



MEMORANDUM

TO: Stewart Guerin, Chair, Valuation of Securities (E) Task Force
Members of the Valuation of Securities (E) Task Force

FROM: Bob Carcano, Senior Counsel, Investment Analysis Office

CC: Charles Therriault, Director, NAIC Securities Valuation Office

DATE: September 9, 2016

RE: Proposed Amendments to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to Implement the Decision to Transfer Oversight of Subsidiary, Controlled and Affiliated Entity Investments to the Statutory Accounting Principles (E) Working Group.

1. Introduction – During a conference call held Feb. 22, 2016, the Valuation of Securities (E) Task Force agreed to transfer oversight for the valuation of investments in subsidiary, controlled and affiliated (SCA) entities to the Statutory Accounting Principles (E) Working Group. The Task Force requested that the SVO advise when the Working Group had determined where it would house the guidance and that SVO prepare a proposed amendment to the P&P Manual that would retain a filing requirement but delete the valuation rules from P&P Manual. In a memorandum dated September 7, the Working Group notified the Task Force that it adopted revisions to *SSAP No. 97—Subsidiary, Controlled and Affiliated Entities* (SSAP No. 97) that incorporate the SCA guidance from the P&P Manual into a new appendix within SSAP No. 97. Consistent with the prior direction of the Task Force, the SVO presents a proposed amendment to the P&P Manual. The proposed amendment, shown below, would:

- Delete references to SCA investments in Part One, Section 2 (b) related to the process governing appeals of SVO decisions;
- Delete text describing administrative symbols and their application to SCA investments from Part One, Section 3 (b) (v) (B);
- Delete the definition of SCA in Part Two, Section 1;
- Delete information in Part Two, Section 8 describing when and how to use the SUB 1 and SUB 2 forms; insert a filing requirement for SCA investments, a reference to the Appendix to *SSAP No. 97* and text distinguishing between SCA investments filed with the FRS Division and bonds between related parties that may still be filed with the SVO;
- Delete instructions pertaining to required documentation for SCA investments in Part Two, Sections 10 and 11;
- Modify the special procedure that applies to SCA bond investments in Part Three, Section 2 (d) to reflect the division of valuation responsibility between the FRS and SVO, and
- Delete the SCA valuation instructions in Part Five, Section 2.

2. Proposed Amendments

EXECUTIVE OFFICE • 444 North Capitol Street NW, Suite 700 • Washington, DC 20001-1509	p 202 471 3990	f 816 460 7493
CENTRAL OFFICE • 1100 Walnut Street, Suite 1500 • Kansas City, MO 64106-2197	p 816 842 3600	f 816 783 8175
CAPITAL MARKETS & INVESTMENT ANALYSIS OFFICE • One New York Plaza, Suite 4210 • New York, NY 10004	p 212 398 9000	f 212 382 4207

Part One - Purposes, General Policies and Instructions to the SVO ...

Section 2. Policies Defining the SVO Staff Function ...

b) Review of SVO Credit, Classification or Valuation Decisions

(i) Requests for Clarification of SVO Decisions

Any insurer that owns a security for which the SVO has provided an NAIC Designation, a classification or a valuation, ~~or which is an SCA investment~~, may request a clarification of the decision from the SVO ...

(ii) Appeals of SVO Analytical Decisions

(A) Condition to Filing of an Appeal

Any insurer that owns a security for which the SVO has performed a credit assessment, a classification analysis or a valuation, ~~or which is an SCA investment~~, may appeal the SVO credit assessment, classification or valuation decision, provided that the appeal must be filed within 120 days of the SVO decision ...

(B) Procedure for Filing an Appeal ...

This appeal procedure applies only to situations where the SVO has expressed an analytical conclusion in the exercise of its ~~quality assessment, credit risk assessment, classification or valuation functions or its analysis of Subsidiary, Controlled and Affiliated (SCA) investments~~. The stated procedure encompasses initial filings, annual updates and securities not rated by an NAIC CRP...

(v) Review of SVO Decisions by the VOS/TF

(A) Task Force Review for Alleged Violations of Procedures

(1) Request for Review

Any insurer that has filed a security for an NAIC Designation, a classification or a valuation, ~~or which is an SCA investment~~, and is concerned that a decision relative to the security was not made in accordance with the procedures in this Manual, may request consideration of this concern by the VOS/TF.

Section 3. Internal Administration ...

b) Definitions of NAIC Designation Categories, Valuation Indicators, Administrative Symbols and Conventions

...

(v) SVO Administrative Symbols

SVO administrative symbols convey information about a security or an administrative procedure instead of an opinion of credit quality or Unit Price. The administrative symbols in use by the SVO and their meanings are described below ...

~~(B) — The SVO SCA Companies Group Administrative Symbols~~

~~The SVO SCA Companies Group uses the following administrative symbols to denote the status of the filing or to comment on the value claimed by the reporting insurance company. The symbols and their meaning are published here solely to facilitate understanding by NAIC members.~~

~~* — When entered in the status field of the VOS Database screen:~~

~~**NV** — signifies Not Valued and means that the SVO SCA Companies Group has received and processed a SUB-1 form filing for the SCA investment shown. See Part Five, Section 2(d)(v) of this Manual for a discussion of the significance of this administrative symbol.~~

~~**AP** — indicates that the value claimed by the reporting insurance company for the SCA investment in its SUB-2 filing was approved by the SVO SCA Companies Group and entered into the status field of the VOS Database screen.~~

~~**D** — indicates that the value claimed by the reporting insurance company in its SUB 2 filing was disapproved, the value entered in the status field of the VOS Database screen was determined by the SCA Companies Group and the two values differ materially.~~

~~**R** — indicates that the information submitted in support of a SUB 1 or SUB 2 filing is incomplete and the SVO SCA Companies Group has issued an InfoReq request for the missing information.~~

~~▪ — When entered in the comment field of the VOS Database screen:~~

~~**a** — indicates that the value claimed by the reporting insurance company in its SUB 2 filing was disapproved, the value entered into the comment field of the VOS Database screen was determined by the SVO SCA Companies Group and the two values differ slightly.~~

~~**e** — indicates that the value entered in the comment field of VOS Database screen differs materially from the value claimed by the reporting insurance company for the SCA investment. This administrative symbol is only used with the status field administrative symbol D discussed above.~~

~~**i** — indicate that the value entered in the comment field of the VOS Database was not calculated on the basis of 12/31 financial statements.~~

~~▪ — When entered by an insurance company in its annual financial statement blank:~~

~~**J** — means, when used in context of SCA Companies Group, that the valuation reported for the SCA investment was reviewed by the SVO and was deemed to be reasonable, calculated in accordance with an appropriate valuation method under Part Five, Section 2 (c) of this Manual, and calculated accurately by the insurance company.~~

~~**K** — when used to report an SCA investment, means that the valuation reported for the SCA investment was not assigned or reviewed by the SVO but was derived by the insurance company itself pending a valuation analysis by the SVO, or is an SCA investment described in Part Five, Section 2(b) (iv) (B) of this Manual, that is not required to be reviewed by the SVO.~~

...

Part Two Filing with the SVO

Section 1. General Definitions Used In This Manual

The following definitions are intended to have relevance only for this Manual. No suggestion is intended that these definitions have any relevance to any other NAIC publication ...

~~SCA (Subsidiary, Controlled or Affiliated) company, as used in Part Five, Section 2 of this Manual and other portions of this Manual related to Part Five, Section 2 of this Manual, means a company (the SCA company) that is in a relationship with another company ("person") that possesses, directly or indirectly, the power to direct or cause the direction of the management and policies of the SCA company, whether through the ownership of voting securities, by contract (other than a commercial contract for goods or non-management services) by common management or otherwise, unless the power is the result of an official position with or corporate office held by the company. Control shall be presumed to exist if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing ten percent (10%) or more of the voting securities of any other person.~~

Section 8. When to use SUB 1 or SUB 2 Forms Investments in Subsidiary, Controlled and Affiliated Entities

~~An investment in the form of common stock issued by an insurance or non insurance subsidiary, controlled or affiliated company of the reporting insurance company or an investment in the form of a preferred stock issued by an insurance subsidiary, controlled or affiliated company of the reporting insurance company is reported by filing a SUB 1 form within 30 days of the acquisition or formation of the investment.~~

~~An insurer makes a SUB 1 filing in order to report the SCA investment to the SVO and to obtain confirmation that the investment is economic and reasonable within the meaning of Part Five, Section 2 (d)(iii) of this Manual.~~

~~In June of the following year, the insurance company that reported the SCA investment on a SUB 1 form in the previous year is required to file a SUB 2 form. SUB 2 filings are made in order to obtain SVO's opinion as to whether the value claimed by the insurer is approved or disapproved as the value to be reported on its next NAIC Financial Statement Blank. Refer to Part Five, Section 2 of this Manual for a detailed description of the procedures and criteria applicable to SUB 1 and SUB 2 form filings.~~

~~To generate the appropriate form, the reporting insurance company highlights the appropriate menu item in ISIS. With either form, a valid securities identifier and an NAIC Company Code for the parent, ultimate parent and/or the subsidiary, controlled or affiliated company that is the subject of the filing is required. No SIC Code is required for an SCA filing.~~

An investment in the form of common stock issued by an insurance or non-insurance subsidiary, controlled or affiliated (SCA) entity of the reporting insurance company or an investment in the form of a preferred stock issued by an insurance subsidiary, controlled or affiliated company of the reporting insurance company **is required to be filed with the NAIC Financial Regulatory Services Division in the manner and form and with the documentation provided for in the Appendix to *Statement of Statutory Accounting Principles (SSAP) No. 97, Investments in Subsidiary, Controlled and Affiliated Entities.***

An investment in the form of a bond issued by an insurance or noninsurance SCA entity of the reporting insurance company **is filed with the SVO.** To file an SCA bond investment, the reporting insurance company files a completed SAR, an Audited Financial Statement for the subsidiary, a copy of the corporate resolution authorizing the issuance of the debt, written evidence that the transaction has been approved by the state of domicile or that no such approval is necessary and, if the subsidiary is an insurance company, the subsidiary's most recent NAIC Financial Statement Blank, together with the reporting insurance company's NAIC Financial Statement Blank, internal investment committee memorandum for the investment and loan documentation appropriate to the transaction.

An investment in the form of a preferred stock issued by a noninsurance SCA entity of the reporting insurance company **is filed with the SVO.** To file an SCA preferred stock issued by a non-insurer, the reporting insurance company files an Audited Financial Statement for the issuer of the preferred stock, a copy of the corporate resolution authorizing the issuance of the preferred stock, written evidence that the transaction has been approved by the state of domicile or that no such approval is necessary, together with details of the terms of the preferred stock, as well as the NAIC Financial Statement Blank for the reporting insurance company.

Part Three, Section 2(d) of this Manual describes the additional analytical procedures applicable to such filings.

Section 10. Reporting Conventions and Required Documents ...

c) Reporting Conventions and Required Documents

Specific reporting conventions for initial reports that all reporting insurance companies should follow are described below ...

~~(iv) — Subsidiaries, Controlled and Affiliated (SCA) Companies~~

~~(A) — Debt Issued by an SCA Company~~

~~Responsibility for analysis and valuation of SCA investments in the form of a bond is assigned to SVO Corporate Securities Group. Part Three, Section 2(d) of this Manual describes the additional analytical procedures applicable to such filings. To report an SCA bond investment, the reporting insurance company shall file a completed SAR, an Audited Financial Statement for the subsidiary, a copy of the corporate resolution authorizing the issuance of the debt, written evidence that the transaction has been approved by the state of domicile or that no such approval is necessary and, if the subsidiary is an insurance company, the subsidiary's most recent NAIC Financial Statement Blank, together with the reporting insurance~~

~~company's NAIC Financial Statement Blank, internal investment committee memorandum for the investment and loan documentation appropriate to the transaction.~~

~~(B) — Preferred Stock Issued by an SCA Company~~

~~Responsibility for analysis and valuation of SCA investments in the form of preferred stock issued by a non-insurer is assigned to the SVO Corporate Securities Group. Part Three, Section 2(d) of this Manual describes the additional analytical procedures applicable to such filings.~~

~~To report an SCA preferred stock issued by a non-insurer, the reporting insurance company shall file an Audited Financial Statement for the issuer of the preferred stock, a copy of the corporate resolution authorizing the issuance of the preferred stock, written evidence that the transaction has been approved by the state of domicile or that no such approval is necessary, together with details of the terms of the preferred stock, as well as the NAIC Financial Statement Blank for the reporting insurance company.~~

~~(C) — Common Stock and Preferred Stock Issued by an SCA Company~~

~~Responsibility for analysis and valuation of SCA investments in the form of common stock and preferred stock issued by an insurer is assigned to the SVO SCA Companies Group. Common stock of an SCA company may be filed using any of the valuation methods listed under Part Five, Section 2(e)(i)(B)(1) and (2) of this Manual. The following paragraphs detail the documentation that must accompany SUB form filings for year end when any one of the valuation methods discussed in Part Five, Section 2(e) of this Manual, is chosen. Prior to following these instructions, the reader should be thoroughly familiar with Part Five, Section 2 of this Manual. Insurance companies without Audited Financial Statements should use the statutory equity method discussed immediately below.~~

~~If the statutory equity* method in Part Five, Section 2(e)(i)(B)(1) and (2) of this Manual is chosen, submit:~~

- ~~(1) — The most recent NAIC Financial Statement Blank of the direct insurer Parent,~~
- ~~(2) — The balance sheet & income statement of the SCA Company (adjusted for non-admitted assets), and~~
- ~~(3) — The Treasury Stock Form (required where there is mutual ownership of common stock between the parent and the SCA).~~

~~See, Part Five, Section 2(b)(iv) of this Manual for a Special Reporting Instruction applicable to SCA investments involving domestic insurance company subsidiaries.~~

~~If the GAAP Equity method in Part Five, Section 2(e)(i)(B)(3) of this Manual is chosen, submit:~~

- ~~(1) — The most recent NAIC Financial Statement Blank and Audited Financial Statement of the Parent,~~
- ~~(2) — The latest Audited Financial Statement of the SCA Company,~~
- ~~(3) — The Goodwill Work Sheet (if goodwill is part of the value), and~~
- ~~(4) — The Treasury Stock Form (required where there is mutual ownership of common stock between the Parent and the SCA Company).~~

~~If the Market Value method in Part Five, Section 2(e)(i)(A) of this Manual is chosen, submit:~~

- ~~(1) — The most recent NAIC Financial Statement Blank of the Parent,~~
- ~~(2) — The most recent Audited Financial Statement of the SCA Company, and~~
- ~~(3) — The Treasury Stock Form (required where there is mutual ownership of common stock between the Parent and the SCA Company).~~

~~SSAP No. 97, paragraph 8a sets forth base discount percentages that are tied to the ownership percentages in an SCA valued at market value. Pursuant to paragraph 7, the SVO may determine a discount rate above the established base discounts. The~~

~~reporting insurance company may obtain the discount rate to be applied to its common stock from the Manager of the Subsidiaries Group of the SVO.~~

~~If the Preferred Stock of Insurance Subsidiaries method in Part Five, Section 2(c)(i)(B)(6) of this Manual is chosen, submit:~~

- ~~(1) — The most recent NAIC Financial Statement Blank of the Parent,~~
- ~~(2) — The most recent Audited Financial Statement of the SCA Company if it is not an insurance company or the most recent NAIC Financial Statement Blank of the SCA company if it is an insurance company, and~~
- ~~(3) — A document containing the details and terms of the preferred stock.~~

~~If the Foreign Subsidiary method in Part Five, Section 2(c)(i)(B)(4) and (5) of this Manual is chosen, submit:~~

- ~~(1) — The most recent NAIC Financial Statement Blank of Parent, and~~
- ~~(2) — The most recent Audited Financial Statement (in English) of the SCA Company.~~

Section 11. Subsequent Reporting ...

e) Reporting Conventions and Required Documents

Specific reporting conventions that all reporting insurance companies should follow are described below ...

~~(vii) — Subsidiary, Affiliated and Controlled Companies~~

~~— Subsequent reporting for an SCA company consists of the filing of a SUB 2 form and the documentation required under Section 10(c)(iv) of this Part above.~~

Part Three – Credit Assessment

Section 2. Corporate Bonds and Preferred Stock – Special Assessment Situations

Bonds and preferred stock that fit the description set out below shall be subject to the general procedures specified above as well as the specific or special procedures identified below.

d) SCA Debt and Preferred Stock

~~Part Five, Section 2 of this Manual governs valuation of Subsidiary, Controlled and Affiliated (SCA) investments in the form of common stock and in the form of preferred stock issued by an insurance company.~~ This section applies to credit assessment of any SCA investment in the form of a debt instrument purchased (or otherwise acquired) from an insurance or non-insurance entity (SCA debt) and preferred stock issued by a non-insurer entity (SCA preferred stock). This procedure is used to determine whether an SCA debt or SCA preferred transaction is eligible for reporting as an Investment Security pursuant to Part Two Section 2 (a) of this Manual.

(i) Procedure

Prior to applying the procedures required by Part Five, Section 2 of this Manual, the SVO shall:

(A) Confirm that the SCA relationship has been reported to the NAIC Financial Reporting Services Division, SVO per Part Five, Section 2 of this Manual and that the SVO has conducted the analysis required by Part Five, Section 2(d)(iii) of this Manual and found the SCA common stock transaction to be reasonable within the meaning of that section. ~~If the SCA common stock transaction has not been reported, the SVO shall issue an InfoReq for documentation pertinent to the SCA common stock transaction and conduct the analysis required by Part Five, Section 2(d)(iii) of this Manual before processing the SCA debt or SCA preferred stock. If the SCA common stock transaction was reported but was not deemed to be reasonable, the SVO shall not process the SCA debt or SCA preferred stock transaction and shall inform the reporting insurance company and the state of domicile in writing of this decision.~~

(B) If the SCA common stock transaction was reported and found to be reasonable, the SVO shall:

(1) Inform the state insurance department of the reporting insurance company's state of domicile that the SCA debt or SCA preferred stock has been filed with the SVO.

~~(2) Review the holding company system of which the reporting insurance company is a part, including the impact that the SCA transaction may have on SVO's ability to assign an NAIC Designation to the SCA debt or SCA preferred stock transaction.~~

(3) Evaluate whether the SCA debt or SCA preferred stock is an arms-length and an economic transaction within the meaning of NAIC statutory accounting guidance on related party transactions. ~~In making this determination, the Corporate Securities Group shall consider the same elements discussed in Part Five, Section 2(d)(iii) of this Manual and may consider other appropriate criteria as well.~~

(4) Evaluate whether the SCA debt or SCA preferred stock transaction is circular within the meaning of Part One, Section 2(c)(ii) of this Manual.

(5) In the case of SCA preferred stock, determine the SCA preferred stock issuer's senior unsecured debt designation and obtain the appropriate designation level for the preferred stock by applying the methodology specified in Section 1(b) of this Part above ...

~~Part Five—Valuation of Securities~~

~~Section 2. Valuation of Subsidiary Controlled and Affiliated Investments~~

~~a) — The SCA Reporting Cycle~~

~~An SCA investment, as defined in Part Two, Section 1 of this Manual, purchased during any one calendar year will be reported to the SVO on a SUB 1 form within 30 days of the acquisition or formation of the investment. The SVO will process that filing in the same year but will not at that time approve or disapprove a value for the SCA investment. By June of the following year, the insurance company will submit a SUB 2 filing for the previously purchased SCA investment reported on a SUB 1 form and later that year, the SVO SCA Companies Group will approve a value for the transaction. The value approved by the SVO at the conclusion of the SUB 2 form filing is reported by the insurance company on its NAIC Financial Statement Blank. If the insurance company has reported a value for the SCA investment on its NAIC Financial Statement Blank that differs from the value approved by the SVO, the insurer is required to adjust the reported value in its next quarterly NAIC Financial Statement Blank unless otherwise directed by the insurer's state of domicile.~~

~~b) — Reporting Framework~~

~~(i) — Value of Common Stock~~

~~Insurance companies described in Part Two, Section 2(a) of this Manual, shall use one of the valuation methods described in sub paragraph (c) below to calculate the value of their common stock investments in insurance and non insurance SCA companies. Not later than June 1 for existing SCA investments, and within 30 days of the acquisition or formation of a new SCA investment, an insurance company shall calculate the value of its common stock investments in foreign insurance and all non insurance company SCA entities and report the value to the SVO. Please refer to sub paragraph (b)(iv)(B) of this Section, below.~~

~~(ii) — Initial Reporting of SCA Investments~~

~~(A) — Reporting Method~~

~~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 NAIC Financial Statement Blank, (ii) which method of those described in sub paragraph (c) below 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 SVO only if the SVO determines it has been provided with all material information with respect to all SCA companies of the reporting insurance company that require valuation.~~

~~(B) — Purpose of SUB 1 Form Filing~~

~~The purpose of a SUB 1 filing is to determine whether the reported SCA investment provides economic value to the insurance company and whether the value claimed is reasonable in view of the totality of the transaction and the specifics of the insurance company. If the SVO SCA Companies Group determines that the reported transaction meets the tests specified in this sub Part, it enters the administrative symbol NV in the status field of the VOS Database screen. If the SVO SCA Companies Group determines that the transaction does not meet the tests specified in this sub Part, it shall not enter the transaction into the VOS Database and instead notifies the reporting insurance company and the state of domicile in writing of its determination.~~

~~(iii) — Subsequent Reporting of SCA Investments~~

~~(A) — Reporting Method~~

~~By June of the year following the acquisition or formation, and reporting of an SCA investment on the SUB 1 form, the insurance company shall submit a SUB 2 form filing for the same SCA investment.~~

~~(B) — Compliance and Administration~~

~~Each year the SVO SCA Companies Group shall compile a list of all SCA investments reported as SUB 1 form filings for which a SUB 2 form filing has not yet been received. For these transactions, the SVO SCA Companies Group 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.~~

~~By June 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. All SCA investments from the same ultimate Holding Company must be submitted together.~~

~~(C) — Purpose of SUB 2 Form Filing~~

~~As more specifically described below, 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 NAIC Financial Statement Blank.~~

~~(iv) — Special Instructions~~

~~(A) — SCA Investments Completed at or Near Year-End~~

~~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 SVO SCA Companies Group is authorized to accept a SUB 1 filing from such an insurance company and to process such SUB 1 filing as a combined SUB 1 and SUB 2 filing.~~

~~(B) — Special Instruction — Book Value of U.S. Insurer's Common Stock~~

~~No filing of an investment in the common stock of a domestic SCA insurance company valued pursuant to Part Five, Section 2, (c)(i)(B)(1) of this Manual shall be made with the SVO after January 1, 1999. Insurers who select the Section 2(c)(i)(B)(1) valuation method to value an investment of common stock of a U.S. insurance SCA company after January 1, 1999 shall continue to apply the methodology and rules of this valuation method. The calculations made in support of such valuations and the rationale employed to address other relevant issues under Section 2(c)(i)(B)(1) of this Part shall be retained for the benefit of state insurance examiners.~~

~~(v) — Consistency in Application of Chosen Valuation Method~~

~~Nothing in this Part shall be read as requiring an insurance company to value all of its SCA company common stock pursuant to the same method. However, the valuation method used for a specific SCA company shall be applied consistently from year~~

~~to year. An insurer that has previously selected any valuation method and that now wishes to change to another valuation method 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 SVO with evidence of that approval as part of the SUB 1 or SUB 2 filing.~~

~~e) Valuation Methods~~

~~Statutory accounting guidance for investments in SCA entities is contained in:~~

~~SSAP No. 97 Investments in Subsidiary, Controlled and Affiliated Entities, A Replacement of SSAP No. 88;~~

~~SSAP No. 68 Business Combinations and Goodwill;~~

~~SSAP No. 41 Surplus Notes; and~~

~~SSAP No. 32 Investments in Preferred Stock, (including investments in preferred stock of subsidiary, controlled and affiliated entities).~~

~~The reader should refer to the NAIC Accounting Practices and Procedures Manual for detailed accounting guidance.~~

~~(i) Market and Equity Valuation Methods~~

~~Insurance companies may use the Market Valuation Method described in paragraph (A) below or one of the equity methods described in paragraph (B) below. For investments in SCAs described in Section 2(e)(i)(B) 1, 2, 3, 4, 5 and 6 of this Part, the reporting insurance company shall compute its shares of earnings or losses after deducting the investee's preferred dividends on outstanding cumulative preferred stock, whether or not such dividends are declared.~~

~~(A) Market Valuation Method~~

~~(1) Conditions to Use~~

~~A reporting insurance company may use the Market Valuation Method for any subsidiary whose common stock trades on the New York Stock Exchange, the American Stock Exchange, the NASDAQ National Exchange, or the Tokyo Stock Exchange provided ownership in the subsidiary is between 10% and 85%. Once the reporting insurance company uses the Market Valuation Method for a particular subsidiary, it must obtain the approval of the domiciliary commissioner before changing the valuation method to an equity method. The SCA must have at least 2 million shares outstanding with a total market value of at least \$50 million in the public's control.~~

~~(2) Calculation of Discount Rate~~

~~(X) Upon receipt of subsidiary information, the SVO shall calculate the subsidiary's market value by reference to the market value of the stock, discounted for size and depth of the market and, in the case of restricted common stock, for legal restrictions on transferability.~~

~~(Y) The resulting discount rate may be greater depending on the ownership percentages (measured at the holding company level) detailed below.~~

~~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;~~

~~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;~~

~~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. 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~~

~~Any ownership percentages exceeding 85% will result in the SCA being recorded on an equity method.~~

~~(Z) — The reporting insurance company that selects this method shall obtain the discount rate to be applied to its common stock from the SVO. The discounts listed above are minimum discounts. The SVO calculation may result in discounts in market value higher than the illustrations set forth above.~~

~~(B) — Equity Methods~~

~~If a SCA investment does not meet the requirements for the market valuation approach in Section 2(c)(i)(A) of this Part above, or if the requirements are met, but a reporting entity elects not to use the market valuation approach, the reporting entity's proportionate share of its investments in SCAs shall be recorded as follows:~~

~~(1) — Investments in U.S. Insurance SCA Entities~~

~~Investments in U.S. insurance SCA entities shall be recorded based on the underlying audited statutory equity (where equity is defined as net of preferred stock and surplus notes of the investee) of the respective entity's financial statements, adjusted for any unamortized goodwill as provided for in SSAP No. 68.~~

~~(2) — Investments in Non-Insurance SCA Entities Statutory Basis~~

~~Investments in non-insurance SCA entities engaged in the activities described in SSAP No. 97, paragraph 8b.ii. shall be adjusted to an audited statutory basis of accounting, if 20% or more of the SCA's revenue is generated from the reporting entities and its affiliates. For purposes of this section, revenue means GAAP revenue reported in the audited GAAP financial statements, excluding realized and unrealized capital gains and losses. Statutory basis of accounting shall be based on the underlying audited U.S. GAAP equity of the respective entity with the adjustments required by paragraph 9 of SSAP No. 97. If the reporting entity also holds an investment in preferred stock and or surplus notes refer to paragraphs 23 through 27 of SSAP No. 97. For guidance on investments in downstream holding companies refer to paragraphs 17-19 of SSAP No. 97.~~

~~(3) — Investments in Non-Insurance SCA Entities GAAP Basis~~

~~Investments in non-insurance SCA entities that do not qualify under the preceding subparagraph (B)(2) shall be recorded based on the audited GAAP equity of the investee.~~

~~(4) — Investments in Foreign Insurance SCA Entities~~

~~Investments in foreign insurance SCA entities shall be recorded based on the underlying audited US GAAP equity of the respective entity adjusted to a statutory basis of accounting, for reserves of the foreign insurance SCA with respect to the business it assumes directly and indirectly from an US insurer using the statutory accounting principles promulgated in the NAIC Accounting Practices and Procedures Manual and for any audit adjustments resulting from the annual GAAP audit. Statutory basis of accounting shall be based on the underlying U.S. GAAP equity of the respective entity with the adjustments required by paragraph 9 of SSAP No. 97.~~

~~GAAP is defined as those pronouncements included in the United States GAAP Hierarchy as described in AICPA Statement of Auditing Standard No. 69, The Meaning of Present Fairly in Conformity With GAAP. Foreign SCA entities are defined as those entities incorporated or otherwise legally formed under the laws of a foreign country. Foreign insurance SCA entities are defined as alien insurers formed according to the legal requirements of a foreign country.~~

~~(5) — Investments in Foreign Non-Insurance SCA Entities~~

~~Investments in foreign non-insurance SCA entities shall follow the guidance in this Section 2 (c)(i)(B)(2) or (3) based on the revenue and activity criteria noted above, which requires that accounting be based on the underlying adjusted audited US GAAP equity of the respective entity. Statutory basis of accounting shall be based on the underlying audited US GAAP equity of the respective entity with the adjustments required by paragraph 9 of SSAP No. 97.~~

~~(6) — Investments in the Preferred Stock of an SCA~~

~~Investments in the preferred stock of an SCA shall be accounted for in accordance with the provisions of SSAP No. 32. If in addition to preferred stock the reporting entity also holds an investment in common stock and/or surplus notes refer to paragraphs 23 through 27 of SSAP No. 97 and paragraph 10 of SSAP No. 41.~~

~~d) — SVO Assessment and Review of SUB 1 Form~~

~~Upon receipt of the reporting insurance company's SUB 1 filing, the SVO SCA Companies Group shall conduct an assessment in the following manner:~~

~~(i) — Extraneous Factors~~

~~If the SVO SCA Companies Group 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 SVO SCA Companies Group shall take such action as seems appropriate under the circumstances. If no concerns or issues relevant to valuation exist, the SVO SCA Companies Group shall proceed to the step described in (ii) below.~~

~~(ii) — Appropriateness of Valuation Method~~

~~The SVO SCA Companies Group 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 Section 2(e)(i)A and B of this Part above. If a reporting insurance company submits a SUB 1 form filing that reports a value calculated under an inappropriate method, the SVO SCA Companies Group 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. Upon completion of this review process, the SVO SCA Companies Group shall proceed to the step described in (iii) below.~~

~~(iii) — Assess Transaction~~

~~The SVO SCA Companies Group 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 SVO SCA Companies Group may consider other factors that appear relevant from the context of the transaction including:~~

~~(A) — The specific tax, accounting or other regulatory treatment sought.~~

~~(B) — Whether the transaction effects a legally effective, binding and permanent transfer of the risks and rewards of ownership.~~

~~(C) — The effect of the SCA valuation on the solvency of the insurer.~~

~~(D) — 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.~~

~~(E) — The right to dividends or other payments from the SCA and any limitations thereto.~~

~~(F) — The nature, extent and demonstrable financial value of the business operations of the SCA.~~

~~(G) — The value of the assets owned by the SCA.~~

~~If the SVO SCA Companies Group 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 SVO SCA Companies Group shall notify the reporting insurance company and the NAIC member of the reporting insurance company's state of domicile and request guidance.~~

~~(iv) — Valuation Method~~

~~If the SVO SCA Companies Group determines that the SCA investment raises no issues under subsection (iii) above, the SVO SCA Companies Group shall proceed to review whether the reporting insurance company has correctly applied the~~

~~procedure described in Section 2(c) of this Part for the chosen valuation method and made the adjustments called for in sub-paragraph (f) below.~~

~~(v) — Enter Not Valued (NV)~~

~~If the SCA investment reported on the SUB 1 form filing is deemed to meet the assessment and reviews described in subsections (i) through (iv) above, the SVO SCA Companies Group shall enter the administrative symbol NV in the status field of the VOS Database. The administrative symbol NV will be applied to every SUB 1 filing where the reported SCA investment meets the tests described above, with the exception of those filings described under Section 2(b)(iv) of this Part above. The NV symbol will be revised to a value if and when the filer submits a SUB 2 form on the same transaction and the SCA Companies Group approves a final value based on the information provided.~~

~~Assignment of the administrative symbol NV to an SCA investment does not mean and shall not be interpreted to mean that the SVO is expressing an opinion as to the value claimed by the reporting insurance company for the reported SCA investment. The NV administrative symbol implies only that based on the information provided the SVO SCA Companies Group has determined that the SCA investment meets the tests described in this sub-paragraph (d).~~

~~e) — SVO Assessment and Review of SUB 2 Form~~

~~(i) — Monitoring of VOS Database~~

~~By June 1 of each year, the SVO SCA Companies Group 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 VOS Database. The SVO SCA Companies Group's review shall encompass a review of 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 NAIC Financial Statement Blank to ascertain the materiality of SCA investments and a review of the VOS Database to determine whether SCA debt and SCA preferred securities have been assigned NAIC Designations. As part of its analysis, the SVO shall review the portion of the bond investments carried by the parent or a subsidiary insurer with a Z notation. If the SVO determines that the portion of the Z bonds shown on the documentation is significant, the SVO shall not process the SUB 2 filing until the insurance company reports the bonds to permit removal of the Z notation.~~

~~(ii) — Assess and Adjust Reported Values~~

~~Upon completion of the procedures described above, the SVO SCA Companies Group will determine whether the value reported by the insurance company was calculated in accordance with the instructions for the valuation method chosen and verify that the claimed value reflects the adjustments required by sub-paragraph (f) below.~~

~~(iii) — Check NAIC Financial Statement Blank; Finalize a Value~~

~~(A) — NAIC Financial Statement Blank~~

~~Prior to finalizing a value for the reported SCA investment, the SVO SCA Companies Group will verify that the value reported to the SVO and the value reported on the NAIC Financial Statement Blank are the same. If the values are not the same, the SVO SCA Companies Group will approve the lower value.~~

~~(B) — Finalize Value~~

~~The SVO SCA Companies Group will remove the administrative symbol NV and enter the approved value in the status field of the VOS Database, except in the case of filings made under sub-paragraph 2(b)(iii) of this Part in which case the SCA Companies Group shall assign the final value, if any.~~

~~(C) — Written Notification~~

~~The SVO SCA Companies Group 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 SVO, the SVO SCA~~

~~Companies Group shall enter the administrative symbol D in the status field of the VOS Database and provide written notification to the reporting insurance company and the company's state of domicile of this action.~~

~~f) — Make Adjustments to Reported Value~~

~~The SVO SCA Companies Group shall adjust the value reported by the insurance company on a SUB 1 or SUB 2 filing in accordance with the following procedures:~~

~~(i) — Reduction of Goodwill~~

~~The capital and surplus of a reporting insurance company, reported on the statutory balance sheet filed with the domiciliary state commissioner, may not include an amount greater than 10%, in the aggregate, of goodwill from all sources, including life, accident and health, and deposit type assumption reinsurance. See also, SSAP No. 68 for definitions of and accounting guidance for goodwill.~~

~~(ii) — Non-admitted Asset Value~~

~~(A) — For non insurance SCA entities that meet the revenue and activity criteria of paragraph 8bii of SSAP No. 97 and foreign insurance SCAs described in 8biv, that use a method other than market value, the value of the reporting company's SCA investment is calculated by reducing GAAP equity by the value of any asset that does not conform to the criteria for an admitted asset as outlined in paragraph 9a. of SSAP No. 97.~~

~~(B) — Costs that are capitalized in accordance with GAAP but expensed pursuant to statutory accounting as promulgated in the NAIC Accounting Practices and Procedures Manual (e.g., deferred policy acquisition costs) should be expensed.~~

~~(C) — Capital and surplus shall be adjusted pursuant to the procedure described in paragraph 9c. of SSAP No. 97.~~

~~(D) — Pursuant to paragraph 9d. of SSAP No. 97 in the case of non insurance and foreign insurance SCA entities, the reporting insurance company shall non-admit the amount of goodwill of the SCA in excess of 10% of the audited GAAP equity of the SCA's last audited financial statement.~~

~~(E) — Non-admit the amount of net deferred tax assets (DTAs) of the SCA in excess of 10% of the audited GAAP equity of the SCA's last audited financial statements.~~

~~(F) — Adjust the 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 described in paragraphs 12 and 13 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 those 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.~~

~~(iii) — Reciprocal Ownership~~

~~(A) — Reciprocal Ownership Relationships~~

~~1. — 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 eliminate the value of those shares from the value of the reporting entity. This is referred to as elimination of reciprocal ownership.~~

~~2. — 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.~~

~~3. — 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.~~

~~(B) — Investments in Downstream Holding Companies~~

~~The reader should refer to paragraph 17 of SSAP No. 97 for details regarding the valuation of a downstream holding company. 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 SSAP No. 97. This adjusted amount would then be the reported value of the investment in downstream holding company at the higher level insurance company.~~

~~(C) — Investments in Surplus Notes of a Subsidiary, Controlled and Affiliated Entity~~

~~Investments in the surplus notes of an SCA shall be accounted for in accordance with the provisions of SSAP No. 41. If the reporting entity also holds an investment in preferred stock or surplus notes refer to paragraphs 23 through 27 of SSAP No. 97.~~

G:\DATA\Vos-tf\Meetings\2017\February\B Task Force 2016 Amend P&P For SCAs.docx