

Investment Reporting Update

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Steve Johnson – PA DOI

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- **18 years with PA Department**
- **2001 NAIC Robert Dineen Award recipient**
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- **CPA since 1980**
- **1977 graduate of Shippensburg University (PA)**



Investment Reporting

■ **Outline of Presentation:**

- Quick Recap of Larger Changes Effective 1Q2008
- Substantive Changes Effective Year End 2008
- 2008 Non Substantive Changes
- 2009 Changes

Quick Recap of Larger Changes Effective 1Q2008

Schedule D Verification

MODIFY COLUMNS ON SCHEDULE D VERIFICATION
SCHEDULE D – VERIFICATION BETWEEN YEARS

Bonds and Stocks

- | | |
|---|-------|
| 1. Book/adjusted carrying value, December 31 of prior year | _____ |
| 2. Cost of bonds and stocks acquired, Column 7, Part 3 | _____ |
| 3. Accrual of discount | _____ |
| 4. Unrealized valuation increase (decrease): | _____ |
| 4.1 Column 12, Part 1 | _____ |
| 4.2 Column 15, Part 2, Section 1 | _____ |
| 4.3 Column 13, Part 2, Section 2 | _____ |
| 4.4 Column 11, Part 4 | _____ |
| 5. Total gain (loss) on disposals, Column 19, Part 4 | _____ |
| 6. Deduct consideration for bonds and stocks disposed of Column 7, Part 4 | _____ |
| 7. Amortization of premium | _____ |
| 8. Total foreign exchange change in book adjusted carrying value: | _____ |
| 8.1 Column 15, Part 1 | _____ |
| 8.2 Column 19, Part 2, Section 1 | _____ |
| 8.3 Column 16, Part 2, Section 2 | _____ |
| 8.4 Column 15, Part 4 | _____ |
| 9. Deduct current year's other than temporary impairment recognized | _____ |
| 9.1 Column 14, Part 1 | _____ |
| 9.2 Column 17, Part 2, Section 1 | _____ |
| 9.3 Column 14, Part 2, Section 2 | _____ |
| 9.4 Column 13, Part 4 | _____ |
| 10. Book/adjusted carrying value at end of current period (Lines 1+2+3+4+5-6-7+8-9) | _____ |
| 11. Deduct total nonadmitted amounts | _____ |
| 12. Statement value at end of current period (Line 10 minus 11) | _____ |

Schedule D Verification

SCHEDULE D – VERIFICATION BETWEEN YEARS

Bonds and Stocks	
1.	Book/adjusted carrying value, of bonds and stocks, December 31 of prior year
2.	Cost of bonds and stocks acquired, Column 7, Part 3
3.	Accrual of discount
4.	Unrealized valuation (increase (decrease) by adjustment:
4.1	Columns 12–14, Part 1
4.2	Columns 15–17, Part 2, Section 1
4.3	Column 1513, Part 2, Section 2
4.4	Columns 11–13, Part 4
5.	Total gain (loss) on disposals, Column 19, Part 4
6.	Deduct consideration for bonds and stocks disposed of Column 7, Part 4
7.	Amortization of premium
8.	Total foreign exchange change in book adjusted carrying value:
8.1	Column 15, Part 1
8.2	Column 19, Part 2, Section 1
8.3	Column 16, Part 2, Section 2
8.4	Column 15, Part 4
9.	Deduct current year's other than temporary impairment recognized
9.1	Column 14, Part 1
9.2	Column 17, Part 2, Section 1
9.3	Column 14, Part 2, Section 2
9.4	Column 15, Part 4
10.	Book/adjusted carrying value at end of current period (Lines 1+2+3+4+5-6-7+8-9)
11.	Total valuation allowance
12.	Subtotal (Lines 9 plus 10)
11.	Deduct total nonadmitted amounts
12.	Statement value at end of current period (Line 10 minus 11)

Schedule D Verification Changes

Schedule D Verification (Pertains to Annual Changes, quarterly changes are for consistency with annual with differences where necessary):

- 1) Move to previous page with Schedule BA Verification, making Summary of Country separate page, and make one column format like others.
- 2) Make single description column like other schedules, thus allowing longer descriptions.
- 3) Change line 4 from increase/decrease by adjustment to unrealized valuation increase/decrease to be consistent with the underlying detail schedule.
- 5) Add the word “on disposals” to gain (loss) to be consistent with other Verification schedules.

Schedule D Verification Changes

Schedule D Verification (Pertains to Annual Changes, quarterly changes are for consistency with annual with differences where necessary):

- 6) Add Current Year's Other than Temporary Impairment at line 9 to be consistent with the underlying detail schedule.
- 7) Add formula to line 10 as well as new line 12 to see the appropriate sign of each row.
- 8) Delete Total valuation allowance line and the subtotal line that follows and renumber.
- 9) Add the word "Deduct" to line 11, thereby giving instruction for how this line should be entered.
- 10) Change wording (allow more room) of last line to "Statement value at end of current period."

QUARTERLY: SCHEDULE A, B, BA

PART 2

Showing All Real Estate, Mortgage Loans and Other Long-Term Investments ACQUIRED During the Current Quarter

PART 3

Showing All Real Estate, Mortgage Loans and Other Long-Term Investments DISPOSED, Transferred or Repaid During the Current Quarter

ANNUAL: SCHEDULE A, B, BA

PART 1

Showing All Real Estate, Mortgage Loans and Other Long-Term Investments OWNED December 31 of Current Year

PART 2

Showing All Real Estate, Mortgage Loans and Other Long-Term Investments Loans ACQUIRED During the Year

PART 3

Showing All Real Estate, Mortgage Loans and Other Long-Term Investments DISPOSED, Transferred or Repaid During the Year

Annual Schedule D, Pt 1A


► Add new footnote to Quarterly Schedule D, Part 1B and Annual Schedule D, Part 1A, Section 1

- Allows companies to include non-rated, short-term investments and cash equivalents in those schedules, despite the fact that they are not rated.

SCHEDULE D – PART 1A – SECTION 1

Quality and Maturity Distribution of All Bonds Owned December 31, at Book/Adjusted Carrying Values by Major Types of Issues and NAIC Designations

l) Includes the following amount of non-rated short-term and cash equivalent bonds by NAIC designation: NAIC 1 \$ ___; NAIC 2 \$ ___; NAIC 3 ___; NAIC 4 \$ ___; NAIC 5 \$ ___; NAIC 6 \$ ___.



Summary of Substantive Changes Effective Year-End 2008



Summary Investment Pages

- **Relocate Summary Investment Schedule with the Detail Investment Schedules**
 - Allows all investment pages to be located easier
 - Allows non investment pages to be located easier
 - Results in changes to the PDFs as well (all investment pages to be included in one PDF)
 - Results in new SI pages before the E Pages
 - Summary Investment Schedule
 - Sch A, B, BA, D verifications
 - Summary By Country
 - Schedule D Part1A
 - Schedule DA verifications followed by Replication
 - Schedule E verification
 - E Pages

Summary Investment Schedule

- Clarify the correct reporting of money market mutual funds and bond funds
- Line 2 – Other debt & Other Fixed Income Securities (excluding short-term)
 - Include Class One Bond Mutual Funds & Exchange Traded Funds
- Line 3.1 – Investments in Mutual Funds
 - Include only mutual funds reported in Sch Part 2-2
- Line 8 – Cash, Cash Equivalents and Short-term investments
 - Specifies to include Exempt MMFs and Class One MMFs

Schedule D, Code Column

- Add various new codes for different reasons.
 - Add code “M” for securities not under the exclusive control for multiple reasons.
 - Enter “@” in this column for all Principal STRIP Bonds or other zero coupon bonds, and “&” for To Be Announced (TBA) bonds.
 - Enter “*” for Class One Bond Mutual Funds and “#” for Exchange Traded Funds in the “Code” (Column 3) column.

SCHEDULE D – PART 1

Showing All Long-Term BONDS Owned December 31 of Current Year

Codes	
3	
Code	

Schedule D, Foreign Column

- **Modify the instruction to refer to the Investment Schedules General Instructions for determining the appropriate code.**
- **Add matrix to Schedule D and DA.**

SCHEDULE D – PART 1

Showing All Long-Term BONDS Owned December 31 of Current Year

Codes	
	4
	Foreign

Schedule D, Foreign Column

Code	Nationality of Issuer			Country Issued In			Currency of Security		
	US	Can	Foreign	US	Can	Foreign	US	Can	Foreign
None	Y	N	N	Y	N	N	Y	N	N
A	N	Y	N	N	Y	N	Y	N	N
C	Y	Y	Y	N	Y	Y	N	Y	N
D	N	N	Y	N	N	Y	N	N	Y
F	N	N	Y	N	N	Y	Y	N	N
I	N	Y	N	Y	N	N	Y	N	N
R	N	N	Y	Y	N	N	Y	N	N
T	N	Y	N	Y	Y	Y	N	N	Y
U	N	Y	N	Y	N	N	N	Y	N
O	Y	N	N	Y	N	N	N	N	Y

Schedule D, Interest Columns

- **Principal STRIP Bonds or other zero coupon bonds**
 - Allows rate of interest to be entered as zero.
 - Allows N/A to be entered for how paid.

SCHEDULE D – PART 1
Showing All Long-Term BONDS Owned December 31 of Current Year

Interest	
16	18
Rate Of	How Paid

Schedule D Pt 1-Column 22

- ▶ **Add instructions to Schedule D, Parts 1, 4, and 1A for maturity date reporting.**
 - (Perpetual bonds S/B 1/1/YYYY where YYYY is =9999)

SCHEDULE D – PART 1
Showing All Long-Term BONDS Owned December 31 of Current Year

Dates	
21	22
Acquired	Maturity
	01/01/9999

Sch D (& DA) Maturity Column

■ Schedule D

- Leave “Maturity Date” field blank for Class One Bond Mutual Funds and “#” for Exchange Traded Funds. No crosscheck error because of “*” and “#” symbols added for code column.

■ Schedule DA

- Leave “Maturity Date” field blank for Exempt and Class One Money Market Funds. No crosscheck error because specs changed to allow this for lines 7999999 & 8099999.

SCHEDULE D – PART 1

Showing All Long-Term BONDS Owned December 31 of Current Year

Dates
22*
Maturity

*Column 6 on
Schedule DA

Supplemental Investment Risk Interrogatories

- Clarify an issuer may have more than one unique series of CUSIP numbers, this should be taken into account when determining the 10 largest exposures to a single issuer/borrower/investment.
 - i.e. FNMAs/ FHLMCs CMOs



Fair Value

- Add a column for method used to obtain fair value to Schedule D, Part 1 and Schedule D, Part 2, Sections 1 & 2.

- Make the column an **electronic only** column for Schedule D, Part 1 and Schedule D, Part 2, Sections 1 & 2.



Fair Value Column

- Reason for Proposal
 - Do not believe insurers comply with Part 6 of the SVO manual
 - Changes the current requirements as it pertains to obtaining a unit price.
 - Part 6 of the SVO P&P Manual provides
 - Publicly traded securities-SVO selects the public price reported for the last trading day of the year, and reports that unit price
 - Private placements-Insurance companies provide the SVO with two written price quotes on the letterhead of financial institutions, which the SVO uses to set the unit price

Fair Value Column

- **The revised Part 6 provides that (effective Annual 2008)**
 - An insurer is required to follow the procedures when reporting fair values in the Blank, or otherwise directed by the state of domicile.
 - The procedure states:
 - "An insurance company shall either report the fair value determined by the SVO for a security or determine a fair value in accordance with one of the valuation methodologies described in paragraph (c) below. When determining on selecting a valuation method, the insurance company shall seek to obtain a fair value that reliably reflects the price at which the security would sell in an arms length transaction between a willing buyer and seller in possession of the same information. Only where a market valuation based fair value is unobtainable, should the insurance company select a valuation method that would yield an analytically determined fair value. The insurance company shall identify the valuation method used to obtain fair price to determine the Rate Per Share Used to Obtain Fair Value in Schedule D."

Fair Value Column

- Publicly traded securities-SVO use a price, and then would publicly identify the vendor(s) it used
- Private placements-SVO continue to determine analytical values
- However, insurers can choose to use the SVO values, or could also use another approved valuation method as follows:
 - a-Determined by a Pricing Service
 - b-Determined by a Stock Exchange
 - c-Determined by broker or custodian
 - d-Determined by the insurer
 - e-Determined by Valuation Published in VOS



Fair Value Column

- Adopted proposal also impacts the following:

- **Life insurers**

- Bonds with a designation of NAIC 6
 - Preferred stocks with a designation of NAIC 4, 5 or 6
 - Common Stock

- **P&C & Health companies**

- Bonds with a designation of NAIC 3-6
 - Preferred stocks with a designation of NAIC 3-6
 - Perpetual preferred with a designation of NAIC 1 or 2
 - Common Stock



Fair Value Column

- Envisions the NAIC will develop a mechanism to calculate the averages for the insurer reported prices for each CUSIP
- This would allow regulators to compare what the company reported with this average value
- Reports would be developed to identify material differences
- SVO Research Team will be available to regulators to evaluate the pricing methods used by a company
- Provides flexibility to insurers while still allowing regulators a process to consider the appropriateness of the reported value



Fair Value Column & FAS 157

- **The Blanks change is effective for year-end 2008, the NAIC has yet to complete its deliberations on FAS 157. What could the impact be?**
 - **Valuation-** FAS 157 doesn't change the valuation basis on any assets or liabilities, but it does impact how those items are calculated as it requires the technique used to maximize observable inputs.
 - Paragraph 21 of FAS 157 "Valuation techniques used to measure fair value shall maximize the use of observable inputs and minimize the use of unobservable inputs."
 - AP&P Manual definition of fair value "...If quoted market prices are not available, the estimate of fair value shall be based on the best information available."
 - Blanks Change-"Whenever possible, fair value should represent the price at which the security could be sold, based on market information. Fair value should only be determined analytically when the market based value cannot be obtained."



What is FAS 157

- FAS 157 defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements
- Fair Value Definition:
 - 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



FAS 157 – Fair Value

- Fair value hierarchy gives highest priority to quoted prices in active markets for identical assets or liabilities and the lowest level to unobservable inputs
 - Level 1 inputs - Quoted prices in active markets for identical assets or liabilities
 - Level 2 inputs - Inputs other than quoted prices within Level 1 that are directly or indirectly observable for the assets or liabilities
 - Level 3 inputs - Unobservable inputs for the asset or liability. Unobservable inputs shall be used to measure fair value to the extent that 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. Unobservable inputs shall reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability.




FAS 157 – Fair Value

- **Disclosure-Paragraphs 32-35 of FAS 157**
 - 32 (summarized) – For each major category of assets and liabilities measured on recurring basis
 - Fair value segregated by level within the hierarchy (eg. Level 1, 2, 3)
 - For Level 3, a reconciliation from beg and ending balances
 - Realized and unrealized by period and where reported
 - Purchases, sales, issuance, settlements, transfers
 - For annual reporting, valuation method used to measure fair value and a discussion of any changes in techniques.



Fair Value Column & FAS 157

- **What could the impact on the annual statement if FAS 157 is adopted?**
 - Expected Disclosure-Difficult to say
 - Maybe a public bond would be reported as “2a-Name of pricing service” (meaning level 2 and determined from pricing service)
 - Or maybe just disclosed in the audit report
 - FAS 157 Disclosure Requirements-Extensive, as shown previously
 - New SAPWG process requires the communication to the AICPA Audit Issues Task Force
 - Likely required to be disclosed in audit reports June 1, 2009 as required by auditing standards.



2008 Non Substantive Changes (Annual Instructions)



Schedule A Part 2

- **Clarify reporting of encumbrances on Part 2: include**
 - new real estate investments and their encumbrances.
 - permanent improvements and changes in encumbrances to existing properties acquired in prior periods and their encumbrances.
- Report individually each property acquired or transferred from another category; (e.g., joint ventures, Schedule BA).
- Property acquired and sold during the same quarter should be reported in both Part 2 and Part 3.




Schedule A – Verification

- **Add language to clarify that:**
 - completion of prior year ended rows for
 - actual cost at time of acquisition,
 - additional investment made after acquisition,
 - current year change in encumbrances,
 - other than temporary impairment and
 - depreciation

is encouraged, but not required (required for 2009).

Prior year numbers should still add down, which may require some allocation based upon the best available information.



Schedule B – Verification

- Add language to clarify that
 - completion of prior year ended rows for:
 - capitalized deferred interest and other,
 - unrealized valuation increase (decrease),
 - mortgage interest points and commitment fees
 - and other than temporary impairment

is encouraged, but not required (required for 2009).

Prior year numbers should still add down, which may require allocation of the unidentified items into unrealized valuation increase (decrease).



Schedule BA – Verification

- Add language to clarify that completion of prior year ended rows for:
 - capitalized deferred interest and other,
 - unrealized valuation increase (decrease),
 - foreign exchange and
 - other than temporary impairment

is encouraged, but not required (required for 2009).

However, prior year numbers should still add down, which may have allocation of the unidentified items into unrealized valuation increase (decrease).



Supplemental Investment Risks Interrogatories

- New instruction reads:
- “Within each of the following 3 categories of NAIC Country Sovereign ratings which are available on the NAIC website (1, 2, & 3 or below), identify the 2 countries in which the company has its largest aggregate foreign investment exposures (regardless of currency exposure), and report the dollar value and percentage of company investments issued within each of those countries.”
- Countries rated NAIC – 1:
 - 6.01 Country 1: \$ %
 - 6.02 Country 2: \$ %
- Countries rated NAIC – 2:
 - 6.03 Country 1: \$ %
 - 6.04 Country 2: \$ %
- Countries rated NAIC – 3 or below:
 - 6.05 Country 1: \$ %
 - 6.06 Country 2: \$ %”



2009 Changes



Net Foreign Withholding Taxes

- For Schedule D Pts 1, 2, 4, & 5, Sch DA Pt 1 and Sch E Pt 2:
 - Report **income received** amounts net of foreign withholding taxes
 - Result of question from the industry (net or gross)
 - Subgroup asked what the industry wanted (net or gross)
 - They indicated net because that was the information currently obtained, even though theoretically gross may be more consistent with the approach taken for investment income in others parts of the statement.



Hybrid Securities Reporting

Adds a definition for Hybrid Securities:

- Securities whose proceeds are accorded some degree of equity treatment by 1 or more AROs and/or which are recognized as regulatory capital by the issuer's primary regulatory authority.
- Hybrid securities are designed with characteristics of debt and of equity & are intended to provide protection to the issuer's senior note holders (sometimes referred to as capital securities).
- Examples of hybrid securities include Trust Preferreds, Yankee Tier 1s (w & w/o coupon step ups) & debt-equity hybrids (w & w/o mandatory triggers).

Hybrid Securities Reporting

Reporting in Schedule D, Part 1

Hybrid Securities

Issuer Obligations	4299999
Single Cls Mort-Backed/Asset-Backed Securities	4399999
Defined Multi-Cls Res Mortgage-Bckd Securities	4499999
Other Multi-Cls Res Mortgage-Backed Securities	4599999
Defined Multi-Cs Coml Mortgage-Bckd Securities	4699999
Other Multi-Cls Coml Mrtg-Bckd/Asset-Bckd Sec	4799999
Subtotals – Hybrid Securities	4899999

Investment Reporting

Questions???