to be rendered after the valuation date, and for benefits expected to be payable for days of hospitalization and days of disability occurring after the valuation date. This liability is sometimes referred to as a liability for unaccrued benefits. A claim reserve, which represents an estimate of the unaccrued claim payments expected to be made (which may or may not be discounted with interest), must be established. *SSAP No. 54R—Individual and Group Accident and Health Contracts defines this as a Claim Reserve differentiated from the Claim Liability in paragraph 2 above.*
5. When an insurer has not been informed, on or before the valuation date, concerning a claim that has been incurred on or prior to the valuation date, the claim is considered an “unreported claim” for annual statement purposes.
6. “Date of disablement” is the earliest date the insured is considered as being disabled under the definition of disability in the contract, based on a doctor’s evaluation or other evidence. Normally this date will coincide with the start of any elimination period.
7. “Elimination period” is a specified number of days, weeks, or months starting at the beginning of each period of loss, during which no benefits are payable.

8. “Gross premium” is the amount of premium charged by the insurer. It includes the net premium (based on claim-cost) for the risk, together with any loading for expenses, profit or contingencies.
9. The term “group long-term disability income” includes group contracts providing group disability income coverage with a maximum benefit duration longer than two years. Group long-term disability income contracts are based on a group pricing structure. The term “group long-term disability” does not include group short-term disability (coverage with benefit periods of two years or less in maximum duration). It also does not include voluntary group disability income coverage that is priced on an individual risk structure and generally sold in the workplace.
10. The term “group insurance” includes blanket insurance and franchise insurance and any other forms of group insurance.
11. “Level premium” is a premium calculated to remain unchanged throughout either the lifetime of the policy or for some shorter projected period of years. The premium need not be guaranteed; in which case, although it is calculated to remain level, it may be changed if any of the assumptions on which it was based are revised at a later time. Generally, the annual claim costs are expected to increase each year and the insurer, instead of charging premiums that correspondingly increase each year, charges a premium calculated to remain level for a period of years or for the lifetime of the contract. In this case the benefit portion of the premium is more than needed to provide for the cost of benefits during the earlier years of the policy and less than the actual cost in the later years. The building of a prospective contract reserve is a natural result of level premiums.
12. “Long-term care insurance” is any insurance policy or rider advertised, marketed, offered or designed to provide coverage for not less than twelve (12) consecutive months for each covered person on an expense incurred, indemnity, prepaid or other basis; for one or more necessary or medically necessary diagnostic, preventive, therapeutic, rehabilitative, maintenance or personal care services, provided in a setting other than an acute care unit of a hospital. Such term also includes a policy or rider which provides for payment of benefits based upon cognitive impairment or the loss of functional capacity. Long-term care insurance may be issued by insurers; fraternal benefit societies; nonprofit health, hospital, and medical service corporations; prepaid health plans; health maintenance organizations or any similar organization to the extent they are otherwise authorized to issue life or health insurance. Long-term care insurance shall not include any insurance policy which is offered primarily to provide basic Medicare supplement coverage, basic hospital expense coverage, basic medical-surgical expense coverage, hospital confinement indemnity coverage, major medical expense coverage, disability income or related asset-protection coverage, accident only coverage, specified disease or specified accident coverage, or limited benefit health coverage.
13. “Modal Premium” refers to the premium paid on a contract based on a premium term which could be annual, semi-annual, quarterly, monthly, or weekly. Thus if the annual premium is \$100 and if, instead, monthly premiums of \$9 are paid then the modal premium is \$9.
14. Normally the terminal reserve is a positive value. However, if the values of the benefits are decreasing with advancing age or duration it could be a negative value, called a “negative reserve.”
15. “Preliminary Term Reserve Method” is a method of valuation whereby the valuation net premium for each year falling within the preliminary term period is exactly sufficient to cover the expected incurred claims of that year, so that the terminal reserves will be zero at the end of the year. As of the end of the preliminary term period, a new constant valuation net premium (or stream of changing valuation premiums) becomes applicable such that the present value of all such premiums is equal to the present value of all claims expected to be incurred following the end of the preliminary term period.
16. “Present value of amounts not yet due on claims” represents the reserve for “claims unaccrued” (see definition), which may be discounted at interest.

17. “Rating block” means a grouping of contracts determined by the valuation actuary based on common characteristics, such as a policy form or forms having similar benefit designs.

18. The term “reserve” is used to include all items of benefit liability, whether in the nature of incurred claim liability or in the nature of contract liability relating to future periods of coverage, and whether the liability is accrued or unaccrued. An insurer under its contracts promises benefits which result in:

- a. Claims that have been incurred, that is, for which the insurer has become obligated to make payment, on or prior to the valuation date. On these claims, payments expected to be made after the valuation date for accrued and unaccrued benefits are liabilities of the insurer which shall be provided for by establishing claim reserves; or
- b. Claims that are expected to be incurred after the valuation date. Any present liability of the insurer for these future claims shall be provided for by the establishment of contract reserves and unearned premium reserves.

19. “Terminal reserve” is the reserve at the end of a contract year and is defined as the present value of benefits expected to be incurred after that contract year minus the present value of future valuation net premiums.

20. “Unearned premium reserve” values that portion of the premium paid or due to the insurer which is applicable to the period of coverage extending beyond the valuation date. Thus if an annual premium of \$120 was paid on November 1, \$20 would be earned as of December 31 and the remaining \$100 would be unearned. The unearned premium reserve could be on a gross basis as in this example or on a valuation net premium basis.

21. “Valuation net modal premium” is the modal fraction of the valuation net annual premium that corresponds to the gross modal premium in effect on any contract to which contract reserves apply. Thus if the mode of payment in effect is quarterly, the valuation net modal premium is the quarterly equivalent of the valuation net annual premium.

22. “Worksite Disability Policies” refers to individual short-term disability policies that are sold at the worksite through employer-sponsored enrollment, cover normal pregnancy, and that have benefit periods up to 24 months. Worksite disability policies do not include personal disability policies sold to an individual and not associated with employer-sponsored enrollment. They also do not include business overhead expense, disability buyout or key person policies, in whatever manner those policies are sold.

Scope

23. These standards apply to all individual and group health and accident and sickness insurance coverages, including single premium credit disability insurance. All other credit insurance is not subject to Appendix A-010.

24. When an insurer determines that adequacy of its health insurance reserves requires reserves in excess of the minimum standards specified herein, such increased reserves shall be held and shall be considered the minimum reserves for that insurer.

25. With respect to any block of contracts, or with respect to an insurer’s health business as a whole, a prospective gross premium valuation is the ultimate test of reserve adequacy as of a given valuation date. Such a gross premium valuation will take into account, for contracts in force, in a claims status, or in a continuation of benefits status on the valuation date, the present value as of the valuation date of: all expected benefits unpaid, all expected expenses unpaid, and all unearned or expected premiums, adjusted for future premium increases reasonably expected to be put into effect.

26. Such a gross premium valuation is to be performed whenever a significant doubt exists as to reserve adequacy with respect to any major block of contracts, or with respect to the insurer's health business as a whole. In the event inadequacy is found to exist, immediate loss recognition shall be made and the reserves restored to adequacy. Adequate reserves (inclusive of claim, premium and contract reserves, if any) shall be held with respect to all contracts, regardless of whether contract reserves are required for such contracts under these standards.

27. Whenever minimum reserves, as defined in this Appendix, exceed reserve requirements as determined by a prospective gross premium valuation, such minimum reserves remain the minimum requirement under these standards.

28. The following paragraphs set forth minimum standards for three categories of health insurance reserves:

- a. Claim Reserves;
- b. Premium Reserves;
- c. Contract Reserves.

29. Adequacy of an insurer's health insurance reserves is to be determined on the basis of all three categories combined. However, these standards emphasize the importance of determining appropriate reserves for each of the three categories separately.

Claim Reserves

30. General:

- a. Claim reserves are required for all incurred but unpaid claims on all health insurance policies. For contracts with an elimination period, the duration of disablement shall be measured as dating from the time that benefits would have begun to accrue had there been no elimination period.
- b. Appropriate claim expense reserves are required with respect to the estimated expense of settlement of all incurred but unpaid claims.
- c. All such reserves for prior valuation years are to be tested for adequacy and reasonableness along the lines of claim runoff schedules in accordance with the statutory financial statement including consideration of any residual unpaid liability.
- d. For claim reserves on policies that require contract reserves, the claim incurral date is to be considered the "issue date" for determining the table and interest rate to be used for claim reserves.
- e. The maximum interest rate for claim reserves is specified in Exhibit 1.
- f. With respect to claim reserves for policies issued before the operative date¹ of the Valuation Manual, the requirements for claim reserves on claims incurred after that date shall be as described in this Appendix A-010 based on the incurred date of the claim.

¹ The historical application of new requirements for claim reserves has been the incurred date of the claim. The 2009 changes to the Standard Valuation Law apply new requirements provided through the *Valuation Manual* only to policies issued after the effective date of the changes and the *Valuation Manual*. This addition makes new requirements for claim reserves applicable based on the incurred date irrespective of the policy issue date – i.e. consistent with historical practice.

Minimum Morbidity Standards for Individual Disability Income Claim Reserves:

31. For individual disability income claims incurred January 1, 2001, to January 1, 2007, each insurer may elect which of the following to use as the minimum morbidity standard for claim reserves:

- a. The minimum morbidity standard in effect for claim reserves as of the date the claim was incurred, or
- b. The standards as defined in paragraph 32, which applies on or after January 1, 2017, shall be applied to all open claims unless the company chooses on or after January 1, 2017, to apply the standards in paragraph 31.c. Once an insurer elects to calculate reserves for all open claims on the newer standards defined in paragraph 32 or paragraph 31.c., all future valuations must be on that basis.
- c. The standards as defined in paragraph 33 through paragraph 36, which apply on or after January 1, 2017, shall be applied to all open claims. Once an insurer elects to calculate reserves for all open claims on the standards defined in paragraph 33 through paragraph 36, all future valuations must be on that basis.

32. For individual disability income claims incurred on or after January 1, 2007, and prior to the effective date for the company as determined in paragraph 35, the minimum standards with respect to morbidity are those specified in Exhibit 1, except that, at the option of the insurer, assumptions regarding claim termination rates for the period less than two (2) years from the date of disablement may be based on the insurer's experience, if such experience is considered credible, or upon other assumptions designed to place a sound value on the liabilities.

33. For claims incurred on or after January 1, 2020, the minimum standards are those specified in Exhibit 1, including (as derived in accordance with *Actuarial Guideline L—2013 Individual Disability Income Valuation Table Actuarial Guideline*):

- a. The use of the insurer's own experience;
- b. An adjustment to include an own experience measurement margin; and
- c. The application of a credibility factor.

34. In determining the minimum reserves in accordance with paragraph 33, the provisions in paragraph 33.a., 33.b. and 33.c. are not required if:

- a. The insurer meets the Own Experience Measurement Exemption provided in Actuarial Guideline L; or
- b. For worksite disability policies with benefit periods of up to two years, at the option of the insurer, disabled life reserves may be based on the insurer's experience, if such experience is considered credible, or upon other assumptions and methods designed to place a sound value on the liabilities.

35. An insurer may begin to use the minimum reserve standards in paragraph 33 at a date earlier than January 1, 2020, but not prior to January 1, 2017.

36. An insurer may, within three years² of January 1, 2020 (or such earlier date it elects under paragraph 35), apply the new standards in paragraph 33 to all open claims incurred prior to the effective date of paragraph 33 for the insurer. Once an insurer elects to calculate reserves for all open claims based on paragraph 33, all future valuations must be on that basis.

Minimum Morbidity Standards for Group Disability Income Claim Reserves

37. For group disability income claims incurred from January 1, 2001, through December 31, 2006, with a duration from date of disablement of more than two (2) years but less than five (5) years, reserves may be based on the insurer's experience if such experience is considered credible and for which the insurer maintains underwriting and claim administration control.

38. For group disability income claims incurred prior to January 1, 2007, each insurer may elect to use as the minimum morbidity standard for claim reserves:

- a. The group disability income claims minimum morbidity standard in effect for claim reserves as of the date the claim was incurred; or
- b. After the effective date selected by the company in paragraphs 41 and 42, the standards as defined in paragraphs 41 and 42 applied to all open group long-term disability income claims, or
- c. The standards as defined in paragraphs 41 and 42 applied to all open group disability income claims.

Once an insurer elects to calculate reserves for all open claims on a more recent standard, then all future valuations must be on that basis.

39. For group long-term disability income claims incurred on or after January 1, 2007, but before the effective date selected by the company in paragraph 42, and group disability income claims incurred on or after January 1, 2007, that are not group long-term disability income, the minimum standards with respect to morbidity are those specified in Exhibit 1, except that, at the option of the insurer:

- a. Assumptions regarding claim termination rates for the period less than two (2) years from the date of disablement may be based on the insurer's experience, if the experience is considered credible, or upon other assumptions designed to place a sound value on the liabilities.
- b. Assumptions regarding claim termination rates for the period two (2) or more years but less than five (5) years from the date of disablement may, with the approval of the commissioner, be based on the insurer's experience if such experience is considered credible and for which the insurer maintains underwriting and claim administration control.
- c. With respect to claims termination standards in paragraphs 37 and 39.b., for experience to be considered credible for purposes of this appendix, the company should be able to provide claim termination patterns over no more than six (6) years reflecting at least

² The 2013 Table requires additional information that was not required to determine claim reserves under prior tables. The three year period is a period after the date a company starts using the 2013 Table for new claims to allow the company to update its claims data to use the 2013 Table for claims incurred prior to that date. For example, if a company begins to use the 2013 Table on January 1, 2020, for claims incurred after that date, it does not need to immediately convert all existing claims. This provision allows for the run-off of existing claims until December 31, 2022. As of that date (or an earlier date), the company must either continue use of the existing tables applicable to these claims or may convert all still open claims to the 2013 Table (adding the necessary data only for the remaining open claims).

5,000 claims terminations during the third through fifth claims durations on reasonably similar applicable policy forms. The request for such approval of a plan of modification to the reserve basis must be in writing and must include:

- i. An analysis of the credibility of the experience;
 - ii. A description of how all of the insurer's experience is proposed to be used in setting reserves;
 - iii. A description and quantification of the margins to be included;
 - iv. A summary of the financial impact that the proposed plan of modification would have had on the insurer's last filed annual statement;
 - v. A copy of the approval of the proposed plan of modification by the commissioner of the state of domicile; and
 - vi. Any other information deemed necessary by the commissioner.
- d. For claim reserves to reflect "sound values" and/or reasonable margins, reserve tables based on credible experience should be adjusted regularly to maintain reasonable margins.

40. On or after October 1, 2014, with respect to incurred claims subject to paragraph 39, each insurer may elect which of the following to use as the minimum morbidity standard for group long-term disability income claim reserves:

- a. The minimum morbidity standard in effect for claim reserves as of the date the claim was incurred, or
- b. The standards as defined in paragraph 41, applied to all open claims.

Once an insurer elects to calculate reserves for all open claims on a more recent standard, then all future valuations must be on that basis.

41. For group long-term disability income claims incurred on or after January 1, 2017, or the earlier date that is chosen for optional early adoption, but not before October 1, 2014, the minimum standards with respect to morbidity shall be based on the 2012 GLTD termination table with considerations of:

- a. The insurer's own experience computed in accordance with Actuarial Guideline XLVII, as included in the most current version of the NAIC *Accounting Practices and Procedures Manual*,
- b. An adjustment to include an own experience measurement margin derived in accordance with Actuarial Guideline XLVII, as included in the most current version of the NAIC *Accounting Practices and Procedures Manual*, and
- c. A credibility factor derived in accordance with Actuarial Guideline XLVII, as included in the most current version of the NAIC *Accounting Practices and Procedures Manual*.

42. An insurer may begin to use the minimum reserve standards in paragraph 41 at a date earlier than January 1, 2017, but not prior to October 1, 2014. An insurer may apply the standards in paragraph 41 to all open claims incurred prior to the effective date of paragraph 41 for the insurer. Once an insurer elects to calculate reserves for all open claims based on paragraph 41, all future valuations must be on that basis. This option with respect to Exhibit 1, paragraph 1.a.iii.(a) and paragraph 1.a.iii.(b) may be selected only if

the insurer maintains adequate claim records for claims incurred to use the 2013 Individual Disability Income (IDI) Valuation Table appropriately.

Minimum Morbidity Standards for Other Health Insurance Claim Reserves

43. The reserve shall be based on the insurer's experience, if such experience is considered credible, or upon other assumptions designed to place a sound value on the liabilities.

44. Claim Reserve Methods Generally – A generally accepted actuarial reserving method or other reasonable method, or a combination of methods may be used to estimate all claim liabilities. The methods used for estimating liabilities generally may be aggregate methods, or various reserve items may be separately valued. Approximations based on groupings and averages may also be employed. Adequacy of the claim reserves, however, shall be determined in the aggregate.

Premium Reserves

45. General:

- a. Except as noted in paragraph 46.b., unearned premium reserves are required for all contracts with respect to the period of coverage for which premiums, other than premiums paid in advance, have been paid beyond the date of valuation.
- b. Single premium credit disability insurance individual policies and group certificates are excluded from unearned premium reserve requirements of paragraphs 45-47.
- c. If premiums due and unpaid are carried as an asset, such premiums must be treated as premiums in force, subject to unearned premium reserve determination. The value of unpaid commissions, premium taxes, and the cost of collection associated with due and unpaid premiums must be carried as an offsetting liability.
- d. The gross premiums paid in advance for a period of coverage commencing after the next premium due date which follows the date of valuation may be appropriately discounted to the valuation date and shall be held as a separate liability.

46. Minimum Standards for Unearned Premium Reserves:

- a. The minimum unearned premium reserve with respect to any contract is the pro rata unearned modal premium that applies to the premium period beyond the valuation date, with such premium determined on the basis of:
 - i. The valuation net modal premium on the contract reserve basis applying to the contract; or;
 - ii. The gross modal premium for the contract if no contract reserve applies.
- b. However, in no event may the sum of the unearned premium and contract reserves for all contracts of the insurer subject to contract reserve requirements be less than the gross modal unearned premium reserve on all such contracts, as of the date of valuation. Such reserve shall never be less than the expected claims for the period beyond the valuation date represented by such unearned premium reserve, to the extent not provided for elsewhere.

47. Premium Reserve Methods Generally – The insurer may employ suitable approximations and estimates; including, but not limited to groupings, averages and aggregate estimation; in computing premium reserves. Such approximations or estimates shall be tested periodically to determine their continuing adequacy and reliability.

Contract Reserves

48. General:

- a. Contract reserves are required, unless otherwise specified in paragraph 48.b. for:
 - i. All individual and group contracts with which level premiums are used; or
 - ii. All individual and group contracts with respect to which, due to the gross premium pricing structure at issue, the value of the future benefits at any time exceeds the value of any appropriate future valuation net premiums at that time. This evaluation may be applied on a rating block basis if the total premiums for the block were developed to support the total risk assumed and expected expenses for the block each year, and a qualified actuary certifies the premium development. The actuary should state in the certification that premiums for the rating block were developed such that each year's premium was intended to cover that year's costs without any prefunding. If the premium is also intended to recover costs for any prior years, the actuary should also disclose the reasons for and magnitude of such recovery. The values specified in this paragraph shall be determined on the basis specified in paragraph 49.
 - iii. If rates are determined such that each year's premium is intended to cover that year's cost, the rating block approach results in no contract reserves unless required by paragraph 51. If rates are designed to prefund future years' costs, contract reserves will be required.
- b. Contracts not requiring a contract reserve are contracts which cannot be continued after one year from issue and contracts already in force on January 1, 2001, for which no contract reserve was required under SSAP No. 54R, paragraph 42.
- c. The contract reserve is in addition to claim reserves and premium reserves.
- d. The methods and procedures for contract reserves shall be consistent with those for claim reserves for any contract, or else appropriate adjustment must be made when necessary to assure provision for the aggregate liability. The definition of the date of incurral must be the same in both determinations.
- e. The total contract reserve established shall incorporate provisions for moderately adverse deviations.

49. Minimum Standards for Contract Reserves:

- a. Basis:
 - i. Morbidity or other Contingency. Minimum standards with respect to morbidity are those set forth in Exhibit 1.
 - (a) Valuation net premiums used under each contract must have a structure consistent with the gross premium structure at issue of the contract as this relates to advancing age of insured, contract duration and period for which gross premiums have been calculated.
 - (b) Except as provided in paragraph 48.a.ii., if for a policy form there is no gross premium variation by age, the valuation net premiums will nonetheless vary based on age at issue for each contract since at issue the

present value of valuation net premiums for a contract must equal the present value of tabular claim costs.

- (c) Contracts for which tabular morbidity standards are not specified in Exhibit 1 shall be valued using tables established for reserve purposes by a qualified actuary. The morbidity tables shall contain a pattern of incurred claims cost that reflects the underlying morbidity and shall not be constructed for the primary purpose of minimizing reserves.
 - (d) Effective January 1, 2007, when determining the morbidity assumptions, the actuary shall use assumptions that represent the best estimate of anticipated future experience, but shall not incorporate any expectation of future morbidity improvement. Morbidity improvement is a change, in the combined effect of claim frequency and the present value of future expected claim payments given that a claim has occurred, from the current morbidity tables or experience that will result in a reduction to reserves. It is not the intent of this provision to restrict the ability of the actuary to reflect the morbidity impact for a specific known event that has occurred and that is able to be evaluated and quantified.
 - (e) Business in force prior to January 1, 2007, may be permitted to retain the original reserve basis, which may not meet the provisions of (d) above.
- ii. Interest. The maximum interest rate is specified in Exhibit 1.
 - iii. Termination rates. Termination rates used in the computation of reserves shall be on the basis of a mortality table as specified in Exhibit 1 except as noted in the following paragraphs.
 - (a) Under contracts for which premium rates are not guaranteed, and where the effects of insurer underwriting are specifically used by policy duration in the valuation morbidity standard or for return of premium or other deferred cash benefits, total termination rates may be used at ages and durations where these exceed specified mortality table rates, but not in excess of the lesser of:
 - (1) Eighty percent of the total termination rate used in the calculation of the gross premiums, or
 - (2) Eight percent.
 - (b) For long-term care individual policies or group certificates, issued within the period January 1, 2001, to December 31, 2006, the contract reserve may be established on a basis of separate:
 - (1) Mortality (as specified in Exhibit 1) and
 - (2) Terminations other than mortality, where the terminations are not to exceed:
 - (i) For policy years one through four (4), the lesser of eighty percent (80%) of the voluntary lapse rate used in the calculation of gross premiums and eight percent (8%);

- (ii) For policy years five (5) and later, the lesser of one hundred percent (100%) of the voluntary lapse rate used in the calculation of gross premiums and four percent (4%).
 - (c) For long-term care individual policies or group certificates issued on or after January 1, 2007, the contract reserve shall be established on the basis of:
 - (1) Mortality (as specified in Exhibit 1); and
 - (2) Terminations other than mortality, where the terminations are not to exceed:
 - (i) For policy year one, the lesser of eighty percent (80%) of the voluntary lapse rate used in the calculation of gross premiums and six percent (6%).
 - (ii) For policy years two (2) through four (4), the lesser of eighty percent (80%) of the voluntary lapse rate used in the calculation of gross premiums and four percent (4%).
 - (iii) For policy years five (5) and later, the lesser of one hundred percent (100%) of the voluntary lapse rate used in the calculation of gross premiums and two percent (2%), except certificates under policies issued to one or more employers or labor organizations, or to a trust or to the trustees of a fund established by one or more employers or labor organizations, or a combination thereof, for employees or former employees or a combination thereof, or for members or former members or a combination thereof, of a labor organization where the 2% shall be three percent (3%).
 - (d) Where a morbidity standard specified in Exhibit 1 is on an aggregate basis, such morbidity standard may be adjusted to reflect the effect of insurer underwriting by policy duration. The adjustments must be appropriate to the underwriting.
- b. Reserve Method:
 - i. For insurance except long-term care and return of premium or other deferred cash benefits, the minimum reserve is the reserve calculated on the two-year full preliminary term method; that is, under which the terminal reserve is zero at the first and also the second contract anniversary.
 - ii. For long-term care insurance, the minimum reserve is the reserve calculated on the one-year full preliminary term method.
 - iii. (a) For return of premium or other deferred cash benefits, the minimum reserve is the reserve calculated as follows:

- (1) On the one-year preliminary term method if the benefits are provided at any time before the twentieth anniversary;
 - (2) On the two-year preliminary term method if the benefits are only provided on or after the twentieth anniversary.
- (b) The preliminary term method may be applied only in relation to the date of issue of a contract. Reserve adjustments introduced later, as a result of rate increases, revisions in assumptions (e.g., projected inflation rates) or for other reasons, are to be applied immediately as of the effective date of adoption of the adjusted basis.
- c. Negative Reserves. Negative reserves on any benefit may be offset against positive reserves for other benefits in the same contract, but the total contract reserve with respect to all benefits combined may not be less than zero.
- d. Nonforfeiture Benefits for Long-Term Care Insurance. The contract reserve on a policy basis shall not be less than the net single premium for the nonforfeiture benefits at the appropriate policy duration, where the net single premium is computed according to the above specifications.

50. Alternative Valuation Methods and Assumptions Generally – Provided the contract reserve on all contracts to which an alternative method or basis is applied is not less in the aggregate than the amount determined according to the applicable standards specified above; an insurer may use any reasonable assumptions as to interest rates, termination and/or mortality rates, and rates of morbidity or other contingency. Also, subject to the preceding condition, the insurer may employ methods other than the methods stated above in determining a sound value of its liabilities under such contracts, including but not limited to the following: the net level premium method; the one-year full preliminary term method; prospective valuation on the basis of actual gross premiums with reasonable allowance for future expenses; the use of approximations such as those involving age groupings, groupings of several years of issue, average amounts of indemnity, grouping of similar contract forms; the computation of the reserve for one contract benefit as a percentage of, or by other relation to, the aggregate contract reserves exclusive of the benefit or benefits so valued; and the use of a composite annual claim cost for all or any combination of the benefits included in the contracts valued.

51. Tests For Adequacy and Reasonableness of Contract Reserves:

- a. Annually, an appropriate review shall be made of the insurer's prospective contract liabilities on contracts valued by tabular reserves, to determine the continuing adequacy and reasonableness of the tabular reserves giving consideration to future gross premiums. The insurer shall make appropriate increments to such tabular reserves if such tests indicate that the basis of such reserves is no longer adequate subject, however, to the minimum standards in paragraph 49.
- b. In the event a company has a contract or a group of related similar contracts, for which future gross premiums will be restricted by contract, insurance department regulations, or for other reasons, such that the future gross premiums reduced by expenses for administration, commissions, and taxes will be insufficient to cover future claims, the company shall establish contract reserves for such shortfall in the aggregate.

Reinsurance

52. Increases to, or credits against reserves carried, arising because of reinsurance assumed or reinsurance ceded, must be determined in a manner consistent with these minimum reserve standards and with all applicable provisions of the reinsurance contracts which affect the insurer's liabilities.

Exhibit 1 Specific Standards For Morbidity, Interest And Mortality**Morbidity**

1. Minimum morbidity standards for valuation of specified individual contract health insurance benefits are as follows:

a. Disability Income Benefits Due to Accident or Sickness

i. Contract Reserves for Contracts issued before January 1, 2020:

- (a) The 1985 Commissioners Individual Disability Tables A (85CIDA); or
- (b) The 1985 Commissioners Individual Disability Tables B (85CIDB).
- (c) Each insurer shall elect, with respect to all individual contracts issued in any one statement year, whether it will use Tables A or Tables B as the minimum standard.

ii. Contract Reserves for Contracts issued on or after January 1, 2020:

The 2013 IDI Valuation Table with modifiers as described in Actuarial Guideline L. An insurer may begin to use the 2013 IDI Valuation Table with modifiers at a date earlier than January 1, 2020, but not prior to January 1, 2017.

Within three years of 2020, or the earlier date that an insurer begins to use the 2013 IDI Valuation Table, the insurer may elect to apply that morbidity standard for all policies issued subject to other valuation tables. This may be done if the following conditions are met:

- (a) The insurer must apply the morbidity standard to all inforce policies and incurred claims;
- (b) The insurer elects or has elected to apply the 2013 IDI Valuation Table to all claims incurred, regardless of incurred date;
- (c) The insurer maintains adequate policy records on policies issued prior to 2020 that allow the insurer to apply the 2013 IDI Valuation Table appropriately; and
- (d) Once an insurer elects to calculate reserves for all inforce policies based on the 2013 IDI Valuation Table morbidity standard, all future valuations must be on that basis

iii. Claim Reserves:

(a) For claims incurred from January 1, 2001, through December 31, 2001:

Each insurer may elect which of the following to use as the minimum standard for claims incurred prior to January 1, 2002:

- (1) The minimum morbidity standard in effect for contract reserves on currently issued contracts, as of the date the claim is incurred, or

- (2) The standard as defined in Exhibit 1, paragraph 1.a.iii.(b) on or after January 1, 2002, applied to all open claims, or
- (3) The standard as defined in Exhibit 1, paragraph 1.a.iii.(c) on or after January 1, 2017, applied to all open non-worksite claims, provided the insurer maintains adequate claim records to allow the insurer to apply the standard defined in Exhibit 1, paragraph 1.a.iii.(c). This option is available whether claims incurred prior to January 1, 2002, were determined under Exhibit 1, paragraph 1.a.iii.(a) or paragraph 1.a.iii.(b).
- (4) Once an insurer elects to calculate reserves for all open claims on the standard defined in Exhibit 1, in either paragraph 1.a.iii.(b) or paragraph 1.a.iii.(c), all future valuations must be on that basis.
- (b) For claims incurred on or after January 1, 2002, and prior to January 1, 2020:

The 1985 Commissioners Individual Disability Table A (85CIDA) with claim termination rates multiplied by the following adjustment factors:

Duration	Adjustment Factor	Adjusted Termination Rates*
Week 1	0.366	0.04831
2	0.366	0.04172
3	0.366	0.04063
4	0.366	0.04355
5	0.365	0.04088
6	0.365	0.04271
7	0.365	0.04380
8	0.365	0.04344
9	0.370	0.04292
10	0.370	0.04107
11	0.370	0.03848
12	0.370	0.03478
13	0.370	0.03034
Month 4	0.391	0.08758
5	0.371	0.07346
6	0.435	0.07531
7	0.500	0.07245
8	0.564	0.06655
9	0.613	0.05520
10	0.663	0.04705
11	0.712	0.04486
12	0.756	0.04309
13	0.800	0.04080
14	0.844	0.03882
15	0.888	0.03730

Duration	Adjustment Factor	Adjusted Termination Rates*
16	0.932	0.03448
17	0.976	0.03026
18	1.020	0.02856
19	1.049	0.02518
20	1.078	0.02264
21	1.107	0.02104
22	1.136	0.01932
23	1.165	0.01865
24	1.195	0.01792
Year 3	1.369	0.16839
4	1.204	0.10114
5	1.199	0.07434
6 and later	1.000	**

* The adjusted termination rates derived from the application of the adjustment factors to the DTS Valuation Table termination rates shown in exhibits 3a, 3b, 3c, 4, and 5 (*Transactions of the Society of Actuaries* (TSA) XXXVII, pp. 457-463) is displayed. The adjustment factors for age, elimination period, class, sex, and cause displayed in exhibits 3a, 3b, 3c, and 4 should be applied to the adjusted termination rates shown in this table.

** Applicable DTS Valuation Table duration rate from exhibits 3c and 4 (TSA XXXVII, pp. 462-463).

The 85CIDA table so adjusted for the computation of claim reserves shall be known as 85CIDC (The 1985 Commissioners Individual Disability Table C).

(c) For claims incurred on or after 2020, the 2013 IDI Valuation Table with modifiers and adjustments for company experience as prescribed in Actuarial Guideline L, except for worksite disability policies with benefit periods of 24 months or less.

(d) For worksite disability policies, claim reserves may be calculated using claim run-out analysis or claim triangles, or other methods that place a sound value on the reserves that are appropriate for the business and risks involved.

b. Hospital Benefits, Surgical Benefits and Maternity Benefits (Scheduled benefits or fixed time period benefits only)

i. Contract Reserves:

The 1974 Medical Expense Tables, Table A, Transactions of the Society of Actuaries, Volume XXX, pg. 63. Refer to the paper (in the same volume, pg. 9) to which this table is appended, including its discussions, for methods of adjustment for benefits not directly valued in Table A: "Development of the 1974 Medical Expense Benefits," Houghton and Wolf.

- ii. Claim Reserves:
No specific standard. See paragraph 1.f. of this Exhibit.
- c. Cancer Expense Benefits
 - i. Contract Reserves:
 - (a) Contracts issued on or after January 1, 1986, and before January 1, 2019: The 1985 NAIC Cancer Claim Cost Tables (1985 CCCT).
 - (b) Contracts issued on or after January 1, 2019:
 - (i) For first occurrence and hospitalization benefits: The 2016 Cancer Claim Cost Valuation Tables (2016 CCCVT): <https://content.naic.org/sites/default/files/actuary-01-naic-2017-cancer-claim-cost-valuation-table.xlsx>.
 - (ii) For all other benefits: Assumptions based on company experience, relevant industry experience and actuarial judgement. Such assumptions should be appropriate for valuation which considers margin for adverse experience.
 - (iii) For contracts issued on or after January 1, 2018, and before January 1, 2019, a company may elect to use morbidity basis described in paragraphs (i.) and (ii). Once a company begins use of the 2016 CCCVT for new issues, it may not revert to the 1985 CCCT.
 - ii. Claim Reserves:
No specific standard. See paragraph 1.f. of this Exhibit.
- d. Accidental Death Benefits
 - i. Contract Reserves:
The 1959 Accidental Death Benefits Table.
 - ii. Claim Reserves:
Actual amount incurred.
- e. Single Premium Credit Disability
 - i. Contract Reserves:
 - (a) For contracts issued on or after January 1, 2002:
 - (i) For plans having less than a thirty-day elimination period, the 1985 Commissioners Individual Disability Table A (85CIDA) with claim incidence rates increased by twelve percent (12%).
 - (ii) For plans having a thirty-day and greater elimination period, the 85CIDA for a fourteen-day elimination period with the adjustment in Item (i).

(b) For contracts issued prior to January 1, 2002, each insurer may elect either Item (i) or (ii) to use as the minimum standard. Once an insurer elects to calculate reserves for all contracts on the standard defined in Item (a), all future valuations must be on that basis.

(i) The minimum morbidity standard in effect for contract reserves on currently issued contracts, as of the date the contract was issued, or

(ii) The standard as defined in Item (a), applied to all contracts.

ii. Claim Reserves:

Claim reserves are to be determined as provided in paragraph 44.

f. Other Individual Contract Benefits

i. Contract Reserves:

For all other individual contract benefits, morbidity assumptions are to be determined as provided in the reserve standards.

ii. Claim Reserves:

For all benefits other than disability, claim reserves are to be determined as provided in the standards.

2. Minimum morbidity standards for valuation of specified group contract health insurance benefits are as follows:

a. Disability Income Benefits Due to Accident or Sickness where this Appendix references this Exhibit; otherwise, Actuarial Guideline XLVII, as included in the most current version of the NAIC *Accounting Practices and Procedures Manual*.

i. Contract Reserves:

The 1987 Commissioners Group Disability Income Table (87CGDT).

ii. Claim Reserves:

The 1987 Commissioners Group Disability Income Table (87CGDT);

b. Single Premium Credit Disability

i. Contract Reserves:

(a) For contracts issued on or after January 1, 2002:

(i) For plans having less than a thirty-day elimination period, the 1985 Commissioners Individual Disability Table A (85CIDA) with claim incidence rates increased by twelve percent (12%).

(ii) For plans having a thirty-day and greater elimination period, the 85CIDA for a fourteen-day elimination period with the adjustment in item (i).

- ii. For contracts issued prior to January 1, 2002, each insurer may elect either Item (a) or (b) to use as the minimum standard. Once an insurer elects to calculate reserves for all contracts on the standard defined in Item (a), all future valuations must be on that basis.
 - (a) The minimum morbidity standard in effect for contract reserves on currently issued contracts, as of the date the contract was issued, or
 - (b) The standard as defined in Item (a), applied to all contracts.
- iii. Claim Reserves:
 Claim reserves are to be determined as provided in paragraph 44.
- c. Other Group Contract Benefits
 - i. Contract Reserves:
 For all other group contract benefits, morbidity assumptions are to be determined as provided in the reserve standards.
 - ii. Claim Reserves:
 For all benefits other than disability, claim reserves are to be determined as provided in the standards.

Interest

- 3. For contract reserves the maximum interest rate is the maximum rate allowed by Appendix A-820 in the valuation of whole life insurance issued on the same date as the health insurance contract.
- 4. For claim reserves on policies that require contract reserves, the maximum interest rate is the maximum rate allowed by Appendix A-820 in the valuation of whole life insurance issued on the same date as the claim incurral date.
- 5. For claim reserves on policies not requiring contract reserves, the maximum interest rate is the maximum rate allowed by Appendix A-820 in the valuation of single premium immediate annuities issued on the same date as the claim incurral date, reduced by 100 basis points.

Mortality

- 6. a. Unless paragraph 7 or paragraph 8 of this Exhibit 1 applies, the mortality basis used for all policies except long-term care individual policies and group certificates issued before January 1, 2001, shall be according to a table (but without use of selection factors) permitted by law for the valuation of whole life insurance issued on the same date as the health insurance contract.
- b. For long-term care insurance individual policies or group certificates issued from January 1, 2001, through December 31, 2006, the mortality basis used shall be the 1983 Group Annuity Mortality Table without projection. For long-term care insurance individual policies or group certificates issued on or after January 1, 2007, the mortality basis used shall be the 1994 Group Annuity Mortality Static Table.

7. Other mortality tables adopted by the NAIC and promulgated by the commissioner may be used in the calculation of the minimum reserves if appropriate for the type of benefits and if approved by the commissioner. The request for approval shall include the proposed mortality table and the reason that the standard specified in paragraph 6.a. of this Exhibit 1 is inappropriate.

8. For single premium credit insurance using the 85CIDA table, no separate mortality shall be assumed.

Not for Distribution

Exhibit 2 Reserves for Waiver of Premium (Supplementary explanatory material)

1. Waiver of premium reserves involve several special considerations. First, the disability valuation tables promulgated by the NAIC are based on exposures that include contracts on premium waiver as in-force contracts. Hence, contract reserves based on these tables are NOT reserves on “active lives” but rather reserves on contracts “in force.” This is true for the 1964 CDT and for both the 1985 CIDA and CIDB tables.

2. Accordingly, tabular reserves using any of these tables should value reserves on the following basis:

- a. Claim reserves should include reserves for premiums expected to be waived, valuing as a minimum the valuation net premium being waived.
- b. Premium reserves should include contracts on premium waiver as in-force contracts, valuing as a minimum the unearned modal valuation net premium being waived.
- c. Contract reserves should include recognition of the waiver of premium benefit in addition to other contract benefits provided for, valuing as a minimum the valuation net premium to be waived.

If an insurer is, instead, valuing reserves on what is truly an active life table, or if a specific valuation table is not being used but the insurer’s gross premiums are calculated on a basis that includes in the projected exposure only those contracts for which premiums are being paid, then it may not be necessary to provide specifically for waiver of premium reserves. Any insurer using such a true “active life” basis should carefully consider, however, whether or not additional liability should be recognized on account of premiums waived during periods of disability or during claim continuation.

Appendix A-200

Separate Accounts Funding Guaranteed Minimum Benefits Under Group Contracts

Relevant SSAPs:

SSAP No. 51R—Life Contracts

SSAP No. 52—Deposit-Type Contracts

SSAP No. 56—Separate Accounts

Relevant NAIC Model Laws/Regulations:

Standard Valuation Law (#820)

Actuarial Opinion and Memorandum Regulation (#822)

Scope

1. This appendix applies to a group life insurance contract providing survivor income benefits, a group annuity contract, or a funding agreement if the contract is a group contract that utilizes a separate account and provides guaranteed minimum benefits. This appendix shall not apply to modified guaranteed annuities or modified guaranteed life insurance or variable annuity or variable life insurance subject to appendices A-255, A-588, A-250, and A-270 or equity index products but this appendix shall apply to index contracts as defined in paragraph 18.

Definitions

2. “Account assets” means separate account assets plus any assets held in the general account or a supplemental account to meet the asset maintenance requirements.
3. “Account contracts” means the contracts providing guaranteed minimum benefits or other benefits and funded by a separate account and, if applicable, funded in part by the general account or a supplemental account to meet the asset maintenance requirements.
4. “Actuarial opinion” means the valuation actuary’s opinion covering reserves for contract liabilities under account contracts that is required to be submitted to the commissioner.
5. “Actuarial memorandum” means the memorandum of the valuation actuary that supports the actuarial opinion covering reserves for contract liabilities under account contracts.
6. “Appointed actuary” means the qualified actuary appointed or retained either directly by or by the authority of the board of directors through an executive officer of the company to prepare the annual statement of actuarial opinion for the company as a whole.
7. “Asset maintenance requirements” means the requirement to maintain assets to fund contract benefits in accordance with paragraphs 30-45.
8. “Book value contract” means a fixed accumulation contract (GIC), purchased under a retirement plan or plan of deferred compensation, established or maintained by an employer, that does not participate in the investment experience of a separate account, with a fixed interest rate guarantee, including a guarantee based on an external index, and that is supported by a separate account, the plan of operations of which provides that the separate account’s assets are valued as if the assets were held in the insurance company’s general account.
9. “Class of contracts” means the set of all contracts to which a given plan of operations pertains.

10. “Contract” means a group life insurance policy, group annuity contract, or funding agreement that is within the scope of this appendix as set forth in paragraph 1.
11. “Contract benefits” means the amounts obligated to be paid by the insurance company under an account contract.
12. “Contract liabilities” means the liabilities of the insurance company under account contracts, including liabilities with respect to which guarantees as to amount are provided by the insurance company and liabilities with respect to which guarantees as to amount are not provided by the insurance company.
13. a. “Derivative instrument” means an agreement, option, instrument or a series or combination of them:
- i. To make or take delivery of, or assume or relinquish, a specified amount of one or more underlying interests, or to make a cash settlement in lieu thereof; or
 - ii. That has a price, performance, value or cash flow based primarily upon the actual or expected price, level, performance, value or cash flow of one or more underlying interests.
- b. Derivative instruments include options, warrants used in a hedging transaction and not attached to another financial instrument, caps, floors, collars, swaps, forwards, futures and any other agreements, options or substantially similar instruments or any series or combination of them.
14. “Duration” means, with respect to separate account or supplemental account assets or guaranteed contract liabilities, a measure of the price sensitivity of a stream of cash flows to interest rate movements, including, but not limited to, modified duration or option adjusted duration.
15. “General account” means the assets of the insurance company other than separate account and supplemental account assets, and associated reserves.
16. “Guaranteed minimum benefits” means benefits payable under the terms of the contract that are based on either (1) the greater of paragraph 16.a. or 16.b., or (2) paragraph 16.c. where:
- a. Is that part of the market value of account assets that determines the contractholder’s benefits, i.e., to the extent the assets are beneficially “client” assets; provided, that if asset performance does not determine the contractholder’s benefit, this subparagraph equals zero;
 - b. Is a fixed minimum guarantee related to all or part of the considerations received under the contract; and
 - c. Is an amount based upon a publicly available interest rates series or an index of the aggregate market value of a group of publicly traded financial instruments, either of which is specified in the contract.
17. “Hedging transaction” means a derivative transaction, involving use of one or more derivative instruments, that is entered into and maintained to reduce:
- a. The risk of a change in the value, yield, price, cash flow or quantity of assets or liabilities that the insurer has acquired or incurred or anticipates acquiring or incurring; or
 - b. The currency exchange risk or the degree of exposure as to assets or liabilities that an insurer has acquired or incurred or anticipates acquiring or incurring.

18. “Index contract” means a contract under which contract benefits shall be based upon a publicly available interest rate series or an index of the aggregate market value of a group of publicly traded financial instruments, either of which is specified in the contract, and that does not provide a guarantee of some or all of the consideration received plus earnings at a fixed rate specified in advance and that does not provide any secondary guarantees on elective benefits or maturity values.
19. “Market value separate account” means a separate account in which the separate account assets are valued at their market value.
20. “Nationally Recognized Statistical Rating Organization (NRSRO)” means a rating organization so designated by the Securities and Exchange Commission of the United States of America (SEC) which has applied to, and whose NRSRO status has been confirmed by, the NAIC Securities Valuation Office.
21. “Plan of operations” means a written plan meeting the requirements of paragraph 29.
22. “Prudent estimate” assumption means an assumption developed by applying a margin to the best estimate assumption for that risk.
23. “Qualified actuary” means an individual who is qualified to sign statements of actuarial opinion in accordance with the qualification standards set forth in Appendix A-820.
24. “Spot rate”
- “Treasury-based spot rate corresponding to a given time of benefit payment means the yield on a zero-coupon non-callable and non-prepayable United States government obligation maturing at that time, or the zero-coupon yield implied by the price of a representative sampling of coupon-bearing, non-callable and non-prepayable United States government obligations in accordance with a formula set forth in the plan of operation.
 - “Index spot rate” corresponding to a given time of benefit payment means the zero-coupon yield implied by (x) the Barclays Short Term Corporate Index (for a given time of benefit payment under one year) or (y) the zero-coupon yield implied by the Barclays U.S. Corporate Investment Grade Bond Index (for a given time of benefit payment greater than or equal to one year).
 - “Blended spot rate” corresponding to a given time of benefit payment means a blend of 50% of each of (i) the Treasury-based spot rate, and (ii) the index spot rate. To the extent that guaranteed contract liabilities are denominated in the currency of a foreign country rates, in one of the two (2) highest rating categories by an independent nationally recognized United States rating agency acceptable to the commissioner and which are supported by investments denominated in the currency of the foreign country, the Treasury-based spot rate component of the blended spot rate may be determined by reference to substantially similar obligations of the government of the foreign country. For liabilities other than those described above, the blended spot rate shall be determined on a basis mutually agreed upon by the insurer and the commissioner.
25. “Supplemental account” means a separate account to which assets may be contributed by the insurance company for the purpose of complying, in whole or in part, with the asset maintenance requirement and with respect to which neither the account contracts nor applicable law shall provide that the assets of the supplemental account are not chargeable with liabilities arising out of any other business of the insurance company.
26. “United States government obligation” means a direct obligation issued, assumed, guaranteed or insured by the United States of America or by an agency or instrumentality of the United States.