Date: 10/26/2018

2018 Fall National Meeting — San Francisco, California

STATUTORY ACCOUNTING PRINCIPLES (E) WORKING GROUP
Thursday, November 15, 2018
9:00 – 11:30 A.M.
Continental 6 - Hilton, Ballroom Level

OVERVIEW AGENDA

1. SAPWG Hearing – Adoption of Minutes—Dale Bruggeman (OH)
2. SAPWG Hearing – Review and Adoption of Non-Contested Positions—Dale Bruggeman (OH)
   - Ref #2018-23: SSAP No. 68 Mergers
   - Ref #2018-24EP: Editorial and Maintenance Update
   - Ref #2018-28: Life and Annuity Liquidity Disclosures
   - Ref #2018-29: Consistency Revisions to A-820
   - Ref #2018-30: Hedge Effectiveness Documentation
   - Ref #2018-31: Extension of Ninety-Day Rule for Impact of Hurricane Florence and Hurricane Michael
3. SAPWG Hearing – Review of Comments on Exposed Substantive Items—Dale Bruggeman (OH)
   - Ref #2016-03: Derivatives Hedging Variable Annuity Guarantees
   - Ref #2017-28: Reinsurance Credit
   - Ref #2017-32: SSAP No. 30 – Investment Classification Project
4. SAPWG Hearing – Review of Comments on Exposed Non-Substantive Items—Dale Bruggeman (OH)
   - Ref #2018-17: Structured Settlements
   - Ref #2018-18: Structured Notes
   - Ref #2018-19: Elimination of Modified Filing Exempt (MFE)
   - Ref #2018-20: Debt Forgiveness Between Related Parties
   - Ref #2018-21: SSAP No. 72 Distributions
   - Ref #2018-22: Participation Agreement in a Mortgage Loan
   - Ref #2018-26: SCA Loss Tracking – Accounting Guidance
   - Ref #2018-27: SSAP No. 48 Entities’ Loss Tracking
5. SAPWG Meeting – Maintenance Agenda – Pending List—Dale Bruggeman (OH)
   - Ref #2018-32: SSAP No. 26R – Prepayment Penalties
   - Ref #2018-33: SSAP No. 30R – Pledges to FHLBs
   - Ref #2018-34: SSAP No. 30R – Foreign Mutual Funds
   - Ref #2018-35: ASU 2018-07, Improvements to Nonemployee Share Based Payment Accounting
   - Ref #2018-37: ASU 2018-14: Changes to the Disclosure Requirements for Defined Benefit Plans
   - Ref #2018-38: Prepaid Providers
   - Ref #2018-39: Interest on Claims
   - Ref #2018-41: ASU 2017-13, Amendments to SEC Paragraphs
   - Ref #2018-42: ASU 2018-02, Reclassification of Certain Tax Effects from AOCI
   - Ref #2018-44: ASU 2018-05, Income Taxes, Amendments to SEC Paragraphs Pursuant to SAB 118
   - Ref #2018-45: ASU 2018-06, Codification Improvements to Topic 942 – Depository and Lending
6. SAPWG Meeting – Any Other Matters Brought Before the Working Group—Dale Bruggeman (OH)
   - Update on FASB Long-Duration Insurance Contracts Project (ASU 2018-12)
   - Update on Exposures with Nov. 30, 2018 Comment Letter Deadline
   - Disclosure Requirement from Agenda Item 2018-08 (Owner and Beneficiary of Life Insurance)
   - Update on Agenda Item 2018-04: VOSTF Bank Loan Referral
   - Update on Agenda Item 2016-20: ASU 2016-13, Credit Losses
   - Working Capital Finance Investments
   - Vital Source / BookShelf Product
   - Review of GAAP Exposures

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Hearing Agenda

Statutory Accounting Principles (E) Working Group
Hearing Agenda
November 15, 2018

ROLL CALL

Dale Bruggeman, Chair, Ohio
Jim Armstrong, Vice Chair, Iowa
Richard Ford, Alabama
Kim Hudson, California
Kathy Belfi, Connecticut
Dave Lonchar, Delaware
Eric Moser, Illinois
Caroline Brock / Stewart Guerin, Louisiana

Judy Weaver, Michigan
Doug Bartlett, New Hampshire
Stephen Wiest, New York
Joe DiMemmo, Pennsylvania
Doug Slape / Jamie Walker, Texas
Doug Stolte / David Smith, Virginia
Amy Malm, Wisconsin

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

REVIEW AND ADOPTION OF MINUTES


REVIEW AND ADOPTION of NON-CONTESTED POSITIONS

The Working Group may elect to discuss the following items even though no comments were received.
1. Ref #2018-23: SSAP No. 68 Mergers
4. Ref #2018-28: Life and Annuity Liquidity Disclosures
5. Ref #2018-29: Consistency Revisions to A-820
6. Ref #2018-30: Hedge Effectiveness Documentation

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<th>Ref #</th>
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<tbody>
<tr>
<td>2018-23 SSAP No. 68 (Julie)</td>
<td>SSAP No. 68 Mergers</td>
<td>3</td>
<td>Supportive of Changes</td>
<td>IP - 9</td>
</tr>
</tbody>
</table>

Summary:
During the Summer National Meeting, the Working Group exposed nonsubstantive revisions to **SSAP No. 68—Business Combinations and Goodwill** to clarify that statutory mergers include scenarios in which the stock ownership of an owned entity is cancelled, with the parent entity incorporating the assets and liabilities directly on their financial statements.

For example:
- Insurance reporting entity owns 70% of SCA Entity A outstanding common stock
- Insurance reporting entity acquires remaining 30% of SCA Entity A outstanding common stock
- Insurance reporting entity cancels SCA’s common stock thereby dissolving the corporate structure of the SCA and reports the SCAs assets and liabilities directly on the insurance reporting entity’s financial statements.

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Interested Parties’ Comments:
Interested parties are supportive of the changes.

Recommended Action:
NAIC staff recommends adopting the exposed revisions to SSAP No. 68—Business Combinations and Goodwill as final. These revisions clarify that statutory mergers include scenarios in which the stock of an owned entity is cancelled, with the parent entity incorporating the assets and liabilities directly on their financial statements. This clarification confirms that these transactions are subject to the merger guidance in SSAP No. 68.

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<tr>
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Summary:
During the Summer National Meeting, the Working Group exposed nonsubstantive revisions to incorporate editorial and maintenance revisions as follows:

- **SSAP No. 86—Derivatives**: The guidance in SSAP No. 86, paragraph 57.j, details the Dec. 31, 2017, effective date for the aggregate derivative financing premiums disclosures. With the 2018 adoption of additional individual disclosures in paragraph 57.h.ii. (captured in Schedule DB), the reference for the 2017 effective date for paragraph 57.h. is no longer accurate. Revisions were proposed to remove the effective date from the guidance.

- **SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities**: SSAP No. 97, paragraph 49, detailing effective date and transition guidance, references guidance that was incorporated into SSAP No. 97 and then deleted. Proposed revisions remove old paragraph numbers, which are not applicable in the current SSAP, and update the description of the changes to reference the new SSAPs, which describe the changes.

- **Appendix A-010 Minimum Reserve Standards for Individual and Group Health Insurance Contracts**
  - Update paragraph reference in Exhibit 1, paragraph 1.c.i.(b)(iii). These revisions were adopted in agenda item 2017-09 regarding the 2016 Cancer Claim Cost Valuation Tables (2016 CCCVT). This update is needed because the paragraph numbering in Appendix A-010 is slightly different from Model 10.
  - The language incorporated into Exhibit 1, paragraph 1.a.ii., regarding the 2013 Individual Disability Income Valuation Table (2013-ID1) referenced an incorrect date, which was updated to be consistent with changes to the Model 10 previously adopted by the Health Actuarial (B) Task Force, and with the revisions adopted by the Statutory Accounting Principles (E) Working Group in agenda item 2016-17.

Interested Parties’ Comments:
Interested parties have no comments.

Recommended Action:
NAIC staff recommends adopting the editorial and maintenance revisions to SSAP No. 86, SSAP No. 97 and Appendix A-A010, as described above and in the agenda item.
Summary:
During the Summer National Meeting, the Working Group exposed nonsubstantive revisions to SSAP No. 22 to reject ASU 2018-01, Leases – Land Easement Practical Expedient for Transition to Topic 842. It was noted that the rejection would be captured initially in SSAP No. 22, and then also identified in the substantively revised SSAP No. 22R being developed in response to ASU 2016-02, Leases.

Interested Parties’ Comments:
Interested parties support the proposed rejection of ASU 2018-01.

Recommended Action:
NAIC staff recommends adopting the exposed revisions to SSAP No. 22—Leases to reject ASU 2018-01. Reference of this rejection will also be captured in the proposed substantively revised SSAP No. 22R being developed under ASU 2016-02, Leases.

Summary:
During the Summer National Meeting, the Working Group exposed nonsubstantive revisions to SSAP No. 51—Life Contracts, SSAP No. 52—Deposit-Type Contracts and SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance to add life liquidity disclosures and expand the variable annuity liquidity disclosures for year-end 2019.

The revisions proposed within this agenda item were referred by the Financial Stability (EX) Task Force. Additionally, the Blanks (E) Working Group has already adopted disclosure modifications to reflect the changes. (Since the disclosures are not effective until year-end 2019, if the Statutory Accounting Principles (E) Working Group modifies the disclosures, a subsequent blanks proposal will be submitted to incorporate the changes.)

Interested Parties’ Comments:
Interested parties are supportive of the changes.

Recommended Action:
NAIC staff recommends adopting the exposed revisions to SSAP No. 51—Life Contracts, SSAP No. 52—Deposit-Type Contracts and SSAP No. 61R—Deposit-Type and Accident and Health Reinsurance. NAIC staff notes that blanks revisions have already been considered by the Blanks (E) Working Group, therefore a blanks proposal does not need to be sponsored by the Working Group.
Hearing Agenda

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<tr>
<td>2018-29</td>
<td><strong>Consistency Revisions to A-820</strong></td>
<td>7</td>
<td>Support Revisions</td>
<td>IP - 12</td>
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<tr>
<td>2018-30</td>
<td><strong>Hedge Effectiveness Documentation</strong></td>
<td>8</td>
<td>No Comments</td>
<td>IP - 1</td>
</tr>
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**Summary:**
During the Summer National Meeting, the Working Group exposed nonsubstantive revisions to *Appendix A-820—Minimum Life and Annuity Reserve Standards* to remove the phrase “good and sufficient” reserve as it is not consistent with the related NAIC *Standard Valuation Law Model 820*.

**Interested Parties’ Comments:**
Interested parties support the removal of the phrase “good and sufficient reserve” because it is not consistent with the NAIC *Standard Valuation Law* (Model 820).

**Recommended Action:**
NAIC staff recommends adopting the exposed revisions to *Appendix A-820—Minimum Life and Annuity Reserve Standards* to remove the phrase “good and sufficient.”

**Summary:**
On Nov. 15, 2018, the Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 86—Derivatives* to incorporate hedge effectiveness documentation provisions reflected in *ASU 2017-12, Derivatives and Hedging*. The revisions proposed to SSAP No. 86 reflect a limited adoption of ASU 2017-12 to incorporate the following provisions:

- Allow companies to perform subsequent assessments of hedge effectiveness qualitatively if certain conditions are met.
- Allow companies more time to perform the initial quantitative hedge effectiveness assessment.
- Clarify that companies may apply the “critical terms match” method for a group of forecasted transactions if the transactions occur and the derivatives mature within the same 31-day period or fiscal month, and the other requirements for applying the critical terms match method are satisfied.

The revisions are proposed to be effective Jan. 1, 2019, with early adoption permitted for year-end 2018. A restriction is included that limits U.S. GAAP filers in early adopting only if they have early adopted ASU 2017-12 for year-end 2018.

**Interested Parties’ Comments:**
Interested parties have no comment.

**Recommended Action:**
NAIC staff recommends that the Working Group adopt revisions to incorporate limited provisions from ASU 2017-12 pertaining to the documentation of hedge effectiveness, as exposed in agenda item 2018-30,
with an effective date of Jan. 1, 2019. The revisions propose to allow early adoption for year-end 2018 in accordance with the provisions reflected in the SSAP.

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<tr>
<td>2018-31 INT 18-04 (Jake)</td>
<td>Extension of Ninety-Day Rule for the Impact of Hurricane Florence and Hurricane Michael</td>
<td>9 &amp; 10</td>
<td>TBD</td>
<td>Pending</td>
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**Summary:**
On October 26 the Working Group exposed, via evote, an agenda item and tentative interpretation (INT) to provide a 60-day extension from the ninety-day rule for uncollected premium balances, bills receivable and amounts due from agents and policyholders directly impacted Hurricane Florence, Hurricane Michael, tropical storm Florence and tropical storm Michael, or the related flooding. This INT is consistent with previous temporary extensions granted for other nationally significant catastrophes. This agenda item and tentative INT were exposed for a two-week comment period ending Nov. 9, 2018

**Interested Parties’ Comments:**
Pending – Comments due Nov. 9, 2018

**Recommended Action:**
NAIC staff recommends adoption of the exposed INT. Due to the short-term nature of the applicability of this extension, which expires March 6, 2019, this interpretation will be publicly posted on the Statutory Accounting Principles (E) Working Group’s website. This interpretation will be automatically nullified on March 7, 2019 and will be included as a nullified INT in Appendix H – Superseded SSAPs and Nullified Interpretations in the “as of March 2019” Accounting Practices and Procedures Manual.

Note that the proposed extension temporarily overrides SSAP No. 6, paragraph 9 for affected policies, therefore the policy statement in Appendix F (see authoritative literature) requires 2/3rd (two-thirds) of the Working Group members to be present and voting and a supermajority of the Working Group members present to vote in support of the interpretation before it can be finalized.
REVIEW of COMMENTS on EXPOSED SUBSTANTIVE ITEMS

The Working Group will consider each of the following items separately.
1. Ref #2016-03: Derivatives Hedging Variable Annuity Guarantees
2. Ref #2016-20: ASU 2016-13, Credit Losses
3. Ref #2017-28: Reinsurance Credit
4. Ref #2017-32: SSAP No. 30 – Investment Classification Project

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<tbody>
<tr>
<td>2016-03</td>
<td>New SSAP (Julie) Derivatives Hedging Variable Annuity Guarantees</td>
<td>11 &amp; 12</td>
<td>Limited Comments</td>
<td>ACLI - 14</td>
</tr>
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Summary:
During the Summer National Meeting, the Working Group exposed an issue paper and new SSAP to prescribe specific accounting and reporting guidance for derivatives that hedge interest rate risk of variable annuity guarantees. The issue paper and proposed SSAP included revisions from previously submitted comments from the ACLI and regulators.

ACLI Comments:
We have commented previously on many elements of the Exposure Draft and will therefore limit our comments to remaining open issues.

Comments on Timing and Effective Date
ACLI has stated previously that we support making the proposed guidance effective as soon as possible, because we do not believe the accounting changes need to wait until the work of the Variable Annuity Issues Working Group (VAIWG) related to reserves is complete. The framework for reserve changes was adopted by the NAIC in August and will likely be effective in 2020, with early adoption in 2019 under active consideration. Therefore, we recommend making the effective date January 1, 2020, with early adoption permitted.

Variable annuity reserves will not be fully sensitive to changes in interest rates, even after introduction of the updated framework. Timely adoption and implementation of SSAP 108 will reduce the accounting mismatch and potential negative consequences of a rising interest environment for companies that do not have the special accounting treatment in place. It will also facilitate migration away from existing Permitted Practices.

Comments on Transition
We appreciate the efforts by regulators and NAIC staff to draft the transition language in a way that will help insurers with existing Permitted Practices transition to the new guidance. We believe the intent is that the use of a transition method approved by a domiciliary state regulator would not result in a new Permitted Practice. We suggest adding clarifying language that an approved transition method should not be considered a new Permitted Practice, as long as the insurer is fully compliant with the provisions of the SSAP for new deferrals after implementation.

Other Comments
The following additional comments reflect changes in the reserving guidance being developed by industry and regulators:
Paragraph 6b – We suggest modifying the first sentence as follows: “Actuarial certifications of VM-21 reserves, consistent with VM-21 Valuation Manual requirements”. We believe the actuarial certification requirements could end up in another section of the Valuation Manual and removing this phrase would accommodate this potential change.

Paragraph 13eii and Appendix A: We suggest clarifying with a footnote the result of this calculation (the coverage ratio) should not exceed 100% nor drop below zero.

Paragraph 14: The Standard Scenario will likely be replaced by the Standard Projection. Therefore, we suggest modifying the following statement as follows: “The amortization timeframe shall equal the Macaulay duration of the guarantee benefit cash flows based on the VM-21 Standard Scenario”. As an alternative, a technical correction could be made to the SSAP once the reserving guidance is finalized.

Appendix A: The illustration contains two references to paragraph 14 that should be updated to paragraph 13. The reference to 14.b.1 should be replaced with 13.e.i and (14.b.i less 14.b.iii) should be changed to (13.e.i less 13.e.iii).

**Recommended Action:**
NAIC staff recommends adopting the proposed SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees and corresponding Issue Paper 159—Special Accounting for Limited Derivatives with modifications to address the issues identified by the ACLI as discussed below.

**Effective Date Discussion:** The ACLI has suggested a January 1, 2020 effective date, with early adoption permitted. Although the ACLI supports the SSAP being effective as early as possible, however, this effective date was suggested as the Variable Annuity Issues (E) Working Group work related to reserves is likely to be effective in 2020, with early adoption in 2019 permitted. NAIC staff recommends discussion from the Working Group on when SSAP No. 108 will be effective:

- **Option 1: Effective Date Jan. 1, 2020, Early Adoption for Year-End 2018** – This would allow companies to eliminate permitted practices and follow the established SSAP, however, the new reporting schedules and disclosure templates will not be available. *(This would eliminate Note 1 reporting for permitted / prescribed practices if the company follows the adopted SSAP, but would require narrative disclosures, as required in the SSAP, in Note 21. With this option, there would be no data-captured disclosures, but information would be captured as narrative disclosures.)*

- **Option 2: Effective Date Jan. 1, 2020, Early Adoption for Year-End 2019** – This would require companies to retain permitted practices for year-end 2018 (which will likely be consistent with prior year) and allow early adoption of the SSAP at the same time that the new reporting schedule and disclosure templates will be available. *(This would require Note 1 reporting if there are permitted / prescribed practices approved for 2018, but would eliminate that requirement in 2019 if the company follows the adopted SSAP. For 2019, assuming the disclosure and schedule templates have been adopted through blanks, information would be data-captured in the 2019 year-end financial statements.)*

- **Option 3: Specify an effective date of January 1, 2020 without early adoption permitted** – This will ensure that all companies move to the new SSAP at the same time at a time that is expected to correspond with the work of the Variable Annuity Issues (E) Working Group. *(This would require Note 1 reporting if permitted / prescribed practices are approved for 2018 and 2019, but would eliminate that requirement in 2020 if the company follows the adopted SSAP. For 2020, assuming the disclosure / templates have been adopted through blanks, information would be data-captured in the 2020 financial statements.)*

- **Option 4: Specify that the effective date will correspond to the effective date of the Variable Annuity Issues (E) Working Group work on reserves** – This approach will not specify an effective
date in the SSAP, but rather allow the Working Group to continue monitoring the work of the VAIWG and subsequently identify the effective date that corresponds with the actual effective date of the VAIWG reserve changes. *(This would require Note 1 reporting if permitted / prescribed practices are granted until the effective date of the standard. Once the SSAP is effective, assuming the disclosure / templates have been adopted through blanks, that information would be data-captured in the financial statements.)*

**Modifications Reflected:** In accordance with comments of the ACLI, NAIC staff recommends adopting SSAP No. 108, and the corresponding issue paper, with the modifications noted below. *(NAIC staff has presented the revisions as they would be reflected in the SSAP. Identical revisions will be reflected in the issue paper.)* The only change proposed by the ACLI not reflected is in paragraph 14. The ACLI comments proposed to remove “Standard Scenario” as that may change in the future. NAIC staff recommends retaining the reference until that change occurs. At that time, an editorial change can occur to reference the updated calculation.

- **Transition:** The ACLI suggested adding language that an approved transition method should not be considered a new permitted accounting practice as long as the insurer is fully compliant with the provisions of the SSAP after implementation.

  **Proposed Revision:**

  24. This statement is effective ____. 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.

- **Other Comments:** The following modifications reflect the additional comments of the ACLI:

  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 **VM-24—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 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.

13.e. Reporting entities shall utilize the following calculation for establishing the deferred asset (also illustrated in Appendix 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 movements FN. 

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.

Footnote: 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 Scenario, but shall not exceed a period of 10 years.

Appendix 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).\( \text{FN} \)

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.

Footnote: The result of this calculation (the coverage ratio) should not exceed 100% nor drop below zero.

To illustrate the above calculation:

**Clearly Defined Hedging Strategy (CDHS) characteristics**

<table>
<thead>
<tr>
<th>Hedged item</th>
<th>Rider claims less rider fees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hedged risk</td>
<td>50% of the rho (first-order IR level sensitivity)</td>
</tr>
</tbody>
</table>

**Calculation of the deferred asset or liability**

*Note: positive values = increase in liability*

\[
\begin{align*}
\text{Fair value gain (loss) in hedged item attributable to interest rate movement} & \quad (500) \\
\text{13.e.i. - Fair value gain (loss) in hedged item attributable to hedged risk} & \quad (250) \\
\end{align*}
\]

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:

\[
\begin{align*}
\text{Fair value gain (loss) in full-contract cash flows attributable to IR movement} & \quad (700) \\
\text{13.e.ii - Quantity calculated in 134.eb.i. as a % of the (700) above} & \quad 36\% \\
\end{align*}
\]

\[
\begin{align*}
\text{VM-21 liability increase (decrease) from beginning of period to end of period} & \quad 400 \\
\text{VM-21 liability increase (decrease) attributable to interest rate movements} & \quad (100) \\
\text{13.e.iii - VM-21 liability increase (decrease) attributable to the hedged risk} & \quad (36) \\
\end{align*}
\]

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.

\[
\begin{align*}
\text{13.e.iv – Deferred asset (134.be.i less 134.eb.iii) attributable to hedged risk} & \quad (214) \\
\text{(This is shown as a negative – to be consistent with the decrease in VM-21 liability – but represents a deferred asset. Deferred assets reflect fair value losses.)} \\
\end{align*}
\]
Summary:
This agenda item is working to clarify the determination of reinsurance credit. In addition, it is addressing a Financial Analysis (E) Working Group (FAWG) referral which noted issues with reinsurance including trends regarding the use of reinsurance noted in financial analysis reviews. FAWG noted that the while the number of contracts may be limited, they appear to be more prevalent in troubled company situations and are being offered by otherwise well-regarded reinsurers. The April 2017 FAWG referral noted concerns with risk limiting features. The referral noted that the motivation for the contracts appears to be surplus relief, without a significant amount of insurance risk being transferred to the reinsurer.

The Working Group previously exposed language in August 2017 and then formed two informal drafting groups (1-life and health and 2-property and casualty) to develop detailed recommendations. During the 2018 Summer National Meeting, the Working Group exposed revisions recommended by the informal reinsurance drafting groups as follows:

- Exposed substantive revisions to SSAP No. 62R—Property and Casualty Reinsurance to incorporate guidance from EITF 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises and from EITF D-035, FASB Staff Views on Issue No. 93-6. (Drafting notes are not planned to be in the final document.) The Working Group also requested, input on the effective date.

- Exposed nonsubstantive revisions to SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance to incorporate disclosures. The proposed revisions also update the question-and-answer guidance in Appendix A-791—Life and Health Reinsurance Agreements (A-791) to clarify the applicability of A-791. The Life and Health exposure was noted as an interim exposure to gain more input for the informal drafting group’s continued work. The Financial Analysis (E) Working Group was notified of the exposure with a request for comments on whether the proposed disclosures adequately address the referral.

Note as the full agenda item is over 35 pages only exposed revisions were included the materials.

Interested Parties’ Comments:
Interested parties have no comments.

Connecticut Department of Insurance in response to notice sent to the Financial Analysis (E) Working Group:

We have reviewed SSAP Agenda Item # 2017-28 with respect to the proposed disclosures and updates to Appendix A-791 and SSAP No. 61R. Our primary objective was to provide feedback on whether the enhanced disclosures in SSAP No. 61R would be sufficient to address FAWG’s concern with life reinsurance contracts incorporating risk-limiting features.

We have recently become aware of experience-rated YRT treaties that cede group term life risk with the primary purpose of achieving RBC relief for the cedant. The experience–refund feature is combined with “excessively high” YRT premiums, substantially mitigating and/or all but eliminating risk transfer to the assuming reinsurer.

The existence of these treaties will not be captured by the proposed disclosures to SSAP No. 61R (paragraphs 82-87). We, therefore, propose modifying the end of the second sentence of paragraph 83 to read “… a loss ratio
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corridor or YRT premiums in excess of amounts collected on the ceded policies.”. We do not cite the experience-refund feature, as non-abusive experience refunds are common, accepted and not readily attackable. Further, it is the excessive level of reinsurance premiums that in practice limits the risk transfer and makes the net cost to the cedant (when combined with the experience-refund feature) attractive to the cedant.

We note that the blanket exclusion accorded to YRT reinsurance in Appendix A-791 remains unchanged in the proposed revision, which focuses instead on elaborating on the phrase “certain non-proportional reinsurance”. To address the concern mentioned above, three changes should be considered. Specific to Appendix A-791, we suggest expanding the second sentence of the current language to read “… does not meet the intended definition of YRT if (1) the surplus relief … from the reinsurer, or (2) the YRT premium paid to the reinsurer exceeds the equivalent amount collected by the ceding insurer.” and modifying the third line of the first paragraph to read “significant surplus relief or RBC ratio enhancement”. The third change does not impact Appendix A-791 but instead modifies paragraph 19 of SSAP No. 61R. We would add “2.e.” to the list of objectionable Appendix A-791 paragraphs cited (i.e. … paragraphs 2.b., 2.c., 2.d., 2.e., 2.h., …).”

NAIC staff has illustrated the Connecticut recommended revisions as shaded changes to A-791 and the exposed SSAP No. 61R below.

CT proposed disclosure edit to SSAP No.61R:

83. Disclose any 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, or YRT premiums in excess of the equivalent amounts collected on the ceded policies; a loss cap, an aggregate limit or similar effect. 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. (Drafting Note: Similar to SSAP No. 62R, paragraph 93.)

9. 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.e., 2.h., 2.i., 2.j. or 2.k., shall follow the guidance for reinsurance accounting, including paragraphs 55-57 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.

Q – Aside from assumption reinsurance, what other types of reinsurance are exempt from the accounting requirements?

A – Yearly renewable term (YRT) and certain nonproportional reinsurance arrangements, such as stop loss and catastrophe reinsurance are exempt because these do not normally provide significant surplus relief or RBC ratio enhancement and therefore are outside the scope of this Appendix. If a catastrophe arrangement takes a reserve credit for actual losses beyond the attachment point or the unearned premium reserve (UPR) of the current year's premium, there will most likely be no regulatory concern.

Similarly, if a YRT treaty provides incidental reserve credits for the ceding insurer's net amount at risk for the year with no other allowance to enhance surplus, there will most likely be no regulatory concern. For purposes of this exemption, a treaty labeled as YRT does not meet the intended definition of YRT if [1] the surplus relief in the first year is greater than that provided by a YRT treaty with zero first year reinsurance premium and no additional allowance from the reinsurer [2] the YRT premium paid to the reinsurer exceeds the equivalent amount collected by the ceding insurer.

Additional pertinent information applicable to all YRT treaties and to non-proportional reinsurance arrangements is contained in paragraphs 19 and 20 of SSAP No. 61R.
To further elaborate on the phrase “certain non-proportional reinsurance” in paragraph 1, the beginning of the answer notes that contracts such as stop-loss and catastrophe do not normally provide significant surplus relief, and are therefore not subject to the accounting guidance in Appendix A-791. Non-proportional reinsurance agreements are considered not to provide significant surplus relief if they possess all of the following features. For the purposes of defining these features, the term “triggering event” means the event or sequence of events that would lead to a loss being reimbursable by the reinsurer pursuant to the terms of the reinsurance agreement.

1. The triggering event has not occurred at the time of the inception of the reinsurance agreement.

2. The triggering event is materially less likely than not to occur during each settlement period of the reinsurance agreement.

3. There is no initial reinsurance credit for ceded policy reserves and any reinsurance expense allowance or commission is reported so that surplus is not impacted until the related premium is reported as earned.

These criteria shall be evaluated separately for each measurement period under the reinsurance agreement, where the measurement period is that period of time for which the direct writer’s experience is used to determine the amounts owed to and from the reinsurer. If there are carry-forwards of experience debits or credits from one calendar year to the next, then those multiple years will be considered one settlement period.

The fact that the triggering event does eventually occur, is not itself evidence that the second criterion above has not been met. The criterion should be evaluated based on reasonable expectations rather than posteriori results.

NJ Comments on YRT

We understand that SAPWG is currently reviewing a referral from the Financial Analysis (E) Working Group (FAWG) regarding risk limiting features in reinsurance contracts.

The New Jersey Department of Banking and Insurance (NJDOBI) has recently become aware of a practice for Group Life YRT Reinsurance which may also require interpretive guidance and/or changes to SSAP No. 6/R - Life and Health Reinsurance and Appendix A-791 - Life and Health Reinsurance Agreements. We understand there are Group Life YRT Reinsurance arrangements which significantly reduce net amount at risk subject to RBC charges for ceding insurers with limited transfer of risk of the business to the assuming reinsurers. We also understand that the companies are interpreting and treating the reinsurance arrangements as qualifying for reinsurance accounting under statutory accounting (ST AT), but not under GAAP.

Features within the treaties that limit the transfer of risk of the business to assuming reinsurers include (but may not be limited to):

1. Ceding insurers may pay reinsurance premium well in excess of the proportionate direct YRT premiums.

2. Ceding insurers may be subject to annual re-pricing by the assuming reinsurers that can be multiple times (3x-4x) of the proportionate direct YRT premiums.

3. The arrangements may employ both a Loss Carryforward Account" and an "Experience Refund." Any amounts advanced to the ceding insurer by the reinsurers under the treaties for negative experience will be notionally tracked in an off-balance sheet loss carryforward account and credited with interest at rates stipulated in the treaties. Repayment of the outstanding loss carryforward balance occurs upon the generation of subsequent positive experience. Positive experience must be used first to reduce the balance included in the loss carry forward account; any excess positive experience remaining after full payment of the loss carryforward balance (and any associated risk charges owing) will be retained by the ceding
insurer. The reinsurance arrangements are automatically renewable on an annual basis. If the ceding insurer cancels, the ceding insurer is obligated to pay any balance in the loss carryforward account.

The STAT analyses apparently hinge on the "transfer of proportionate share of mortality risk" under paragraph 19 of SSAP 61R (which limits the application of A-791 for YRT arrangements) and the overarching criteria of paragraph 17. The parties to the contracts believe that reinsurers do assume a theoretical, ultimate risk of loss under the treaties if everyone was to die in the same year or every group insurance policyholder were to cancel or lapse and there was an outstanding loss carryforward. Absent these events, the reinsurer has little or no risk of loss. However, this position results in a circumstance where SSAP 61R would be less stringent than its GAAP counterpart ASC 944-20. This appears contrary to the intent and approach of statutory accounting.

The impact of these transactions may be tracked within the Annual Statement. Typically, the arrangements are listed on Schedule S - Part 3 - Section 1 (life reinsurance ceded). The reinsured ceded in-force amount is reported on the Exhibit of Life Insurance, Column 9, Line 22 which reduces the total Group Life Amount of Insurance on Column 9, Line 23 (amount of insurance adjusted for reinsurance). The RBC C-2 Charges are based on the Exhibit of Life Insurance, Column 9, Line 23, resulting in the elimination of any risk-based charge for the YRT reinsurance arrangements. As the accounting issues are reviewed, the applicable statutory reporting implications would also need to follow (i.e., treaties subject to deposit accounting should not receive a reduction in RBC.)

Similar in nature to the original FAWG referral, we are concerned that reinsurance contracts with these types of risk-limiting features will continue to mask the true financial performance and position of insurers, as well as the risks they are exposed to. Therefore, we recommend the current Statutory Accounting Principles (E) Working Group work be expanded to take on the above issue.

**Recommended Action:**
NAIC staff recommends adopting the revisions to SSAP No. 62R with a January 1, 2019 effective date and directing NAIC staff to draft an issue paper documenting the substantive revisions. NAIC staff recommends forwarding Connecticut and New Jersey feedback on the SSAP No. 61R and A-791 exposure to the informal life and health reinsurance drafting group to continue their work.

Both and Connecticut and New Jersey have raised some concerns regarding reinsurance credit and risk transfer on yearly renewable term (YRT) contracts. Connecticut provide recommend edits on YRT issues in their comments on the A-791 and SSAP No. 61R exposed revisions.

New Jersey comments are regarding group life YRT reinsurance arrangements which significantly reduce net amount at risk subject to RBC charges for ceding insurers while limiting the transfer of (risk of the business) to the assuming reinsurers. These features may greatly reduce the possibility of loss to the reinsurer, however insurers are taking large risk-based capital benefits.

Both states noted concerns with YRT contracts that are taking a greater proportion of reinsurance premium than the proportional premium on the underlying direct premium. The greater proportion can be either by direct charges or through the use of loss carryforward or experience refund features which can make the possibility of reinsurer loss remote. NAIC staff recommendation is to forward these comments to the informal life and health reinsurance drafting group and expand the work of the informal drafting group. In addition, staff recommends soliciting additional states to join the informal drafting group.
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Summary:
During the Summer National Meeting, the Working Group exposed an issue paper and substantively revised SSAP No. 30R—Unaffiliated Common Stock. Key revisions detailed within the proposed guidance improve the common stock definition and include closed-end funds and unit-investment trusts within scope.

Interested Parties’ Comments:
Interested parties are supportive of the proposed changes to SSAP No. 30, the related Issue Paper, and a January 1, 2019 effective date.

Some in industry have noted that existing SSAP No. 30 scope language includes “shares of mutual funds” while the new exposure only specifically scopes in SEC registered mutual funds. Foreign open-ended mutual funds that are structured similarly to SEC registered mutual funds with an NAV that is calculated and published periodically and used as the basis for purchases and redemptions should be included in SSAP No. 30. Additionally, foreign open-ended mutual funds are often registered with and regulated by competent regulatory bodies. Interested parties believe a case can be made to expand the scope of SSAP No. 30 to include such registered foreign open-end mutual funds, with similar structure and regulation, and respectfully ask the Working Group to explore this idea during 2019. Interested Parties can provide further information on such foreign open-end mutual funds upon the Working Group’s request.

Recommended Action:
NAIC staff recommends that the Working Group adopt the exposed substantially revised SSAP No. 30R—Unaffiliated Common Stock, and the corresponding Issue Paper (to be named Issue Paper No. 158—Unaffiliated Common Stock) with an effective date of Jan. 1, 2019. NAIC staff recommends sponsoring a blanks proposal to capture information on Unit Investment Trusts and Closed End Funds on Schedule D-2-2. (Currently mutual funds have a separate reporting line.)

NAIC staff has prepared an agenda item to begin considering the issue of foreign mutual funds as requested by interested parties. This item is included on the Meeting agenda with a request for exposure.
REVIEW of COMMENTS on EXPOSED NON-SUBSTANTIVE ITEMS

The Working Group will consider each of the following items separately:
1. Ref #2017-17: Structured Settlements
2. Ref #2017-18: Structured Notes
3. Ref #2018-19: Elimination of MFE
4. Ref #2018-20: Debt Forgiveness Between Related Parties
5. Ref #2018-21: SSAP No. 72 Distributions
6. Ref #2018-22: Participation Agreement in a Mortgage Loan
7. Ref #2018-26: SCA Loss Tracking – Accounting Guidance
8. Ref #2018-27: SSAP No. 48 Entities’ Loss Tracking

**Summary:**
During the Summer National Meeting, the Working Group exposed nonsubstantive revisions proposing accounting and reporting guidance for structured settlement income streams acquired by insurers as investments. The proposed accounting and reporting reflected the following concepts:

1. Structured settlement income streams acquired by insurance reporting entities, when the reporting entity is not the owner or payee of a corresponding annuity, through acquisition of an interest in a securitized pool that meets the scope requirements of SSAP No. 43R—Loan-backed and Structured Securities shall follow the accounting and reporting guidance of that SSAP. (This is not a change from existing guidance.)

2. Period certain (non-life contingent) structured settlement income streams acquired by insurance reporting entities, when the reporting entity is not the owner or payee of a corresponding annuity, as individual investments (not as securitizations), are considered other long-term investments, captured on Schedule BA, and permitted as admitted assets when the structured settlement income stream has been legally acquired in accordance with all state and federal requirements. These acquisition requirements include court-approval of the income stream transfer from the original beneficiary. If a structured settlement income stream has not been legally transferred from the original beneficiary to the insurer acquirer, the structured settlement shall be fully nonadmitted by the insurance reporting entity. (Unless there is legal transfer, nonadmittance is required as the acquirer may not be entitled to receive the future income streams.) In addition to nonadmittance, the insurer acquirer must also appropriately report the excise tax required under the IRS code.

3. Life contingent structured settlement income streams acquired by insurance reporting entities, when the reporting entity is not the owner or payee of a corresponding annuity, as individual investments (not as securitizations), are considered other long-term investments, captured on Schedule BA, and shall be fully nonadmitted. (With life contingent income streams, nonadmittance is required as it is uncertain whether any future income streams will be received. As such, these items should not be considered admitted assets available for policyholder claims under SSAP No. 4—Assets and Nonadmitted Assets.)

4. As this agenda item is focusing on structured settlements, the guidance should not be inferred to “life settlement” acquisitions. Life settlements are not structured settlements. A life settlement transaction is when an investor purchases an insurance policy from an insured and continues to pay the premium payments so that when the insured event occurs (e.g., death of the insured), the investor receives the death benefit. In life settlements, the investor often pays the insured an amount greater than the cash surrender
value of the insurance policy, with an expectation that the insured event will occur in a timeframe that the
death benefit received is greater than the cost of the purchase price and the future premium payments to
keep the policy active. As detailed in this agenda item, a structured settlement is the legal right to future
cash flows and does not reflect the acquisition of an insurance policy. Unlike life settlements, there is no
cash surrender value to structured settlements, and payments under the structured settlement are not
renegotiable once set.

Interested Parties’ Comments:
Interested parties support the proposed accounting and reporting guidance on structured settlements.

Recommended Action:
NAIC staff recommends adopting the exposed revisions to SSAP No. 21—Other Admitted Assets to
prescribe accounting guidance when a reporting entity acquires the legal rights to receive payments from a
structured security. With adoption, NAIC staff recommends direction from the Working Group on
whether the proposed revisions should be considered substantive or nonsubstantive. At this time, NAIC staff
does not suggest a dedicated reporting line on Schedule BA for structured settlements. Rather, NAIC staff
recommends a blanks proposal to incorporate annual statement instructions to clarify that each structured
settlement can be reported separately as “any other class of asset” on Schedule BA, unless the structured
settlement can be aggregated with other structured settlements with similar terms and payout streams.

As detailed in the exposed guidance, reporting entities that acquire period-certain structured settlement income
streams shall reported these as other long-term invested assets (on Schedule BA). These assets shall be admitted if
the rights to the future payment stream had been legally acquired in accordance with state and federal
requirements. All life contingent structured settlements as well as any period-certain structured settlements not
acquired in accordance with all legal requirements, shall be reported on Schedule BA as nonadmitted assets.

Additionally, at the time of exposure, the Working Group directed a referral to the Valuation of Securities Task
Force. A referral response has been received indicating that the Task Force and the NAIC Investment Analysis
Office (IAO) support the proposal to establish statutory accounting guidance for structured settlements. This
response identifies that purchases of cash streams by assignment of the right to payments due under structured
settlements are already filed with, and designated for credit quality, by the SVO.

Substantive / Nonsubstantive: NAIC staff notes that the exposure requested input on whether the proposed
changes should be considered substantive or nonsubstantive changes. No input was received from
interested parties on this element.

- If considered nonsubstantive, the revisions would be considered effective immediately unless the
  Working Group chooses to specify a separate effective date. Although it is an option, nonsubstantive
  revisions do not normally have a related issue paper.
- If considered substantive, the revisions should have a stated effective date and be accompanied by a
  corresponding issue paper. (Even if substantive, the Working Group could prescribe a year-end 2018
effective date, and the issue paper could be subsequently developed for historical purposes.)
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### Summary:

During the Summer National Meeting, the Working Group exposed nonsubstantive revisions to revise guidance for structured notes when the reporting entity holder assumes a risk of principal loss based on an underlying component unrelated to the credit risk of the issuer. The exposed revisions are summarized as follows:

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

- **SSAP No. 26R—Bonds**: Revisions remove securities from the bond definition when the contractual amount of the instrument to be paid at maturity is at risk for other than the failure of the borrower to pay the contractual amount due. This guidance identifies that the instrument may be in the form of a debt instrument, but the issuer obligation to return principal is contingent on the performance of an underlying variable (e.g., equity index or performance of an unrelated security.) The revisions also delete the structured note disclosure.

- **SSAP No. 43R—Loan-backed and Structured Securities**: Revisions explicitly capture mortgage-reference securities in scope. This is an explicit exception to the LBSS definition, as the items do not qualify as “loan-backed securities” as the pool of mortgages are not held in trust, and the amounts due under the investment are not backed by the referenced mortgages.

- **SSAP No. 86—Derivatives**: Revisions capture structured notes in scope when there is a risk of principal loss based on the terms of the agreement (in addition to default risk).

### Interested Parties’ Comments:

Interested parties agree with NAIC staff that the accounting for such structured notes, where the investor assumes risk of principal loss based on an underlying component unrelated to the credit risk of the issuer, warrants scrutiny given today’s amortized cost treatment currently afforded under SSAP No. 26R. Such scrutiny is also warranted because, unlike US GAAP, embedded derivatives are not bifurcated from the host investment under statutory accounting. Fair value measurement of such securities may be appropriate under statutory accounting.

However, interested parties believe these bonds, where the investor assumes some risk of principal loss based on an underlying component unrelated to the credit risk of the issuer, can be better addressed within SSAP No. 26R. Specifically, by requiring their measurement at fair value, through unrealized gain/loss, similar to 1) an insurer that maintains an Asset Valuation Reserve (AVR), for bonds with an NAIC designation of 6, 2) an insurer that does not maintain an AVR, for bonds with an NAIC designation of 3-6 and 3) mandatory convertible bonds, when fair value is below cost. This achieves the following three objectives:

1. Requires fair value reporting as suggested is appropriate per the exposure draft,

2. Does not require the host bond investment, with an embedded derivative, to be reported under SSAP No. 86 as a derivative, along with its embedded derivative component, and
3) Reduces the likelihood that an insurance company may inadvertently run afoul of certain state investment limitations, that may prohibit insurers from holding speculative derivative instruments. That is, by classifying a whole bond investment, as a derivative, just because the bond investment hosts an embedded derivative component.

Interested parties are supportive of the NAIC staff’s proposed definition of structured notes (i.e., the investor assumes the risk of principal loss unrelated to the credit risk of the issuer) and are supportive of NAIC’s staff’s view that all such structured notes, regardless of maturity, should be recorded at fair value. However, interested parties believe all such structured notes, including those acquired with a remaining maturity of year or less at the time of acquisition, should also be reported at fair value within SSAP No. 26R.

Lastly, interested parties are supportive of the NAIC staff’s proposed exception that would include mortgage-referenced securities within the scope of SSAP No. 43R as such securities are, in substance similar, to other SSAP No. 43R securities and where the credit risk can be assessed by existing methodologies of the NAIC Securities Valuation Office and/or the NAIC Structured Securities Group. However, interested parties would propose one small change (underlined) to the NAIC staff’s proposed changes to paragraph 33 of SSAP No. 43R to ensure consistency with other in substance similar securities:

(For mortgage-referenced securities, an OTTI is considered to have occurred when there has been a delinquency or other credit event in the reference pool of mortgages, such that the entity does not expect to recover the entire amortized cost basis of the security.)

Recommended Action:
In reviewing the interested parties’ comments, NAIC staff has the provided the following discussion points:

- It is correct that the form of a structured note is a debt instrument. However, the debt instrument is a “wrapper” around the underlying derivative component. **It is the derivative component that impacts the amount of principal, or original investment amount, that will be returned at maturity.**

- The amount of principal repayment is often determined based on the underlying component as of the date of maturity. As such, even if the underlying component appears to be on the upside on prior reporting dates, if on the date of maturity, the underlying component drops below the downside threshold, any principal repayment will be calculated based on that maturity date (resulting in principal loss). Additionally, there is an extremely limited secondary market, and if attempting to sell the security in advance of the maturity date, the holder should expect to sell at a significant discount to its value. Although NAIC staff agrees that fair value is likely still the most appropriate reporting value, any reported “fair value” will be a level 3 measurement (determined without observable inputs), and **any fair value amount reported on a financial statement reporting date will not approximate the principal repayment that would be calculated as of the date of maturity.**

- NAIC staff agrees that if these items are captured in scope of SSAP No. 26R, the guidance for mandatory convertibles is likely most appropriate, however, the differences between structured notes and mandatory convertibles are significant. With a mandatory convertible, the instrument will convert to an equity instrument on a specific date, or in response to a specific trigger, but the reporting entity is not required to liquidate the equity instrument at the time of conversion. As such, the reporting entity could continue to hold the equity instrument and benefit from potential future increases in value. **With a structured note, the instrument terminates on the date of maturity and the holder receives the principal repayment based on the underlying trigger (e.g., equity performance) as of the point in time.** As such, there is no potential for a reporting entity to continue holding the instrument to regain value. **This structure is a derivative forward, in which two parties commit to transact at a future specified date in accordance with terms of the agreement established at acquisition.**
Guidance for mandatory convertibles requires measurement at the lower of amortized cost or fair value. Mandatory convertibles are not reported with NAIC designations or CRP ratings. For RBC purposes, the formula adjusts mandatory convertibles to reflect what would be owned at the time of conversion. (For example, if the mandatory convertible was to result in common stock at the time of conversion, the RBC charge for the convertible results in the common stock charge.) The lack of NAIC designations for these items is problematic as all Schedule D-1 items are presumed to be reported with NAIC designations. Even with the specific process for mandatory convertibles, the RBC and AVR instructions are not clear on where these are captured (by NAIC designation bucket) prior to the adjustments for the convertible component.

- NAIC staff does not agree with the interested parties’ objective to prevent these instruments from being considered speculative derivatives and limited under state investment limitations. It is NAIC staff’s opinion that these instruments are speculative derivatives. NAIC staff believes the structure of these items has occurred to allow classification as a debt instrument (based on form), when the instrument is in substance a derivative instrument. As such, NAIC staff believes these instruments should be captured in state derivative investment limitations.

- The reporting for cash equivalents and short-term investments is designed for situations in which the investment is so near maturity there is limited expected change in the credit quality of the instrument. (This is why such investments are not reported with NAIC designations and the RBC charge is minimal.) For structured notes, regardless of the timeframe till maturity, the creditworthiness of the issuer has no bearing on the formula that determines the amount of principal repayment, or return of original investment, as of the date of maturity. (Remittance could be impacted by the credit quality of the issuer, but the key issue with these securities is the uncertainty of the actual principal repayment that will be owed based on the underlying derivative component.) As such, based on the design and underlying derivative components, these instruments should never be reported as short-term or cash equivalents.

Pursuant to the discussion points above, NAIC staff supports reporting structured notes, when the contractual amount of the instrument to be paid at maturity is at risk for other than failure of the borrower to pay the amount due, as derivatives. Reporting as derivatives is more appropriate based on the substance of the transaction, rather than the design to reflect a debt instrument.

For the Fall NM, NAIC staff suggests the Working Group to take action under one of the following options:

- Option 1: Adopt the exposed revisions, with the modification suggested by interested parties to SSAP No. 43R. If preferring adoption, the Working Group could consider a Jan. 1, 2019 effective date, to prevent a change in reporting immediately before year-end.

- Option 2: Re-expose the proposed revisions with the modification to SSAP No. 43R suggested by interested parties. This re-exposure would reflect the same concepts as the original exposure but allow more time for further review of the classification of structured notes as either bonds or derivatives. (This is NAIC staff’s preferred option to give the regulators more time to consider interested parties’ and NAIC staff comments on this issue.)

- Option 3: Direct NAIC staff to draft revisions to incorporate the interested parties’ proposal to treat structured notes in scope of SSAP No. 26R, with provisions for measurement and NAIC designations to be similar to mandatory convertibles. (This re-exposure would retain the prior concepts for all items except for the structured notes that were originally proposed to be moved to SSAP No. 86 as derivatives.)

NAIC staff notes that the original agenda item was classified as nonsubstantive. If a substantive classification is considered more appropriate, the Working Group could reclassify this agenda item as substantive and direct NAIC staff to prepare an issue paper for subsequent exposure.
NAIC staff also notes that it may be appropriate to proceed with notifying the Blanks (E) Working Group and the Capital Adequacy (E) Task Force of this issue and sponsor a blanks proposal. Regardless of the ultimate decision between bond / derivative for structures notes, NAIC staff would also recommend reporting revisions to separately identify the government sponsored enterprises captured in SSAP No. 43R. If the Working Group is leaning towards SSAP No. 26R for structured notes, NAIC staff would also recommend reporting revisions to identify these investments on Schedule D-1. This would also require RBC revisions as they would not be reported with an NAIC designation and would need to be addressed accordingly.

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**Summary:**
During the Summer National Meeting, the Working Group exposed nonsubstantive revisions to eliminate the MFE process in determining NAIC designation in accordance with the VOSTF referral. As noted in the agenda item, although the Working Group is recommended to proceed with exposure on this agenda item and solicit comments for consideration, final action will not occur on this item until revisions eliminating the MFE process have been adopted by the Valuation of Securities (E) Task Force.

**Interested Parties’ Comments:**
Interested parties are supportive of the Proposal and an effective date as of March 31, 2019, with early application permitted. We understand that any company electing early application would apply this approach to all applicable securities held at December 31, 2018.

**Recommended Action:**
NAIC staff recommends adopting the exposed revisions to SSAP No. 43R to remove the Modified Filing Exempt (MFE) process, with the proposed March 31, 2019 effective date recommended by interested parties. The Valuation of Securities (E) Task Force adopted revisions to eliminate the MFE process during their Oct. 11, 2018 conference call. With adoption, NAIC staff recommends a blanks proposal to eliminate the MFE concept from all annual statement reporting instructions.

With the proposed effective date:

- All reporting entities will be permitted to early adopt the provision and report NAIC designations in accordance with the CRP rating (without adjustment based on purchase price) for the year-end 2018 financial statements. If electing to early adopt, reporting entities electing shall not use the Modified Filing Exempt (MFE) process for any SSAP No. 43R securities.
- Reporting entities that do not elect to early adopt shall report the NAIC designation for all applicable SSAP No. 43R securities in accordance with the MFE process for year-end 2018. These reporting entities must report NAIC designations based on CRP ratings (without purchase price adjustment) beginning with the first quarter 2019 statutory financial statements.
Summary:
During the Summer National Meeting, the Working Group exposed nonsubstantive revisions to SSAP No. 15—Debt and Holding Company Obligations and SSAP No. 25—Affiliates and Other Related Parties to reference existing guidance in SSAP No. 72—Surplus and Quasi-Reorganization when there has been a forgiveness of debt owed. Pursuant to SSAP No. 72:

- Transactions involving the forgiveness of debt owed by a reporting entity to its parent shall be accounted for as contributed surplus. (SSAP No. 72—Paragraph 7)

- Transactions involving the forgiveness of any debt, surplus note, or other obligation owed to the reporting entity from its parent, or other stockholders, shall be accounted for as a dividend. (SSAP No. 72, paragraph 12.i.)

With the exposed revisions information was requested on the following questions:

- **Exposure Question 1** - Should uncollectibility of an amount loaned or advanced to a parent be considered a dividend, instead of a write-off to income? Is it clear when an amount owed from a parent has been deemed uncollectible instead of when debt has been forgiven?

- **Exposure Question 2** – Should additional guidance for the recording of related party service transactions be captured? NAIC staff is aware of instances in which intercompany service costs have been forgiven and not recorded. Generally, the intercompany transaction (and service cost expense / payable) should be recognized at the onset of the contract. Then, if the amount owed is forgiven, the offset to the payable should be to contributed capital. However, if a company does not record the initial entry, then expense recognition is not shown in the F/S.

  Initial Entry for service contract:
  
  Debit - Service Expense / Credit - Payable
  
  If the payable was forgiven, then the entry would be:
  
  Debit – Payable / Credit - Contributed Capital
  
  This would ensure both the expense entry and the impact to contributed capital were recognized.

Interested Parties’ Comments:
Interested parties note that existing guidance contained within SSAP No. 25—Affiliates and Other Related Parties (SSAP No. 25), and SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets (SSAP No. 5R) should be considered in determining the proper accounting treatment for the exposed questions. In addition to the relevant accounting guidance, the exposed questions must also consider specific legal and regulatory requirements related to affiliated company transactions. The comments below are based upon the current guidance contained in SSAP No. 25 and SSAP No. 5, as well as the requirements of the Insurance Holding Company System Regulatory Act (i.e., MDL-440) and the Insurance Holding Company System Model Regulation with Reporting Forms and Instructions (i.e., MDL-450).
Hearing Agenda

NAIC staff Note: Per email confirmation on Oct. 9, 2018, the interested parties are ok with the exposed revisions. The additional detail provided in the comment letter responds to the exposure questions.

Related Party Loans

Exposure Question 1 - Should uncollectibility of an amount loaned or advanced to a parent be considered a dividend, instead of a write-off to income? Is it clear when an amount owed from a parent has been deemed uncollectible instead of when debt has been forgiven?

Interested parties believe the relevant facts and circumstances should be evaluated to determine the appropriate accounting treatment. For example, if the reporting entity has classified this transaction as an admitted asset, the transaction would have required prior regulatory approval, along with a consideration of the parent’s independent payment ability. The reporting entity would also be required to continuously review the asset for impairment in accordance with both SSAP No. 25 and SSAP No. 5R.

As provided in SSAP No. 25, paragraph 8: “…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 the account on a current basis. Evaluation of the collectibility of loans and advances shall be made periodically. If, in accordance with SSAP No. 5R – Liabilities, Contingencies and Impairments of Assets, it is probable that the balance is uncollectible, any uncollectible balance shall be written off and charged to income in the period the determination is made.”

In most instances, the uncollectible determination will be clearly supported by the parent’s financial statements and its ability to pay based upon its liquid assets or revenues from external sources. If the preparer concludes, based upon the application of SSAP No. 5R that the asset is impaired, any uncollectible balance shall be written off and charged to income in the period the determination has been made.

There may be instances where the application of SSAP No. 5R may not be self-evident and the preparer’s determination of the parent’s ability to repay the loan may differ from the domiciliary regulator’s conclusion. These situations may be further complicated by the fact the debtor controls the reporting entity and may conclude there is an impairment rather than a forgiveness of debt. In instances where it may not be clear whether the reporting entity is forgiving the debt, rather than writing off an impaired amount, interested parties recommend that further dialogue with the domiciliary regulator occur to discuss the overall impact of the impairment to the insurance holding company system, and also to determine whether the transaction would be subject to the insurance holding company statutes and regulations. If it is concluded in these situations that the amount due is not impaired, the transaction should be considered either a dividend or a capital contribution.

Transactions Involving Services

Exposure Question 2 – Should additional guidance for the recording of related party service transactions be captured? NAIC staff is aware of instances in which intercompany service costs have been forgiven and not recorded. Generally, the intercompany transaction (and service cost expense / payable) should be recognized at the onset of the contract. Then, if the amount owed is forgiven, the offset to the payable should be to contributed capital. However, if a company does not record the initial entry, then expense recognition is not shown in the F/S.

Initial Entry for service contract:

- Debit - Service Expense / Credit - Payable

If the payable was forgiven, then the entry would be:

- Debit – Payable / Credit - Contributed Capital

This is intended to ensure both the expense entry and the impact to contributed capital were recognized.
Interested parties recommend that no additional guidance is required, as the current guidance included in SSAP No. 25, paragraph 18 explicitly provides that transactions involving services provided between related parties shall be recorded at the amount charged. This guidance does not support the fact pattern outlined in the exposed question where a company does not record the initial expense.

The failure to record the expense associated with the affiliated services is further emphasized in SSAP No. 25, where regulatory scrutiny of related party transactions which do not meet the fair and reasonable standard established by Appendix A-440 may result in (a) amounts charged being re-characterized as dividends or capital contributions, (b) transactions being reversed, (c) receivable balances being nonadmitted, or (d) other regulatory action.

As affiliated service agreements either require prior regulatory approval or are subject to the insurance department’s oversight through financial analysis or financial examination, the insurance regulator has the regulatory authority to determine if the requirements of SSAP No. 25 and the respective service agreements are being followed. In the event that a reporting entity is not following the proper recording of expenses, the current guidance would re-characterize the amounts as a dividend or as a capital contribution.

**Recommended Action:**
NAIC staff recommends that the Working Group adopt the exposed nonsubstantive revisions to SSAP No. 15—Debt and Holding Company Obligations and SSAP No. 25—Affiliates and Other Related Parties to reference existing guidance in SSAP No. 72—Surplus and Quasi-Reorganization when there has been a forgiveness of debt owed.

In review of the interested parties’ comments responding to the exposure questions, at this time NAIC staff does not suggest additional revisions to statutory accounting principles.

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**Summary:**
During the Summer National Meeting, the Working Group exposed nonsubstantive revisions to SSAP No. 72 to provide guidance for when a reporting entity provides a distribution that is a return of capital. This guidance indicates that distributions that reflect a return of capital shall be charged directly to the gross paid in and contributed surplus (which would reduce the adjusted cost basis in the reporting entity).

**Interested Parties’ Comments:**
The regulatory approval requirement is problematic because it conflicts with holding company laws and regulations on distributions, and it is not appropriate for the *NAIC Accounting Practices and Procedures Manual* to override these laws and regulations. If a company has the capacity to pay an ordinary dividend, where no regulatory approval is required, they can either pay as a dividend or return of capital. The decision of whether it’s legally a return of capital (and for tax purposes) is generally made by the board of directors when they approve the distribution. If the board approves the distribution as a return of capital and an insurer has ordinary dividend capacity, this proposed accounting requirement would require regulatory approval whereas the state laws/regulations do not.

If there are concerns or issues with the capital treatment of an ordinary dividend, we recommend that such issues be addressed through the applicable state laws and regulations. As an alternative to the proposal, SSAP No. 72 could be modified to state that the accounting treatment should follow the approach as approved by the board of directors, or if no classification was specified, the distribution should be recorded as a dividend to the extent...
unassigned surplus is positive, with any remaining distribution treated as a return of capital once unassigned funds is reduced to zero. The disclosures could be modified to require identification of the accounting characterization of any distribution as a dividend or return of capital as follows:

“Reporting entities shall receive domiciliary state approval before providing a return of capital to a parent or other stockholder. Distributions that reflect a return of capital shall be charged directly to the gross paid in and contributed surplus. (A return of capital will reduce the adjusted cost basis of the parent/stockholder in the reporting entity.)"

**Recommended Action:**
NAIC staff recommends adopting nonsubstantive revisions to SSAP No. 72, modified from the original exposure as detailed below. (If preferred by the Working Group, the proposed language could be exposed to allow for additional review.) As the domestic regulator should have notice of distributions, and whether they are ordinary, extraordinary or a return of capital, a disclosure has not been proposed.

**Proposed New Paragraph 11** – This paragraph has been modified to remove the domiciliary state approval requirement.

11. Reporting entities shall receive domiciliary state approval before providing a return of capital to a parent or other stockholder. Distributions that reflect a return of capital shall be charged directly to the gross paid in and contributed surplus. (A return of capital will reduce the adjusted cost basis of the parent/stockholder in the reporting entity.)

**Proposed New Footnote to Paragraph 13** – This paragraph does not have any suggested revisions but has been reflected for illustration purposes.

1213. 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:

i. Dividends to Stockholders

Dividends 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 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—Affiliates and Other Related Parties;

New Footnote: 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.)
Summary:
During the Summer National Meeting, the Working Group exposed nonsubstantive revisions to SSAP No. 37—Mortgage Loans to clarify that a mortgage loan acquired through a mortgage loan participation agreement is limited to a single mortgage loan agreement with a sole borrower. Consistent with existing guidance in SSAP No. 37, investments that reflect ownership in a mortgage loan fund are not in scope of SSAP No. 37.

Additional Background Info: The guidance for acquiring mortgages through a “participation agreement” was adopted at the same time as the revisions to identify “participants” in mortgage loans. (A participant in a mortgage is defined when there is more than one lender identified on the loan documents as providing funds to a sole borrower.) Although the guidance for a “participant” in a mortgage loan is explicit that the guidance pertains to mortgages issued to a “sole borrower,” and there is explicit guidance in SAP No. 37 that identifies that investments that reflect involvement in a “mortgage loan fund” are not considered mortgage loans, the agenda item was drafted as the “participation agreement” language was being used as a reference to incorporate ownership interests in pool / funds of mortgages as SSAP No. 37 (Schedule B) mortgage loans.

Interested Parties’ Comments:
Interested parties understand from the “Description of Issue” of the Form A that the proposed revisions are intended to prohibit loans secured by “pools of mortgages” and “loan funds” from being accounted for as mortgage loans under SSAP No. 37. However, there are situations where a mortgage loan has multiple borrowers that are related parties to one another for operational ease and for additional security. There could also be instances where there is more than one borrower as is the case with “Tenant-in-Common” loans where the borrowers are jointly and severally liable as borrowers under one loan. Interested Parties do not believe that it is necessary to specify that a mortgage loan is to a “sole borrower” to preclude pools of mortgages and loan funds from being accounted for as a mortgage loan under SSAP No. 37. In fact, SSAP 37 already specifies that investments in mortgage loan funds are not within the scope of SSAP 37 per paragraph 2. Interested parties recommend that the proposed revisions strike the reference to a “sole borrower” and clarify that the mortgage loan agreement may include “one or more borrowers.” This will preserve the situation where related party borrowers on a loan agreement secured by multiple mortgaged real estate properties can appropriately be accounted for as a real estate mortgage loan as well as other situations where there is more than one borrower named in the loan agreement as could be typical for specific types of mortgage loans.

Also, after re-reading footnotes “a” and “b” in SSAP 37, interested parties would like to suggest some wording changes to both paragraphs to better clarify the distinction between co-lending agreements and participation agreements. We offer proposed edits, which we have tracked below from the SSAP No. 37 version currently in the Accounting Practices and Procedures Manual.

Proposed Wording Changes to SSAP 37:

a. Reporting entity is a “co-lender” participant in a single mortgage loan agreement that identifies more than one lender (which includes the reporting entity) providing funds to one or more a sole borrowers with the real estate collateral securing all lenders identified in the agreement. For these 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 participation agreement” rather than a solely-owned mortgage loan is that no one lender of the lending group may unilaterally foreclose on the mortgage. With these agreements, the lenders must foreclose on the mortgage loan as a group.

1 Tenancy-in-Common relates to a property’s joint ownership by two or more unrelated or related bodies in equal or unequal shares.

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b. Reporting entity has a “participation agreement” to invest in a mortgage loan issued by another entity. The mortgage loan may have one or more borrowers. Although the reporting entity is not named on the original mortgage loan agreement, the original issuer sells a portion of the mortgage loan to an incoming participant lender (“participant”) co-lender and the sale is documented by an assignment of a participation interest or participation agreement between the selling lender and the participant co-lender. With these agreements, the participant co-lender acquires an undivided participation interest in the mortgage loan and will have receive direct interest in the amount of their participation in the rights related to repayment of the loan based on its pro-rata share of the loan and the collateral given to secure the loan. The financial rights and obligations of the participants lenders in these agreements shall be similar to those in a direct loan.

**Recommended Action:**
Although NAIC staff understands the intent of the interested parties’ proposed modifications, NAIC staff believes that if the interested parties’ proposed edits were incorporated, then the guidance would be inadvertently interpreted to specifically allow “bundled” mortgage loans (which would also be considered a mortgage loan “fund”) to be considered in scope of SSAP No. 37. This is contrary to the intent of the proposed agenda item.

The design of Schedule B, and RBC (particularly for life companies), is for single-mortgage loan reporting. Meaning, each mortgage shall be reported separately, and reported with the loan-to-value ratio (as applicable) in the RBC calculation. Although NAIC staff understands that a single mortgage loan agreement could have more than one lender (co-lender), and potentially more than one borrower (as in the “tenant-in-common” scenario), the interested party proposed language does not limit the “more than one borrower” to these limited situations.

NAIC staff recommends that the Working Group expose revisions to SSAP No. 37 to clarify that the intent is single mortgage loan agreements.

### SSAP No. 37–Mortgage Loans

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

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

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

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

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

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

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

   b. Reporting entity has a “participation agreement” to invest in a single mortgage agreement mortgages (sole borrower) originally issued by another entity. Although the reporting entity is not named on the original mortgage loan agreement, the original issuer sells a portion of the mortgage loan to an incoming participant lender (co-lender) and the sale is documented by an assignment of a participation interest or participation agreement between the selling lender and the co-lender participant. With these agreements,
the participant-lender acquires an undivided participation interest in the single mortgage loan and will have rights related receive direct interest in the amount of their participation in the right to repayment of the loan based on its pro-rata share of the single mortgage loan and the collateral given to secure the loan. The financial rights and obligations of the lenders-participants in these agreements shall be similar to those in a direct loan.

3 The scope of this SSAP is limited to single mortgage loan agreements. Although single mortgage loan agreements can potentially have more than one lender (e.g., co-lenders/participations) and more than one borrower (such as in a tenancy-in-common arrangement), the concept of a “single mortgage loan” does not include arrangements in which a reporting entity acquires more than one mortgage in a sole transaction. (For example, if a reporting entity was to acquire an interest in a “bundle” of mortgage loans with various unrelated borrowers and collateral, this agreement would be outside of the scope of this SSAP.)

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Summary:
During the Summer National Meeting, the Working Group exposed nonsubstantive revisions to SSAP No. 97 to clarify the existing reporting requirements when a reporting entity has a negative equity valuation in an SCA investment. Specifically, the proposed revisions clarify that a reporting entity’s negative equity value shall be reported as a contra-asset in the following scenarios:

- In all instances in which the limited statutory adjustments required by paragraph 9 results in a negative equity valuation of the investment. (This would apply to 8.b.ii and 8.b.iv entities.)
- When the reporting entity has guaranteed obligations or committed further financial support to an SCA. Recognition of the negative equity in the SCA is in addition to the guarantee liability required under SSAP No. 5R. (This applies to all SCA entities.)

Interested Parties’ Comments:
Interested parties do not agree with the proposed revisions to SSAP No. 97 paragraph 13e. With respect to proposed subparagraph i of paragraph 13e, adjustments pursuant to SSAP No. 97 paragraph 9 (the “limited statutory adjustments”) have nothing to do with SCA operational losses that drive a negative equity value. As such, any negative equity reported as a result of the paragraph 9 limited statutory adjustments would not be responsive to the new SSAP No. 97 paragraph 34 SCA loss tracking disclosure.

With respect to the proposed subparagraph ii of paragraph 13e, the proposed revisions include similar language to the original Agenda item 2018-09 exposure. As such, interested parties have significant concerns with respect to this proposed subparagraph and we reiterate our previous comments on the same issue (from Agenda item 2018-09) that is now included in the current exposure:

Interested parties believe this proposed guidance would erroneously understate the reporting entity’s surplus by double-counting the impact of the parent insurer’s guarantee or commitment of the SCA’s obligations. For example, assume a parent insurer has a guarantee to pay a fee to a third party if the SCA’s equity drops below zero, and no other commitment related to the SCA entity. Assume at year end that the SCA’s equity is negative $100,000 thousand and the parent insurer owes the third party $20,000 under the terms of the guarantee. Under current guidance, the parent insurer would carry its SCA investment at $0 and record a liability of $20,000 under the guarantee. The $20,000 liability represents the extent of the parent insurer’s obligation and exposure to loss related to the SCA. Under the proposed guidance, the parent insurer would record the $20,000 guarantee liability as well as a liability (in the form of a contra-asset) of $100,000, the latter of which is not an obligation of the parent insurer.
**Recommended Action:**
NAIC staff recommends that this agenda item be re-exposed with direction for NAIC staff to work with interested parties’ as well as research the applicable U.S. GAAP guidance to determine whether changes should occur to existing guidance that requires negative SCA reporting when there is a guarantee or commitment to provide financial support. With re-exposure, additional comments are requested on various situations that may exist.

NAIC staff notes that this agenda item clarifies existing accounting guidance in SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities and does not propose any new guidance. The intent of the agenda item was to clearly identify when a reporting entity is required to report negative equity in its investment in an SCA (rather than halt at a zero position). Pursuant to existing guidance in SSAP No. 97, when a reporting entity’s share of losses exceeds its investment in an SCA and there is guarantee or commitment to provide funding, the reporting entity is required to report its investment in the SCA at a negative equity value and report the guarantee in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets.

It should be noted that the obligation to report a guarantee / commitment is always governed by SSAP No. 5R and is not a provision that is “triggered” when the reporting entity’s share of losses exceeds its investment in the SCA. If there is a guarantee or commitment to fund, SSAP No. 5R requires liability recognition for that guarantee. The provisions under SSAP No. 5R require reporting the noncontingent (non-triggered) liability to represent the “fair value of the guarantee” at inception. A “contingent” guarantee (once triggered per the terms of the guarantee), is recognized under the provisions of paragraph 8 of SSAP No. 5R, which requires recognition with a charge to operations. (SSAP No. 5R has a limited exclusion for noncontingent guarantees (initial recognition) for wholly-owned subsidiaries, but if not wholly-owned, guarantees between parents and subsidiaries or between corporations under common control are subject to the initial recognition and disclosure requirements. Contingent guarantees (triggered) are always liabilities until paid.)

The guidance in SSAP No. 97, requiring both the negative position in the investment in the SCA and the guarantee obligation is not new, the revisions were simply highlighting the existing guidance in SSAP No. 97 in which negative equity in the SCA investment is required.

Staff highlights that if there are no revisions to SSAP No. 97, the following elements continue to exist:

- Paragraph 9 requires negative reporting for 8.b.ii entities as a result of limited statutory adjustments.
- Paragraph 13e requires negative equity reporting when the share of losses exceeds the investment in the SCA and there is a guarantee or commitment to provide further support. (This is also addressed in Question 7 in Exhibit C - Implementation Questions and Answers.)
- Paragraph 13e requires guaranteed obligations to be recorded in accordance with SSAP No. 5R.

(This agenda item captured the requirements in paragraph 9 (GAAP with statutory valuation adjustments) and the equity method adjustments in paragraph 13e in the equity method adjustments paragraph.)
Summary:
During the Summer National Meeting, the Working Group exposed nonsubstantive revisions to SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies, to incorporate guidance and disclosures when a reporting entity’s share of losses in a SSAP No. 48 entity exceeds its investment in the SSAP No. 48 entity. (The provisions proposed for SSAP No. 48 entities are similar to the provisions already in place for SCAs in SSAP No. 97. The disclosure illustration is just expanded so that the disclosure captures both SCAs and SSAP No. 48 entities in a single location.)

Interested Parties’ Comments:
Interested parties note that the proposed changes to paragraph 6 of SSAP No. 48 only apply to investments in SSAP No. 48 entities of more than a minor ownership interest. Such SSAP No. 48 entities are subject to the equity method accounting requirements of SSAP No. 97, including the requirements of SSAP No. 97 paragraph 13e (regarding a reporting entity’s share of losses exceeding the carrying value). Therefore, the proposed additions to paragraph 6 of SSAP No. 48 are not necessary. Notwithstanding this point, interested parties also note that, with respect to the proposed subparagraph “a” of paragraph 6 of SSAP No. 48, the proposed revisions to SSAP No. 48 include similar language to the original Agenda item 2018-09 exposure. Interested parties have significant concerns with respect to this proposed subparagraph and we reiterate our previous comments on the same issue (from Agenda item 2018-09) that is now included in the current exposure:

With respect to the proposed subparagraph “a” of paragraph 6 of SSAP No. 48, interested parties believe this proposed guidance would erroneously understate the reporting entity’s surplus by double-counting the impact of the parent insurer’s guarantee or commitment of the investee’s obligations. For example, assume a reporting entity has a guarantee to pay a fee to a third party if the investee’s equity drops below zero, and no other commitment related to the reporting entity. Assume at year end that the investee’s equity is negative $100,000 thousand and the reporting entity owes the third party $20,000 under the terms of the guarantee. Under current guidance, the reporting entity would carry its investment at $0 and record a liability of $20,000 under the guarantee. The $20,000 liability represents the extent of the reporting entity’s obligation and exposure to loss related to the investee. Under the proposed guidance, the reporting entity would record the $20,000 guarantee liability as well as a liability (in the form of a contra-asset) of $100,000, the latter of which is not an obligation of the reporting entity.

Because the SSAP No. 48 entities in question are subject to the equity method accounting requirements of SSAP No. 97, interested parties do not believe the proposed disclosure additions to paragraph 20 of SSAP No. 48 are necessary, especially the new proposed disclosure paragraph “20d” of SSAP No. 48. It appears this proposed disclosure is meant to replicate the SSAP No. 97 paragraph 34 disclosure. Interested parties note that the SSAP No. 97 paragraph 34 disclosure was meant to capture information related to the limited number of SSAP No. 97 noninsurance entities, primarily in response to questions that arose regarding the completeness and timeliness of SCA filings with the SVO. Detailed information about all SSAP No. 48 entities is already included in Schedule BA and no such SVO filings are required for SSAP No. 48 entities. These newly proposed disclosures would be excessive and duplicative.

Instead, interested parties suggest that the new paragraph 34.a of SSAP No. 97 be repurposed as a standalone paragraph (i.e., a new paragraph 35) and made applicable to all subsidiary, controlled and affiliated entities, including SSAP No. 48 entities. In addition, in order to make it clear to a reader of SSAP No. 48 that certain SSAP No. 97 disclosures may apply, interested parties recommend the following additional language to paragraph 6 of SSAP No. 48:
“Investments in these ventures, except for joint ventures, partnerships and limited liability companies with a minor ownership interest, shall be reported using an equity method as defined in SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities (SSAP No. 97), paragraphs 8.b.i. through 8.b.iv. A reporting entity whose shares of losses in such an SSAP No. 48 entity exceeds its investment in the SSAP No. 48 entity shall disclose the information required by paragraph 34a SSAP No. 97.”

**Recommended Action:**
NAIC staff recommends that the Working Group adopt the proposed edits to SSAP No. 48, paragraph 6 as recommended by interested parties. With this adoption, the loss-tracking disclosure for SSAP No. 48 entities will be required for year-end 2018. **NAIC staff recommends that continued discussion of additional revisions be postponed, or occur in conjunction with, agenda item 2018-26.** NAIC staff notes that blanks revisions will also be incorporated to reflect this change.

**Proposed Edits to SSAP No. 48:**

6. Investments in these ventures, except for joint ventures, partnerships and limited liability companies with a minor ownership interest, shall be reported using an equity method as defined in SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities (SSAP No. 97), paragraphs 8.b.i. through 8.b.iv. A reporting entity whose shares of losses in such an SSAP No. 48 entity exceeds its investment in the SSAP No. 48 entity shall disclose the information required by SSAP No. 97, paragraph 34a.

The 18 pages of comment letters are included in Attachment 25.
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**Meeting Agenda**

**Statutory Accounting Principles (E) Working Group**

**Meeting Agenda**

**November 15, 2018**

**A. Consideration of Maintenance Agenda – Pending List**

1. Ref #2018-32: SSAP No. 26R - Prepayment Penalties
2. Ref #2018-33: SSAP No. 30R - Pledges to FHLBs
3. Ref #2018-34: SSAP No. 30R - Foreign Mutual Funds
4. Ref #2018-35: ASU 2018-07, Improvements to Nonemployee Share Based Payment Accounting
7. Ref #2018-38: Prepaid Providers
8. Ref #2018-39: Interest on Claims

**The following new agenda items all propose to reject U.S. GAAP as not applicable to statutory accounting:**

10. Ref #2018-41: ASU 2017-13, Amendments to SEC Paragraphs

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<td>2018-32</td>
<td>Prepayment Penalties</td>
<td>A - Agenda Item</td>
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<tr>
<td>SSAP No. 26R (Julie)</td>
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**Summary:**

In 2016, guidance was adopted to SSAP No. 26R to clarify the calculation of investment income for prepayment penalty and/or acceleration fees for bonds liquidated prior to scheduled termination. Since the adoption of that guidance, comments have been received on how the calculations should be applied when the call price is below par.

**Adopted calculation:**

Realized Gain / Loss = Difference between Par and BACV
Investment Income = Consideration Received Less Par

Comparing the calculation for when the call price is above par, and for when the call price is less than par:

<table>
<thead>
<tr>
<th>Call Price Above Par Premium</th>
<th>Call Price Above Par Discount</th>
<th>Call Price Less Than Par</th>
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<tr>
<td>Par</td>
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<td>103</td>
<td>103</td>
<td>26</td>
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<tr>
<td>Loss (100-102)</td>
<td>Gain (100-98)</td>
<td>Gain (100-25)</td>
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<tr>
<td>(2)</td>
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<td>Income (103-100)</td>
<td>Income (103-100)</td>
<td>Income (26-100)</td>
</tr>
<tr>
<td>3</td>
<td>3</td>
<td>(74)</td>
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In the first two examples, when the consideration received is greater than par, the allocation accurately reflects the realized gain and the investment income for the prepayment penalty. The examples adopted in 2017 were focused on situations where amounts received were greater than par. In the third example, in which the consideration is less than par, the allocation to investment income for the prepayment penalty misrepresents that there has been a large realized gain and a large realized loss. Although the net impact in the financial statements correctly reflects $1 in net gain, the calculation in SSAP No. 26 would require the reporting entity to show a $75 realized gain (which could impact AVR and IMR) and a $74 net investment income loss (which impacts the income statement and dividend calculation).

Although NAIC staff agrees that prepayment penalties reported as investment income shall be separately reported from realized gains / losses, NAIC staff notes that the resulting impact of the gross calculation, when the call price is less than par, may result with unintended consequences to AVR / IMR and net income.

The intent of this agenda item is to propose clarifications to the guidance to clarify that the calculation to determine realized gains / loss and investment income shall be followed in situations in which the consideration received exceeds par. In situations in which consideration received is less than par, the reporting entity shall separately allocate the consideration received between investment income and realized gain / loss in accordance with the terms of the callable bond. The portion of consideration received that represents prepayment penalties and/or acceleration fees shall be reported as investment income.

Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose proposed revisions to SSAP No. 26R, as detailed in the agenda item, to provide guidance for situations in which the consideration received from a callable bond is less than par. In these situations, the reporting entity shall separately allocate the consideration received between investment income and realized gain / loss in accordance with the terms of the callable bond. The portion of consideration received that represents prepayment penalties and/or acceleration fees shall be reported as investment income.

As part of the exposure, comments are requested on whether the illustration in the agenda item should be added to the appendix and/or if all of the appendix for prepayment penalties should be eliminated / condensed.

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<td>SSAP No. 30R (Julie)</td>
<td>B – Agenda Item</td>
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<td>Pledges to FHLBs</td>
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Summary:
This agenda item has been drafted to clarify the accounting guidance if an insurer pledges assets to a Federal Home Loan Bank (FHLB) on behalf of an affiliate. The proposed revisions detailed within this agenda item are consistent with existing guidance in SSAP No. 4—Assets and Nonadmitted Assets, but intend to address any uncertainty on the existing statutory accounting guidance.

The existing guidance in SSAP No. 4 related to assets restricted by a related party was incorporated from INT 01-03: Assets Pledged as Collateral or Restricted for the Benefit of a Related Party. That INT was initially effective June 11, 2001 and is explicit that if the assets of an insurance entity are pledged or otherwise restricted by the actions 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. As such, the INT, and the guidance in SSAP No. 4, identifies that these assets shall not be recognized as admitted assets.

NAIC staff has become aware of a situation in which an insurer, who was not a member of the FHLB, had pledged assets to an FHLB on behalf of their affiliate. The affiliate was the FHLB member. The insurer that had...
pledged assets to the FHLB had taken the position that the pledged assets were permitted to be admitted as they met the requirements for admittance pursuant to paragraph 14 of SSAP No. 30—Unaffiliated Common Stock. NAIC staff notes that the guidance in SSAP No. 30 was intended to address the accounting for FHLB transactions by reporting entities that are FHLB members. This guidance is inclusive as it addresses the insurer’s reporting of the FHLB capital stock, the insurer’s pledging of collateral to the FHLB and disclosures when the insurer borrows funds from the FHLB. In no situation was the guidance for collateral pledged to the FHLB intended to be used out of context and applied by either FHLB or non-FHLB members that pledged funds on behalf of an affiliate member.

In addition to clarifying applicability of the existing guidance in SSAP No. 4, which is an overall concept that applies to all pledges of assets, this agenda item requests comments from regulators, interested parties and the FHLB regarding the ability for non-members to engage in activities with the FHLB on behalf of an affiliate that is a member of the FHLB. Comments are requested on whether the existing guidance for FHLBs, which allows admitted asset treatment for FHLB stock although the stock is significantly restricted and cannot be liquidated for policyholder claims, shall be retained if the reporting entity is utilizing their FHLB membership to obtain FHLB benefits for affiliates.

**Recommendation:**

NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to SSAP No. 30—Unaffiliated Common Stock, as detailed in the agenda item, to clarify that an insurer that pledges assets to an FHLB on behalf of an affiliate shall be captured in the concept detailed in footnote 2 of SSAP No. 4. This concept identifies that 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 reporting entity and are not available to satisfy policyholder obligations and shall be nonadmitted.

NAIC staff has identified that the current disclosures for FHLBs are not designed to capture “affiliate” activity, and a reporting entity that reports “collateral pledged to an FHLB” when the reporting entity is not an FHLB member may appear to be misleading without further documentation that the affiliate is not an FHLB member and only an affiliate of the FHLB member. Although revisions are proposed to clarify that any asset pledged to an FHLB by a non-FHLB member shall be nonadmitted, NAIC staff has also proposed additional revisions to clarify that the SSAP No. 30 guidance is restricted to reporting entities that are FHLB members. Lastly, the revisions propose to clarify that any transaction that is entered into on behalf of an affiliate, but is completed in a manner to exclude the affiliate involvement (e.g., pledging assets directly to the FHLB on behalf of an affiliate) shall be considered a related party transaction under SSAP No. 25—Affiliates and Other Related Parties.

With this exposure, comments are requested from the regulators, interested parties and the FHLBs on the following: *(Previously, from past discussions, affiliate transactions with FHLBs were not expected to occur.)*

- Ability for non-FHLB member to borrow funds based on affiliate FHLB membership.
- “Group” FHLB Membership – Meaning the FHLB membership is determined / divided among more than one affiliate, in which all affiliated companies are considered FHLB members (with FHLB privileges), based on the “group” agreement.
- Prevalence of insurer assets being pledged to an FHLB for an affiliate FHLB member / borrower.
- Whether the existing guidance for FHLBs, which allows admitted asset treatment for FHLB stock although the stock is significantly restricted and cannot be liquidated for policyholder claims, shall be retained if the reporting entity is utilizing their FHLB membership to obtain FHLB benefits for affiliates.
Summary:
This agenda item has been drafted to consider whether foreign mutual funds should be in scope of SSAP No. 30R in accordance with the request per the interested parties’ Oct. 5, 2018 comment letter:

Some in industry have noted that existing SSAP No. 30 scope language includes “shares of mutual funds” while the new exposure only specifically scopes in SEC registered mutual funds. Foreign open-ended mutual funds that are structured similarly to SEC registered mutual funds with a NAV that is calculated and published periodically and used as the basis for purchases and redemptions should be included in SSAP No. 30. Additionally, foreign open-ended mutual funds are often registered with and regulated by competent regulatory bodies. Interested parties believe a case can be made to expand the scope of SSAP No. 30 to include such registered foreign open-end mutual funds, with similar structure and regulation, and respectfully ask the Working Group to explore this idea during 2019. Interested Parties can provide further information on such foreign open-end mutual funds upon the Working Group’s request.

The guidance in SSAP No. 30—Unaffiliated Common Stock, prior to the adoption of SSAP No. 30R, included in scope “shares of mutual funds, regardless of the types or mix of securities owned by the fund (e.g., bonds, stocks, money market instruments...” Since there is no reference to foreign mutual funds in SSAP No. 30 or the corresponding Issue Paper No. 30—Investments in Common Stock (excluding investments in common stock of subsidiary, controlled or affiliated entities), when drafting SSAP No. 30R, NAIC staff had the impression that the phrase “mutual fund” was intended to reflect an SEC registered open-end investment company investment, as U.S. retail investors can only buy funds that are registered with the SEC. (Global or international funds can also be registered with the SEC, hence, these are permissible to U.S. investors.) All SEC registered funds must comply with the Investment Company Act of 1940. However, per the comments from interested parties, “mutual funds” can be issued from other jurisdictions, and NAIC staff would agree that foreign mutual funds should not be treated different than foreign common stock.

SEC Definition: A mutual fund is an SEC-registered open-end investment company that pools money from many investors and invests the money in stocks, bonds, short-term money-market instruments, other securities or assets, or some combination of these investments.

Foreign mutual funds are funds registered outside of the US SEC in accordance with specific rules / regulations of the foreign country. Examples of foreign mutual funds include:

- **The European Union:** Mutual funds authorized for sale in Europe are governed by regulations from the Undertakings for Collective Investment in Transferable Securities, or UCITS. To market a fund across all member countries of the European Union, only need to register the fund in one EU country under the authority of that country's financial regulator. For example, in Ireland, it is the Irish Financial Services Regulatory Authority. In turn, the IFSRA is part of the Committee of European Securities Regulators, which is in charge of coordinating the securities regulators of all the EU countries.

- **The Hong Kong Market:** There are two fund governing bodies in the Hong Kong market: the Securities and Futures Commission (SFC) and the MPFSA. The SFC's rules are broader and not as specific or restrictive as the rules set forth by the MPFSA, and they apply to all funds marketed in Hong Kong, no matter what type of mutual fund they are. MPFSA only governs funds that are marketed for use in the retirement accounts of its residents. This means that funds suitable for investment in retirement accounts must abide by both SFC and MPFSA rules. However, as the MPFSA rules are more restrictive than SFC rules, fund managers can usually concentrate on the MPFSA rules, knowing that compliance with these rules will usually ensure compliance with the broader rules as well.
• **Other Markets:** Other markets have their own structure and regulations:

  o Canada mutual funds are subject to provincial securities laws as well as national rules known as NI 81-102. The NI stands for "National Instrument." For example, dealers who sell mutual funds must be registered with the securities regulator of their province, while the mutual fund asset manager must ensure that the fund they manage abides by the NI 81-102 rules.

  o Taiwan mutual fund market is regulated by the Financial Supervisory Committee in accordance with the Securities Investment Trust and Consulting Act.

**Recommendation**

NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose proposed revisions to SSAP No. 30R, as detailed in the agenda item, to explicitly permit foreign open-end mutual funds to be in scope of SSAP No. 30R. With this exposure, NAIC staff would recommend referrals to the Capital Adequacy (E) Task Force and the Valuation of Securities (E) Task Force to obtain comments with regards to the proposed revisions and identified questions.

With the proposed edits, NAIC staff would also suggest comments to address the following situations:

1) Should only certain jurisdictions be permitted for their mutual funds inclusion as common stock? (For example, UK, Hong Kong, Canadian, etc.)

2) Should Canadian mutual funds continue to be considered “domestic” in accordance with the current annual statement instructions as they are subject to different regulations from the U.S. SEC. Should a new code shall be established for Canadian mutual funds on Schedule D-2-2?

3) Should all foreign mutual funds (including or excluding Canadian mutual funds) be captured in the Supplemental Investment Risk Interrogatory as foreign investments?

4) Should there be clarification that only U.S. SEC registered mutual funds that qualify for diversification are excluded from the Asset Concentration Factor section of the risk-based capital filing? In staff view, only U.S. SEC registered mutual funds shall be reported in the general interrogatories 29.1 through 29.3.

NAIC staff notes that SSAP No. 30, with reporting on Schedule D-2-2, is the most appropriate reporting location for all authorized and regulated open-end mutual funds. With the reporting requirements, including information on foreign investments, NAIC staff does not object to reporting foreign open-end mutual funds in the same manner as foreign common stock investments, noting that mutual funds and common stock investments receive the same risk-based capital charge. NAIC staff notes that other foreign funds shall not be captured within scope of D-2-2 but shall be captured under SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies and reported on Schedule BA.

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<td><em>ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting</em></td>
<td>D – Agenda Item</td>
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**Summary:**

This agenda item has been drafted to consider *ASU 2018-07: Improvements to Nonemployee Share-Based Payment Accounting* (ASU 2018-07) for statutory accounting. This ASU was issued in June 2018 as part of the FASB simplification initiative and intends to reduce cost and complexity, with improvements for financial reporting for share-based payments issued to nonemployees. The ASU expands the scope of *ASC Topic 718 – Stock Compensation*, which previously only included share-based payments to employees, to include share-based
payments issued to nonemployees for goods and services. This results with substantial alignment for share-based payments to employees and nonemployees, and results with *ASC Subtopic 505-50 – Equity Payments to Nonemployees* being superseded.

Prior to the issuance of the ASU, the U.S. GAAP guidance for share-based payments was significantly different for employees and nonemployees. With the ASU, the U.S. GAAP guidance in ASC Topic 718 will be applicable to all share-based payments except for specific guidance on inputs to an option pricing model and the attribution of cost (that is, the period of time over which share-based payment awards vest and the pattern of cost recognition over that period).

The amendments in the ASU are effective for public companies Jan. 1, 2019. For all other companies, the amendments are effective Dec. 31, 2020. At transition, reporting entities are required to measure their impacted nonemployee awards at fair value through a cumulative effect adjustment as of the beginning of the year.

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

**Recommendation:**
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to adopt with modification ASU 2018-07 in *SSAP No. 104R*. These revisions will eliminate the specific section for nonemployee awards from *SSAP No. 104R* and include guidance for nonemployees with the share-based payment guidance for employees in the same manner as U.S. GAAP. With the revisions proposed to *SSAP No. 104R*, revisions are also proposed to *SSAP No. 95—Nonmonetary Transactions* to update previously adopted U.S. GAAP guidance, as well as to update references in Appendix D. With exposure, comments are also requested on three questions:

1. **NAIC staff recommends that this item be categorized as nonsubstantive, as the resulting share-based payment concepts have previously been reflected within SSAP No. 104R, and it is not expected that the revisions for nonemployees will have a significant impact on insurance reporting entities.** NAIC staff requests comments during the exposure period on whether the proposed revisions from ASU 2018-07 to SSAP No. 104R should be considered a substantive change.

2. **NAIC staff recommends removal of Exhibit B, which detailed the minimum information to be disclosed.** As the disclosures are in the annual audited financial statements only, NAIC staff believes that reference to the U.S. GAAP guidance for the detailed disclosures is all that is needed in the SSAP. **NAIC staff requests comments on whether this disclosure detail should remain in the SSAP.**

3. **NAIC staff notes that the original adoption of SSAP No. 104 referenced continued application of SSAP No. 13 for awards outstanding that were originally accounted for under SSAP No. 13. Although this information has not been removed in the proposed revisions to adopt ASU 2018-07, **NAIC staff requests comments on whether this guidance is still applicable, and if this transition guidance can be deleted.**

**Due to the extent of proposed changes to SSAP No. 104R, the revisions are detailed in a separate document. The proposed statutory modifications to ASU 2018-07 are consistent with prior modifications for share-based payment guidance:**

a. **GAAP references to “public and nonpublic” guidance have been eliminated.** The revisions propose to require entities that report share-payment transactions under U.S. GAAP as “public” entities to report the same measurement amounts for 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) are 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 SSAP No. 104R.

g. Inclusion of guidance specific to statutory for consolidated/holding company plans.

To facilitate review, the revised SSAP No. 104R identifies the corresponding ASC reference for each paragraph (and each paragraph referenced). Additionally, areas where there are SAP modifications are noted and shaded. (The ASC citations and staff notes are not proposed to be included in the final version.) With the intent to converge with U.S. GAAP, except when modified for SAP, revisions were also captured to reflect the U.S. GAAP guidance as presented in the ASC. This included the addition of guidance not previously captured in SSAP No. 104, or the rearrangement of guidance to be in the same location as it is found in the ASC. (In most situations in which paragraphs have been rearranged, only actual revisions to the guidance are noted as changes. The tracked change to the paragraph numbers shows the location of the guidance in SSAP No. 104R."

With the revisions reflected in SSAP No. 104R, the following references would also be required:

- **Issue Paper No. 146—Share-Based Payments with Nonemployees** will be revised with a notation that the guidance reflected within has been superseded with the adoption of ASU 2018-07, and is no longer reflected in SSAP No. 104R.

- Appendix D will identify the following pre-codification standards as superseded and no longer adopted in statutory accounting:
  
  o **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;**
  
  o **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;**
  
  o **FASB Emerging Issues Task Force 00-18: Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other Than Employees;** and

- The Appendix D FASB Codification to Pre-Codification GAAP will remove ASC 505-50 as that Subtopic has been superseded.
Meeting Agenda

Review of Other SSAPs:

In addition to guidance impacting share-based payment transactions, ASU 2018-07 also incorporated revisions to other sections of the FASB ASC. In accordance with the NAIC staff review of these changes, revisions are proposed to **SSAP No. 95—Nonmonetary Transactions**, to reflect the changes to ASC 470-20, but are not considered necessary for the other impacted ASC sections.

The guidance previously reflected in SSAP No. 95 was originally contained in **EITF 01-01: 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 modifications to incorporate guidance regarding the measurement date from **EITF 96-18: Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services**. (The guidance from Issue 1 in EITF 96-18 was adopted in SSAP No. 95.)

With the revisions from ASU 2018-07, the guidance in SSAP No. 95 is proposed to be revised to reflect the current U.S. GAAP guidance. This includes revisions to update the measurement date guidance previously adopted, as the provisions from EITF 96-18 were superseded with the issuance of ASU 2018-07. (The measurement date guidance in EITF 96-18 was reflected in ASC 505-50-30-11, and the entire ASC 505-50 was superseded with the issuance of ASU 2018-07.) The revisions also reflect provisions from the EITF 01-01 and **FSP EITF 00-19-2: Accounting for Registration Payment Arrangements** adopted under SAP, but not previously reflected in SSAP No. 95. (FSP EITF 00-19-2 was noted as adopted in SSAP No. 5R, but the guidance in ASC 470-20-30-23 reflects aspects of this guidance as well.) (The SSAP No. 95 revisions are detailed in the agenda item.)

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Summary:

This agenda item has been drafted to consider **ASU 2018-13, Changes to the Disclosure Requirements for Fair Value Measurement** for statutory accounting. This ASU was issued in August 2018 as part of a FASB project to improve the effectiveness of disclosures in the notes to the financial statements. Additionally, in August 2018, the FASB finalized a proposed **FASB Concepts Statement, Conceptual Framework for Financial Reporting – Chapter 8: Notes to Financial Statements**. The intent of this Concept Statement is to identify a broad range of possible information for the Board’s consideration when deciding on the disclosure requirements for a particular topic. From that broad set, the Board will identify a narrower set of disclosures to be required on the basis of, among other considerations, an evaluation of whether the expected benefits of providing the information justify the expected costs. The amendments in ASU 2018-13 are the result of the Board’s final deliberations of the concepts in the Concepts Statement as they relate to fair value measurement disclosures.

The ASU modifies the disclosure requirements in **ASC Topic 820, Fair Value Measurement** as follows:

**Removed Disclosures:** The following disclosure requirements were removed:

1. **Amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy** - This disclosure was removed as it was deemed not useful because the fair value measurements for level 1 and level 2 are based on observable market prices, and users agreed that the removal would not result in eliminating decision-useful information about fair value measurements. (This disclosure was previously adopted for SAP and reflected in paragraph 47b of **SSAP No. 100R—Fair Value**.)
2. **Policy for timing of transfers between levels** – This disclosure was removed as it was not deemed to provide cost-beneficial information. (This disclosure was previously adopted for SAP and reflected in paragraphs 47b and 47f of SSAP No. 100R.)

3. **Valuation processes for Level 3 fair value measurements** - This disclosure was removed as it was not deemed to provide cost-beneficial information. (This disclosure was not previously included in SSAP No. 100R—Fair Value.)

Modified Disclosures: The following disclosure requirements were modified:

1. **Level 3 Rollforward** – In lieu of a rollforward for Level 3 fair value measurements, a nonpublic entity is required to disclose transfers into and out of Level 3 of the fair value hierarchy and purchases and issues of Level 3 assets and liabilities. Although the FASB concluded that the level 3 rollforward is useful and should be retained as a required disclosure, the board concluded that nonpublic entities should have the same exemptions as private entities. Although the rollforward is not required for nonpublic entities, information on the purchases, issues, and transfers in/out of Level 3 is required, because it is important for nonpublic entity users to be able to identify when the entity has either increased its Level 3 assets and liabilities or transferred assets or liabilities into/out of Level 3, which could signal an increase or decrease in uncertainty of the fair value measurements. (The level 3 rollforward was previously adopted for SAP in paragraph 47e of SSAP No. 100R.)

2. **Liquidation Timing for Net Asset Value (NAV)** – For investments in certain entities that calculate NAV, an entity is required to disclose the timing of liquidation of an investee’s assets and the date when restrictions from redemption might lapse only if the investee has communicated the timing to the entity or announced the timing publicly. This disclosure was modified as timing of a liquidation is irrelevant to the measurement of investments measured at NAV. However, since the timing is useful information to the users, the information is still required when it has been communicated to the entity. (This disclosure was previously adopted for SAP in paragraph 51b of SSAP No. 100R.)

3. **Measurement Uncertainty Disclosure** – The amendments clarify that the measurement uncertainty disclosure is to communicate information about the uncertainty in measurement as of the reporting date. The FASB clarified this disclosure as the intent it to disclose uncertainty and not sensitivity. Reporting entities that previously disclosed uncertainty should be unaffected. Entities that had previously disclosed sensitivity to expected future changes would no longer disclose that forward-looking information. (This disclosure was not duplicated in SAP and there is no current reference to “sensitivity” in the existing disclosures.)

New Disclosures: The following disclosure requirements were added for public companies. (These are not required for nonpublic entities.)

1. **Change in Unrealized Gains/Losses in OCI** – The new disclosure requires information on the changes in unrealized gains and losses for the period included in other comprehensive income (OCI) for recurring Level 3 fair value measurements held at the end of the reporting period. (This disclosure was also considered for Level 1 and Level 2 measurements, but the Board concluded that the expected benefits did not justify the expected costs.) The Board decided that this disclosure for Level 3 fair value measurements will provide users additional information without significant cost as entities already perform additional analyses for Level 3 measurements.

2. **Significant Unobservable Inputs** – The new disclosure requires the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. In requiring this disclosure, the Board noted that many entities already disclose the range and weighted average, and users agreed that this information is useful to their analyses and is used to assess the reasonableness of the assumptions, inputs and techniques used by the entity to develop the significant unobservable inputs for
Level 3 fair value measurements. The FASB noted that this disclosure helps users identify red flags and ask an entity’s management questions.

In addition to the revisions noted, the FASB also removed the phrase “at a minimum” from the disclosure requirements to promote the appropriate exercise of discretion by entities when considering fair value measurement disclosures and to clarify that materiality is an appropriate consideration of entities and their auditors when evaluating disclosure requirements.

The amendments detailed in ASU 2018-13 are effective Jan. 1, 2020, with specific provisions as follows:

- The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements, and the narrative description for measurement uncertainty should be applied prospectively for only the most recent interim or annual period presented at initial adoption.

- All other amendments should be applied retrospectively to all periods presented upon their effective date.

- Early adoption is permitted upon issuance of the ASU. An entity is permitted to early adopt any removed or modified disclosure upon issuance of the ASU, and delay adoption of the additional disclosures until their effective date.

Recommendation:
NAIC staff recommends that the Working Group move this item to the nonsubstantive active listing and expose revisions to SSAP No. 100R, as detailed in the agenda item, to adopt with modification the disclosure amendments reflected in ASU 2018-13. Additionally, revisions have been proposed to SSAP No. 100R to update and clarify the actions by the Working Group on related U.S. GAAP pronouncements.

The following ASU 2018-13 amendments are proposed to be adopted in SSAP No. 100R:

- Revisions to describe the disclosure objective. (The revisions to paragraph 47 of SSAP No. 100R reflect the guidance / intent from the FASB changes made to ASC 820-10-50-1 through 820-10-50-1D.)

- Revisions to eliminate information on transfers between hierarchy level 1 and level 2 for items measured and reported at fair value. (The deletion of paragraph 48c reflects the deletion of ASC 820-10-50-2bb.)

- Revisions to paragraph 48.d.vi and 48e incorporate changes made to ASC 820-10-50-2c3 and 820-10-50-2C, eliminating the disclosure of the reporting entity’s policy for determining when transfers between levels have occurred.

- Revisions to paragraphs 52, 52b and 52e to reflect the GAAP disclosure changes related to the calculation of net asset value from ASC 820-10-50-6A, including subparagraphs 6Ab and 6Ae.

The following ASU 2018-13 amendments are not proposed to be reflected:

- GAAP disclosures, and related revisions, for “nonrecurring” fair value measurements. The SAP disclosures are specific to assets and liabilities measured and reported at fair value or NAV. For statutory accounting, information on the fair value hierarchy and method used to obtain fair value is captured in the investment schedule for all reported assets. Additionally, information on the fair value hierarchy by class of assets is captured in a financial instrument disclosure.

- GAAP disclosures identifying changes in unrealized gains and losses reported in OCI for level 3 assets still held at the end of the reporting period. This disclosure is not considered necessary for statutory accounting as fair value changes are reflected as unrealized while the asset is held, unless an OTTI is
recognized. The investment schedules already identify unrealized gains or losses as well as OTTI on an individual asset basis.

- New public entity disclosure to capture the range and weighted average (including the weighted average calculation) of significant unobservable inputs used to develop Level 3 fair value measurements and nonpublic entity quantitative disclosure on significant unobservable inputs. These disclosures were incorporated to replace a disclosure of the valuation processes in determining Level 3 measurements, which had yet to be incorporated into SAP. (The disclosure on the valuation process was incorporated from ASU 2011-04, which is still pending review for SAP.) (NAIC staff does not believe this disclosure is necessary for statutory accounting, but comments are requested if regulators would like this detail.)

- GAAP revisions clarifying the requirements to provide a narrative disclosure of uncertainty of fair value Level 3 measurements, and how the inputs used to determine Level 3 inputs could have been different at the reporting date. These GAAP revisions modified an existing disclosure requiring disclosure of the “sensitivity” of the fair value measurement, which had yet to be incorporated into SAP. (The disclosure on the sensitivity and how changes in unobservable inputs was incorporated from ASU 2011-04, which is still pending review for SAP.) (NAIC staff does not believe this disclosure is necessary for statutory accounting, but comments are requested if regulators would like this detail.)

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<tr>
<td>2018-37</td>
<td>ASU 2018-14, Changes to the Disclosure Requirements for Defined Benefit Plans</td>
<td>G – Agenda Item</td>
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<tr>
<td>SSAP No. 92</td>
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<tr>
<td>SSAP No. 102</td>
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Summary:
This agenda item has been drafted to consider ASU 2018-14, Changes to the Disclosure Requirements for Defined Benefit Plans for statutory accounting. This ASU was issued in August 2018 as part of a Financial Accounting Standards Board (FASB) project to improve the effectiveness of disclosures in the notes to the financial statements. Additionally, in August 2018, the FASB finalized a proposed FASB Concepts Statement, Conceptual Framework for Financial Reporting – Chapter 8: Notes to Financial Statements. The intent of this Concept Statement is to identify a broad range of possible information for the Board’s consideration when deciding on the disclosure requirements for a particular topic. From that broad set, the Board will identify a narrower set of disclosures to be required on the basis of, among other considerations, an evaluation of whether the expected benefits of providing the information justify the expected costs. The amendments in ASU 2018-14 are the result of the Board’s final deliberations of the concepts in the Concepts Statement as they relate to defined benefit plan disclosures.

The ASU modifies the disclosure requirements in ASC 715-20, Defined Benefit Plans as follows:

Removed Disclosures: The following disclosure requirements were removed:

1. Amounts in accumulated other comprehensive income (AOCI) expected to be recognized as components of net periodic benefit cost over the next fiscal year.

2. Amount and timing of plan assets expected to be returned to the employer.

3. The disclosures related to the June 2001 amendments to the Japanese Welfare Pension Insurance Law

4. Related party disclosures about the amount of future annual benefits covered by insurance and annuity contracts and significant transactions between the employer or related parties and the plan.
5. For nonpublic entities, the reconciliation of the opening balances to the closing balances of plan assets measured on a recurring basis in Level 3 of the fair value hierarchy. However, nonpublic entities will be required to disclose separately the amounts of transfers into and out of Level 3 of the fair value hierarchy and purchases of Level 3 plan assets.

6. For public entities, the effects of a one-percentage-point change in assumed health care cost trends rates on the (a) aggregate of the service and interest cost components or net periodic benefit costs and the (b) benefit obligation for postretirement health care benefits.

**New Disclosures:** The following disclosure requirements were added:

1. The weighted-average interest crediting rates for cash balance plans and other plans with promised interest crediting rates.

2. An explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period.

**Clarified Disclosures:** The ASU also clarifies the existing disclosure requirements, which state that the following information for defined benefit plans should be disclosed:

1. The projected benefit obligation (PBO) and the fair value of plan assets for plans with PBOs in excess of plan assets.

2. The accumulated benefit obligation (ABO) and the fair value of plan assets for plans with ABOs in excess of plan assets.

The amendments detailed in ASU 2018-14 are effective Jan. 1, 2021 for public business entities and Jan. 1, 2022 for all other entities. Early adoption is permitted for all entities. (Entities should apply the amendments on a retrospective basis to all periods presented.)

**Recommendation:**
NAIC staff recommends that the Working Group move this item to the nonsubstantive active listing and expose revisions to SSAP No. 92—Postretirement Benefits Other Than Pensions and SSAP No. 102—Pensions to adopt with modification the disclosure amendments reflected in ASU 2018-14. Similar to past actions, the statutory modifications will not permit reduced disclosure provisions for nonpublic entities. Rather, the amendments to SSAP No. 92 and SSAP No. 102 will reflect the U.S. GAAP disclosure requirements for public entities.

The proposed amendments to SSAP No. 92 and SSAP No. 102 reflect the following U.S. GAAP changes from ASU 2018-14. (The related paragraph for SSAP No. 92 and SSAP No. 102 is also noted.)

- New U.S. GAAP disclosure for the interest crediting rates – (SSAP 92: ¶66.j; SSAP 102: ¶68.k)
- Deletion of disclosure on the effect of a 1% point increase or decrease – (SSAP 92: ¶66.l; SSAP 102: N/A)
- Deletion of disclosure for the approximate amount of future annual benefits covered by insurance contracts – (SSAP 92: ¶66.m; SSAP 102: ¶68.1)
- New U.S. GAAP disclosures on the reasons for significant gains and losses related to changes in defined benefit obligations and any other significant change not otherwise apparent in the required disclosures – (SSAP 92: ¶66.q; SSAP 102: ¶68.p)
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- Deletion of disclosure on the amounts in unassigned funds expected to be recognized as component of net periodic benefit cost over the fiscal years – (SSAP 92: ¶66.r; SSAP 102: ¶68.q)

- Deletion of disclosure of the amount and timing of any plan assets expected to be returned to the employer during the 12-month period that follows the most recent annual statement of financial position – (SSAP 92: ¶66.s; SSAP 102: ¶68.r)

- Matched update terms to GAAP terminology for disclosure of two or more plans – (SSAP No. 92: ¶69; SSAP No. 102: ¶69)

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<td>2018-38 (Robin)</td>
<td>Prepayments to Service and Claims Adjusting Providers</td>
<td>H – Agenda Item</td>
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Summary:
This agenda item seeks to address a regulator inquiry regarding prepayments to providers of claims and adjusting services in which the service provider is prepaid by the insurer. While the initial inquiry for this agenda item was a prepaid roadside assistance provider, the accounting issues are relevant to other providers of claims and adjusting services as well.

The prepayments can take a variety of forms and the provider can take on a variety of duties, but in the example provided, the roadside assistance provider was being prepaid a flat fee for a minimum number of vehicles/policies regardless of claims incurred or sales. The provider additionally received a flat fee per vehicle if actual sales exceed the negotiated minimum number of vehicles. The provider, who is not an insurer, was contracted to provide roadside assistance and administer and settle claims using only the prepaid amounts. So, to use a health care analogy, the provider accepts a “capitated” payment to administer and settle claims.

Discussions with industry representatives indicate that in most cases, roadside assistance providers may have rates that are negotiated, but providers are not typically prepaid. Rather, when the insured calls for assistance negotiated rate providers are dispatched and subsequently paid at negotiated rates as the claims for assistance are incurred. This agenda item is focused on prepayments to providers.

To provide a fictional numeric example, the minimum annual payment to the provider was for 50,000 vehicles at $10 per vehicle, with additional payments per vehicle required if sales exceed the initial fees. The provider in this example, was also responsible for administering claims and dispatching service in exchange for the “capitated” fee. Therefore, the roadside assistance provider would not bill the insurer further when claims are incurred.

The statutory accounting and reporting questions at issue are how the direct writer accounts for and reports the prepaid claims and adjusting expenses initially and subsequently. The existing guidance notes that claim adjusting expenses are not reduced for payments to third parties. The guidance in SSAP No. 55 indicates liabilities shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to managed care providers. The prepaid expenses under consideration may include a prepayment for claims administration and or a prepayment for the claims.

In reviewing the annual statement instructions for the Underwriting and Expense Exhibit, Part 3, and the related instructions for property and casualty expenses, the initial prepayment to the provider seems be consistent with miscellaneous underwriting expense.

For policies that purchase the coverage and incurred a claim, it seems appropriate to reclassify a proportionate percentage of the initial prepayment to claims incurred and loss adjustment expenses as losses are incurred and adjusted. However, it would be inappropriate to allocate claims expense and claims adjusting expenses to policies that did not purchase the coverage and inappropriate to allocate the costs of the provider to claims or claims...
adjusting expenses prior to incurring the claims. Therefore, in the event of prepayment to a third-party provider, some of the costs may remain in miscellaneous underwriting expense.

Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 55 to provide guidance as follows:

1. The initial prepayment for providers of claims adjusting expense and claim payment is recognized as a miscellaneous underwriting expense.

2. Subsequently, for direct policies that purchased the related insurance coverage which used the claims or adjusting services incur losses which are paid, a proportionate percentage of the initial provider prepayment amounts are reclassified from miscellaneous underwriting expense to claims adjustment expense and or claims expense, as applicable.

3. To the extent that additional amounts are prepaid for direct policies that did not purchase services, the prepaid expenses shall remain in miscellaneous underwriting expenses.

Note that NAIC staff envisions that additional annual statement instruction clarifications may be indicated after the Working Group finalizes guidance.

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<td>2018-39</td>
<td>SSAP No. 55 (Robin)</td>
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<td>Interest on Claims</td>
<td>I – Agenda Item</td>
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Summary:
This agenda item seeks to clarify the reporting of interest payable on claims. Most states and jurisdictions have a law regarding prompt payment of claims, particularly for accident and health policies. These laws are to encourage the payment of claims in a timely manner and ensure that if the claims are not paid in a timely manner, the claimant is made whole for the delay in payment. Although there are variations in legal details, the laws typically require payment of “clean claims” within a specified number of days, (examples 30-60 days) and require the payment of interest to the claimant/provider etc., if the claim is not paid with the specified required time. The rate of interest varies by jurisdiction, as does the frequency of how often the interest rate changes. A “clean claim” is typically a claim not in dispute for which sufficient documentation is provided. In addition, federal health programs such as Medicare and Medicaid also have requirements for the payment of interest on overdue claims.

The accounting issue is providing explicit guidance regarding the reporting of the interest expense paid on overdue claims. NAIC has received questions noting a diversity in practice on the reporting of this expense. Some industry representatives advocated for the expense to be reported as part of the claim. However, as the expense is avoidable if the claim is paid promptly, NAIC staff does not advocate for interest expense to be part of a claim. Rather for accident and health policies in particular, the interest expense is a consequence of the reporting entity’s operating activities as opposed to the actual claim. From a review of SSAP No. 55, interest required by prompt payment laws and other similar requirements seems to be a cost of not adjusting the claim in a timely manner and would therefore, fit the description of claims adjusting expenses. Because this cost does not fit the definition of defense or cost containment adjustment expense, it would next default to the claims adjusting expense subcategory of adjusting and other. However, in some instances, the payment of interest on claims seems to be a regulatory penalty which should be reported as fines and penalties of regulatory authorities. Therefore, NAIC staff identifies that the primary choices for reporting interest on claims expenses are loss or claims adjusting expense, subcategory adjusting and other or regulatory penalties and fines.

NAIC staff’s informal discussions have suggested several ways of determining if the interest paid on a claim is a regulatory penalty. Some people suggested basing the determination on whether the amount paid was required by
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law and or based on a regulatory finding or violation. This approach seeded to be problematic, as prompt payment requirements can require automatic payment of interest in compliance with the law. Additionally, is it also possible for there to be a regulatory penalty for entities which have not paid the required interest in “violation” of a law or regulation etc. This second situation may result in interest payments to insureds and fines or regulatory penalties paid to the regulatory agency. After discussion, staff recommends making the determination based on the party that receives the interest as follows:

a. interest paid to claimants are reported as claims adjusting expense, adjusting and other.
b. interest paid to regulatory authorities are reported as a regulatory penalties and fines

Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and:

1. Expose revisions to SSAP No. 55 to clarify the reporting of interest on accident and health claims;

The following is proposed to be added as other claims adjustment expense:

9.b.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.)

2. Notify the Health Actuarial (B) Task Force of the exposure;

3. Request comments on other lines of business for subsequent revisions. For life companies, such elements are expected to be considered claims, whereas for property and casualty entities the guidance is expected to have similar treatment for health companies. Comments are requested on whether these allocations would be considered appropriate; and

4. Request comments on the effective date.

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Summary:
The FASB issued *ASU 2018-15, Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract* in August 2018. This ASU was issued to align the requirements for capitalizing implementation costs of obtaining a cloud computing license, which are incurred in a hosting arrangement that’s a service contract, with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. It allows companies to capitalize the costs of acquiring a cloud computing license, which is consistent with the treatment of internal-use software. The licensing costs would be capitalized and expensed over a 3-to-5 year amortization period, depending on the type of software. Implementation costs include the costs in identifying a system for a business, deploying the system and providing support to train employees on how to use the system effectively. FASB describes a hosting arrangement as “that in which an end user of software does not take possession of the software; rather, the software application resides on a vendor’s or third party’s hardware, and the customer accesses and uses the software on an as-needed basis over the internet or via a dedicated line.”

The amendments in ASU 2018-15 are effective for public companies for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years. For all other entities, these amendments are effective for
annual reporting periods beginning after December 15, 2020, and interim periods within annual periods beginning after December 15, 2021. Early adoption is permitted, but these amendments should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption.

Currently, SSAP No. 16R—Electronic Data Processing Equipment and Software provides guidance on whether costs shall be expensed or capitalized. The existing SAP guidance is twofold:

1) Existing guidance in SSAP No. 16R requires that entities that license internal-use computer software must follow the guidance in SSAP No. 22—Leases. SSAP No. 22 states that all leases should be considered operating leases, with the rent expense recognized over the lease term.

2) Existing guidance in SSAP No. 16R specifies that costs of operating system software developed or obtained for internal use and web site development shall be depreciated over a period not to exceed three years, and costs to develop or obtain nonoperating system software shall be depreciated over a period not to exceed five years.

With this ASU, FASB has noted that the costs to implement a cloud computing software licensing arrangement (which is ultimately a leasing arrangement) shall be capitalized. This ASU is specific to the implementation cost, and not the ongoing lease expense. (However, under the revised U.S. GAAP lease standard, operating leases would be reported as “right to use assets” on the balance sheet. Currently, it is anticipated that this provision would be rejected for statutory accounting, with continued reporting of operating leases under SAP.)

NAIC staff notes that if the nonoperating system software implementation costs are capitalized, this would impact the income statement, as such capitalized assets would be nonadmitted on the balance sheet. Regardless, this is a surplus-neutral event.

Recommendation:
Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and direct NAIC staff to expose this agenda item with comments requested on one of the two options provided below. NAIC staff is recommending that all of the cloud computing costs are nonoperating, but comments would be requested on whether any cloud computing costs should be considered operating system software.

- Option 1: Treat the implementation cost of acquiring a cloud computing license as part of lease cost, and expense when incurred. (This would be in line with the provision in SSAP No. 16R that entities that license internal-use computer software should follow SSAP No. 22.)

- Option 2: Treat the implementation cost of acquiring a cloud computing license similar to a software development cost and capitalize the nonoperating system software costs as a nonadmitted asset, with amortization not to exceed 5 years, consistent with nonoperating system software. (This would adopt the concepts in the ASU with modification that all licensing software is treated as nonoperating system software.)
The following new agenda items all propose to reject U.S. GAAP as not applicable to statutory accounting:

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<td>2018-41</td>
<td><strong>ASU 2017-13, Amendments to SEC Paragraphs</strong></td>
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**Summary:**
This ASU provides updated transition guidance for public reporting entities. (A public reporting entity is defined as one that is required by the U.S. SEC to file or furnish financial statements, or does file or furnish (e.g., voluntarily) with the SEC.

The updated guidance clarifies when public business entity as well private companies must implement the guidance from *ASU 2014-09, Revenue from Contracts with Customers (Topic 606), ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients, ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers, and ASU 2017-05, Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets.*

Specifically, there are three main updates from the ASU:

1. Updates to Topic 606 and 842 for when these revenue and lease accounting changes are effective for public business entities;
2. Rescission of prior SEC staff announcements in Topic 605 and Topic 840, which are superseded by Topic 606 and Topic 842, effective on the date of transition from the old to new ASC guidance; and
3. Guidance for leveraged leases in Topic 842 that requires that all components of a leveraged lease be recalculated from inception of the lease based on the revised aftertax cash flows arising from the change in the tax law (Tax Cuts and Jobs Act), including revised tax rates.

**Recommendation:**
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to *Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2017-13, Amendments to SEC Paragraphs Pursuant to the Staff Announcement at the July 20, 2017 EITF Meeting and Rescission of Prior SEC Staff Announcements and Observer Comments as not applicable to statutory accounting.*

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<td>2018-42</td>
<td><strong>ASU 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income</strong></td>
<td>L – Agenda Item</td>
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**Summary:**
This agenda item has been drafted to formally consider *ASU 2018-02: Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income* (ASU 2018-02) for statutory accounting. This GAAP item was preliminarily considered in agenda item 2018-01: Federal Income Tax Reform, but at that time, the GAAP item was only an exposure, and not an adopted ASU.
The amendments in ASU 2018-02 allow a reclassification from accumulated other comprehensive income (AOCI) to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act (TCJA). The provisions provide entities an election to reclassify the income tax effects of the TCJA on items within AOCI to retained earnings, with required disclosure if an entity does not elect to reclassify. For entities electing to reclassify the tax effects, the ASU prescribes what should be captured in the reclassification. The ASU was provided to address concerns regarding “stranded tax effects” resulting from the TCJA and only relates to the reclassification of income tax effects from that Act. The ASU does not affect the underlying U.S. GAAP guidance that requires the effect of a change in tax laws or rates to be included in income from continuing operations.

The ASU is effective for fiscal years beginning after Dec. 15, 2018, and interim periods within those years, with early adoption permitted. The amendments should be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the tax rate from the TCJA is recognized.

Additional background: Agenda item 2018-01 considered the impact of the TCJA on SSAP No. 101—Income Taxes. As part of this review, revisions were adopted to paragraph 8 to clarify how changes in tax rates should be reflected for statutory accounting. These revisions resulted in a footnote to detail the reporting lines that could be impacted by the change. With the review of SSAP No. 101, the GAAP exposure (prior to the issuance of ASU 2018-02) was reviewed and a conclusion was reached that statutory accounting does not result with “stranded tax effects,” therefore guidance, similar to what was proposed for U.S. GAAP, was not needed in statutory accounting. Although the issued ASU 2018-02 does vary from the original U.S. GAAP exposure (e.g., ASU provides an election, not a requirement for reclassification), these changes do not alter the original assessment of “stranded tax effects” under SAP.

Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to reject ASU 2018-02 as not applicable to statutory accounting in Appendix D—Nonapplicable GAAP Pronouncements.

Although this guidance could be rejected in SSAP No. 101, as the ASU only allows reclassification from AOCI to retained earnings in response to the TCJA and does not affect underlying GAAP guidance related to income taxes, NAIC staff believes it would be most appropriate to reject this ASU as not applicable. As noted, statutory accounting does not have a “stranded” tax effect issue and does not need to incorporate guidance similar to what is being considered for U.S. GAAP.

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<td>2018-43 Appendix D (Jake)</td>
<td><strong>ASU 2018-04, Investments—Debt Securities (Topic 320) and Regulated Operations (Topic 980), Amendments to SEC Paragraphs</strong></td>
<td>M — Agenda Item</td>
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Summary:
Accounting Standards Update 2018-04: Investments—Debt Securities (Topic 320) and Regulated Operations (Topic 980), Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 117 and SEC Release No. 33-9273 (ASU 2018-04) was issued by the FASB to supersede guidance for Securities Exchange Commission (SEC) reporting entities for “other than temporary” and for other factors to consider when evaluating impairment of individual available-for-sale and held-to-maturity securities.

Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to **Appendix D—Nonapplicable GAAP Pronouncements** to reject **ASU 2018-04 as not applicable to statutory accounting**. This item is proposed to be rejected as not applicable as ASU 2018-04 is specific to deletion of SEC paragraphs, which are not applicable to statutory accounting.
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<td>ASU 2018-05, Income Taxes (Topic 740), Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118</td>
<td>N – Agenda Item</td>
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**Summary:**

**Recommendation:**
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2018-05 - Income Taxes (Topic 740), Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118 as not applicable to statutory accounting. This item is proposed to be rejected as not applicable as ASU 2018-05 is specific to SEC paragraphs, which are not applicable to statutory accounting.

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<td>2018-45</td>
<td>ASU 2018-06, Codification Improvements to Topic 942, Financial Services—Depository and Lending</td>
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**Summary:**
ASU 2018-06, Codification Improvements to Topic 942, Financial Services—Depository and Lending (ASU 2018-06) was issued by the Financial Accounting Standards Board (FASB) to supersede outdated guidance from the Office of the Comptroller of the Currency’s Banking Circular 202, Accounting for Net Deferred Tax Charges (Circular 202) that was included in Subtopic 942-740, Financial Services—Depository and Lending—Income Taxes. The guidance in ASU 2018-06 relates to the tax consequences of bad debt reserves of savings and loans (and other qualified thrift lenders) that arose in tax years beginning before Dec. 31, 1987.

**Recommendation:**
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2018-06 - Codification Improvements to Topic 942, Financial Services—Depository and Lending as not applicable to statutory accounting. This item is proposed to be rejected as not applicable as ASU 2018-06 is specific to savings and loans and not relevant for insurance entities.

**ANY OTHER MATTERS**

a. **Update on FASB Long-Duration Insurance Contracts Project**

Update: The FASB finalized their discussion of the Long-Term Insurance Contracts project, and the adopted ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts was issued in August 2018. NAIC staff has completed their preliminary review of the agenda item with a tentative recommendation to reject ASU 2018-12 for statutory accounting. (This rejection is in line with previous consideration of similar GAAP standards, as insurance entities shall follow the statutory provisions in accounting and reporting for insurance contracts.) Although NAIC Staff’s initial assessment is to reject the ASU, consideration will occur on whether any new disclosures from ASU 2018-12 should be incorporated for statutory accounting.
After corresponding with industry, it was identified that discussions are still occurring with the FASB on implementation and transition dates. As such, it was requested that NAIC staff delay presenting the agenda item to the Working Group for initial exposure. NAIC staff will continue to work with industry on any updates from FASB on the transition / implementation, and on whether any specific disclosures should be incorporated for statutory purposes. It is anticipated that the agenda item will be exposed in 2019. (With the ASU’s current effective date of 2021, there is plenty of time to consider statutory revisions as needed.)

- Industry representatives are expected to provide additional information on FASB discussions

**b. Update on Exposures with Nov. 30, 2018 Comment Letter Deadline:**

In accordance with an industry request, the items noted below have extended comment letter deadlines ending Nov. 30, 2018.

- **Agenda Item 2016-02: ASU 2016-02, Leases**
  
  *Update:* NAIC staff is working directly with industry on a few discussion points, mostly related to sales-leaseback accounting and differences from U.S. GAAP.

- **Agenda Item 2018-06: Regulatory Transactions – Referral from the Reinsurance (E) Task Force**
  
  *Update:* NAIC staff is working directly with industry to define the issues and identify the transactions that should be in scope of the guidance.

- **Agenda Item 2018-07: Surplus Note Accounting – Referral from the Reinsurance (E) Task Force**
  
  *Update:* NAIC staff is working directly with industry on the surplus note transactions in scope.

**c. Disclosure Requirement from Agenda Item 2018-08 Owner and Beneficiary of Life Insurance**

During the Summer National Meeting, the Working Group adopted revisions to SSAP No. 21, paragraph 6 to clarify guidance when the reporting entity is the owner and beneficiary of a life insurance policy. With the adoption of this guidance, the following disclosure was adopted:

> 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.)

As this disclosure was adopted by the SAPWG, it is required in the narrative for year-end 2018 statutory financial statements. Consideration is planned on whether the disclosure should be data-captured.

When there are narrative disclosures adopted for year-end, NAIC staff will generally provide a memo to the Blanks (E) Working Group to identify that the narrative disclosure is required, provide an example on how the narrative disclosure should be reflected, and identify which note it should be captured in. (If there is no related existing disclosure, then it would be captured as an “other item” in Note 21.) For the disclosure adopted to SSAP No. 21, NAIC staff has received a proposal from the ACLI to capture percentage information (rather than $ amounts) to detail the amount of the cash surrender value by investment vehicle. For example:

> The Company is the owner and beneficiary of life insurance policies included in [name of Assets line] at their cash surrender values. At December 31, 2018, the investments in various fund structures underlying variable life insurance policies comprise investment characteristics of x% equity, x% fixed income, x% real estate, x% cash/short-term investments and x% other.

> In reviewing this ACLI suggested disclosure, would suggest that the total CSV allocated to investment vehicles be included in the disclosure, with percentage allocations that match the
The Company is the owner and beneficiary of life insurance policies included in [name of Assets line] at their cash surrender values pursuant to SSAP No. 21, paragraph 6. At December 31, 2018, the cash surrender value in an investment vehicle is $______, and is allocated into the following categories: x% bonds, x% stocks, x% mortgage loans, x% real estate, x% cash and short-investments, x% derivatives and x% other invested assets. Investments in various fund structures underlying variable life insurance policies comprise investment characteristics of x% equity, x% fixed income, x% real estate, x% cash/short-term investments and x% other.

To reiterate, even if there is no disclosure example provided to the Blanks (E) Working Group, since the disclosure has been adopted by the Statutory Accounting Principles (E) Working Group, the narrative disclosure is required for year-end 2018. If no example is provided, then each reporting entity would simply use the format they believe is appropriate to satisfy the disclosure.

d. Update on Agenda Item 2018-04: VOSTF – Bank Loan Referral
   NAIC staff has been researching “bank loans” and discussing with industry on the types of bank loans utilized by insurers. NAIC staff is still evaluating the information received and anticipates an exposure of this agenda item in the interim.

e. Update on Agenda Item 2016-13: ASU 2016-13, Credit Losses
   During the interim, NAIC staff confirmed the intent for the discussion draft SAP modifications was to utilize an approach similar to the available-for-sale (AFS) U.S. GAAP guidance, with the inclusion of a fair value floor. With this confirmation, comments are expected from interested parties on this approach. Subsequent discussion will occur once comments are received and reviewed by NAIC staff.

f. Working Capital Finance Investments – WCFI - (Attachment P)
   The NAIC SAPWG staff is aware that the Valuation of Securities (E) Task Force has been discussing WCFI. At this time, a referral has been received from the Task Force providing background information, on the issues that were raised at the Task Force and a general conclusion that the majority of them would need to be addressed at the SAPWG. The referral indicates that proposed revisions may be submitted to SSAP No. 105 from the ACLI. Consideration of these proposed revisions will occur when received.

g. Vital Source / BookShelf Product
   The NAIC is moving forward with use of the Vital Source / BookShelf Product for 2019. Bookshelf is both an on-line and downloadable product, meaning that once purchased, it would provide the ability to access the AP&P Manual on-line using a personal ID and password, and by downloading the product to a personal device (computer, reader, phone, etc.), eliminating the need for an internet connection.

   Also, as noted during the Summer National Meeting, please be notified that the NAIC may begin to require a “pre-order” process for the AP&P Manual. This process is intended to ensure that the number of hard-copy books are sufficient to meet the need (with a limited number of extra copies), but to not have a significant number of extra copies. With this process, those that do not respond with a request for a hard-copy version will be able to order a hard-copy manual as long as there are extras copies available. If there are no hard copies available, the customer would be limited to the electronic version. (Additional information on this process and how to sign-up for a hard-copy will be subsequently communicated.)

h. Review of GAAP Exposures
   Currently, there are no FASB Exposure Documents open for comment.

Comment deadline for exposed and new items is February 15, 2019.
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