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>SSAP No. 26R (Julie) Prepayment Penalties</td>
<td>A - Agenda Item</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:

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<tr>
<th>Call Price Above Par</th>
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<th>Call Price Less Than Par</th>
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<tr>
<td>Premium</td>
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<td>BACV</td>
<td>102</td>
<td>BACV 98</td>
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<td>Consideration</td>
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<td>Consideration 103</td>
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| Loss (100-102)       | Gain (100-98)        | Gain (100-25) 75         |
| Income (103-100)     | Income (103-100)     | Income (26-100) (74)     |
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 receives 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>2018-33 SSAP No. 30R (Julie)</td>
<td>Pledges to FHLBs</td>
<td>B – Agenda Item</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.
Meeting Agenda

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<td>Foreign Mutual Funds</td>
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<td>SSAP No. 30R (Julie)</td>
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**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>*ASU 2018-07, Improvements to Nonemployee Share-Based</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...
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.
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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<td><strong>ASU 2018-13, Changes to the Disclosure Requirements for Fair Value Measurement</strong></td>
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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><strong>ASU 2018-14, Changes to the Disclosure Requirements for Defined Benefit Plans</strong></td>
<td>G – Agenda Item</td>
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<tr>
<td>SSAP No. 92</td>
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<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</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 claim 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</td>
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<td>Interest on Claims</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 website 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>ASU 2017-13, Amendments to SEC Paragraphs</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>ASU 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income</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.

### Summary:

Accounting Standards Update 2018-04: Investments—Debt Securities (Topic 320) and Regulated Operations (Topic 980), Amendments to SEC Paragraphs (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>Appendix D</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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**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
Meeting Agenda

investment categories on the assets page as follows:

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

Issue: SSAP No. 26R – Prepayment Penalties

Check (applicable entity): [ ] P/C [ ] Life [ ] Health
- Modification of existing SSAP
- New Issue or SSAP
- Interpretation

Description of Issue: 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</th>
<th>Call Price Above Par</th>
<th>Call Price Less Than Par</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium</td>
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<td></td>
</tr>
<tr>
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<td>100</td>
<td>Par</td>
</tr>
<tr>
<td>BACV</td>
<td>102</td>
<td>BACV</td>
</tr>
<tr>
<td>Consideration</td>
<td>103</td>
<td>Consideration</td>
</tr>
<tr>
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<td>Gain (100-98)</td>
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<tr>
<td>Income (103-100)</td>
<td>3</td>
<td>Income (103-100)</td>
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<td></td>
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<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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 receives 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.
Existing Authoritative Literature:

**SSAP No. 26R—Bonds:**

16. A bond may provide for a prepayment penalty or acceleration fee in the event the bond is liquidated prior to its scheduled termination date. Such fees shall be reported as investment income when received.

17. The amount of prepayment penalty and/or acceleration fees to be reported as investment income shall be calculated as follows:

   a. The amount of investment income reported is equal to the total proceeds (consideration) received less the par value of the investment; and

   b. Any difference between the book adjusted carrying value (BACV) and the par value at the time of disposal shall be reported as realized capital gains and losses, subject to the authoritative literature in SSAP No. 7.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): Agenda Item 2015-23: Prepayment Penalties and Presentation of Callable Bonds – Bifurcation of Agenda Item 2015-04 amended existing paragraph 16 in SSAP No. 26R regarding prepayment penalties. It specifically noted make whole call provisions when the guidance was developed.

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


Staff 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 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 following illustration should be added to the appendix and/or if all of the appendix for prepayment penalties should be eliminated / condensed.

Proposed Edits to SSAP No. 26R:

16. A bond may provide for a prepayment penalty or acceleration fee in the event the bond is liquidated prior to its scheduled termination date. Such fees shall be reported as investment income when received.

17. The amount of prepayment penalty and/or acceleration fees to be reported as investment income or loss shall be calculated as follows:

   a. For called bonds in which the consideration received exceeds par:

      i. The amount of investment income reported is equal to the total proceeds (consideration) received less the par value of the investment; and
ii. Any difference between the book adjusted carrying value (BACV) and the par value at the time of disposal shall be reported as realized capital gains and losses, subject to the authoritative literature in SSAP No. 7.

b. Called bonds in which the consideration received is less than par:

i. Each bond shall be reviewed individually, in accordance with the terms of the bond and call provisions, to determine the extent a prepayment penalty or acceleration fee, which should be reported as investment income, was received. After determining any prepayment penalty or acceleration fee, the reporting entity shall calculate the resulting realized gain or loss. The following are examples to determine the acceleration fee / prepayment penalty when call price is less than par:

a. If the call price is less than par, and the call terms specify prepayment amounts in excess of current fair value, the amount in excess of fair value shall be considered the prepayment penalty / acceleration fee.

b. Prepayments specifically identified in the contract terms as prepayment penalties or acceleration fees shall also be reported in investment income.

Regulator and industry comments are requested on whether the following illustration should be added to the appendix and/or if all of the appendix for prepayment penalties should be eliminated / condensed.

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<thead>
<tr>
<th>Call Price Less than Par</th>
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<th>Entity 2</th>
<th>Entity 3</th>
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<tbody>
<tr>
<td>Par</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>BACV</td>
<td>24</td>
<td>28</td>
<td>25</td>
</tr>
<tr>
<td>Consideration</td>
<td>26</td>
<td>26</td>
<td>26</td>
</tr>
<tr>
<td>Fair Value</td>
<td>25</td>
<td>25</td>
<td>25</td>
</tr>
<tr>
<td>Gain (Loss)</td>
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<td>(3)</td>
<td>0</td>
</tr>
<tr>
<td>Income</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
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</table>

Staff Review Completed by:
Julie Gann, NAIC Staff – October 2018

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Statutory Accounting Principles (E) Working Group
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Issue: SSAP No. 30 – Pledges to FHLBs

Check (applicable entity):

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<th>P/C</th>
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<td>New Issue or SSAP</td>
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<tr>
<td>Interpretation</td>
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Description of Issue: 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.

Existing Authoritative Literature:

SSAP No. 4—Assets and Nonadmitted Assets

2. For purposes of statutory accounting, an asset shall be defined as: probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. An asset

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1 FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, states:
has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred. These assets shall then be evaluated to determine whether they are admitted. The criteria used is outlined in paragraph 3.

3. As stated in the Statement of Concepts, "The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third party interests should not be recognized on the balance sheet," and are, therefore, considered nonadmitted. For purposes of statutory accounting principles, a nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2, which is accorded limited or no value in statutory reporting, and is one which is:

a. Specifically identified within the Accounting Practices and Procedures Manual as a nonadmitted asset; or


If an asset meets one of these criteria, the asset shall be reported as a nonadmitted asset and charged against surplus unless otherwise specifically addressed within the Accounting Practices and Procedures Manual. The asset shall be depreciated or amortized against net income as the estimated economic benefit expires. In accordance with the reporting entity's written capitalization policy, amounts less than a predefined threshold of furniture, fixtures, equipment, or supplies, shall be expensed when purchased.

4. Transactions which do not give rise to assets as defined in paragraph 2 shall be charged to operations in the period the transactions occur. Those transactions which result in amounts which may meet the definition of assets, but are specifically identified within the Accounting Practices and Procedures Manual as not giving rise to assets (e.g., policy acquisition costs), shall also be charged to operations in the period the transactions occur.

**SSAP No. 30—Unaffiliated Common Stock**

**FHLB Capital Stock**

13. FHLB capital stock is held by reporting entities that are members of an FHLB. Each reporting entity must acquire FHLB capital stock for membership and maintain capital stock holding sufficient to support its business activity (borrowings) in accordance with the respective FHLB's capital plan. The price of FHLB capital stock cannot fluctuate, and all FHLB capital stock must be purchased, repurchased or transferred at its par value. FHLB capital stock is restricted for redemption in accordance with the FHLB capital plan and shall be coded as restricted within the financial statements (e.g., investment schedules and general interrogatories).

Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement No. 5, Accounting for Contingencies, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.

2 If assets of an insurance entity are pledged or otherwise restricted by the action of a related party, the assets are not under the exclusive control of the insurance entity and are not available to satisfy policyholder obligations due to these encumbrances or other third party interests. Thus, pursuant to paragraph 2(c), such assets shall not be recognized as an admitted asset on the balance sheet. Additional guidance for assets pledged as collateral is included in INT 01-31.

3 Membership in an FHLB allows reporting entities to take advances / borrow from the FHLB. These borrowings can be structured in a variety of ways, for example: debt, funding agreements, repurchase agreements, securities lending, etc. Borrowings from an FHLB shall be reflected in the financial statements in accordance with the SSAP that addresses the substance of the agreement.
14. Acquisition of FHLB capital stock allows members to conduct business activity (borrowings) from an FHLB. The amount of capital stock acquired determines the reporting entity's eligible borrowing amount. At a minimum, all borrowings from an FHLB (regardless of structure) must also be fully collateralized in accordance with the FHLB capital plan, which determines the amount of collateral required by type of pledged instrument. Collateral pledged to an FHLB shall be coded as restricted within the financial statements (e.g., investments schedules and general interrogatories). Collateral pledged to an FHLB is considered an admitted asset if all of the following conditions are met:

a. the asset would have been admitted under SSAP No. 4;

b. the pledging insurer continues to receive the income on the pledged collateral;

c. the pledging insurer can remove and substitute other securities with little or advance notice to the FHLB as long as the insurer complies with related investment quality and market value provisions; and

d. there has been no uncured default or event to indicate an impairment or loss contingency for the pledged assets.

FHLB Disclosures

16. For FHLB agreements, the following information shall be disclosed in the financial statements for current and prior year and between general account and separate account activity. The information in the disclosures shall be presented gross even if a right to offset per SSAP No. 64 exists.

a. General description of FHLB agreements, with information on the nature of the agreement, type of borrowing (advances, lines of credit, borrowed money, etc.) and use of the funding.

b. Amount of FHLB capital stock held, in aggregate, and classified as follows: i) membership stock (separated by Class A and Class B); ii) Activity Stock; and iii) Excess Stock. For membership stock, report the amount of FHLB capital stock eligible for redemption and the anticipated timeframe for redemption: i) less than 6 months, ii) 6 months to 1 year, iii) 1 year to 3 years, and iv) 3 to 5 years.

c. Amount (fair value and carrying value) of collateral pledged to the FHLB as of the reporting date. In addition, report the maximum amount of collateral pledged to the FHLB at any time during the current reporting period. (Maximum shall be determined on the basis of carrying value, but with fair value also reported)

d. Aggregate amount of borrowings at the reporting date from the FHLB, reflecting compilation of all advances, loans, funding agreements, repurchase agreements, securities lending, etc., outstanding with the FHLB, and classify whether the borrowing is in substance: i) debt (SSAP No. 15—Debt and Holding Company Obligations), ii) a funding agreement (SSAP No. 52—Deposit-Type Contracts), or iii) Other. For funding agreements, report the total reserves established. Report the maximum amount of aggregate borrowings from an FHLB at any time during the current reporting period, the actual or estimated maximum borrowing capacity as determined by the insurer, with a description of how the borrowing capacity was determined, and whether current borrowings are subject to prepayment penalties.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

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4 For FHLB membership stock to be eligible for redemption, written notification must have been provided to the FHLB prior to the reporting date.
Information or issues (included in Description of Issue) not previously contemplated by the Working Group: None


Staff 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 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) 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.

Proposed Revisions to SSAP No. 30—Unaffiliated Common Stock

FHLB Capital Stock

13. FHLB capital stock is held by reporting entities that are members of an FHLB. Each reporting entity must acquire FHLB capital stock for membership and maintain capital stock holding sufficient to support its business activity (borrowings5) in accordance with the respective FHLB’s capital plan. The price of FHLB capital stock cannot fluctuate, and all FHLB capital stock must be purchased, repurchased or transferred at its par value. FHLB capital stock is restricted for redemption in accordance with the FHLB capital plan and shall be coded as restricted within the financial statements (e.g., investment

5 Membership in an FHLB allows reporting entities to take advances / borrow from the FHLB. These borrowings can be structured in a variety of ways, for example: debt, funding agreements, repurchase agreements, securities lending, etc. Borrowings from an FHLB shall be reflected in the financial statements in accordance with the SSAP that addresses the substance of the agreement.
14. Acquisition of FHLB capital stock allows members to conduct business activity (borrowings) from an FHLB. The amount of capital stock acquired determines the reporting entity’s eligible borrowing amount. At a minimum, all borrowings from an FHLB (regardless of structure) must also be fully collateralized in accordance with the FHLB capital plan, which determines the amount of collateral required by type of pledged instrument. Collateral pledged to an FHLB shall be coded as restricted within the financial statements (e.g., investments schedules and general interrogatories). Collateral pledged to an FHLB by a reporting entity FHLB member is considered an admitted asset if all of the following conditions in subparagraphs 14a-14d are met:

   a. the asset would have been admitted under SSAP No. 4;
   b. the pledging insurer continues to receive the income on the pledged collateral;
   c. the pledging insurer can remove and substitute other securities with little or advance notice to the FHLB as long as the insurer complies with related investment quality and market value provisions; and
   d. there has been no uncured default or event to indicate an impairment or loss contingency for the pledged assets.

New Footnote – As detailed in SSAP No. 4, if assets are pledged or otherwise restricted by the action of a related party, the assets are not permitted to be admitted in the statutory financial statements. As such, a reporting entity pledging assets to an FHLB on behalf of an affiliate shall nonadmit the pledged assets.

15. The guidance in paragraphs 13-14 is specific for reporting entities that are FHLB members. A reporting entity that engages with an FHLB through an “affiliate arrangement” (meaning an affiliate of the reporting entity is the FHLB member), is not considered an FHLB member. In those situations, any FHLB capital stock held by the non-FHLB member reporting entity or collateral pledged to an FHLB on behalf of an affiliate shall be nonadmitted. Detail of the affiliate FHLB arrangement, including any collateral pledged or funds received, shall be captured as a related party transaction (as if the activity occurred directly with the affiliate) under the provisions of SSAP No. 25.

FHLB Disclosures

17. For reporting entity FHLB members agreements, the following information shall be disclosed in the financial statements for current and prior year and between general account and separate account activity. The information in the disclosures shall be presented gross even if a right to offset per SSAP No. 64 exists.

   a. General description of FHLB agreements, with information on the nature of the agreement, type of borrowing (advances, lines of credit, borrowed money, etc.) and use of the funding.

   b. Amount of FHLB capital stock held in aggregate, and classified as follows: i) membership stock (separated by Class A and Class B); ii) Activity Stock; and iii) Excess Stock. For membership stock, report the amount of FHLB capital stock eligible for redemption and the anticipated timeframe for redemption: i) less than 6 months, ii) 6 months to 1 year, iii) 1 year to 3 years, and iv) 3 to 5 years.

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6 For FHLB membership stock to be eligible for redemption, written notification must have been provided to the FHLB prior to the reporting date.
c. Amount (fair value and carrying value) of collateral pledged to the FHLB as of the reporting date. In addition, report the maximum amount of collateral pledged to the FHLB at any time during the current reporting period. (Maximum shall be determined on the basis of carrying value, but with fair value also reported)

d. Aggregate amount of borrowings at the reporting date from the FHLB, reflecting compilation of all advances, loans, funding agreements, repurchase agreements, securities lending, etc., outstanding with the FHLB, and classify whether the borrowing is in substance: i) debt (SSAP No. 15—Debt and Holding Company Obligations), ii) a funding agreement (SSAP No. 52—Deposit-Type Contracts), or iii) Other. For funding agreements, report the total reserves established. Report the maximum amount of aggregate borrowings from an FHLB at any time during the current reporting period, the actual or estimated maximum borrowing capacity as determined by the insurer, with a description of how the borrowing capacity was determined, and whether current borrowings are subject to prepayment penalties.

Staff Review Completed by:
Julie Gann, NAIC Staff – June 2018
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: SSAP No. 30R – Foreign Mutual Funds

Check (applicable entity):

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</table>

Description of Issue: 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...” Although 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:
  - 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.
  - Taiwan mutual fund market is regulated by the Financial Supervisory Committee in accordance with the Securities Investment Trust and Consulting Act.

**Foreign Reporting on D-2-2:**
Common stocks owned are reflected in Schedule D-2-2. This schedule currently captures information on foreign securities in column 4 in accordance with the following Annual Statement Instructions:

For the Foreign Code columns in Schedules D and DA, the following codes should be used:

- **“A”**  For Canadian securities issued in Canada and denominated in U.S. dollars.
- **“B”**  For those securities that meet the definition of foreign provided in the Supplement Investment Risk Interrogatories and pay in a currency other than U.S. dollars.
- **“C”**  For foreign securities issued in the U.S. and denominated in U.S. dollars
- **“D”**  For those securities that meet the definition of foreign as provided in the Supplement Investment Risk Interrogatories and denominated in U.S. dollars (e.g., Yankee Bonds or Eurodollar Bonds).

Leave blank for those securities that do not meet the criteria for the use of “A,” “B,” “C,” or “D.”

*(Staff Note – If the investment is a Canadian investment in Canadian dollars, it would not be noted as foreign.)*

**Select definitions Per the Supplemental Investment Risk Interrogatory:**

Foreign Investment: An investment in a foreign jurisdiction, or an investment in a person, real estate or asset domiciled in a foreign jurisdiction. An investment shall not be deemed to be foreign if the issuing person, qualified primary credit source or qualified guarantor is a domestic jurisdiction or a person domiciled in a domestic jurisdiction, unless:

- (a) The issuing person is a shell business entity; and
- (b) The investment is not assumed, accepted, guaranteed or insured or otherwise backed by a domestic jurisdiction or person, that is not a shell business entity, domiciled by a domestic jurisdiction.
Domestic Jurisdiction: The United States, Canada, any state, any province of Canada or any political subdivision of any of the foregoing.

Foreign Jurisdiction: A jurisdiction other than a domestic jurisdiction.

The Supplemental Investment Risks Interrogatory captures information on foreign investments:
(Per the definition of domestic jurisdiction, investments in Canada are not captured as “foreign” in the SIRI. Questions 5-10 are only completed if the aggregate foreign investments exceed 2.5% of total admitted assets.)

4. Assets held in foreign investments:

4.01 Are assets held in foreign investments less than 2.5% of the reporting entity’s total admitted assets? Yes [ ] No [ ]

If response to 4.01 above is yes, responses are not required for interrogatories 5 – 10.

4.02 Total admitted assets held in foreign investments

4.03 Foreign-currency-denominated investments

4.04 Insurance liabilities denominated in that same foreign currency

5. Aggregate foreign investment exposure categorized by NAIC sovereign designation:

5.01 Countries designated NAIC 1

5.02 Countries designated NAIC 2

5.03 Countries designated NAIC 3 or below

6. Largest foreign investment exposures by country, categorized by the country’s NAIC sovereign designation:

6.01 Country 1: $......................................................%  
6.02 Country 2: $......................................................%  
6.03 Country 1: $......................................................%  
6.04 Country 2: $......................................................%  
6.05 Country 1: $......................................................%  
6.06 Country 2: $......................................................%  

7. Aggregate unhedged foreign currency exposure

8. Aggregate unhedged foreign currency exposure categorized by NAIC sovereign designation:

8.01 Countries designated NAIC 1

8.02 Countries designated NAIC 2

8.03 Countries designated NAIC 3 or below

9. Largest unhedged foreign currency exposures by country, categorized by the country’s NAIC sovereign designation:
## 9. Countries designated NAIC 1:

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<thead>
<tr>
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<th>1</th>
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</thead>
<tbody>
<tr>
<td>9.01 Country 1:</td>
<td>$......................</td>
<td>..................... %</td>
</tr>
<tr>
<td>9.02 Country 2:</td>
<td>$......................</td>
<td>..................... %</td>
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</tbody>
</table>

## 9. Countries designated NAIC 2:

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<tbody>
<tr>
<td>9.03 Country 1:</td>
<td>$......................</td>
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<tr>
<td>9.04 Country 2:</td>
<td>$......................</td>
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## 9. Countries designated NAIC 3 or below:

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<tbody>
<tr>
<td>9.05 Country 1:</td>
<td>$......................</td>
<td>..................... %</td>
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<tr>
<td>9.06 Country 2:</td>
<td>$......................</td>
<td>..................... %</td>
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</table>

## 10. Ten largest non-sovereign (i.e. non-governmental) foreign issues:

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<th>3</th>
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<td>10.01</td>
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<td>$......................</td>
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<td>10.02</td>
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<td>10.10</td>
<td></td>
<td></td>
<td>$......................</td>
<td>..................... %</td>
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</tbody>
</table>

## 11. Amounts and percentages of the reporting entity’s total admitted assets held in Canadian investments and unhedged Canadian currency exposure:

### 11.01 Are assets held in Canadian investments less than 2.5% of the reporting entity’s total admitted assets?  
Yes [ ]  No [ ]

*If response to 11.01 is yes, detail is not required for the remainder of Interrogator 11.*

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<thead>
<tr>
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<tbody>
<tr>
<td>11.02 Total admitted assets held in Canadian investments</td>
<td>$......................</td>
<td>..................... %</td>
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<tr>
<td>11.03 Canadian-currency-denominated investments</td>
<td>$......................</td>
<td>..................... %</td>
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<tr>
<td>11.04 Canadian-denominated insurance liabilities</td>
<td>$......................</td>
<td>..................... %</td>
</tr>
<tr>
<td>11.05 Unhedged Canadian currency exposure</td>
<td>$......................</td>
<td>..................... %</td>
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</table>

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**Mutual Fund Reporting in the General Interrogatories:**

### 29. This interrogatory is applicable to Property/Casualty and Health entities only.

### 29.2 The diversified mutual funds (diversified according to the U.S. Securities and Exchange Commission (SEC) in the Investment Company Act of 1940 [Section 5(b)(1)]) that are excluded from the Asset Concentration Factor section of the risk-based capital filing are to be disclosed in this interrogatory.

### 29.3 “Significant Holding” means the top five largest holdings of the mutual fund. For each diversified mutual fund disclosed in Interrogatory 29.2, the top largest holdings of the mutual fund must be disclosed in this interrogatory.
The “Amount of Mutual Fund’s Book/Adjusted Carrying Value Attributable to the Holding” should be based upon the fund’s latest available valuation as of year-end (e.g., fiscal year-end or latest periodic valuation available prior to year-end).

The “Date of Valuation” should be the date of the valuation amount provided in the Amount of Mutual Fund’s Book/Adjusted Carrying Value Attributable to the Holding column.

29.1 Does the reporting entity have any diversified mutual funds reported in Schedule D – Part 2 (diversified according to the Securities and Exchange Commission (SEC) in the Investment Company Act of 1940 [Section 5 (b) (1)])? Yes [   ] No [   ]

29.2 If yes, complete the following schedule:

<table>
<thead>
<tr>
<th>1</th>
<th>CUSIP #</th>
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<th>Name of Mutual Fund</th>
<th>3</th>
<th>Book/Adjusted Carrying Value</th>
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<td>TOTAL</td>
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29.3 For each mutual fund listed in the table above, complete the following schedule:

<table>
<thead>
<tr>
<th>1</th>
<th>Name of Mutual Fund (from above table)</th>
<th>2</th>
<th>Name of Significant Holding of the Mutual Fund</th>
<th>3</th>
<th>Amount of Mutual Fund’s Book/Adjusted Carrying Value Attributable to the Holding</th>
<th>4</th>
<th>Date of Valuation</th>
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Existing Authoritative Literature:

**SSAP No. 30—Unaffiliated Common Stock (Prior to Substantive Revisions)**

3. Common stocks (excluding investments in affiliates) are securities which represent a residual ownership in a corporation and shall include:

a. Publicly traded common stocks;

b. Master limited partnerships trading as common stock and American deposit receipts only if the security is traded on the New York, American, or NASDAQ exchanges;

c. Publicly traded common stock warrants;

d. **Shares of mutual funds, regardless of the types or mix of securities owned by the fund (e.g., bonds, stocks, money market instruments), except for:**

   i. Bond Mutual Funds which qualify for bond treatment, as identified in Part Six, Section 2, of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*;

   ii. Money Market Mutual Funds on the U.S. Direct Obligations/Full Faith and Credit Exempt List, as identified in Part Six, Section 2, of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*;

   e. Exchange Traded Funds, except for those identified for bond or preferred stock treatment, as identified in Part Six, Section 2, of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*;

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1 Pursuant to SSAP No. 2R, effective December 31, 2017, money market mutual funds shall be reported as cash equivalents and valued at fair value (net asset value allowed as a practical expedient).
f. Common stocks that are not publicly traded, including equity interests in certified capital companies in accordance with INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO); and

g. Common stocks that are restricted as to transfer of ownership. Restricted stock shall be defined as a security for which sale is restricted by governmental or contractual requirement (other than in connection with being pledged as collateral), except where that requirement terminates within one year or if the holder has the power by contract or otherwise to cause the requirement to be met within one year. Any portion of the security that can be reasonably expected to qualify for sale within one year is not considered restricted. Regardless of redemption timeframe, FHLB capital stock is considered restricted stock until actual redemption by the FHLB.

SSAP No. 30R—Unaffiliated Common Stock

3. Common stocks (excluding investments in affiliates) are securities which represent a residual / subordinate ownership in a corporation. This definition includes:
   a. Publicly traded common stocks;
   b. Common stocks that are not publicly traded;
   c. Common stocks restricted as to transfer of ownership. Restricted stock shall be defined as a security for which sale is restricted by governmental or contractual requirement (other than in connection with being pledged as collateral), except where that requirement terminates within one year or if the holder has the power by contract or otherwise to cause the requirement to be met within one year. Any portion of the security that can be reasonably expected to qualify for sale within one year is not considered restricted. Regardless of redemption timeframe, FHLB capital stock is considered restricted stock until actual redemption by the FHLB.

4. In addition, the following equity investments are captured within scope of this statement:
   a. Master limited partnerships trading as common stock and American deposit receipts only if the security is traded on the New York or NASDAQ exchange;
   b. Publicly traded common stock warrants;
   c. Shares of SEC registered Investment Companies captured under the Investment Company Act of 1940 (open-end investment companies (mutual funds), closed-end funds and unit investment trusts), regardless of the types or mix of securities owned by the fund (e.g., bonds or stocks), except for Bond Mutual Funds which qualify for bond treatment, as identified in Part Six, Section 2, of the Purposes and Procedures Manual of the NAIC Investment Analysis Office;
   d. Exchange Traded Funds, except for those identified for bond or preferred stock treatment, as identified in Part Six, Section 2, of the Purposes and Procedures Manual of the NAIC Investment Analysis Office; and
   e. Equity interests in certified capital companies in accordance with INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO); and

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2 Restricted stock shall be defined as a security for which sale is restricted by governmental or contractual requirement (other than in connection with being pledged as collateral), except where that requirement terminates within one year or if the holder has the power by contract or otherwise to cause the requirement to be met within one year. Any portion of the security that can be reasonably expected to qualify for sale within one year is not considered restricted. Regardless of redemption timeframe, FHLB capital stock is considered restricted stock until actual redemption by the FHLB.

3 Unless as specifically noted, the equity investments identified within scope are subject to the provisions of this standard as if they were common stock investments.

4 Non-SEC registered investment companies (e.g., private investment companies or hedge funds) are excluded from the scope of this statement.

5 Money market mutual funds are considered cash equivalents under SSAP No. 2R.
5. Investments within scope of this statement meet the definition of assets as defined in SSAP No. 4—Assets and Nonadmitted Assets and are admitted assets to the extent they conform to the requirements of this statement.

**Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):** None

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

**Convergence with International Financial Reporting Standards (IFRS):** Not applicable.

**Staff 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 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 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.

**Proposed Edits to SSAP No. 30R:**

4. In addition, the following equity investments are captured within scope of this statement:

   a. Master limited partnerships trading as common stock and American deposit receipts only if the security is traded on the New York or NASDAQ exchange;

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6 Unless as specifically noted, the equity investments identified within scope are subject to the provisions of this standard as if they were common stock investments.
b. Publicly traded common stock warrants;

c. Shares of SEC registered Investment Companies captured under the Investment Company Act of 1940 (open-end investment companies, closed-end funds and unit investment trusts), regardless of the types or mix of securities owned by the fund (e.g., bonds or stocks), except for Bond Mutual Funds which qualify for bond treatment, as identified in Part Six, Section 2, of the Purposes and Procedures Manual of the NAIC Investment Analysis Office;

d. Exchange Traded Funds, except for those identified for bond or preferred stock treatment, as identified in Part Six, Section 2, of the Purposes and Procedures Manual of the NAIC Investment Analysis Office; and

d.e. Foreign open-end mutual funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction. Other foreign funds are excluded from the scope of this statement.

e.f. Equity interests in certified capital companies in accordance with INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO); and

Staff Review Completed by:
Julie Gann, NAIC Staff – June 2018

7 Non-SEC registered investment companies (e.g., private investment companies or hedge funds) are excluded from the scope of this statement.

8 Money market mutual funds are considered cash equivalents under SSAP No. 2R.
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting

Check (applicable entity):

- Modification of existing SSAP
- New Issue or SSAP
- Interpretation

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<th>P/C</th>
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<th>Health</th>
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<tbody>
<tr>
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<tr>
<td>New Issue or SSAP</td>
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<td>Interpretation</td>
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Description of Issue: 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 in 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.)

Existing Authoritative Literature:

- **SSAP No. 104R—Share-Based Payments** – This statement provides statutory accounting principles for transactions in which an entity exchanges equity instruments to employees and nonemployees in share-based payment transactions. The current guidance in SSAP No. 104R adopts with modification ASC Topic 718 – Stock Compensation and Subtopic 505-50 – Equity Payments to Non-Employees.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): In 2017, the Working Group adopted with modification ASU 2016-09, Improvements to Employee Share-Based Payment Accounting and incorporated the U.S. GAAP simplifications from that project into SAP.

Information or issues (included in Description of Issue) not previously contemplated by the Working Group: None
Convergence with International Financial Reporting Standards (IFRS): IFRS 2 addresses share-based payments issued to employees and other parties. Transactions with other parties, the share-based payment is measured at fair value of the goods or services unless that fair value is not reliably measurable, in which case the fair value of the award is used. The fair value is measured at the date the entity obtains the goods or the counterparty renders the service. For the remaining updates in the ASU, generally IFRS standards neither have comparable guidance, nor explicitly permit practical expedients.

Staff 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:

- **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.)**

- **Prepaid assets are nonadmitted.**

- **GAAP references are revised to reference applicable statutory accounting guidance.**

- **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”).**

- **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 modification 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.

**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 ETIF 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.)

Proposed Revisions to SSAP No. 95:

**Accounting for a Convertible Instrument Granted or Issued to a Nonemployee for Goods or Services or a Combination of Goods or Services and Cash**

17. The guidance in paragraph 18 (470-20-25-18 and 470-20-25-19) addresses a convertible instrument that is issued or granted to a nonemployee in exchange for goods or services or a combination of goods or services and cash. The convertible instrument contains a nondetachable conversion option that permits the holder to convert the instrument into the issuer's stock. (470-20-25-17)

18. Once an instrument is considered "issued" for accounting purposes, pursuant to SSAP No. 104R, distributions paid or payable should be characterized as financing costs (that is, as interest or dividends). Prior to that time, distributions paid or payable under the instrument should be characterized as a cost of the underlying goods or services. (470-20-25-18) the accretion of a discount on a convertible instrument resulting from a beneficial conversion option does not begin until the instrument is issued for accounting purposes. If the convertible instrument is issued for cash proceeds that indicate that the instrument includes a beneficial conversion feature and the purchaser of the instrument also provides (receives) goods or services to (from) the issuer that are the subject of a separate contract, the convertible instrument shall be recognized with a corresponding increase or decrease in the purchase or sales price of the goods or services. (470-20-25-19)

19. To determine the fair value of a convertible instrument granted as part of a share-based payment transaction to a nonemployee in exchange for goods or services that is equity in form or, if debt in form, that can be converted into equity instruments of the issuer, the entity shall first apply SSAP No. 104R. (470-20-30-22)

20. The requirements of this statement shall then be applied such that the fair value determined pursuant to SSAP No. 104R is considered the proceeds from issuing the instrument for purposes of determining whether a beneficial conversion option exists. The measurement of the intrinsic value, if any, of the conversion option (for separate recognition as additional paid-in capital – 470-20-25-5) shall then be computed by comparing the proceeds received for the instrument (the instrument's fair value under SSAP No. 104R) to the fair value of the common stock that the grantee would receive upon exercising the conversion option. For purposes of determining whether a convertible instrument contains a beneficial conversion feature for separate recognition as additional paid-in capital (470-20-25-5), an entity shall use the effective conversion price based on the proceeds allocated to the convertible instrument to compute the intrinsic value, if any, of the embedded conversion option. (470-20-30-23)

(Note – The US GAAP guidance references paragraph 470-20-25-5 as noted in this paragraph. Under that guidance, the embedded beneficial conversion feature presented in a convertible instrument shall be recognized at issuance by allocating a portion of the proceeds equal to the intrinsic value of that feature to additional paid in capital. Reference to this separate recognition has been included for statutory purposes.)

21. If a convertible instrument is issued in exchange for goods or services, the measurement date should be used both to measure the fair value of the convertible instrument and to measure the intrinsic value, if any, of the conversion option as of the date the convertible instrument granted as part of a share-based payment award becomes fully vested. That is, in measuring the intrinsic value of the conversion option for separate recognition as additional paid-in capital (470-20-25-5), the fair value of the issuer's equity securities into which the instrument can be converted shall be determined as of the date the convertible instrument granted as part of a share-based payment award becomes fully vested, and not on the commitment date. (470-20-30-24)
17. The measurement date is the earlier of either of the following:

   a. The date at which a commitment for performance by the counter party to earn the convertible instrument is reached (a "performance commitment")

   b. The date at which the counter party’s performance is complete

18. If a convertible instrument is issued in exchange for goods or services (or a combination of goods or services and cash), both of the following guidelines for determining the fair value of convertible instruments shall be used to measure the fair value of that instrument: (470-20-30-25)

   a. Consistent with this SSAP, the fair value of an equity instrument shall be determined based on either the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable. Accordingly, if the fair value of the goods or services received is reliably determinable, and the issuer has not recently issued similar convertible instruments, the fair value of the goods or services should be used to measure the transaction.

   b. Recent issuances of similar convertible instruments for cash to parties that only have an investor relationship with the issuer may provide the best evidence of fair value of the convertible instrument.

   c. If reliable information about (a) or (b) above, is not available, the fair value of the convertible instrument should be deemed to be no less than the fair value of the equity shares into which it can be converted.

19. Whether distributions paid or payable on a convertible instrument issued or granted in exchange for goods or services (or a combination of goods or services and cash) should be recognized as a financing cost (that is, interest expense or dividends) or as a cost of the goods or services received or receivable from the counterparty.

20. Once an instrument is considered “issued” for accounting purposes, distributions paid or payable should be characterized as financing costs. Prior to that time, distributions paid or payable under the instrument should be characterized as a cost of the underlying goods or services. the accretion of a discount on a convertible instrument resulting from a beneficial conversion option does not begin until the instrument is issued for accounting purposes.

21. In cases where a company reporting entity issues a convertible instrument for cash proceeds that indicate that the instrument includes a beneficial conversion option, and the purchaser of the instrument provides (receives) goods or services to (from) the issuer that are the subject of a separate contract, the terms of both the agreement for goods or services and the convertible instrument shall be evaluated to determine whether their separately stated pricing is equal to the fair value of the goods or services and convertible instrument. If that is not the case, the convertible instrument initially should be recognized at its fair value with a corresponding increase or decrease in the purchase or sales price of the goods or services. It may be difficult to evaluate whether the separately stated pricing of a convertible instrument is equal to its fair value. If an instrument issued to a goods or services provider (or purchaser) is part of a larger issuance, a substantive investment in the issuance by unrelated investors (who are not also providers or purchasers of goods or services) may provide evidence that the price charged to the goods or services provider represents the fair value of the convertible instrument. (470-20-30-26)

Other Impacted ASC Guidance from ASU 2018-07.
As noted, corresponding SAP revisions have not been deemed necessary for these updated ASC sections:

• ASC 260-10 – Earnings Per Share – Guidance for EPS is not applicable to statutory accounting.

• ASC 323-10 – Equity Method and Joint Ventures – The ASU revisions update the references to the prior guidance, expanding references to employees and non-employees and using terminology for “share-based payment awards” in lieu of “stock based compensation.” These references are not captured in SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies.

• ASC 480-10 – Distinguishing Liabilities from Equity – The ASU revisions remove reference to 505-50 and incorporate minor wording changes to guidance not reflected in statutory accounting.

• ASC 606-10 – Revenue from Contracts with Customers – The ASU revisions includes reference to equity instruments granted as consideration payable. The guidance in ASC 606 was rejected for statutory accounting.

• ASC 805-30 – Business Combinations – Goodwill or Gain from Bargain Purchase, Including Consideration Transferred – The revisions incorporate minor wording changes and update implementation illustrations. The GAAP guidance for business combinations was rejected (or still pending review) for statutory accounting.

• ASC 815-10 – Derivatives and Hedging – The revisions remove reference to ASC 505-50 and update presentation and implementation guidance not reflected in statutory accounting.

• ASC 820-10 – Fair Value Measurement – The ASU revisions remove reference to ASC 505-50.

Staff Review Completed by:
Julie Gann, NAIC Staff – August 2018
Statement of Statutory Accounting Principles No. 104 - Revised

Share-Based Payments

STATUS

Type of Issue ...................................... Common Area
Issued .................................................. August 11, 2012; Substantively revised December 15, 2013
Effective Date ..................................... January 1, 2013; Substantive revisions detailed in Issue Paper No. 146 effective December 31, 2014
Affects ................................................ Supersedes SSAP No. 13; Nullifies and incorporates INT 99-17, INT 00-06, INT 00-32 and INT 01-14
AFFECTED BY........................................ No other pronouncements
INTERPRETED BY ................................ No other pronouncements
RELEVANT APPENDIX A GUIDANCE .... None

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SCOPE OF STATEMENT

1. This statement provides statutory accounting principles for transactions in which an entity exchanges its equity instruments to employees and non-employees\(^1\) in share-based payment transactions, including employee share purchase plans and deferred compensation obligations held in a rabbi trust. This statement does not provide statutory accounting principles for employee share ownership plans; those transactions are addressed in SSAP No. 12—Employee Stock Ownership Plans.

SUMMARY OF ISSUE

2. The objective of accounting for transactions under share-based payment arrangements with employees is to recognize in the financial statements the employee goods or services received in exchange for equity instruments issued granted or liabilities incurred and the related cost to the entity as those goods or services are consumed received. The objective of accounting for share-based payment transactions with non-employees is to recognize in the financial statements the most reliably measurable fair values of such transactions. This statement uses the terms compensation and payment in their broadest senses to refer to the consideration paid for employee goods or services and goods and services regardless of whether the supplier is an employee. (718-10-10-1)

3. The accounting for all share-based payment transactions shall reflect the rights conveyed to the holder of the instruments and the obligations imposed on the issuer of the instruments, regardless of how those transactions are structured. This statement requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. This statement establishes fair value as the measurement objective in accounting for share-based payment arrangements and requires all entities to apply a fair-value-based measurement method\(^2\) in accounting for share-based payment transactions with employees except for equity instruments held by employee stock ownership plans. (718-10-10-2.)

(SAP Modification – Deleted reference to ESOP as those items are not in scope of this SSAP.)

Scope and Scope Exceptions

4. Employees—This statement applies to all share-based payment transactions in which a grantor an entity acquires employee goods or services to be used or consumed in the grantor’s own operations by issuing (or offering to issue) its shares, share options, or other equity instruments or by incurring liabilities to an employee or nonemployee that meet either of the following conditions: (718-10-15-3)

a. The amounts are based, at least in part\(^3\), on the price of the entity’s shares or other equity instruments.

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\(^1\) Guidance referencing grantees is intended to be applicable to recipients of both employee and nonemployee awards, and guidance referencing employees or nonemployees is only applicable to those specific types of awards.

\(^2\) Accounting pronouncements that require fair value measurements but that are excluded from SSAP No. 100R—Fair Value is limited to this statement addressing share-based payment transactions. The fair value measurement objective in this statement is generally consistent with the fair value measurement objective in SSAP No. 100R. However, for certain share-based payment transactions with employees, the measurements at the grant date are fair-value-based measurements, not fair value measurements. Although some measurements in this statement are fair value measurements, for practical reasons this statement is excluded in its entirety from SSAP No. 100R. To be consistent with GAAP guidance on share-based payment transactions, the definition of fair value for use in this statement is: “the amount at which the asset (or liability) could be bought (or incurred) or sold (settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale.” Observable market prices of identical or similar equity or liability instruments in active markets are the best estimate of fair value and, if available, should be used as the basis for the measurement of equity and liability instruments awarded in a share-based payment transaction with employees.

\(^3\) The phrase “at least in part” is used because an award of share-based compensation may be indexed to both the price of an entity’s shares and something else that is neither the price of the entity’s shares nor a market, performance, or service condition.
b. The awards require or may require settlement by issuing the entity’s equity shares or other equity instruments.

5. Share-based payments awarded to a grantee an employee of the reporting entity by a related party or other holder of an economic interest in the entity as compensation for goods or services provided to the reporting entity are share-based payment transactions to be accounted for under this statement unless the transfer is clearly for a purpose other than compensation for goods or services to the reporting entity. The substance of such a transaction is that the economic interest holder makes a capital contribution to the reporting entity, and that entity makes a share-based payment to its employee the grantee in exchange for services rendered or goods received. An example of a situation in which such a transfer is not compensation is a transfer to settle an obligation of the economic interest holder to the employee grantee that is unrelated to goods or services to be used or consumed in a grantor’s own operations. Employment by the entity.(718-10-15-4)

6. Non-Employees - This statement applies to all share-based payment transactions in which an entity acquires goods or services by issuing (or offering to issue) its shares, share-options, or other equity instruments or by incurring liabilities to a goods or service provider that is not an employee in amounts based, at least in part, on the price of the entity’s shares or other equity instruments or that require or may require settlement by issuing the entity’s equity shares or other equity instrument.

7-6. The guidance in this statement does not apply to: (718-10-15-5 and 718-10-15-5A.)

a. Equity instruments held by an employee stock ownership plan. Such equity instruments shall follow the guidance in SSAP No. 12—Employee Stock Ownership Plans (SSAP No. 12).

b. The guidance in this statement does not apply to transactions involving equity instruments granted either issued to a lender or investor that provides financing to the issuer or issued in a business combination.

c. Transactions involving equity instruments granted in conjunction with selling goods or services to customers as part of a contract (for example, sales incentives). If consideration payable to a customer is payment for a distinct good or service from the customer, then the entity shall account for the purchase of the good or service in the same way it accounts for other purchases from suppliers. Therefore, share-based payment awards granted to a customer for a distinct good or service to be used or consumed in the grantor’s own operations are accounted for under this statement.

7. Paragraphs 115-122 applies to all entities that use employee share purchase plans. This is a separate, and distinct scope, from share-based payment transactions captured in paragraph 4. (718-50-15-1, 718-50-15-2)

8. The guidance for share-based payments to employees is contained in paragraphs 9-112 and 115-143, and the guidance for share-based payments to non-employees is contained in paragraphs 113-140. The guidance for employees is further divided as follows:


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*See Footnote 2*
e. __________ Consolidated/Holding Company Share-Based Payment Plans: Paragraphs 110-112

**Employee Share-Based Payments - Compensatory**

**Recognition – ASC 718-10-25**

Principle for Share-Based Payment Transactions

9. _______ Stock purchase and stock option plans that do not meet the criteria of a non-compensatory plan (paragraphs 103-109 106-112) and are otherwise excluded from the scope of this statement shall be classified as compensatory and follow the recognition, measurement and disclosure guidance in paragraphs 10-103.

10. _______ An entity shall recognize the goods acquired or services received in a share-based payment transaction with an employee when it obtains the goods or as services are received, as further described in paragraphs 9-10 (718-10-25-2A through 25-2B). Employee services themselves are not recognized before they are received. The entity shall recognize either a corresponding increase in equity or a liability, depending on whether the instruments granted satisfy the equity or liability classification criteria (see paragraphs 14-27 15-29) (718-10-25-6 through 25-19A). As the services are consumed, the entity shall recognize the related cost. (718-10-25-2)

9. _______ Employee services themselves are not recognized before they are received. As the services are consumed, the entity shall recognize the related cost. For example, as services are consumed, the cost usually is recognized in determining net income of that period, for example, as expenses incurred for employee services. In some circumstances, the cost of services may be initially capitalized as part of the cost to acquire or construct another asset, such as inventory, and later recognized in the income statement when that asset is disposed of or consumed. This statement refers to recognizing compensation cost rather than compensation expense because any compensation cost that is capitalized as part of the cost to acquire or construct an asset would not be recognized as compensation expense in the income statement. (718-10-25-2A)

10. _______ Transactions with nonemployees in which share-based payment awards are granted in exchange for the receipt of goods or services may involve a contemporaneous exchange of the share-based payment awards for goods or services or may involve an exchange that spans several financial reporting periods. Furthermore, by virtue of the terms of the exchange with the grantee, the quantity and terms of the share-based payment awards to be granted may be known or not known when the transaction arrangement is established because of specific conditions dictated by the agreement (for example, performance conditions). Judgment is required in determining the period over which to recognize cost, otherwise known as the nonemployee’s vesting period. (718-10-25-2B)

11. _______ This guidance does not address the period(s) or the manner (that is, capitalize versus expense) in which an entity granting the share-based payment award (the purchaser or grantor) to a nonemployee shall recognize the cost of the share-based payment award that will be issued, other than to require that a nonadmitted prepaid asset or expense be recognized (or previous recognition reversed) in the same period(s) and in the same manner as if the grantor had paid cash for the goods or services instead of paying with or using the share-based payment award. (718-10-25-2C) (SAP Modification – Incorporated reference to clarify that a recognized asset representing the cost of the share-based payment award would be a nonadmitted prepaid asset under SAP. This is consistent with the modification from ASC 505-50.)

11-12. _______ The accounting for all share-based payment transactions shall reflect the rights conveyed to the holder of the instruments and the obligations imposed on the issuer of the instruments, regardless of how those transactions are structured. For example, the rights and obligations embodied in a transfer of equity shares to an employee for a note that provides no recourse to other assets of the employee grantee (that is,
other than the shares) are substantially the same as those embodied in a grant of equity share options. Thus, that transaction shall be accounted for as a substantive grant of equity share options. (718-10-25-3)

42-13. Assessment of both the rights and obligations in a share-based payment award and any related arrangement and how those rights and obligations affect the fair value of an award requires the exercise of judgment in considering the relevant facts and circumstances. (718-10-25-4)

Determining the Grant Date

43-14. As a practical accommodation, in determining the grant date of an award subject to this statement, assuming all other criteria in the grant date definition have been met, a mutual understanding of the key terms and conditions of an award to an individual employee grantee shall be presumed to exist at the date the award is approved in accordance with the relevant corporate governance requirements (that is, by the Board or management with the relevant authority) if both of the following conditions are met: (718-10-25-5)

a. The award is a unilateral grant and, therefore, the recipient does not have the ability to negotiate the key terms and conditions of the award with the employer grantee.

b. The key terms and conditions of the award are expected to be communicated to an individual recipient within a relatively short time period from the date of approval. A relatively short time period is that period in which an entity could reasonably complete all actions necessary to communicate the awards to the recipients in accordance with the entity's customary human resource practices.

Determining Whether to Classify a Financial Instrument as a Liability or As Equity

44-15. Paragraphs 14-2715-29 (718-10-25-6 through 718-10-25-19A), provide guidance for determining whether certain financial instruments awarded in share-based payment transactions are liabilities. In determining whether an instrument not specifically discussed in those paragraphs shall be classified as a liability or as equity, an entity shall apply statutory accounting principles applicable to financial instruments issued in transactions not involving share-based payment. (718-10-25-6) (SAP Modification – Reference to SAP instead of GAAP.)

45-16. Unless paragraphs 16-2717-29 (718-10-25-8 through 25-19A) require otherwise, an entity shall apply the classification criteria in Exhibit A, as they are effective at the reporting date, in determining whether to classify as a liability a freestanding financial instrument given to an employee grantee in a share-based payment transaction. Paragraphs 68-7276-81 (718-10-35-9 through 35-14) provide criteria for determining when instruments subject to this statement subsequently become subject to other applicable statutory accounting principles. (718-10-25-7) (SAP Modification – Reference to SAP instead of GAAP.)

46-17. In determining the classification of an instrument, an entity shall take into account the classification requirements that are effective for that specific entity at the reporting date as established by Exhibit A. In addition, a call option written on an instrument that is not classified as a liability under those classification requirements also shall be classified as equity so long as those equity classification requirements for the entity continue to be met, unless liability classification is required under the provisions of paragraphs 20-21 19 and 20 (718-10-25-11 through 25-12). (718-10-25-8)

47-18. Exhibit A does not apply to outstanding shares embodying a conditional obligation to transfer assets, for example, shares that give the employee grantee the right to require the employer grantor to repurchase them for cash equal to their fair value (puttable shares). A put right may be granted to the employee grantee in a transaction that is related to a share-based compensation arrangement. If exercise of such a put right would require the entity to repurchase shares issued under the share-based
compensation arrangement, the shares shall be accounted for as puttable shares. A puttable (or callable) share awarded to an employee-grantee as compensation shall be classified as a liability if either of the following conditions is met: (718-10-25-9)

a. The repurchase feature permits the employee-grantee to avoid bearing the risks and rewards normally associated with equity share ownership for a reasonable period of time from the date the good is delivered or the requisite service is rendered and the share is issued. An employee-grantee begins to bear the risks and rewards normally associated with equity share ownership when all the goods are delivered or all the requisite service has been rendered and the share is issued. A repurchase feature that can be exercised only upon the occurrence of a contingent event that is outside the employee-grantee’s control (such as an initial public offering) would not meet this condition until it becomes probable that the event will occur within the reasonable period of time.

b. It is probable that the employer-grantor would prevent the employee-grantee from bearing those risks and rewards for a reasonable period of time from the date the share is issued. For this purpose, a period of six months or more is a reasonable period of time.

18.19. A puttable (or callable) share that does not meet either of those conditions shall be classified as equity. (718-10-25-10)

19.20. Options or similar instruments on shares shall be classified as liabilities if either of the following conditions is met: (718-10-25-11)

a. The underlying shares are classified as liabilities.

b. The entity can be required under any circumstances to settle the option or similar instrument by transferring cash or other assets. A cash settlement feature that can be exercised only upon the occurrence of a contingent event that is outside the employee-grantee’s control (such as an initial public offering) would not meet this condition until it becomes probable that event will occur.

20.21. For example, a reporting entity that is a Securities and Exchange Commission (SEC) registrant may grant an option to an employee-grantee that, upon exercise, would be settled by issuing a mandatorily redeemable share. Because the mandatorily redeemable share would be classified as a liability under Exhibit A (as well as under SSAP No. 72—Surplus and Quasi-Reorganizations), the option also would be classified as a liability. (718-10-25-12) (SAP Modification – Reference to SAP guidance.)

21.22. An award may be indexed to a factor in addition to the entity’s share price. If that additional factor is not a market, performance, or service condition, the award shall be classified as a liability for purposes of this statement, and the additional factor shall be reflected in estimating the fair value of the award. (718-10-25-13)

22.23. For this purpose, an award of equity share options granted to an employee-grantee of an entity’s foreign operation that provides for a fixed exercise price denominated either in the foreign operation’s functional currency or in the currency in which the foreign operation’s employee’s pay is denominated shall not be considered to contain a condition that is not a market, performance, or service condition. Therefore, such an award is not required to be classified as a liability if it otherwise qualifies as equity. For example, equity share options with an exercise price denominated in euros granted to employees or nonemployees of a U.S. entity’s foreign operation whose functional currency is the euro are not required to be classified as liabilities if those options otherwise qualify as equity. In addition, such options granted to employees and nonemployees are not required to be classified as liabilities even if the functional
currency of the foreign operation is the U.S. dollar, provided that the foreign operation’s employees to whom the options are granted are paid in euros. (718-10-25-14)

24. For purposes of applying paragraph 22 (718-10-25-13), a share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity’s equity securities trades shall not be considered to contain a condition that is not a market, performance, or service condition. Therefore, in accordance with that paragraph, such an award shall not be classified as a liability if it otherwise qualifies for equity classification. For example, a parent entity whose functional currency is the Canadian dollar grants equity share options with an exercise price denominated in U.S. dollars to grantees of a Canadian entity with the functional and payroll currency of the Canadian dollar. If a substantial portion of the parent entity’s equity securities trades on a U.S. dollar denominated exchange, the options are not precluded from equity classification. (718-10-25-14A)

23-25. The accounting for an award of a share-based payment shall reflect the substantive terms of the award and any related arrangement. Generally, the written terms provide the best evidence of the substantive terms of an award. However, an entity’s past practice may indicate that the substantive terms of an award differ from its written terms. For example, an entity that grants a tandem award under which a grantee an employee receives either a stock option or a cash-settled stock appreciation right is obligated to pay cash on demand if the choice is the grantee’s employee’s, and the entity thus incurs a liability to the employee. In contrast, if the choice is the entity, it can avoid transferring its assets by choosing to settle in stock, and the award qualifies as an equity instrument. However, if an entity that nominally has the choice of settling awards by issuing stock predominately settles in cash or if the entity usually settles in cash whenever a grantee asks for cash settlement, the entity is settling a substantive liability rather than repurchasing an equity instrument. In determining whether an entity that has the choice of settling an award by issuing equity shares has a substantive liability, the entity also shall consider whether: (718-10-25-15)

a. It has the ability to deliver the shares. (Federal securities law generally requires that transactions involving offerings of shares under employee share option arrangements be registered, unless there is an available exemption. For purposes of this statement, such Requirements to deliver registered shares do not, by themselves, imply that an entity does not have the ability to deliver shares and thus do not require an award that otherwise qualifies as equity to be classified as a liability.)

b. It is required to pay cash if a contingent event occurs (see paragraphs 19-2020-21) (718-10-25-11 through 25-12).

24-26. A provision that permits grantees employees to effect a broker-assisted cashless exercise of part or all of an award of share options through a broker does not result in liability classification for instruments that otherwise would be classified as equity if both of the following criteria are satisfied: (718-10-25-16)

a. The cashless exercise requires a valid exercise of the share options.

b. The employee-grantee is the legal owner of the shares subject to the option (even though the employee-grantee has not paid the exercise price before the sale of the shares subject to the option).

25-27. A broker that is a related party of the entity must sell the shares in the open market within a normal settlement period, which generally is three days, for the award to qualify as equity. (718-10-25-17)
26.28. Similarly, a provision for either direct or indirect (through a net-settlement feature) repurchase of shares issued upon exercise of options (or the vesting of nonvested shares), with any payment due employees withheld to meet the employer’s statutory withholding requirements resulting from the exercise, does not, by itself, result in liability classification of instruments that otherwise would be classified as equity. However, if the amount that is withheld, or may be withheld at the employer’s discretion, is in excess of the maximum statutory tax rates in the employee’s applicable jurisdictions, the entire award shall be classified and accounted for as a liability. That is, to qualify for equity classification, the employer must have a statutory obligation to withhold taxes on the employee’s behalf, and the amount withheld cannot exceed the maximum statutory tax rates in the employees’ applicable jurisdictions. The maximum statutory tax rates are based on the applicable rates of the relevant tax authorities (for example, federal, state, and local), including the employee’s share of payroll or similar taxes, as provided in tax law, regulations, or the authority’s administrative practices, not to exceed the highest statutory rate in that jurisdiction, even if that rate exceeds the highest rate that may be applicable to the specific award grantee. (718-10-25-18)

27.29. Cash paid to a tax authority by an employer grantor when withholding shares from a grantee’s award for tax withholding purposes shall be considered cash flows from financing activities in the Statement of Cash Flows as it represents an outlay to reacquire the entity’s equity instruments. (230-10-45-15) (718-10-25-19A)

Modification of an Award [Note – Moved to paragraph 85]

28.1. An entity shall account for the effects of a modification as described in paragraphs 76-79, unless all of the following are met:

a. The fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the original award immediately before the original award is modified. If the modification does not affect any of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification.

b. The vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified.

c. The classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified.

Market, Performance, and Service Conditions

29.30. Accruals of compensation cost for an award with a performance condition shall be based on the probable outcome of that performance condition—compensation cost shall be accrued if it is probable that the performance condition will be achieved and shall not be accrued if it is not probable that the performance condition will be achieved. If an award has multiple performance conditions (for example, if the number of options or shares an employee earns varies depending on which, if any, of two or more performance conditions is satisfied), compensation cost shall be accrued if it is probable that a performance condition will be satisfied. In making that assessment, it may be necessary to take into account the interrelationship of those performance conditions. (718-10-25-20)

30.31. If an award requires satisfaction of one or more market, performance, or service conditions (or any combination thereof), compensation cost shall be recognized if the good is delivered or the requisite
service is rendered, and no compensation cost shall be recognized if the good is not delivered or the requisite service is not rendered. (718-10-25-21)

Payroll Taxes

31-32. A liability for employee payroll taxes on employee stock compensation shall be recognized on the date of the event triggering the measurement and payment of the tax to the taxing authority (for a nonqualified option in the United States, generally the exercise date). Payroll taxes, even though directly related to the appreciation on stock options, are operating expenses and shall be reflected as such in the statement of operations. (718-10-25-22 & 718-10-25-23)

Initial Measurement – ASC 718-10-30

32-33. While some of the material in paragraphs 32-3533-62 (Section 718-10-30) was written in terms of awards classified as equity, it applies equally to awards classified as liabilities. The subparagraphs of paragraph 37 provide specific guidance for awards classified as liabilities. (718-10-30-1)

32-34. A share-based payment transaction with employees shall be measured based on the fair value (or in certain situations specified in this statement, a calculated value or intrinsic value) of the equity instruments issued. (718-10-30-2)

34-35. An entity shall account for the compensation cost from share-based payment transactions with employees in accordance with the fair-value-based method set forth in this statement. That is, the cost of goods obtained or services received from employees in exchange for awards of share-based compensation generally shall be measured based on the grant-date fair value of the equity instruments issued or on the fair value of the liabilities incurred. The cost of goods obtained or services received by an entity as consideration for equity instruments issued or liabilities incurred in share-based compensation transactions with employees shall be measured based on the fair value of the equity instruments issued or the liabilities settled. The portion of the fair value of an instrument attributed to employee service—goods obtained or services received is net of any amount that a grantee employee pays (or becomes obligated to pay) for that instrument when it is granted. For example, if a grantee employee pays $5 at the grant date for an option with a grant-date fair value of $50, the amount attributed to employee service goods or services provided by the grantee is $45. (718-10-30-3)

35-36. However, this statement provides certain exceptions (paragraph 5255 (718-10-30-21) to that measurement method if it is not possible to reasonably estimate the fair value of an award at the grant date. A reporting entity that is not able to reasonably estimate the fair value of its equity options and similar instruments may measure its liabilities under share-based payment arrangements at intrinsic value (see paragraphs 3738.b. and 3452) (718-30-30-2 and 718-10-30-20). (718-10-30-4) (SAP Modification – Under GAAP this guidance is limited to nonpublic entities.)

Terms of the Award Affect Fair Value

36-37. The terms of a share-based payment award and any related arrangement affect its value and, except for certain explicitly excluded features, such as a reload feature, shall be reflected in determining the fair value of the equity or liability instruments granted. For example, the fair value of a substantive option structured as the exchange of equity shares for a nonrecourse note will differ depending on whether a granteecmployee is required to pay nonrefundable interest on the note. (718-10-30-5)

Measurement Objective – Fair Value at Grant Date

37-38. The measurement objective for equity instruments awarded to granteecemployees is to estimate the fair value at the grant date of the equity instruments that the entity is obligated to issue when grantees have delivered the good or employees have rendered the requisite service and satisfied any other
conditions necessary to earn the right to benefit from the instruments (for example, to exercise share options). That estimate is based on the share price and other pertinent factors, such as expected volatility, at the grant date. The following subparagraphs provide guidance regarding the measurement objective and measurement date for liability instruments:

a. Measurement Objective and Measurement Date for Awards Classified as Liabilities: At the grant date, the measurement objective for liabilities incurred under share-based compensation arrangements is the same as the measurement objective for equity instruments awarded to employees-grantees as described in paragraph 3738. However, the measurement date for liability instruments is the date of settlement.

b. Intrinsic Value Option Measurement Objective and Measurement Date for Awards Classified as Liabilities: of Entities Subject to Paragraph 51: An entity subject to paragraph 51A reporting entity shall make a policy decision of whether to measure all of its liabilities incurred under share-based payment arrangements at fair value or to measure all such liabilities at intrinsic value. Consistent with the guidance in paragraph 51, an entity that is not able to reasonably estimate the fair value of its equity share options and similar instruments because it is not practicable for it to estimate the expected volatility of its share price shall make a policy choice of whether to measure its liabilities under share-based payment arrangements at calculated value or at intrinsic value. An entity can make the accounting policy election in this paragraph, to change its measurement of all liability-classified awards from fair value to intrinsic value in accordance with the adoption of ASU 2016-09, Improvements to Employee Share-Based Payment Accounting (ASU 2016-09) in paragraph 143 of this statement.

38. The fair value of an equity share option or similar instrument shall be measured based on the observable market price of an option with the same or similar terms and conditions, if one is available.

39. Such market prices for equity share options and similar instruments granted in share-based payment transactions to employees are frequently not available; however, they may become so in the future. As such, the fair value of an equity share option or similar instrument shall be estimated using a valuation technique such as an option-pricing model. For this purpose, a similar instrument is one whose fair value differs from its intrinsic value, that is, an instrument that has time value. For example, a share appreciation right that requires net settlement in equity shares has time value; an equity share does not.

Factors or Restrictions that Impact the Determination of Fair Value at Grant Date

Vesting Versus Nontransferability

40. To satisfy the measurement objective in paragraph 3738, the restrictions and conditions inherent in equity instruments awarded to employees are treated differently depending on whether they continue in effect after the requisite service period or the nonemployee’s vesting period. A restriction that continues in effect after an entity has issued awards to employees, such as the inability to transfer vested equity share options to third parties or the inability to sell vested shares for a period of time, is considered in estimating the fair value of the instruments at the grant date. For equity share options and similar instruments, the effect of nontransferability (and nonhedgeability, which has a similar effect) is taken into account by reflecting the effects of grantees’ expected exercise
and postvesting employment-termination behavior in estimating fair value (referred to as an option’s expected term). (718-10-30-10)

42. On an award-by-award basis, an entity may elect to use the contractual term as the expected term when estimating the fair value of a nonemployee award to satisfy the measurement objective in paragraph 38 (718-10-30-6). Otherwise, an entity shall apply the guidance in this statement in estimating the expected term of a nonemployee award, which may result in a term less than the contractual term of the award. (718-10-30-10A)

43. When a reporting entity chooses to measure a nonemployee share-based payment award by estimating its expected term and applies the practical expedient in paragraph 53 (718-10-30-20A), it must apply the practical expedient to all nonemployee awards that meet the condition in paragraph 54 (718-10-30-20B). However, a reporting entity may still elect, on an award-by-award basis, to use the contractual term as the expected term as described in paragraph 42 (718-10-30-10A). (718-10-30-10B) (SAP Modification – Under U.S. GAAP this paragraph is limited to nonpublic entities.)

Forfeitability

44. A restriction that stems from the forfeitability of instruments to which employees have not yet earned the right, such as the inability either to exercise a nonvested equity share option or to sell nonvested shares, is not reflected in estimating the fair value of the related instruments at the grant date. Instead, those restrictions are taken into account by recognizing compensation cost only for awards for which grantees deliver the good or employees render the requisite service. (718-10-30-11)

Performance of Service Conditions

45. Awards of share-based employee compensation ordinarily specify a performance condition or a service condition (or both) that must be satisfied for a grantee an employee to earn the right to benefit from the award. No compensation cost is recognized for instruments that employees forfeited because a service condition or a performance condition is not satisfied (that is, for example, instruments for which the good is not delivered or requisite service is not rendered). (718-10-30-12)

46. The fair-value-based method described in paragraphs 37–38 and 40–441–47 (718-10-30-6 and 718-10-30-10 through 30-14) uses fair value measurement techniques, and the grant-date share price and other pertinent factors are used in applying those techniques. However, the effects on the grant-date fair value of service and performance conditions that apply only during the employee’s requisite service period or a nonemployee’s vesting period are reflected based on the outcomes of those conditions. This statement refers to the required measure as fair value. (718-10-30-13)

Market Conditions

47. Some awards contain a market condition. The effect of a market condition is reflected in the grant-date fair value of an award. (Valuation techniques have been developed to value path-dependent options as well as other options with complex terms. Awards with market conditions, as defined in this statement, are path-dependent options.) Compensation cost thus is recognized for an award with a market condition provided that the good is delivered or the requisite service is rendered, regardless of when, if ever, the market condition is satisfied. (718-10-30-14)

Market, Performance, and Service Conditions That Affect Conditions Other than Vesting or Exercisability

48. Market, performance, and service conditions (or any combination thereof) may affect an award’s exercise price, contractual term, quantity, conversion ratio, or other factors that are considered in measuring an award’s grant-date fair value. A grant-date fair value shall be estimated for each possible
outcome of such a performance or service condition, and the final measure of compensation cost shall be based on the amount estimated at the grant date for the condition or outcome that is actually satisfied. (718-10-30-15)

Nonvested or Restricted Shares

46.49. A nonvested equity share or nonvested equity share unit awarded to an employee shall be measured at its fair value as if it were vested and issued on the grant date. (718-10-30-17)

47.50. Nonvested shares granted in share-based payment transactions to employees usually are referred to as restricted shares, but this statement reserves that term for fully vested and outstanding shares whose sale is contractually or governmentally prohibited for a specified period of time. (718-10-30-18)

48.51. A restricted share awarded to a grantee employee, that is, a share that will be restricted after the grantee has a vested right to it, shall be measured at its fair value, which is the same amount for which a similarly restricted share would be issued to third parties. (718-10-30-19)

52. A reporting entity may not be able to reasonably estimate the fair value of its equity share options, nonemployee awards and similar instruments because it is not practicable for the reporting entity to estimate the expected volatility of its share price. In that situation, the entity shall account for its equity share options, nonemployee awards and similar instruments based on a value calculated using the historical volatility of an appropriate industry sector index instead of the expected volatility of the entity’s share price (the calculated value). A reporting entity’s use of calculated value shall be consistent between employee share-based payment transactions and nonemployee share-based payment transactions. Throughout the remainder of this statement, provisions that apply to accounting for share options, nonemployee awards and similar instruments at fair value also apply to calculated value. (718-10-30-19A and 20 combined) (SAP Modification – Under GAAP this guidance is for nonpublic entities.)

49.53. For an award that meets the conditions in paragraph 50 (718-10-30-20B), a reporting entity may make an entity-wide accounting policy election to estimate the expected term using the following practical expedient: (718-10-30-20A) (SAP Modification – Under GAAP this guidance is for nonpublic entities.)

   a. If vesting is only dependent upon a service condition, a reporting entity shall estimate the expected term as the midpoint between the employee’s requisite service period or the nonemployee’s vesting period and the contractual term of the award.

   b. If vesting is dependent upon satisfying a performance condition, an entity first would determine whether the performance condition is probable of being achieved.

      i. If the reporting entity concludes that the performance condition is probable of being achieved, the entity shall estimate the expected term as the midpoint between the employee’s requisite service period or the nonemployee’s vesting period and the contractual term.

      ii. If the reporting entity concludes that the performance condition is not probable of being achieved, the reporting entity shall estimate the expected term as either:

         (a) The contractual term if the service period is implied (that is, the requisite service period or the nonemployee’s vesting period is not explicitly stated but inferred based on the achievement of the performance condition at some undetermined point in the future).
The midpoint between the employee’s requisite service period or the nonemployee’s vesting period and the contractual term if the requisite service period is stated explicitly.

50.54. An reporting entity that elects to apply the practical expedient in paragraph 4953 (718-10-30-20A) shall apply the practical expedient to a share option or similar award that has all of the following characteristics: (718-10-30-20B) (SAP Modification – Under GAAP this guidance is for nonpublic entities.)

a. The share option or similar award is granted at the money.

b. The employee-grantee has only a limited time to exercise the award (typically 30-90 days) if the employee-grantee no longer provides goods or terminates service after vesting.

c. The employee-grantee can only exercise the award. The employee-grantee cannot sell or hedge the award.

d. The award does not include a market condition.

A reporting entity that elects to apply the practical expedient in paragraph 53 (718-10-30-20A) may always elect to use the contractual term as the expected term when estimating the fair value of a nonemployee award as described in paragraph 43 (718-10-30-10A). However, a reporting entity must apply the practical expedient in paragraph 53 (718-10-30-20A) for all nonemployee awards that have all the characteristics listed in this paragraph if that reporting entity does not elect to use the contractual term as the expected term and that reporting entity elects the accounting policy election to apply the practical expedient in paragraph 53 (718-10-30-20A).

Calculated Value for Entities Not Reasonably Able to Estimate Fair Value

51. (SAP Note - Moved to paragraph 52)

Difficulty of Estimation

52.55. It should be possible to reasonably estimate the fair value of most equity share options and other equity instruments at the date they are granted. However, in rare circumstances, it may not be possible to reasonably estimate the fair value of an equity share option or other equity instrument at the grant date because of the complexity of its terms. (718-10-30-21)

52.56. An equity instrument for which it is not possible to reasonably estimate fair value at the grant date shall be accounted for based on its intrinsic value (paragraph 7484) (718-20-35-1) for measurement after issue date. (718-10-30-22)

Reload and Contingent Features

54.57. The fair value of each award of equity instruments, including an award of options with a reload feature (reload options), shall be measured separately based on its terms and the share price and other pertinent factors at the grant date. The effect of a reload feature in the terms of an award shall not be included in estimating the grant-date fair value of the award. Rather, a subsequent grant of reload options pursuant to that provision shall be accounted for as a separate award when the reload options are granted. (718-10-30-23)

55.58. A contingent feature of an award that might cause a grante to return to the entity either equity instruments earned or realized gains from the sale of equity instruments earned for
consideration that is less than fair value on the date of transfer (including no consideration), such as a clawback feature shall not be reflected in estimating the grant-date fair value of an equity instrument. (718-10-30-24)

Requisite Service Period

§6.59. An entity shall make its initial best estimate of the requisite service period at the grant date (or at the service inception date, if that date precedes the grant date) and shall base accruals of compensation cost on that period. (718-10-30-25)

§2.60. The initial best estimate and any subsequent adjustment to that estimate of the requisite service period for an award with a combination of market, performance, or service conditions shall be based on an analysis of all of the following: (718-10-30-26)

a. All vesting and exercisability conditions

b. All explicit, implicit, and derived service periods

c. The probability that performance or service conditions will be satisfied.

Market, Performance, and Service Conditions

§8.61. Performance or service conditions that affect vesting are not reflected in estimating the fair value of an award at the grant date because those conditions are restrictions that stem from the forfeitability of instruments to which granteesemployees have not yet earned the right. However, the effect of a market condition is reflected in estimating the fair value of an award at the grant date (paragraph 4447) (718-10-30-14). For purposes of this statement, a market condition is not considered to be a vesting condition, and an award is not deemed to be forfeited solely because a market condition is not satisfied. (718-10-30-27)

§9.62. In some cases, the terms of an award may provide that a performance target that affects vesting could be achieved after an employee completes the requisite service period or a nonemployee satisfies a vesting period. That is, the employee-grantee would be eligible to vest in the award regardless of whether the employee-grantee is rendering service or delivering goods on the date the performance target is achieved. A performance target that affects vesting and that could be achieved after an employee’s requisite service period or a nonemployee’s vesting period shall be accounted for as a performance condition. As such, the performance target shall not be reflected in estimating the fair value of the award at the grant date. Compensation cost shall be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite-service or goods already have been providedrendered. If the performance target becomes probable of being achieved before the end of the employee’s requisite service period or the nonemployee’s vesting period, the remaining unrecognized compensation cost for which requisite-service or goods have not yet been providedrendered shall be recognized prospectively over the remaining employee’s requisite service period or the nonemployee’s vesting period. The total amount of compensation cost recognized during and after the employee’s requisite service period or the nonemployee’s vesting period shall reflect the number of awards that are expected to vest based on the performance target and shall be adjusted to reflect those awards that ultimately vest. An entity that has an accounting policy to account for forfeitures when they occur in accordance with paragraph 6267 or paragraph 71 (718-10-35-1D or 718-10-35-3) shall reverse compensation cost previously recognized, in the period the award is forfeited, for an award that is forfeited before completion of the employee’s requisite service period or the nonemployee’s vesting period. The employee’s requisite service period and the nonemployee’s vesting period ends when the granteesemployee can cease rendering service or delivering goods and still be eligible to vest in the award if the performance target is achieved. The stated
vesting period (which includes the period in which the performance target could be achieved) may differ from the employee’s requisite service period or the nonemployee’s vesting period. (718-10-30-28)

Subsequent Measurement – ASC 718-10-35

60.63. Guidance that equally applies to both liabilities and equity is generally found in paragraphs 61-7363-83 (ASC 718-10-35). Paragraphs 74-8384-94 (ASC 718-20-35) provide additional subsequent measurement guidance for awards classified as equity and paragraphs 84-8795-98 (ASC 718-30-35) provide additional subsequent measurement guidance for awards classified as liabilities.

Recognition of Nonemployee Compensation Costs

113.64. Reporting entities that grant share-based payments to non-employees a grantor shall recognize the goods acquired or services received in a share-based payment transaction with nonemployees as part of the transaction when it obtains the goods or as services are received. A grantor may need to recognize a nonadmitted prepaid asset before it actually receives goods or services if it first exchanges a share-based payment for an enforceable right to receive those goods or services. Nonetheless, the goods or services shall not be recognized before they are received. (The nonadmitted asset recognized prior to the goods and services would be eliminated upon receipt of the goods and services that are recognized.) (718-10-35-1A – used to be 505-50-25-6 – Paragraph 113 of SSAP No. 104R.) (SAP Modification – Reference nonadmitted prepaid asset.)

114.65. If fully vested, nonforfeitable equity instruments are issued granted at the date the grantor and grantee nonemployee enter into an agreement for goods or services (no specific performance is required by the grantee nonemployee to retain those equity instruments), then, because of the elimination of any obligation on the part of the counterparty nonemployee to earn the equity instruments, a measurement date has been reached. A grantor shall recognize the equity instruments when they are granted issued (in most cases, when the agreement is entered into). Whether the corresponding cost is an immediate expense or a nonadmitted prepaid asset depends on the specific facts and circumstances. A grantor may conclude that an asset (other than a note or a receivable) has been received in return for fully-vested, nonforfeitable nonemployee share-based payment award equity instruments that are issued at the date the grantor and grantee nonemployee enter into an agreement for goods or services (and no specific performance is required by the grantee nonemployee in order to retain those equity instruments). Such an asset shall not be displayed as contra-equity by the grantor of the equity instrument. The transferability (or lack thereof) of the award equity instruments shall not affect the balance sheet display of this nonadmitted prepaid asset. This guidance is limited to transactions in which award equity instruments are transferred to nonemployees other than employees in exchange for goods or services. (718-10-35-1B, moved from 505-50-25-7 and 718-10-45-3 – Paragraph 114 in SSAP No. 104R) (SAP Modification – Reference nonadmitted prepaid asset.)

115.66. An entity may grant fully vested, nonforfeitable equity instruments that are exercisable by the nonemployee grantee only after a specified period of time if the terms of the agreement provide for earlier exercisability if the grantee nonemployee achieves specified performance conditions. Any measured cost of the transaction shall be recognized in the same period(s) and in the same manner as if the entity had paid cash for the goods or services or used cash rebates as a sales discount instead of paying with, or using, the share-based payment award equity instruments. (718-10-35-1C, moved from 505-50-25-8 – Paragraph 115 in SSAP No. 104R)

67. The total amount of compensation cost recognized for share-based payment awards to nonemployees shall be based on the number of instruments for which a good has been delivered or a service has been rendered. To determine the amount of compensation cost to be recognized in each period, an entity shall make an entity-wide accounting policy election for all nonemployee share-based payment awards to do either of the following: (New 718-10-35-1D)
a. Estimate the number of forfeitures expected to occur. The entity shall base initial accruals of compensation cost on the estimated number of nonemployee share-based payment awards for which a good is expected to be delivered or service is expected to be rendered. The entity shall revise that estimate if subsequent information indicates that the actual number of instruments is likely to differ from previous estimates. The cumulative effect on current and prior periods of a change in the estimates shall be recognized in compensation cost in the period of the change.

b. Recognize the effect of forfeitures in compensation cost when they occur. Previously recognized compensation cost for a nonemployee share-based payment award shall be reversed in the period that the award is forfeited.

116.68. A recognized nonadmitted prepaid asset or expense, or sales discount shall not be reversed if a stock option that the nonemployee counterparty has the right to exercise expires unexercised. As noted in paragraph 117, the goods and services shall not be recognized before they are received. (718-10-35-1E, moved from 505-50-25-9 - Paragraph 116 in SSAP No. 104R) (SAP Modification – Reference nonadmitted prepaid asset.)

117.69. A grantor shall recognize either a corresponding increase in equity or a liability, depending on whether the instruments granted satisfy the equity or liability classification criteria established in paragraphs 14-2715-29 (718-10-25-6 through 25-19A) for employee share-based payments. As the goods or services are disposed of or consumed, the grantor shall recognize the related cost, unless other statutory accounting principles require costs to be expensed when incurred. In these instances, when the goods or services are received, the grantor shall recognize the related cost. (718-10-35-1F, moved from 505-50-25-10 – Paragraph 117 of SSAP No. 104R)

Recognition of Employee Compensation Costs Over the Requisite Service

61.70. The compensation cost for an award of share-based employee compensation classified as equity shall be recognized over the requisite service period, with a corresponding credit to equity (generally, paid-in capital). The requisite service period is the period during which an employee is required to provide service in exchange for an award, which often is the vesting period. The requisite service period is estimated based on an analysis of the terms of the share-based payment award. (718-10-35-2)

62.71. The total amount of compensation cost recognized at the end of the requisite service period for an award of share-based compensation shall be based on the number of instruments for which the requisite service has been rendered (that is, for which the requisite service period has been completed). Previously recognized compensation cost shall not be reversed if an employee share option (or share unit) for which the requisite service has been rendered expires unexercised (or unconverted). To determine the amount of compensation cost to be recognized in each period, an entity shall make an entity-wide accounting policy election for all employee share-based payment awards to do either of the following: (718-10-35-3)

a. Estimate the number of awards for which the requisite service will not be rendered (that is, estimate the number of forfeitures expected to occur). The entity shall base initial accruals of compensation cost on the estimated number of instruments for which the requisite service is expected to be rendered. The entity shall revise that estimate if subsequent information indicates that the actual number of instruments is likely to differ from previous estimates. The cumulative effect on current and prior periods of a change in the estimated number of instruments for which the requisite service is expected to be or has been rendered shall be recognized in compensation cost in the period of the change.
b. Recognize the effect of awards for which the requisite service is not rendered when the award is forfeited (that is, recognize the effect of forfeitures in compensation cost when they occur). Previously recognized compensation cost for an award shall be reversed in the period that the award is forfeited.

63.72. An entity shall reverse previously recognized compensation cost for an award with a market condition only if the requisite service is not rendered. (718-10-35-4)

Estimating the Requisite Service Period

64.73. The requisite service period for employee awards may be explicit or it may be implicit, being inferred from an analysis of other terms in the award, including other explicit service or performance conditions. The requisite service period for an award that contains a market condition can be derived from certain valuation techniques that may be used to estimate grant-date fair value. An award may have one or more explicit, implicit, or derived service periods; however, an award may have only one requisite service period for accounting purposes unless it is accounted for as in-substance multiple awards. An award with a graded vesting schedule that is accounted for as in-substance multiple awards is an example of an award that has more than one requisite service period (paragraph 6776) (718-10-35-8). (718-10-35-5)

65.74. The service inception date is the beginning of the requisite service period. If the service inception date precedes the grant date, accrual of compensation cost for periods before the grant date shall be based on the fair value of the award at the reporting date. In the period in which the grant date occurs, cumulative compensation cost shall be adjusted to reflect the cumulative effect of measuring compensation cost based on fair value at the grant date rather than the fair value previously used at the service inception date (or any subsequent reporting date). (718-10-35-6)

66.75. An entity shall adjust that initial best estimate in light of changes in facts and circumstances. Whether and how the initial best estimate of the requisite service period is adjusted depends on both the nature of the conditions identified in paragraph 5760 (718-10-30-26) and the manner in which they are combined, for example, whether an award vests or becomes exercisable when either a market or a performance condition is satisfied or whether both conditions must be satisfied. (718-10-35-7)

Graded Vesting Awards

67.76. An entity shall make a policy decision about whether to recognize compensation cost for an employee award with only service conditions that has a graded vesting schedule in either of the following ways: (718-10-35-8)

a. On a straight-line basis over the requisite service period for each separately vesting portion of the award as if the award was, in-substance, multiple awards.

b. On a straight-line basis over the requisite service period for the entire award (that is, over the requisite service period of the last separately vesting portion of the award).

However, the amount of compensation cost recognized at any date must at least equal the portion of the grant-date value of the award that is vested at that date.

Awards May Become Subject to Other Guidance

68.77. Paragraphs 69-7279-82 (718-10-35-10 through 35-14) are intended to apply to those instruments issued in share-based payment transactions with employees and nonemployees accounted for under this statement, and to instruments exchanged in a business combination for share-based payment awards of the acquired business that were originally granted to employees of the acquired business and are outstanding as of the date of the business combination. Instruments issued, in whole or in part, as
consideration for goods or services other than employee service shall not be considered to have been issued in exchange for employee service when applying the guidance in those paragraphs, irrespective of the employment status of the recipient of the award on the grant date. (718-10-35-9)

78. A convertible instrument award granted to a nonemployee in exchange for goods or services to be used or consumed in a grantor’s own operations is subject to recognition and measurement guidance in this statement until the award is fully vested. Once vested, a convertible instrument award that is equity in form, or debt in form, that can be converted into equity instruments of the grantor, shall follow recognition and measurement through reference to other applicable statutory accounting guidance. (718-10-35-9A) (SAP Modification – Reference SAP instead of GAAP.)

69.79. A freestanding financial instrument issued to a grantee employee in exchange for goods past or future employee services received (or to be received) that is subject to initial recognition and measurement guidance within this statement shall continue to be subject to the recognition and measurement provisions of this statement throughout the life of the instrument, unless its terms are modified when the holder-after a nonemployee vests in the award and is no longer providing goods or services, or a grantee is no longer an employee. Only for purposes of this paragraph, a modification does not include a change to the terms of an award if that change is made solely to reflect an equity restructuring provided that both of the following conditions are met: (718-10-35-10)

   a. There is no increase in fair value of the award (or the ratio of intrinsic value to the exercise price of the award is preserved, that is, the holder is made whole) or the antidilution provision is not added to the terms of the award in contemplation of an equity restructuring.

   b. All holders of the same class of equity instruments (for example, stock options) are treated in the same manner.

70.80. Other modifications of that instrument that take place when the holder-after a nonemployee vests in the award and is no longer providing goods or services, or a grantee is no longer an employee shall be subject to the modification guidance in paragraph 7282 (718-10-35-14). Following modification, recognition and measurement of the instrument shall be determined through reference to other applicable statutory accounting principles. (718-10-35-11) (SAP Modification – Reference SAP instead of GAAP.)

71.81. Once the classification of an instrument is determined, the recognition and measurement provisions of this statement shall be applied until the instrument ceases to be subject to the requirements discussed in paragraph 6979 (718-10-35-10). Other applicable statutory accounting principles apply to a freestanding financial instrument that was issued under a share-based payment arrangement but that is no longer subject to this statement. This guidance is not intended to suggest that all freestanding financial instruments shall be accounted for as liabilities, but rather that freestanding financial instruments issued in share-based payment transactions may become subject to other applicable statutory accounting principles depending of their substantive characteristics and when certain criteria are met. (718-10-35-12 – Note the new language was not newly added, but wasn’t included in SSAP No. 104R.) SAP Modification – Reference SAP instead of GAAP.

72.82. An entity may modify (including cancel and replace) or settle a fully vested, freestanding financial instrument after it becomes subject to other applicable statutory accounting principles. Such a modification or settlement shall be accounted for under the provisions of this statement unless it applies equally to all financial instruments of the same class regardless of whether the holder of the financial instrument is (or was) an employee (or an employee’s beneficiary). Following the modification, the instrument continues to be accounted for under other applicable statutory accounting principles. A modification or settlement of a class of financial instrument that is designed exclusively for and held only
by grantees current or former employees (or their beneficiaries) may stem from the employment or vendor relationship depending on the terms of the modification or settlement. Thus, such a modification or settlement may be subject to the requirements of this statement. See paragraph 6979 (718-10-35-10) for a discussion of changes to awards made solely to reflect an equity restructuring. (718-10-35-14)

Change in Classification Due to Change in Probable Settlement Outcome

73.83. An option or similar instrument that is classified as equity, but subsequently becomes a liability because the contingent cash settlement event is probable of occurring, shall be accounted for similar to a modification from an equity to liability award. That is, on the date the contingent event becomes probable of occurring (and therefore the award must be recognized as a liability), the entity recognizes a share-based liability equal to the portion of the award attributed to past performance service (which reflects any provision for acceleration of vesting) multiplied by the award's fair value on that date. To the extent the liability equals or is less than the amount previously recognized in equity, the offsetting debit is a charge to equity. To the extent that the liability exceeds the amount previously recognized in equity, the excess is recognized as compensation cost. The total recognized compensation cost for an award with a contingent cash settlement feature shall at least equal the fair value of the award at the grant date. The guidance in this paragraph is applicable only for options or similar instruments issued as part of employee compensation arrangements. That is, the guidance included in this paragraph is not applicable, by analogy or otherwise, to instruments outside employee share-based payment arrangements. (718-10-35-15)

Subsequent Measurement - Awards Classified as Equity (718-20)

Fair Value Not Reasonably Estimable

74.84. An equity instrument for which it is not possible to reasonably estimate fair value at the grant date shall be remeasured at each reporting date through the date of exercise or other settlement. The final measure of compensation cost shall be the intrinsic value of the instrument at the date it is settled. Compensation cost for each period until settlement shall be based on the change (or a portion of the change, depending on the percentage of the requisite service that has been rendered for an employee award or the percentage that would have been recognized had the grantor paid cash for the goods or services instead of paying with a nonemployee award at the reporting date) in the intrinsic value of the instrument in each reporting period. The entity shall continue to use the intrinsic value method for those instruments even if it subsequently concludes that it is possible to reasonably estimate their fair value. (718-20-35-1)

Contingent Features

75.85. A contingent feature of an award that might cause an employee a grantee to return to the entity either equity instruments earned or realized gains from the sale of equity instruments earned for consideration that is less than fair value on the date of transfer (including no consideration), such as a clawback feature, shall be accounted for if and when the contingent event occurs. (718-20-35-2)

Modification of An Award

86. An entity shall account for the effects of a modification as described in paragraphs 76-7987-94, (718-20-35-3 through 35-9) unless all of the following are met: (718-20-35-2A) (SAP Note – Moved from paragraph 28)

   a. The fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the original award immediately before the original award is modified. If the modification does not affect any
of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification.

b. The vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified.

c. The classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified.

The disclosure requirements in paragraph 113 (718-10-50-1 through 50-2A and 718-10-50-4) apply regardless of whether an entity is required to apply modification accounting.

76.87. Except as described in paragraph 86, (718-20-35-2A) A modification of the terms or conditions of an equity award shall be treated as an exchange of the original award for a new award. In substance, the entity repurchases the original instrument by issuing a new instrument of equal or greater value, incurring additional compensation cost for any incremental value. The effects of a modification shall be measured as follows: (718-20-35-3)

a. Incremental compensation cost shall be measured as the excess, if any, of the fair value of the modified award determined in accordance with the provisions of this statement over the fair value of the original award immediately before its terms are modified, measured based on the share price and other pertinent factors at that date. As indicated in paragraph 54-52 (718-10-30-20), references to fair value throughout this statement shall be read also to encompass calculated value. The effect of the modification on the number of instruments expected to vest also shall be reflected in determining incremental compensation cost. The estimate at the modification date of the portion of the award expected to vest shall be subsequently adjusted, if necessary, in accordance with paragraph 6267 or 70 (718-10-35-1D or 718-10-35-3).

b. Total recognized compensation cost for an equity award shall at least equal the fair value of the award at the grant date unless at the date of the modification the performance or service conditions of the original award are not expected to be satisfied. Thus, the total compensation cost measured at the date of a modification shall be the sum of the following:

i. The portion of the grant-date fair value of the original award for which the promised good is expected to be delivered (or has already been delivered) or the requisite service is expected to be rendered (or has already been rendered) at that date, and

ii. The incremental cost resulting from the modification.

Compensation cost shall be subsequently adjusted, if necessary, in accordance with paragraph 6267 or 70 (718-10-35-1D or 718-10-35-3).

c. A change in compensation cost for an equity award measured at intrinsic value in accordance with paragraph 7484 (718-20-35-1) shall be measured by comparing the intrinsic value of the modified award, if any, with the intrinsic value of the original award, if any, immediately before the modification.

77.88. An entity that has an accounting policy to account for forfeitures when they occur in accordance with paragraph 6267 or 70 (718-10-35-1D or 718-10-35-3) shall assess at the date of the modification
whether the performance or service conditions of the original award are expected to be satisfied when measuring the effects of the modification in accordance with paragraph 76. However, the entity shall apply its accounting policy to account for forfeitures when they occur when subsequently accounting for the modified award. (718-20-35-3A)

Paragraphs 68-72; 77-82 (718-10-35-9 through 35-14) provide additional guidance on accounting for modifications of certain freestanding financial instruments that initially were subject to this statement but subsequently became subject to other applicable statutory accounting principles. (718-20-35-4)

Short-Term Inducements

Except as described in paragraph 2886 (718-20-35-2A), a short-term inducement shall be accounted for as a modification of the terms of only the awards of employees-grantees who accept the inducement, and other inducements shall be accounted for as modifications of the terms of all awards subject to them. (718-20-35-5)

Equity Restructuring or Business Combination

Exchanges of share options or other equity instruments or changes to their terms in conjunction with an equity restructuring or a business combination are modifications for purposes of this statement. An entity shall apply the guidance in paragraph 2886 (718-20-35-2A) to those exchanges or changes to determine whether it shall account for the effects of those modifications. See paragraph 69-79 (718-10-35-10) for an additional exception. (718-20-35-6)

Repurchase or Cancellation

The amount of cash or other assets transferred (or liabilities incurred) to repurchase an equity award shall be charged to equity, to the extent that the amount paid does not exceed the fair value of the equity instruments repurchased at the repurchase date. Any excess of the repurchase price over the fair value of the instruments repurchased shall be recognized as additional compensation cost. An entity that repurchases an award for which the promised goods have not been delivered or the requisite service has not been rendered has, in effect, modified the employee’s requisite service period or nonemployee’s vesting period to the period for which goods have already been delivered or service already has been rendered, and thus the amount of compensation cost measured at the grant date but not yet recognized shall be recognized at the repurchase date. (718-20-35-7)

Cancellation and Replacement

Except as described in paragraph 2886 (718-20-35-2A), cancellation of an award accompanied by the concurrent grant of (or offer to grant) a replacement award or other valuable consideration shall be accounted for as a modification of the terms of the cancelled award. (The phrase offer to grant is intended to cover situations in which the service inception date precedes the grant date.) Therefore, incremental compensation cost shall be measured as the excess of the fair value of the replacement award or other valuable consideration over the fair value of the cancelled award at the cancellation date in accordance with paragraph 7687 (718-20-35-3). Thus, the total compensation cost measured at the date of a cancellation and replacement shall be the portion of the grant-date fair value of the original award for which the promised good is expected to be delivered (or has already been delivered) or the requisite service is expected to be rendered (or has already been rendered) at that date plus the incremental cost resulting from the cancellation and replacement. (718-30-35-8)

A cancellation of an award that is not accompanied by the concurrent grant of (or offer to grant) a replacement award or other valuable consideration shall be accounted for as a repurchase for no consideration. Accordingly, any previously unrecognized compensation cost shall be recognized at the cancellation date. (718-20-35-9)
Subsequent Measurement - Awards Classified as Liabilities - (718-30)

Measurement

84.95. The fair value of liabilities incurred in share-based payment transactions with employees shall be remeasured at the end of each reporting period through settlement. (718-30-35-1)

85.96. Changes in the fair value (or intrinsic value for an reporting entity that elects that method) of a liability incurred under a share-based payment arrangement that occur during the employee’s requisite service period or the nonemployee’s vesting period shall be recognized as compensation cost over that period. The percentage of the fair value (or intrinsic value) that is accrued as compensation cost at the end of each period shall equal the percentage of the requisite service that has been rendered for an employee award or the percentage that would have been recognized had the grantor paid cash for the goods or services instead of paying with a nonemployee award at that date. Changes in the fair value (or intrinsic value) of a liability that occur after the end of the employee’s requisite service period or the nonemployee’s vesting period are compensation costs of the period in which the changes occur. Any difference between the amount for which a liability award is settled and its fair value at the settlement date as estimated in accordance with the provisions of this statement is an adjustment of compensation cost in the period of settlement. (718-30-35-2) (SAP Modification – Under GAAP intrinsic value is for nonpublic entities)

86.97. Reporting entities shall measure a liability award under a share-based payment arrangement based on the award’s fair value (or calculated permitted value in accordance with paragraph 52) remeasured at each reporting date until the date of settlement. Compensation costs for each period until settlement shall be based on the change (or a portion of the change, depending on the percentage of the requisite service that has been rendered for an employee award or the percentage that would have been recognized had the grantor paid cash for the goods and services instead of paying with a nonemployee award at the reporting date) in the fair value of the instrument for each reporting period. (718-30-35-3 & 35-4 combined) (SAP Modification – Under GAAP the provisions of paragraph 52 are only permitted for nonpublic entities.)

Modification of an Award

87.98. A modification of a liability award is accounted for as the exchange of the original award for a new award. However, because liability awards are remeasured at their fair value (or calculated value for an entity subject to paragraph 52) at each reporting date, no special guidance is necessary in accounting for a modification of a liability award that remains a liability after the modification. (718-30-35-5)

LOOK BACK PLANS

88. The accounting guidance in this section addresses the accounting for certain employee stock purchase plans with a look-back option. An example of a look-back option is a provision that establishes the purchase price as an amount based on the lesser of the stock’s market price at the grant date or its market price at the exercise date (or purchase date).

89. As with all employee share purchase plans, the objective of the measurement process for employee share purchase plans with a look-back option is to reasonably measure fair value of the award at the grant date. Paragraph 74 provides guidance on the measurement requirements if it is not possible to reasonably estimate fair value at the grant date.
Accounting for Tax Effects of Share-Based Compensation Awards Arrangements – (718-740)

90.99. Income tax regulations specify allowable tax deductions for instruments issued under share-based payment arrangements in determining an entity’s income tax liability. For example, under tax law, allowable tax deductions may be measured as the intrinsic value of an instrument on a specified date. The time value component, if any, of the fair value of an instrument generally may not be tax deductible. Therefore, tax deductions may arise in different amounts and in different periods from compensation costs recognized in financial statements. Similarly, the amount of expense reported for an employee stock ownership plan during a period may differ from the amount of the related income tax deduction prescribed by income tax rules and regulations. (718-740-05-4)

91.100. This guidance addresses how temporary differences are recognized for share-based payment arrangement awards that are classified either as equity or as liabilities under the requirements of paragraphs 14-2716-29 (718-10-25-7 through 25-19A). Incremental guidance is also provided for issues related to employee stock ownership plans. (714-740-25-1)

Tax Effects for Instruments Classified as Equity

92.101. The cumulative amount of compensation cost recognized for instruments classified as equity that ordinarily would result in a future tax deduction under existing tax law shall be considered to be a deductible temporary difference in applying the requirements of SSAP No. 101—Income Taxes (SSAP No. 101). The deductible temporary difference shall be based on the compensation cost recognized for financial reporting purposes. Compensation cost that is capitalized as part of the cost of an asset, such as inventory, shall be considered to be part of the tax basis of that asset for financial reporting purposes. (718-740-25-2)

93.102. Recognition of compensation cost for instruments that ordinarily do not result in tax deductions under existing tax law shall not be considered to result in a deductible temporary difference. A future event can give rise to a tax deduction for instruments that ordinarily do not result in a tax deduction. The tax effects of such an event shall be recognized only when it occurs. An example of a future event that would be recognized only when it occurs is an employee's sale of shares obtained from an award before meeting a tax law's holding period requirement, sometimes referred to as a disqualifying disposition, which results in a tax deduction not ordinarily available for such an award. (718-740-25-3)

Tax Effects for Instruments Classified as Liability

94.103. The cumulative amount of compensation cost recognized for instruments classified as liabilities that ordinarily would result in a future tax deduction under existing tax law also shall be considered to be a deductible temporary difference. The deductible temporary difference shall be based on the compensation costs recognized for financial reporting purposes. (718-740-25-4)

Accounting for Tax Effects

104. The deferred tax benefit (expense) that results from increases (or decreases) in the recognized share-based payment temporary difference, for example, an increase that results as additional service is rendered and the related cost is recognized or a decrease that results from forfeiture of an award, shall be recognized in the income statement. (718-740-30-1)

95.105. SSAP No. 101 requires a deferred tax asset to be evaluated for future realization and to be reduced by a statutory valuation allowance if, based on the weight of the available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized. Differences between the deductible temporary difference computed pursuant to paragraphs 101-10292-93 (718-740-25-2 through 25-3) and the tax deduction that would result based on the current fair value of the entity’s shares shall not be considered in measuring the gross deferred tax asset or
determining the need for a valuation allowance for a deferred tax asset recognized under these requirements. (718-740-30-2) (SAP Note – Changes match SSAP No. 101 and GAAP)

96.106. The tax effect of the difference, if any, between the cumulative compensation cost of an award recognized for financial reporting purposes and the deduction for an award for tax purposes shall be recognized as income tax expense or benefit in the income statement. The tax effect shall be recognized in the period in which the amount of the deduction is determined, which is typically when an award is exercised, or expired, in the case of share options, or vests in the case of nonvested stock awards, tax deduction arises or, in the case of an expiration of an award, in the period in which the expiration occurs. The appropriate period depends on the type of award and the guidance in SSAP No. 101. (718-740-35-2)

Tax Benefits of Dividends on Share-Based Payments

97.107. An income tax benefit from dividends or dividend equivalents that are charged to unassigned-funds (surplus) and are paid to employees for any of the following equity classified awards shall be recognized as an income tax expense or benefit in the income statement: (718-740-45-8)

a. Nonvested equity shares

b. Nonvested equity share units

c. Outstanding equity share options.

Accounting for Rabbi Trusts

108. This section addresses the accounting for deferred compensation arrangements where amounts earned by an employee are invested in the stock of the employer and placed in a rabbi trust. Certain of these of those plans allow the employee to immediately diversify into nonemployer securities or to diversify after a holding period (for example, six months); other plans do not allow for diversification. The deferred compensation obligation of some plans may be settled in any of the following: (718-10-05-8 and 718-10-05-9)

a. Cash, by having the trust sell the employer stock (or the diversified assets) in the open market.

b. Shares of the employer’s stock

c. Diversified Assets

In other plans, the deferred compensation obligation may be settled only by the delivery of the shares of the employer stock.

109. The guidance in this section addresses the accounting for deferred compensation that have characteristics in paragraphs 109a or 109b. This section does not address the accounting for stock appreciation rights, even if they are funded through a rabbi trust. (718-10-15-8)

a. If amounts earned by an employee are invested in the stock of the employer and placed in a rabbi trust.

b. Where the employee elects to diversify the assets held by the rabbi trust into nonemployer securities.

98.110. Rabbi trusts are grantor trusts generally set up to fund compensation for a select group of management or highly paid executives. To qualify as a rabbi trust for income tax purposes, the terms of
the trust agreement must explicitly state that the assets of the trust are available to satisfy the claims of general creditors in the event of bankruptcy of the employer. (GAAP Definition)

90.111. The following are the four types of deferred compensation arrangements involving rabbi trusts covered in this guidance: There are four potential scenarios for deferred compensation arrangements where amounts earned by an employee are invested in the stock of the employer and placed in a “rabbi trust.” (718-10-25-15)

Plan A: The plan does not permit diversification and must be settled by the delivery of a fixed number of shares of employer stock.

Plan B: The plan does not permit diversification and may be settled by the delivery of cash or shares of employer stock.

Plan C: The plan permits diversification; however, the employee has not diversified (the plan may be settled in cash, shares of employer stock, or diversified assets).

Plan D: The plan permits diversification and the employee has diversified (the plan may be settled in cash, shares of employer stock, or diversified assets).

400.112. The accounts of the rabbi trust should be consolidated with the accounts of the employer in the financial statements of the employer. (710-10-45-1)

a. For Plan A, employer stock held by the rabbi trust should be classified in equity in a manner similar to the manner in which treasury stock is accounted for. Subsequent changes in the fair value of the employer's stock should not be recognized. The deferred compensation obligation should be classified as an equity instrument and changes in the fair value of the amount owed to the employee should not be recognized. (710-10-25-16 and 718-10-35-2)

b. For Plans B and C, employer stock held by the rabbi trust should be classified in equity in a manner similar to the manner in which treasury stock is accounted for. Subsequent changes in the fair value of the employer's stock should not be recognized. The deferred compensation obligation should be classified as a liability and adjusted with a corresponding charge (or credit) to compensation cost, to reflect the changes in the fair value of the amount owed to the employee. (710-10-25-17 and 718-10-35-3)

c. For Plan D, assets held by the rabbi trust should be accounted for in accordance with statutory accounting principles for the particular asset (for example, if the diversified asset is a marketable unaffiliated common stock equity security, that security would be accounted for in accordance with SSAP No. 30). The deferred compensation obligation should be classified as a liability and adjusted, with a corresponding charge (or credit) to compensation cost, to reflect changes in the fair value of the amount owed to the employee. Changes in the fair value of the deferred compensation obligation should not be recorded in unrealized gains or losses, even if changes in the fair value of the assets held by the rabbi trust are recorded in surplus pursuant to SSAP No. 30—Unaffiliated Common Stock. (710-10-25-18, 710-10-35-4 and 710-10-45-2) SAP Mod on Common Stock and reporting lines.

Disclosures – Employee Share-Based Payments

404.113. An entity with one or more share-based payment arrangements shall disclose information that enables users of the financial statements to understand all of the following: (718-10-50-1)
a. The nature and terms of such arrangements that existed during the period and the potential effects of those arrangements on shareholders;

b. The effect of compensation costs arising from share-based payment arrangements on the income statement;

c. The method of estimating the fair value of the goods or services received, or the fair value of the equity instruments granted (or offered to grant), during the period; and

d. The cash flow effects resulting from share-based payment arrangements.

102.114. The disclosures in paragraph 101-113 are for annual audited statutory financial statements only. This statement adopts FASB Codification 718-10-50-2 for the minimum disclosure information needed to achieve the objective in paragraph 113, noting that a reporting entity may need to disclose additional information to achieve the objectives. Exhibit B illustrates the information needed to achieve the objectives in this paragraph. (Staff Note – NAIC staff proposes to remove Exhibit B and just refer to the GAAP guidance for these annual audited disclosures.)

Employee Share Purchase Plans (718-50)-Based Payments – Noncompensatory Plans

Overview and Background

103.115. This section provides guidance to all entities that use employee share purchase plans. The entity must first determine whether the plan is compensatory or noncompensatory. This is determined by the terms of the plan (paragraphs 104-105116-117) (718-20-25-1 through 25-2). A plan with an option feature, for example a look-back feature, is considered compensatory. (This section on employee share purchase plans has its own discrete scope, which is separate and distinct from the pervasive scope.) (718-50-05-1, 718-50-15-1)

Recognition

104.116. An employee share purchase plan that satisfies all of the following criteria does not give rise to recognizable compensation costs (that is, the plan is noncompensatory): (718-50-25-1)

a. The plan satisfies either of the following conditions:

i. The terms of the plan are no more favorable than those available to all holders of the same class of shares. Note that a transaction subject to an employee share purchase plan that involves a class of equity shares designed exclusively for and held only by current or former employees or their beneficiaries may be compensatory depending on the terms of the arrangement.

ii. Any purchase discount from the market price does not exceed the per-share amount of share issuance costs that would have been incurred to raise a significant amount of capital by a public offering. A purchase discount of 5 percent or less from the market price shall be considered to comply with this condition without further justification. A purchase discount greater than 5 percent that cannot be justified under this condition results in compensation cost for the entire amount of the discount. Note that an entity that justifies a purchase discount in excess of 5 percent shall reassess at least annually, and no later than the first share purchase offer during the fiscal year, whether it can continue to justify that discount pursuant to this paragraph.
b. Substantially all employees that meet limited employment qualifications may participate on an equitable basis.

c. The plan incorporates no option features, other than the following:

i. Employees are permitted a short period of time—not exceeding 31 days—after the purchase price has been fixed to enroll in the plan.

ii. The purchase price is based solely on the market price of the shares at the date of purchase, and employees are permitted to cancel participation before the purchase date and obtain a refund of amounts previously paid (such as those paid by payroll withholdings).

405.117. A plan provision that establishes the purchase price as an amount based on the lesser of the equity share’s market price at date of grant or its market price at date of purchase, commonly called a look-back plan, is an example of an option feature that causes the plan to be compensatory. Similarly, a plan in which the purchase price is based on the share’s market price at date of grant and that permits a participating employee to cancel participation before the purchase date and obtain a refund of amounts previously paid contains an option feature that causes the plan to be compensatory. (718-50-25-2)

406.118. The requisite service period for any compensation cost resulting from an employee share purchase plan is the period over which the employee participates in the plan and pays for the shares. (718-50-25-3)

Initial Measurement

407.119. The objective in paragraph 37 also applies to the fair value measurements associated with grants under a compensatory employee share purchase plan. The objective in this paragraph, Paragraph 38 (718-10-30-6), states that the objective of the fair value measurement method is to estimate the fair value of the equity instruments, based on the share price and other measurement assumptions at the grant date, that are issued in exchange for providing goods or rendering services. Estimating the fair value of equity instruments at the grant date, which are issued in exchange for employee services, also applies to the fair value measurements associated with grants under a compensatory employee share purchase plan. (718-50-30-1)

Look-Back Plans

120. Many employee share purchase plans with a look-back option have differing features. For example, some plans contain multiple purchase periods, other contain reset mechanisms, and still others allow changes in the withholding amounts or percentages after the grant date. In some circumstances, applying the measurement approaches described in this section may not be practicable for certain types of employee share purchase plans. Paragraph 56 (718-20-35-1) provides guidance on the measurement requirements if it is not possible to reasonable estimate fair value at the grant date. (718-50-30-2 and 30-3)

SAP Mod – Did not include example features from GAAP.

Subsequent Measurement

408.121. Changes in total employee withholdings during a purchase period that occur solely as a result of salary increases, commissions, or bonus payments are not plan modifications if they do not represent changes to the terms of the award that was offered by the employer and initially agreed to by the employee at the grant (or measurement) date. Under those circumstances, the only incremental compensation cost is that which results from the additional shares that may be purchased with the additional amounts withheld (using the fair value calculated at the grant date). For example, an employee may elect to participate in the plan on the grant date by requesting that 5 percent of the employee's annual...
salary be withheld for future purchases of stock. If the employee receives an increase in salary during the term of the award, the base salary on which the 5 percent withholding amount is applied will increase, thus increasing the total amount withheld for future share purchases. That increase in withholdings as a result of the salary increase is not considered a plan modification and thus only increases the total compensation cost associated with the award by the grant date fair value associated with the incremental number of shares that may be purchased with the additional withholdings during the period. The incremental number of shares that may be purchased is calculated by dividing the incremental amount withheld by the exercise price as of the grant date (for example, 85 percent of the grant date stock price). (718-50-35-1)

Any decreases in the withholding amounts (or percentages) shall be disregarded for purposes of recognizing compensation cost unless the employee services that were valued at the grant date will no longer be provided to the employer due to a termination. However, no compensation cost shall be recognized for awards that an employee forfeits because of failure to satisfy a service requirement for vesting. The accounting for decreases in withholdings is consistent with the requirement in paragraph 59 that the total amount of compensation cost that must be recognized for an award be based on the number of instruments for which the requisite service has been rendered (that is, for which the requisite service period has been completed). (718-50-35-2)

Employee Share-Based Payments – Consolidated / Holding Company Plans

Except for the disclosure requirement in paragraph 411.124, the provisions of this statement do not apply to a reporting entity, as long as:

a. The reporting entity is not directly liable for obligations under the share-based payment plan.

b. Compensation costs associated with share-based payments provided by a related party or holder of an economic interest in the reporting entity, equal to the required contribution to the plan for the period, are included in allocated expenses to the reporting entity. A liability shall be established for any such contributions due and unpaid.

The reporting entity shall disclose in the financial statements that its employees participate in a plan sponsored by the holding company for which the reporting entity has no legal obligation. The amount of the expense incurred and the allocation methodology utilized by the provider of such benefits shall also be disclosed.

If the reporting entity is directly liable for the share-based payment plan, then the other provisions of this statement apply.

NON-EMPLOYEE SHARE-BASED PAYMENTS

Reporting entities that grant share-based payments to non-employees shall recognize the goods acquired or services received as part of the transaction when it obtains the goods or as services are received. A grantor may need to recognize a nonadmitted prepaid asset before it actually receives goods or services if it first exchanges share-based payment for an enforceable right to receive those goods or services. Nonetheless, the goods or services shall not be recognized before they are received. (The nonadmitted asset recognized prior to the goods and services would be eliminated upon receipt of the goods and services that are recognized.)

If fully vested, nonforfeitable equity instruments are issued at the date the grantor and grantee enter into an agreement for goods or services (no specific performance is required by the grantee to retain those equity instruments), then, because of the elimination of any obligation on the part of the counterparty to earn the equity instruments, a measurement date has been reached. A grantor shall
recognize the equity instruments when they are issued (in most cases, when the agreement is entered into). Whether the corresponding cost is an immediate expense or a nonadmitted prepaid asset depends on the specific facts and circumstances. A grantor may conclude that an asset (other than a note or a receivable) has been received in return for fully-vested, nonforfeitable equity instruments that are issued at the date the grantor and grantee enter into an agreement for goods or services (and no specific performance is required by the grantee in order to retain those equity instruments). Such an asset shall not be displayed as contra-equity by the grantor of the equity instrument. The transferability (or lack thereof) of the equity instruments shall not affect the balance sheet display of this nonadmitted prepaid asset. This guidance is limited to transactions in which equity instruments are transferred to other than employees in exchange for goods or services.

115. An entity may grant fully vested, nonforfeitable equity instruments that are exercisable by the grantee only after a specified period of time if the terms of the agreement provide for earlier exercisability if the grantee achieves specified performance conditions. Any measured cost of the transaction shall be recognized in the same period(s) and in the same manner as if the entity had paid cash for the goods or services or used cash rebates as a sales discount instead of paying with, or using, the equity instruments.

116. A recognized nonadmitted prepaid asset, expense, or sales discount shall not be reversed if a stock option that the counterparty has the right to exercise expires unexercised. As noted in paragraph 117, the goods and services shall not be recognized before they are received.

117. A grantor shall recognize either a corresponding increase in equity or a liability, depending on whether the instruments granted satisfy the equity or liability classification criteria established in paragraphs 14–27 for employee share-based payments. As the goods or services are disposed of or consumed, the grantor shall recognize the related cost, unless other statutory accounting principles require costs to be expensed when incurred. In these instances, when the goods or services are received, the grantor shall recognize the related cost.

Initial Measurement—Reporting Entity Grantor/Issuer

118. Share-based payment transactions with non-employees shall be measured at the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable.

119. The accounting for all share-based payment transactions shall reflect the rights conveyed to the holder of the instruments and the obligations imposed on the issuer of the instruments, regardless of how those transactions are structured. The terms of a share-based payment award and any related arrangement affect its value and, except for certain explicitly excluded features, such as a reload feature, shall be reflected in determining the fair value of the equity or liability instruments granted. Assessment of both the rights and obligations in a share-based payment award and any related arrangement and how those rights and obligations affect the fair value of an award requires the exercise of judgment in considering the relevant facts and circumstances. The minimum value method (a method that reflects the time value of an option but ignores the volatility value) is not an acceptable method for determining the fair value of non-employee awards.

120. If the fair value of goods or services received in a share-based payment transaction with non-employees is more reliably measurable than the fair value of the equity instruments issued, the fair value of the goods or services received shall be used to measure the transaction. In contrast, if the fair value of the equity instruments issued in a share-based payment transaction with non-employees is more reliably measurable than the fair value of the consideration received, the transaction shall be measured based on the fair value of the equity instruments issued.
121. Sales incentives in the form of equity instruments shall be measured at the fair value of the sales incentive or the fair value of the equity instruments issued, whichever is more reliably measurable.

122. The issuer/grantor shall measure the fair value of the equity instruments provided in share-based payment transactions using the stock price and other measurement assumptions as of the earlier of the following dates, referred to as the measurement date:
   
a. The date at which a commitment for performance by the counterparty to earn the equity instruments is reached (a performance commitment5)
   
b. The date at which the counterparty's performance is complete.

123. The counterparty's performance is complete when the counterparty has delivered or, in the case of sales incentives, purchased the goods or services, despite the fact that at that date the quantity or all the terms of the equity instruments may yet depend on other events (this would occur, for example, if a target stock price requirement has not been met when the counterparty has delivered the goods or services).

124. Situations may arise in which counterparty performance may be required over a period of time but the equity award granted to the party performing the services is fully vested and nonforfeitable on the date the parties enter into the contract. While this type of arrangement may be rare, because, typically, vesting provisions do exist, the measurement date for an award that is nonforfeitable and that vests immediately could be the date the parties enter into the contract, even though services have not yet been performed.

125. If fully vested, nonforfeitable equity instruments are issued at the date the grantor and grantee enter into an agreement for goods or services (no specific performance is required by the grantee to retain those equity instruments), then, because of the elimination of any obligation on the part of the counterparty to earn the equity instruments, a measurement date has been reached.

126. If an entity grants fully vested, nonforfeitable equity instruments that are exercisable by the grantee only after a specified period of time and the terms of the agreement provide for earlier exercisability if the grantee achieves specified performance conditions, the grantor shall measure the fair value of the equity instruments at the date of grant and shall recognize that measured cost in the same period(s) and in the same manner as if the grantor had paid cash.

Initial Measurement – Reporting Entity Grantee/Provider

127. An entity (the grantee or provider) may enter into transactions to provide goods or services in exchange for equity instruments. The grantee shall measure the fair value of the equity instruments in these transactions using the stock price and other measurement assumptions as of the earlier of either of the following dates referred to as the measurement date:

   The date the parties come to a mutual understanding of the terms of the equity-based compensation arrangement and a commitment for performance by the grantee to earn the equity instruments (a performance commitment6) is reached, or

5 A performance commitment is a commitment under which performance by the grantee to earn the equity instruments is probable because of sufficiently large disincentives for nonperformance. The disincentives must result from the relationship between the grantor and the grantee. Forfeiture of the equity instruments as the sole remedy in the event of the grantee's nonperformance is not considered a sufficiently large disincentive for purposes of applying the guidance. In addition, the ability to sue for nonperformance, in and of itself, does not represent a sufficiently large disincentive to ensure that performance is probable. (A granting entity may always be able to sue for nonperformance but it is not always clear whether any significant damages would result.)

6 See Footnote 4.
The date at which the grantee's performance necessary to earn the equity instruments is complete (that is, the vesting date).

Measurement

Before the Measurement Date

128. In accordance with other accounting guidance, it may be appropriate for an issuer to recognize costs related to share-based payment transactions with non-employees before a measurement date has occurred:

If the quantity and terms of the equity instruments are known up front, the equity instruments shall be measured at their then-current fair values at each interim financial reporting date.

If the quantity and terms of the equity instruments are not known up front, and the transaction is only impacted by market conditions, the equity instruments shall be measured at their then-current fair values at each interim financial reporting date.

If the quantity and terms of the equity instruments are not known up front, and the transaction is only impacted by counterparty performance conditions or both market conditions and counterparty performance conditions, the equity instruments shall be measured at their best estimate of the possible outcomes. When no amount within a range can be deemed a better estimate, then the midpoint of the range shall be used.

Measurement at the Measurement Date—Transactions Involve Only Market Conditions

129. The quantity or terms of an equity instrument may be dependent only on market conditions. If, on the measurement date, the quantity or any of the terms of the equity instruments are dependent on the achievement of market conditions, then the issuer shall use the fair value of the equity instruments for recognition purposes. That fair value shall be calculated as the fair value of the equity instruments without regard to the market condition plus the fair value of the issuer's commitment to change the quantity or terms of the equity instruments based on whether the market condition is met.

130. As it relates to a grantee, if on the measurement date the quantity or any of the terms of the equity instrument are dependent on a market condition, then the grantee shall measure revenue based on the fair value of the equity instruments inclusive of the adjustment provisions. That fair value would be calculated as the fair value of the equity instruments without regard to the market condition plus the fair value of the commitment to change the quantity or terms of the equity instruments if the market condition is met. That is, the existence of a market condition that, if achieved, results in an adjustment to an equity instrument generally affects the value of the instrument. Pricing models have been adapted to value many of those path-dependent equity instruments.

131. The quantity or terms of an equity instrument may be dependent on counterparty performance conditions. If, on the measurement date, the quantity or any of the terms of the equity instruments are dependent on the achievement of counterparty performance conditions that, based on the different possible outcomes, result in a range of aggregate fair values for the equity instruments as of that date, then the issuer should utilize the best estimate (that is, the variable terms times the applicable number of equity instruments) amount within that range for recognition purposes. When no amount within the range can be deemed a better estimate, then the midpoint of the range shall be used. The amount may be zero only if zero is determined to be the best estimate. This guidance also applies if the quantity or terms of an equity instrument is dependent on both market conditions and counterparty performance conditions.

Subsequent Measurement

132. After the issuer measures the then-current fair value of the issuer's commitment related to the market condition as described in paragraph 129, the issuer shall, to the extent necessary, recognize and
classify future changes in the fair value of this commitment in accordance with any relevant accounting guidance on financial instruments.

133. Paragraph 131 provides measurement date guidance on the measurement of transactions that involve counterparty performance conditions. As each quantity and term become known and until all the quantities and terms that stem from the counterparty's performance become known, the best estimate or midpoint aggregate fair value measured pursuant to the guidance in that paragraph shall be adjusted, to reflect additional cost of the transaction, using the modification accounting methodology described in paragraphs 76-78. That is, the adjustment shall be measured at the date of the revision of the quantity or terms of the equity instruments as the difference between the then-current fair value of the revised instruments utilizing the then-known quantity or term and the then-current fair value of the old equity instruments immediately before the quantity or term becomes known. The then-current fair value is calculated using the assumptions that result in the best estimate or midpoint aggregate fair value (in accordance with paragraph 131) if the quantity or any other terms remain unknown.

134. Paragraph 131 also provides measurement date guidance on the measurement of transactions that involve both market conditions and counterparty performance conditions. Through the date the last performance-related condition is resolved, the issuer shall apply modification accounting (paragraphs 76-78) for the resolution of both counterparty performance conditions and market conditions. If, at the time the last counterparty performance-related condition is resolved, any market conditions remain, then the issuer shall measure the then-current fair value of the issuer's commitment to issue additional equity instruments or change the terms of the equity instruments based on whether the market condition is met. This measured amount is an additional cost of the transaction. After the issuer measures the then-current fair value of the issuer's commitment related to the market condition, the issuer shall, to the extent necessary, recognize and classify future changes in the fair value of this commitment in accordance with any relevant accounting literature on financial instruments.

135. Paragraph 126 addresses the situation in which an entity grants fully vested, nonforfeitable equity instruments with terms that provide for potential acceleration of exercisability and establishes that the grantor shall measure the fair value of the equity instruments at the date of grant and shall recognize that measured cost in the same period(s) and in the same manner as if the grantor had paid cash. For these situations, if, after the arrangement date, the grantee performs as specified and exercisability is accelerated, the grantor shall record incremental cost measured at the date of the revision of the terms of the equity instruments (that is, the acceleration date) as the difference between the then-current fair value of the revised instruments utilizing the accelerated exercisability date and the then-current fair value of the old equity instruments immediately before exercisability is accelerated. If the only change in the terms of the equity instruments is the acceleration of exercisability, the application of this methodology will only result in a significant additional charge if the expected dividend on the underlying instrument exceeds the sum of the effect of discounting the exercise price and the loss of time value (exclusive of the effect of discounting the exercise price) resulting from the early exercise of the equity instrument.

Subsequent Measurement—Grantee Accounting

136. A grantee may be party to an arrangement in which the terms of the equity instruments are subject to adjustment after the measurement date. Paragraphs 137-138 address transactions in which any of the terms of the equity instruments are subject to adjustment after the measurement date (that is, the terms of the equity instrument are subject to adjustment based on performance above the level committed to in a performance commitment, performance after the instrument is earned, or market conditions) and how the grantee shall account for an increase in fair value as a result of an adjustment (upon resolution of the contingency after the measurement date) as revenue.

137. If, on the measurement date, the quantity or any of the terms of the equity instruments are dependent on the achievement of grantee performance conditions (beyond those conditions for which a
performance commitment exists), then changes in fair value of the equity instrument that result from an adjustment to the instrument upon the achievement of a performance condition shall be measured as additional revenue from the transaction using a methodology consistent with modification accounting described in paragraphs 76-78. That is, the adjustment shall be measured at the date of the revision of the quantity or terms of the equity instrument as the difference between the then-current fair value of the revised instruments utilizing the then-known quantity and terms and the then-current fair value of the old equity instruments immediately before the adjustment.

138. Changes in fair value of the equity instruments after the measurement date unrelated to the achievement of performance conditions shall be accounted for in accordance with any relevant guidance on the accounting and reporting for investments in equity instruments.

DISCLOSURES – NON-EMPLOYEE SHARE BASED PAYMENT

139. An entity (grantor) that acquires goods or services other than employee services in share-based payment transactions shall provide disclosures similar to those required by paragraphs 101-102 to the extent that those disclosures are important to an understanding of the effects of those transactions on the financial statements. These disclosures, if applicable, are for annual audited statutory financial statements only.

140. An entity (grantee) shall disclose, in each period’s financial statements, the amount of gross operating revenue recognized as a result of nonmonetary transactions addressed within this statement. These disclosures, if applicable, are for annual audited statutory financial statements only.

Relevant Literature

126. This statement adopts with modification the U.S. GAAP guidance for share-based payment transactions reflected in FASB Accounting Standards Codification (ASC) Topic 718, Compensation – Stock Compensation, as modified by the ASUs listed in subparagraphs 126.a through 126.e, excluding the guidance in ASC Subtopic 718-40, Employee Stock Ownership Plans (ESOPs). Statutory accounting guidance for ESOPs is addressed in SSAP No. 12—Employee Stock Ownership Plans. This adoption with modification includes the related implementation guidance reflected within the FASB Codification Topic 718 not reflected within this standard. The U.S. GAAP guidance adopted with modification reflects the adoption with modification of the following ASUs:

a. ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting. The revisions from ASU 2018-07 expand the scope of ASC 718 to include share based payment transactions for acquiring goods and services from nonemployees. With ASU 2018-17, ASC 505-50, Equity – Equity Payments to Nonemployees was superseded.

b. ASU 2017-09, Scope of Modification Accounting

c. ASU 2016-09, Improvements to Employee Share-Based Payment Accounting

d. ASU 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period

e. ASU 2010-13, Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Current of the Market in Which the Underlying Equity Security Trades

127. The statutory accounting guidance for share-based payments is intended to be consistent with U.S. GAAP. Adopted modifications to U.S. GAAP guidance are as follows:
a. GAAP references to “public and nonpublic” guidance have been eliminated. However, entities that report share-payment transactions under U.S. GAAP as “public” entities shall not report different amounts between U.S. GAAP and SAP. (For example, if a reporting entity reports “fair value” under U.S. GAAP, that entity shall not utilize a “calculated or intrinsic” amount under statutory accounting.)

b. Prepaid assets are nonadmitted.

c. GAAP references are revised to reference applicable statutory accounting guidance.

d. GAAP reporting line items (either explicitly provided in the statement or adopted by reference – such as the GAAP implementation guidance) shall be replaced to reference applicable statutory annual statement line items. (For example, GAAP references to “other comprehensive income” shall be reflected within “Surplus - Unassigned Funds”).

e. GAAP guidance to calculate earnings per share is not applicable to statutory accounting and has not been included within the statement.

f. GAAP effective date and transition, and transition disclosures have not been incorporated. Reporting entities shall follow the effective date and transition elements provided within this statement.

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

141. This statement adopts ASU 2017-09, Compensation — Stock Compensation — Scope of Modification Accounting (ASU 2017-09). The guidance from ASU 2017-09 will be effective for all entities for annual periods, including interim periods within those annual periods, beginning January 1, 2018. Early adoption is permitted, including adoption in any interim period, for all entities for reporting periods for which financial statements have not yet been issued. The guidance shall be applied prospectively to a modification that occurs on or after the effective date.

142. This statement adopts ASU 2014-12, Compensation — Stock Compensation, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (ASU 2014-12) with an effective date of January 1, 2016, with early adoption permitted. ASU 2014-12 allows prospective or retrospective adoption based on the election of the reporting entity. This election is adopted for statutory financial statements; however, reporting entities shall follow the approach used when completing their GAAP financials (if applicable). The disclosures in SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3) shall be completed in the first interim and annual reporting period of adoption.

143. This statement adopts with modification ASU 2016-09 with an effective date of December 31, 2017, with early adoption permitted. The modifications are consistent with those adopted for FASB Codification 718, as reflected in paragraph 144. This adoption with modification encompasses the entire ASU 2016-09, but only revisions to sections previously captured in this statement have been reflected. (For example, the adoption with modification includes the related implementation guidance but the implementation guidance is not reflected within this standard.) ASU 2016-09 provides transition guidance separate for each amendment, either prospective, retrospective, or modified retrospective basis. These transition provisions are not duplicated in this statement, as reporting entities shall follow the approach utilized when completing their U.S. GAAP financials. Consistent with the U.S. GAAP guidance, this involves, in some situations, allowing reporting entities an election of the transition method. The disclosures in SSAP No. 3 shall be completed in the first interim and annual reporting period of adoption.
144. This statement adopts with modification GAAP guidance regarding stock options and stock purchase plans reflected in Topic 718: Compensation—Stock Compensation, as amended by ASU 2010-13, Compensation—Stock Compensation (Topic 18): Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Current of the Market in Which the Underlying Equity Security Trades, with the exception of FASB Codification Subtopic 718-40: Employee Stock Ownership Plans. Statutory guidance on employee stock ownership plans is provided in SSAP No. 12—Employee Stock Ownership Plans. This adoption with modification includes the related implementation guidance reflected within the FASB Codification Topic 718, not reflected within this standard.

Modifications to the adopted GAAP guidance are as follows:

GAAP references are revised to reference applicable statutory accounting guidance.

GAAP reporting line items (either explicitly provided in the statement or adopted by reference—such as the GAAP implementation guidance) shall be replaced to reference applicable statutory annual statement line items. (For example, GAAP references to “other comprehensive income” shall be reflected within “Surplus - Unassigned Funds”).

GAAP guidance to calculate earnings per share is not applicable to statutory accounting and has not been included within the statement.

GAAP effective date and transition, and transition disclosures have not been incorporated. Reporting entities shall follow the effective date and transition elements provided within this statement.

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

145. This statement adopts with modification GAAP guidance regarding the exchange of equity instruments for goods or services with non-employees as reflected in Subtopic 505-50 – Equity, Equity-Payments to Non-Employees. Modifications to this adopted GAAP guidance are as follows: Prepaid assets are nonadmitted. Costs for goods and services shall be recognized when the goods or services are received consistent with other statutory accounting principles. Minimum value method for determining fair value is rejected for all entities. Estimates of expected costs for the exchange of equity instruments dependent on market conditions or performance obligations shall be determined based on the best estimate of fair values. If a better estimate cannot be determined, then the midpoint (rather than the lowest amount) of aggregate fair values within the range shall be used. GAAP references are revised to reference applicable statutory accounting guidance.

146. The adoption with modification of FASB Codification Topic 718 and Subtopic 505-50 detailed in paragraphs 126-145 of this statement also reflects adoption with modification of the following pre-codification GAAP standards: (SAP Note – Standards deleted reflect the pre-codification guidance for Subtopic 505-50, which have been superseded with ASU 2018-07.)

a. FAS 123R, Share-Based Payment (FAS 123R);

b. FAS 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (FAS 150) – (Adopted only to the extent referenced in FAS 123R for classifying instruments as equity or liability for application in this statement. Adopted guidance is reflected in Exhibit A);

c. FASB Staff Position FAS 123(R)-1: Classification and Measurement of Freestanding Financial Instruments Originally issued in Exchange for Employee Services under FASB Statement No. 123(R) (FAS 123R-1);
d. **FASB Staff Position (FSP) FAS 123(R)-2**: Practical Accommodation to the Application of Grant Date as Defined in FASB Statement No. 123(R) (FSP FAS 123R-2);

e. **FASB Staff Position (FSP) FAS123(R)-4**: Classification of Options and Similar Instruments Issued as Employee Compensation That Allow for Cash Settlement upon the Occurrence of a Contingent Event (FSP FAS 123R-4);

f. **FASB Staff Position (FSP) FAS 123(R)-5**: Amendment of FASB Staff Position FAS 123R-1 (FSP FAS 123R-5);

g. **FASB Staff Position (FSP) FAS 123(R)-6**: Technical Corrections of FASB Statement No. 123(R) (FSP FAS 123R-6);

h. **FASB Emerging Issues Task Force 96-18**: Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services;

i. **FASB Emerging Issues Task Force 97-14**: Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested (EITF 97-14);

j. **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;

k. **FASB Emerging Issues Task Force 00-16**: Recognition and Measurement of Employer Payroll Taxes on Employee Stock-Based Compensation (EITF 00-16);

l. **FASB Emerging Issues Task Force 00-18**: Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other Than Employees;

m. **FASB Technical Bulletin 97-01**, Accounting under Statement 123 for Certain Employee Stock Purchase Plans with a Look-Back Option (TB 97-01)

The adoption with modification of FASB Codification Topic 718 in this statement reflects rejection of the following pre-codification GAAP standards:

a. **FASB Staff Position (FSP) FAS 123(R)-3**: Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards (FSP FAS 123R-3); and

b. **FASB Staff Position (FSP) EITF 03-6-1**: Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities (FSP EITF 03-6-1).

**Effective Date and Transition**

This statement was shall be effective prospectively (paragraph 117) for years beginning January 1, 2013, with interim and annual financial reporting thereafter. The cumulative effect of initially applying this statement, if any, shall be recognized as of the required effective date as a change in accounting principle under SSAP No. 3. Early adoption was permitted for December 31, 2012, financial statements, with interim and annual reporting thereafter. At the time of initial adoption of this statement, reporting entities with existing share-based payment instruments that applied the guidance in SSAP No. 13—Stock Options and Stock Purchase Plans were to apply the requirements of SSAP No. 104 prospectively to new awards and to awards modified, repurchased, or cancelled after the required effective date. Those reporting entities were to continue to account for any portion of awards outstanding at the date of initial application using the statutory accounting principles originally applied to those
awards (e.g., SSAP No. 13). (JMG Inquiry – Are there share-based payments still being accounted for under SSAP No. 13, or should this guidance be removed?)

131. Since the initial adoption of SSAP No. 104, subsequent revisions were effective as follows:

   a. ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting: Nonsubstantive revisions effective January 1, 2020, with early application permitted.

   b. ASU 2017-09, Scope of Modification Accounting: Nonsubstantive revisions effective January 1, 2018, applicable to modifications that occur on or after the effective date, with early application permitted.

   c. ASU 2016-09, Improvements to Employee Share-Based Payment Accounting: Nonsubstantive revisions effective December 31, 2017, with early adoption permitted. The adoption included the transition provisions from ASU 2016-19, although not duplicated within this statement.

   d. ASU 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period: Nonsubstantive revisions effective January 1, 2016, with early adoption permitted.

   e. ASU 2010-13, Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Current of the Market in Which the Underlying Equity Security Trades: Captured in the original adoption of SSAP No. 104, effective Jan. 1, 2013.

132. After initial adoption of SSAP No. 104, substantive revisions, detailed in Issue Paper No. 146, were adopted to incorporate guidance for share-based payment transaction with nonemployees. These substantive revisions adopted with modification U.S. GAAP guidance reflected in ASC 505-50, Equity Payments to Nonemployees. Pursuant to the adoption with modification of ASU 2018-07, statutory accounting guidance previously adopted from ASC 505-50 has been superseded. As such, the following pre-codification standards have also been superseded and are no longer considered adopted for statutory accounting:

   a. FASB Emerging Issues Task Force 96-18: Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services:

   b. FASB Emerging Issues Task Force 00-08: Accounting by a Grantee for an Equity Instrument to Be Received in Conjunction with Providing Goods or Services:

   c. FASB Emerging Issues Task Force 00-18: Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other Than Employees; and

140. Reporting entities with existing share-based payment instruments that applied the guidance contained in SSAP No. 13—Stock Options and Stock Purchase Plans (SSAP No. 13) shall apply the requirements of the adopted SSAP No. 104 prospectively to new awards and to awards modified, repurchased, or cancelled after the required effective date. Those reporting entities shall continue to account for any portion of awards outstanding at the date of initial application using the accounting principles originally applied to those awards (SSAP No. 13).

150. The substantive revisions to this statement to incorporate guidance for share-based payment transactions for non-employees, detailed in Issue Paper No. 146, are effective prospectively initially for
years ending December 31, 2014. The cumulative effect of initially applying this statement, if any, shall be recognized as of the required effective date as a change in accounting principle under SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3).

148—151. The guidance in paragraph 59 is effective as of January 1, 2016, with early adoption permitted. Nonsubstantive revisions to adopt ASU 2017-09 are effective January 1, 2018, with early adoption permitted. The revised guidance shall be applied prospectively to modifications that occur on or after the effective date. Nonsubstantive revisions to adopt with modification ASU 2016-09 are effective December 31, 2017, with early adoption permitted, as detailed in paragraph 143 of this statement.

REFERENCES

Other

- SSAP No. 12—Employee Stock Ownership Plans

Relevant Issue Papers

- Issue Paper No. 129—Share-Based Payment, A Replacement of SSAP No. 13

- Issue Paper No. 146—Share-Based Payments With Non-Employees
EXHIBIT A – CLASSIFICATION CRITERIA: LIABILITY OR EQUITY

Classification Criteria

A2. As detailed in paragraph 14-16 of the statement, unless paragraphs 17-29 require otherwise, an entity shall apply the classification criteria detailed in paragraphs 14-27 in the statement, as they are effective at the reporting date, in determining whether to classify a freestanding financial instrument given to an employee in a share based payment transaction in this Exhibit in determining whether to classify a freestanding financial instruments given to a grantee as a liability.

A3. The guidance in this Section Exhibit shall be applied to a freestanding financial instrument in its entirety. Any nonsubstantive or minimal features shall be disregarded in applying the classification provisions of this Section Exhibit. Judgment, based on consideration of all the terms of an instrument and other relevant facts and circumstances, is necessary to distinguish substantive, nonminimal features from nonsubstantive or minimal features. (480-10-25-1)

Mandatorily Redeemable Financial Instruments

A4. A mandatorily redeemable financial instrument shall be classified as a liability unless the redemption is required to occur only upon the liquidation or termination of the reporting entity. (480-10-25-2)

A5. A financial instrument that embodies a conditional obligation to redeem the instrument by transferring assets upon an event not certain to occur becomes mandatorily redeemable if that event occurs, the condition is resolved, or the event becomes certain to occur. (480-10-25-3)

A6. In determining if an instrument is mandatorily redeemable, all terms within a redeemable instrument shall be considered. The following items do not affect the classification of a mandatorily redeemable financial instrument as a liability: (480-10-25-6)

   a. A term extension option
   b. A provision that defers redemption until a specified liquidity level is reached
   c. A similar provision that may delay or accelerate the timing of a mandatory redemption.

A7. If a financial instrument will be redeemed only upon the occurrence of a conditional event, redemption of that instrument is conditional and, therefore, the instrument does not meet the definition of mandatorily redeemable financial instrument in this statement. However, that financial instrument would be assessed at each reporting period to determine whether circumstances have changed such that the instrument now meets the definition of a mandatorily redeemable instrument (that is, the event is no longer conditional). If the event has occurred, the condition is resolved, or the event has become certain to occur, the financial instrument is reclassified as a liability. (480-10-25-7)

Obligations to Repurchase Issuer’s Equity Shares by Transferring Assets

A8. An entity shall classify as a liability (or an asset in some circumstances) any financial instrument, other than an outstanding share, that, at inception, has both of the following characteristics: (480-10-25-8)

   a. It embodies an obligation to repurchase the issuer’s equity shares, or is indexed to such an obligation, and
   b. It requires or may require the issuer to settle the obligation by transferring assets.
A9. In this statement, “indexed to” is used interchangeably with “based on variations in the fair value of.” The phrase “requires or may require” encompasses instruments that either conditionally or unconditionally obligate the issuer to transfer assets. If the obligation is conditional, the number of conditions leading up to the transfer of assets is irrelevant. (480-10-25-9)

A10. Examples of financial instruments that meet the criteria in paragraph A7 of this exhibit include forward purchase contracts or written put options on the issuer’s equity shares that are to be physically settled or net cash settled.

A11. All obligations that permit the holder to require the issuer to transfer assets result in liabilities, regardless of whether the settlement alternatives have the potential to differ.

A12. Certain financial instruments that embody obligations that are liabilities within the scope of this statement also may contain characteristics of assets but be reported as single items. Some examples include the following:

   a. Net-cash-settled or net-share-settled forward purchase contracts.
   b. Certain combined options to repurchase the issuer’s shares.

Those instruments are classified as assets or liabilities initially or subsequently depending on the instrument’s fair value on the reporting date.

A13. An instrument that requires the issuer to settle its obligation by issuing another instrument (for example, a note payable in cash) ultimately requires settlement by a transfer of assets, accordingly:

   a. When applying paragraphs A7-A11 of this exhibit, this also would apply for an instrument settled with another instrument that ultimately may require settlement by a transfer of assets (warrants for puttable shares).
   b. It is clear that a warrant for mandatorily redeemable shares would be a liability under this statement.

Certain Obligations to Issue a Variable Number of Shares

A14. A financial instrument that embodies an unconditional obligation, or a financial instrument other than an outstanding share that embodies a conditional obligation, that the issuer must or may settle by issuing a variable number of its equity shares shall be classified as a liability (or an asset in some circumstances) if, at inception, the monetary value of the obligation is based solely or predominantly on any one of the following:

   a. A fixed monetary amount known at inception (for example, a payable settleable with a variable number of the issuer’s equity shares),
   b. Variations in something other than the fair value of the issuer’s equity shares (for example, a financial instrument indexed to the Standard and Poor’s S&P 500 Index and settleable with a variable number of the issuer’s equity shares), or
   c. Variations inversely related to changes in the fair value of the issuer’s equity shares (for example, a written put option that could be net share settled).

Prohibition on Combining Freestanding Financial Instruments
A15. A freestanding financial instrument that is within the scope of this statement shall not be combined with another freestanding financial instrument in applying paragraphs A3-A13 of this exhibit. For example, a freestanding written put option that is classified as a liability under this statement shall not be combined with an outstanding equity share.

**Distinguishing Liability from Equity – Scope and Scope Exclusions**

A16. The guidance in paragraphs 14-2717-29 of this statement applies to any freestanding financial instrument, including one that has any of the following attributes:

- a. Comprises more than one option or forward contract, or

- b. Has characteristics of both a liability and equity and, in some circumstances, also has characteristics of an asset (for example, a forward contract to purchase the issuer’s equity shares that is to be net cash settled). Accordingly, this statement does not address an instrument that has only characteristics of an asset.

A17. For example, an instrument that consists of a written put option for an issuer’s equity shares and a purchased call option and nothing else is a freestanding financial instrument. That freestanding financial instrument embodies an obligation to repurchase the issuer’s equity shares and is subject to the requirements of this statement.
EXHIBIT B—Disclosure Information

1. The following list indicates the minimum information needed to achieve the objectives in paragraphs 101 and 139 of this statement and illustrates how the disclosure requirements might be satisfied. In some circumstances, an entity may need to disclose information beyond the following to achieve the disclosure objectives:

a. A description of the share-based payment arrangement(s), including the general terms of awards under the arrangement(s), such as:
   i. The requisite service period(s) and any other substantive conditions (including those related to vesting)
   ii. The maximum contractual term of equity (or liability) share options or similar instruments
   iii. The number of shares authorized for awards of equity share options or other equity instruments.

b. The method it uses for measuring compensation cost from share-based payment arrangements with employees.

c. For the most recent year for which an income statement is provided, both of the following:
   i. The number and weighted-average exercise prices (or conversion ratios) for each of the following groups of share options (or share units):
      (a) Those outstanding at the beginning of the year
      (b) Those outstanding at the end of the year
      (c) Those exercisable or convertible at the end of the year
      (d) Those that during the year were:
         (1) Granted
         (2) Exercised or converted
         (3) Forfeited
         (4) Expired
   ii. The number and weighted-average grant-date fair value (or calculated value for an entity that uses that method or intrinsic value for awards measured pursuant to paragraph 53 of this statement) of equity instruments not specified in (c)(1), for all of the following groups of equity instruments:
      (a) Those nonvested at the beginning of the year
Attachment E
SSAP No. 104R  Statement of Statutory Accounting Principles

(b) Those nonvested at the end of the year

c) Those that during the year were:

(1) Granted

(2) Vested

(3) Forfeited

d) For each year for which an income statement is provided, both of the following:

i. The weighted-average grant-date fair value (or calculated value for an entity that uses that method or intrinsic value for awards measured at that value pursuant to paragraphs 52-53 of this statement) of equity options or other equity instruments granted during the year, and

ii. The total intrinsic value of options exercised (or share units converted), share-based liabilities paid, and the total fair value of shares vested during the year.

e) For fully vested share options (or share units) and share options expected to vest (or unvested shares for which the requisite service period has not been rendered but that are expected to vest based on the achievement of a performance condition, if an entity accounts for forfeitures when they occur in accordance with paragraph 62) at the date of the latest statement of financial position, both of the following:

i. The number, weighted-average exercise price (or conversion ratio), aggregate intrinsic value, and weighted-average remaining contractual term of options (or share units) outstanding, and

ii. The number, weighted-average exercise price (or conversion ratio), aggregate intrinsic value, and weighted-average remaining contractual term of options (or share units) currently exercisable (or convertible).

f) For each year for which an income statement is presented, both of the following (An entity that uses the intrinsic value method pursuant to paragraphs 52-53 of this statement is not required to disclose the following information for awards accounted for under that method):

i. A description of the method used during the year to estimate the fair value (or calculated value) of awards under share-based payment arrangements, and

ii. A description of the significant assumptions used during the year to estimate the fair value (or calculated value) of share-based compensation awards, including (if applicable):

(a) Expected term of share options and similar instruments, including a discussion of the method used to incorporate the contractual term of the instrument and employees’ expected exercise and postvesting employment termination behavior into the fair value (or calculated value) of the instrument.
(b) Expected volatility of the entity’s shares and the method used to estimate it. An entity that uses a method that employs different volatilities during the contractual term shall disclose the range of expected volatilities used and the weighted-average expected volatility. An entity that uses the calculated-value method shall disclose the reasons why it is not practicable for it to estimate the expected volatility of its share price, the appropriate industry sector index that it has selected, the reasons for selecting that particular index, and how it has calculated historical volatility using that index.

(c) Expected dividends. An entity that uses a method that employs different dividend rates during the contractual term shall disclose the range of expected dividends used and the weighted-average expected dividends.

(d) Risk-free rate(s). An entity that uses a method that employs different risk-free rates shall disclose the range of risk-free rates used.

(e) Discount for post-vesting restrictions and the method for estimating it.

g. An entity that grants equity or liability instruments under multiple share-based payment arrangements with employees shall provide the information specified in paragraph (a) through (f) separately for different types of awards to the extent that the differences in the characteristics of the awards make separate disclosure important to an understanding of the entity’s use of share-based compensation. For example, separate disclosure of weighted-average exercise prices (or conversion ratios) at the end of the year for options (or share units) with a fixed exercise price (or conversion ratio) and those with an indexed exercise price (or conversion ratio) could be important. It also could be important to segregate the number of options (or share units) not yet exercisable into those that will become exercisable (or convertible) based solely on fulfilling a service condition and those for which a performance condition must be met for the options (share units) to become exercisable (convertible). It could be equally important to provide separate disclosures for awards that are classified as equity and those classified as liabilities. In addition, an entity that has multiple share-based payment arrangements with employees shall disclose information separately for different types of awards under those arrangements to the extent that differences in the characteristics of the awards make separate disclosure important to an understanding of the entity’s use of share-based compensation.

h. For each year for which an income statement is presented, both of the following:

i. Total compensation cost for share-based payment arrangements

(a) Recognized in income as well as the total recognized tax benefit related thereto

(b) Capitalized as part of the cost of an asset.

ii. A description of significant modifications, including:

(a) The terms of the modifications;

(b) The number of employees affected;
(c) The total incremental compensation cost resulting from the modifications.

i. As of the latest balance sheet date presented, the total compensation cost related to nonvested awards not yet recognized and the weighted-average period over which it is expected to be recognized.

j. If not separately disclosed elsewhere, the amount of cash received from exercise of share options and similar instruments granted under share-based payment arrangements and the tax benefit from stock options exercised during the annual period.

k. If not separately disclosed elsewhere, the amount of cash used to settle equity instruments granted under share-based payment arrangements.

l. A description of the entity’s policy, if any, for issuing shares upon share option exercise (or share unit conversion), including the source of those shares (that is, new shares or treasury shares). If as a result of its policy, an entity expects to repurchase shares in the following annual period, the entity shall disclose an estimate of the amount (or a range, if more appropriate) of shares to be repurchased during that period.

m. If not separately disclosed elsewhere, the policy for estimating expected forfeitures or recognizing forfeitures as they occur.

2. In addition to the information required by this statement, an entity may disclose supplemental information that it believes would be useful to investors and creditors, such as a range of values calculated on the basis of different assumptions, provided that the supplemental information is reasonable and does not lessen the prominence and credibility of the information required by this statement. The alternative assumptions shall be described to enable users of the financial statements to understand the basis for the supplemental information.
Statutory Accounting Principles (E) Working Group  
Maintenance Agenda Submission Form  
Form A

**Issue:** ASU 2018-13, Changes to the Disclosure Requirements for Fair Value Measurement

**Check (applicable entity):**

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**Description of Issue:** 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. The different format for nonpublic is new in ASU 2018-13.)

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 is 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 apply 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.

Existing Authoritative Literature:

**SSAP No. 100R—Fair Value:** This SSAP defines fair value, establishes a framework for measuring fair value and establishes disclosure requirements about fair value. SSAP No. 100R consideration of U.S. GAAP standards is as follows:

• **FAS 157, Fair Value Measurements;** (FAS 157) – ** Adopted with Modification**

• **FSP FAS 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement Under Statement 13,** (FSP FAS 157-1) – **Adopted with Modification**

• **FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly** (FSP FAS 157-4) – **Adopted with Modification**

• **ASU 2016-01, Financial Instruments** – **Rejected**

• **ASU 2015-07, Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or its equivalent)** – **Adopted**

• **ASU 2013-03, Clarifying the Scope and Applicability of a Particular Disclosure to Nonpublic Entities** – **Rejected**

• **ASU 2010-06, Fair Value Measurements and Disclosures** – (Topic 820) – **Improving Disclosures about Fair Value Measurements** (ASU 2010-06) – **Adopted with Modification**

• **ASU 2009-12, Investment in Certain Entities that Calculate Net Asset Value per Share (or its equivalent)** - ** Adopted**

• **FAS 107, Disclosures about Fair Value of Financial Instruments as amended by FAS 119, Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments** – **Adopted with Modification.** (Paragraph 15.c. of FAS 119 is rejected.)

• **FASB Emerging Issues Task Force No. 85-20, Recognition of Fees for Guaranteeing a Loan** – **Adopted with Modification**

• **FSP FAS 107-1 and APB-1, Interim Disclosures about Fair Value of Financial Instruments** – **Adopted**

• **FSP FAS 157-2: Effective Date of FASB Statement No. 157** (FSP FAS 157-2) – **Rejected**

• **FSP FAS 157-3: Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active** (FSP FAS 157-3) – **Rejected**

The following “Fair Value” related GAAP issuances are pending SAP review:

• **ASU 2009-05, Fair Value Measurements and Disclosures, Measuring Liabilities at Fair Value**
• ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS

• ASU 2013-09, Fair Value Measurements: Deferral of the Effective Date of Certain Disclosures for Nonpublic Employee Benefit Plans in Update 2011-04.

SSAP No. 100R Disclosure Guidance:

Disclosures

47. A reporting entity shall disclose information that helps users of the financial statements to assess both of the following: (1) For assets and liabilities that are measured and reported\(^1\) at fair value or NAV in the statement of financial position after initial recognition, the valuation techniques and inputs used to develop those measurements; (2) For fair value measurements in the statement of financial position determined using significant unobservable inputs (Level 3), the effect of the measurements on earnings (or changes in net assets) for the period. To meet these objectives, the reporting entity shall disclose the information in paragraphs 47.a. through 47.f. for each class of assets and liabilities measured and reported\(^2\) at fair value or NAV in the statement of financial position after initial recognition. The reporting entity shall determine appropriate classes of assets and liabilities in accordance with the annual statement instructions.

a. The fair value/NAV measurements at the reporting date.

b. The level of the fair value hierarchy within which the fair value measurements are categorized in their entirety (Level 1, 2 or 3). (Investments reported at NAV shall not be captured within the fair value hierarchy, but shall be separately identified.)

c. For assets and liabilities held at the reporting date, the amounts of any transfers between Level 1 and Level 2 of the fair value hierarchy, the reasons for the transfers, and the reporting entity’s policy for determining when transfers between levels are recognized. Transfers into each level shall be disclosed and discussed separately from transfers out of each level.

d. For fair value measurements categorized within Level 2 and Level 3 of the fair value hierarchy, a description of the valuation technique(s) and the inputs used in the fair value measurement. If there has been a change in the valuation technique (for example, changing from a market approach to an income approach or the use of an additional valuation technique), the reporting entity shall disclose that change and the reason(s) for making it.

e. For fair value measurements categorized within Level 3 of the fair value hierarchy a reconciliation from the opening balances to the closing balances disclosing separately changes during the period attributable to the following:

i. Total gains or losses for the period recognized in income or surplus.

ii. Purchases, sales, issues, and settlements (each type disclosed separately)

\(^1\) The term “reported” is intended to reflect the measurement basis for which the asset or liability is classified within its underlying SSAP. For example, a bond with an NAIC designation of 2 is considered an amortized cost measurement and is not included within this disclosure even if the amortized cost and fair value measurement are the same. An example of when such a situation may occur includes a bond that is written down as other-than-temporarily impaired as of the date of financial position. The amortized cost of the bond after the recognition of the other-than-temporary impairment may agree to fair value, but under SSAP No. 26R this security is considered to still be reported at amortized cost.

\(^2\) See Footnote 1

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iii. The amounts of any transfers into or out of Level 3, the reasons for those transfers, and the reporting entity’s policy for determining when transfers between levels are recognized. Transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3.

f. A reporting entity shall disclose and consistently follow its policy for determining when transfers between levels are recognized. The policy about the timing of recognizing transfers shall be the same for transfers into Level 3 as that for transfers out of Level 3. Examples of policies for when to recognize the transfers are as follows:

i. The actual date of the event or change in circumstances that caused the transfer

ii. The beginning of the reporting period

iii. The end of the reporting period.

48. For derivative assets and liabilities, the reporting entity shall present both of the following:

a. The disclosures required by paragraph 47.a., 47.b. and 47.c. on a gross basis

b. The reconciliation disclosures required by paragraph 47.d., 47.e. and 47.f. on either a gross or net basis

49. The quantitative disclosures required in paragraphs 47-48 of this standard shall be presented using a tabular format.

50. The reporting entity shall disclose the fair value hierarchy and the method used to obtain the fair value measurement, or the use of NAV, for all items in which fair value is disclosed within the annual statement investment schedules. This disclosure is satisfied by the completion of the investment schedules in the Annual statement and is not required quarterly.

51. For investments measured using the NAV practical expedient pursuant to paragraph 39, a reporting entity shall disclose information that helps users of its financial statements to understand the nature and risks of the investments and whether the investments, if sold, are probable of being sold at amounts different from net asset value per share. To meet that objective, a reporting entity shall disclose, at a minimum, the following information for instances in which the investment may be sold below NAV, or if there are significant restrictions in the liquidation of an investment held at NAV:

a. The NAV along with a description of the investment/investment strategy of the investee.

b. If the investment that can never be redeemed with the investees, but the reporting entity receives distributions through the liquidation of the underlying assets of the investees, the reporting entity’s estimate of the period of time over which the underlying assets are expected to be liquidated by the investees.

c. The amount of the reporting entity’s unfunded commitments related to investments in the class.

d. A general description of the terms and conditions upon which the investor may redeem the investment.

e. The circumstances in which an otherwise redeemable investment in the class (or a portion thereof) might not be redeemable (for example, investments subject to a lockup or gate). Also, for those otherwise redeemable investments that are restricted from redemption as of the reporting entity’s measurement date, the reporting entity shall disclose its estimate of when the restriction from redemption might lapse. If an estimate cannot be made, the reporting entity shall disclose that fact and how long the restriction has been in effect.
f. Any other significant restriction on the ability to sell investments in the class at the measurement date.

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

52. The reporting entity is encouraged, but not required, to combine the fair value information disclosed under this standard with the fair value information disclosed under other accounting pronouncements (for example, disclosures about fair value of financial instruments) in the periods in which those disclosures are required, if practicable. The reporting entity also is encouraged, but not required, to disclose information about other similar measurements, if practicable.

Disclosures about Fair Value of Financial Instruments

53. A reporting entity shall disclose in the notes to the financial statements, as of each date for which a statement of financial position is presented in the quarterly or annual financial statements, the aggregate fair value or NAV for all financial instruments and the level within the fair value hierarchy in which the fair value measurements in their entirety fall. This disclosure shall be summarized by type of financial instrument, for which it is practicable to estimate fair value, except for certain financial instruments identified in paragraph 54. Fair value disclosed in the notes shall be presented together with the related admitted values in a form that makes it clear whether the fair values and admitted values represent assets or liabilities and to which line items in the Statement of Assets, Liabilities, Surplus and Other Funds they relate. Unless specified otherwise in another SSAP, the disclosures may be made net of encumbrances, if the asset or liability is so reported. A reporting entity shall also disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments. If it is not practicable for an entity to estimate the fair value of the financial instrument or a class of financial instruments, and the investment does not qualify for the NAV practical expedient, the aggregate carrying amount for those items shall be reported as “not practicable” with additional disclosure as required in paragraph 47.

54. The disclosures about fair value prescribed in paragraph 53 are not required for the following:

a. Employers’ and plans’ obligations for pension benefits, other postretirement benefits including health care and life insurance benefits, postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements, as defined in SSAP No. 12—Employee Stock Ownership Plans (SSAP No. 12), SSAP No. 92—Postretirement Benefits Other Than Pensions (SSAP No. 92), SSAP No. 102—Pensions (SSAP No. 102) and SSAP No. 104R—Share-Based Payments (SSAP No. 104R).

b. Substantively extinguished debt subject to the disclosure requirements of SSAP No. 103R—Transfer and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 103R)

c. Insurance contracts, other than financial guarantees and deposit-type contracts

d. Lease contracts as defined in SSAP No. 22—Leases (SSAP No. 22)

e. Warranty obligations and rights

f. Investments accounted for under the equity method

g. Equity instruments issued by the entity
h. Deposit liabilities with no defined or contractual maturities

55. If it is not practicable for an entity to estimate the fair value of a financial instrument or a class of financial instruments, and the investment does not qualify for the NAV practical expedient, the following shall be disclosed:

a. Information pertinent to estimating the fair value of that financial instrument or class of financial instruments, such as the carrying amount, effective interest rate, and maturity; and

b. The reasons why it is not practicable to estimate fair value.

56. In the context of this standard, practicable means that an estimate of fair value can be made without incurring excessive costs. It is a dynamic concept: what is practicable for one entity might not be for another; what is not practicable in one year might be in another. For example, it might not be practicable for an entity to estimate the fair value of a class of financial instruments for which a quoted market price is not available because it has not yet obtained or developed the valuation model necessary to make the estimate, and the cost of obtaining an independent valuation appears excessive considering the materiality of the instruments to the entity. Practicability, that is, cost considerations, also may affect the required precision of the estimate; for example, while in many cases it might seem impracticable to estimate fair value on an individual instrument basis, it may be practicable for a class of financial instruments in a portfolio or on a portfolio basis. In those cases, the fair value of that class or of the portfolio should be disclosed. Finally, it might be practicable for an entity to estimate the fair value only of a subset of a class of financial instruments; the fair value of that subset should be disclosed.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): Agenda item 2011-14 proposed substantive revisions to SSAP No. 100 to adopt with modification ASU 2011-04. Although staff proposed adopting ASU 2011-14, the vast majority of changes within the ASU did not alter the determination of fair value. Rather, ASU 2011-14 was issued to achieve wording consistency with the IFRS. Due to the extent of revisions required, with no material impact to actual application guidance, further progress on this ASU has been delayed to focus on higher priority projects. In addition to ASU 2011-04, ASU 2009-05, Fair Value Measurements and Disclosures, Measuring Liabilities at Fair Value and ASU 2013-09, Deferral of the Effective Date of Certain Disclosures for Nonpublic Employee Benefit Plans in ASU 2011-04 are still pending statutory accounting review.

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

Convergence with International Financial Reporting Standards (IFRS): The amendments in ASU 2018-13 do not change the guidance on measuring fair value, therefore the previous work of the IFRS and FASB to develop common measurement requirements remains effective. The ASU amendments do create disclosure differences based on the FASB’s and IASB’s differing assessments on financial statement users’ needs and the application of the concepts in the Concepts Statement to the disclosures required in Topic 820.

Staff Recommendation:
NAIC staff recommends that the Working Group move this item to the nonsubstantive active listing and expose revisions to SSAP No. 100R 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 nonsubstantive revisions will be effective when adopted, as such, the deleted disclosures would not be required in the 2019 statutory financial statements. Technically, this may be earlier than U.S. GAAP, but U.S. GAAP allows all entities to early adopt any removed disclosures upon issuance of the ASU, and delay adoption of any revised disclosures until Jan. 1, 2020. As such, NAIC staff sees no concern with removing the deleted disclosures in 2019, as it is expected as most companies would no longer be capturing them for GAAP purposes.)
The following ASU 2018-13 amendments are proposed to be adopted in SSAP No. 100R:

1. 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.)

2. 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.)

3. 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.

4. 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:

1. 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.

2. 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.

3. 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 is still pending review for SAP. (The disclosure on the valuation process was incorporated from ASU 2011-04, which is still pending review for SAP.) *(NAIC staff’s initial thoughts are that this disclosure is unnecessary for statutory accounting, but comments are requested if regulators would like this detail.)*

4. 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 into GAAP from ASU 2011-04, which is still pending review for SAP.) *(NAIC staff’s initial thoughts are that this disclosure is unnecessary for statutory accounting, but comments are requested if regulators would like this detail.)*

*(In addition to the revisions from the ASU, a clean-up provision has been incorporated to remove the reference of ASU 2009-12 in paragraph 59.)*
Proposed Revisions to SSAP No. 100R—Fair Value:

Disclosures

47. The objective of the disclosure requirements is to provide information about assets and liabilities measured at fair value in the financial statements as well as fair value amounts disclosed in the notes to financial statements or reporting schedules. A reporting entity shall disclose information that helps users of the financial statements to assess both of the following: (1) For assets and liabilities that are measured and reported at fair value or NAV in the statement of financial position after initial recognition, the valuation techniques and inputs used to develop those measurements; (2) For fair value measurements in the statement of financial position determined using significant unobservable inputs (Level 3), the effect of the measurements on earnings (or changes in net assets) for the period. To meet these objectives, the reporting entity shall disclose the information in paragraphs 47.a—47.f.

47.48. For each class of assets and liabilities measured and reported at fair value or NAV in the statement of financial position after initial recognition. The reporting entity shall determine appropriate classes of assets and liabilities in accordance with the annual statement instructions.

   a. The fair value/NAV measurements at the reporting date.

   b. The level of the fair value hierarchy within which the fair value measurements are categorized in their entirety (Level 1, 2 or 3). (Investments reported at NAV shall not be captured within the fair value hierarchy, but shall be separately identified.)

   c. For assets and liabilities held at the reporting date, the amounts of any transfers between Level 1 and Level 2 of the fair value hierarchy, the reasons for the transfers, and the reporting entity’s policy for determining when transfers between levels are recognized. Transfers into each level shall be disclosed and discussed separately from transfers out of each level.

   d. For fair value measurements categorized within Level 2 and Level 3 of the fair value hierarchy, a description of the valuation technique(s) and the inputs used in the fair value measurement. If there has been a change in the valuation technique (for example, changing from a market approach to an income approach or the use of an additional valuation technique), the reporting entity shall disclose that change and the reason(s) for making it.

   e. For fair value measurements categorized within Level 3 of the fair value hierarchy a reconciliation from the opening balances to the closing balances disclosing separately changes during the period attributable to the following:

      i. Total gains or losses for the period recognized in income or surplus.

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3 The term “reported” is intended to reflect the measurement basis for which the asset or liability is classified within its underlying SSAP. For example, a bond with an NAIC designation of 2 is considered an amortized cost measurement and is not included within this disclosure even if the amortized cost and fair value measurement are the same. An example of when such a situation may occur includes a bond that is written down as other-than-temporarily impaired as of the date of financial position. The amortized cost of the bond after the recognition of the other-than-temporary impairment may agree to fair value, but under SSAP No. 26R this security is considered to still be reported at amortized cost.

4 The term “reported” is intended to reflect the measurement basis for which the asset or liability is classified within its underlying SSAP. For example, a bond with an NAIC designation of 2 is considered an amortized cost measurement and is not included within this disclosure even if the amortized cost and fair value measurement are the same. An example of when such a situation may occur includes a bond that is written down as other-than-temporarily impaired as of the date of financial position. The amortized cost of the bond after the recognition of the other-than-temporary impairment may agree to fair value, but under SSAP No. 26R this security is considered to still be reported at amortized cost.

5 See Footnote 4
ii. Purchases, sales, issues, and settlements (each type disclosed separately)

iii. The amounts of any transfers into or out of Level 3, and the reasons for those transfers, and the reporting entity’s policy for determining when transfers between levels are recognized. Transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3.

f.e. A reporting entity shall disclose and consistently follow its policy for determining when transfers between levels are recognized. The policy about the timing of recognizing transfers shall be the same for transfers into Level 3 as that for transfers out of Level 3. Examples of policies for when to recognize the transfers are as follows:

i. The actual date of the event or change in circumstances that caused the transfer

ii. The beginning of the reporting period

iii. The end of the reporting period.

48.49. For derivative assets and liabilities, the reporting entity shall present both of the following:

a. The disclosures required by paragraph 487.a. and 487.b. on a gross basis

b. The reconciliation disclosures required by paragraph 478.dc., 478.ed. and 487.fe. on either a gross or net basis

49.50. The quantitative disclosures required in paragraphs 487-498 of this standard shall be presented using a tabular format.

50.51. The reporting entity shall disclose the fair value hierarchy and the method used to obtain the fair value measurement, or the use of NAV, for all items in which fair value is disclosed within the annual statement investment schedules. This disclosure is satisfied by the completion of the investment schedules in the Annual statement and is not required quarterly.

51.52. For investments measured using the NAV practical expedient pursuant to paragraph 39, a reporting entity shall disclose information that helps users of its financial statements to understand the nature and risks of the investments and whether the investments, if sold, are probable of being sold at amounts different from net asset value per share. To meet that objective, a reporting entity shall disclose, at a minimum, the following information for instances in which the investment may be sold below NAV, or if there are significant restrictions in the liquidation of an investment held at NAV:

a. The NAV along with a description of the investment/investment strategy of the investee.

b. If the investment that can never be redeemed with the investees, but the reporting entity receives distributions through the liquidation of the underlying assets of the investees, the reporting entity’s estimate of the period of time over which the underlying assets are expected to be liquidated by the investees if the investee has communicated the timing to the reporting entity or announced the timing publicly. If the timing is unknown, the reporting entity shall disclose that fact.

c. The amount of the reporting entity’s unfunded commitments related to investments in the class.

d. A general description of the terms and conditions upon which the investor may redeem the investment.

e. The circumstances in which an otherwise redeemable investment in the class (or a portion thereof) might not be redeemable (for example, investments subject to a lockup or gate). Also, for those otherwise redeemable investments that are restricted from
redemption as of the reporting entity’s measurement date, the reporting entity shall disclose its estimate of when the restriction from redemption might lapse if the investee has communicated that timing to the reporting entity or announced the timing publicly. If an estimate cannot be made the timing is unknown, the reporting entity shall disclose that fact and how long the restriction has been in effect.

f. Any other significant restriction on the ability to sell investments in the class at the measurement date.

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

52-53. The reporting entity is encouraged, but not required, to combine the fair value information disclosed under this standard with the fair value information disclosed under other accounting pronouncements (for example, disclosures about fair value of financial instruments) in the periods in which those disclosures are required, if practicable. The reporting entity also is encouraged, but not required, to disclose information about other similar measurements, if practicable.

Disclosures about Fair Value of Financial Instruments

53-54. A reporting entity shall disclose in the notes to the financial statements, as of each date for which a statement of financial position is presented in the quarterly or annual financial statements, the aggregate fair value or NAV for all financial instruments and the level within the fair value hierarchy in which the fair value measurements in their entirety fall. This disclosure shall be summarized by type of financial instrument, for which it is practicable to estimate fair value, except for certain financial instruments identified in paragraph 545. Fair value disclosed in the notes shall be presented together with the related admitted values in a form that makes it clear whether the fair values and admitted values represent assets or liabilities and to which line items in the Statement of Assets, Liabilities, Surplus and Other Funds they relate. Unless specified otherwise in another SSAP, the disclosures may be made net of encumbrances, if the asset or liability is so reported. A reporting entity shall also disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments. If it is not practicable for an entity to estimate the fair value of the financial instrument or a class of financial instruments, and the investment does not qualify for the NAV practical expedient, the aggregate carrying amount for those items shall be reported as “not practicable” with additional disclosure as required in paragraph 487.

54-55. The disclosures about fair value prescribed in paragraph 543 are not required for the following:

a. Employers’ and plans’ obligations for pension benefits, other postretirement benefits including health care and life insurance benefits, postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements, as defined in SSAP No. 12—Employee Stock Ownership Plans (SSAP No. 12), SSAP No. 92—Postretirement Benefits Other Than Pensions (SSAP No. 92), SSAP No. 102—Pensions (SSAP No. 102) and SSAP No. 104R—Share-Based Payments (SSAP No. 104R).

b. Substantively extinguished debt subject to the disclosure requirements of SSAP No. 103R—Transfer and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 103R)

c. Insurance contracts, other than financial guarantees and deposit-type contracts

d. Lease contracts as defined in SSAP No. 22—Leases (SSAP No. 22)

e. Warranty obligations and rights
f. Investments accounted for under the equity method

g. Equity instruments issued by the entity

h. Deposit liabilities with no defined or contractual maturities

55.56. If it is not practicable for an entity to estimate the fair value of a financial instrument or a class of financial instruments, and the investment does not qualify for the NAV practical expedient, the following shall be disclosed:

a. Information pertinent to estimating the fair value of that financial instrument or class of financial instruments, such as the carrying amount, effective interest rate, and maturity; and

b. The reasons why it is not practicable to estimate fair value.

56.57. In the context of this standard, practicable means that an estimate of fair value can be made without incurring excessive costs. It is a dynamic concept: what is practicable for one entity might not be for another; what is not practicable in one year might be in another. For example, it might not be practicable for an entity to estimate the fair value of a class of financial instruments for which a quoted market price is not available because it has not yet obtained or developed the valuation model necessary to make the estimate, and the cost of obtaining an independent valuation appears excessive considering the materiality of the instruments to the entity. Practicability, that is, cost considerations, also may affect the required precision of the estimate; for example, while in many cases it might seem impracticable to estimate fair value on an individual instrument basis, it may be practicable for a class of financial instruments in a portfolio or on a portfolio basis. In those cases, the fair value of that class or of the portfolio should be disclosed. Finally, it might be practicable for an entity to estimate the fair value only of a subset of a class of financial instruments; the fair value of that subset should be disclosed.

Relevant Literature

57.58. This standard adopts with modification FAS 157, Fair Value Measurements; (FAS 157) FSP FAS 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement Under Statement 13, (FSP FAS 157-1) and FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP FAS 157-4). Modifications from FAS 157, FSP FAS 157-1 and FSP FAS 157-4 include:

a. See revision to paragraph 3.b. from adoption of SSAP No. 104R—Share-Based Payments (SSAP No. 104R).

b. This standard does not adopt the scope exclusions within paragraph 3 of FAS 157 for accounting pronouncements that require or permit measurements that are similar to fair value but that are not intended to measure fair value, including (a) accounting pronouncements that permit measurements that are based on, or otherwise use, vendor-specific objective evidence of fair value and (b) inventory pricing. These items are excluded as they are not prevalent within statutory accounting.

c. This standard does not adopt guidance from FAS 157 regarding the consideration of non-performance risk (own credit risk) in determining the fair value measurement of liabilities. The consideration of own credit-risk in the measurement of fair value liabilities is inconsistent with the statutory accounting concept of conservatism and the assessment of financial solvency for insurers. The fair value determination for liabilities should follow the guidance adopted from FAS 157, with the exception of the consideration of own-performance risk.

d. This standard includes revisions to reference statutory standards or terms instead of GAAP standards or terms.
This standard incorporates the guidance from SSAP No. 27 regarding disclosures about fair value of financial instruments. This incorporated SSAP No. 27 guidance was adopted from FAS 107, Disclosures about Fair Value of Financial Instruments (FAS 107) and was revised to adopt FSP FAS 107-1 and APB-1, Interim Disclosures about Fair Value of Financial Instruments (FSP FAS 107-1 and APB-1). For statutory purposes, the incorporation of this guidance within one standard results in having one comprehensive standard addressing fair value measurements and disclosures.

58-59. In August 2010, this statement adopted with modification the new and revised disclosure requirements within ASU 2010-06, Fair Value Measurements and Disclosures – (Topic 820) – Improving Disclosures about Fair Value Measurements (ASU 2010-06). GAAP revisions within ASU 2010-06 that modify the FASB Codification on aspects originally added by ASU 2009-05, Fair Value Measurements and Disclosures, Measuring Liabilities at Fair Value (ASU 2009-05), and ASU 2009-12, Fair Value Measurements and Disclosures, Investment in Certain Entities that Calculate Net Asset Value per Share (or its equivalent) (ASU 2009-12). These revisions are not adopted, as the underlying GAAP guidance within ASU 2009-05 and ASU 2009-12 has not been considered for statutory accounting. When ASU 2009-05 and ASU 2009-12 are reviewed for statutory accounting, the GAAP guidance considered will reflect the revisions from ASU 2010-06. Subsequent nonsubstantive revisions to the guidance adopted from ASU 2010-06 were incorporated within this Statement in November 2010 to clarify the disclosure requirements for statutory accounting. These revisions removed the distinction between recurring and non-recurring fair value measurements and clarified disclosure requirements for assets and liabilities measured and reported at fair value in the statement of financial position. In this statement adopted with modification disclosure revisions from ASU 2018-13, Changes to the Disclosure Requirements for Fair Value Measurement. Modifications to ASU 2018-13 incorporate revisions to previously adopted GAAP disclosures, and do not incorporate revisions related to disclosures not previously reflected for statutory accounting.

59-60. In November 2017, substantive revisions, as detailed in Issue Paper No. 157, were incorporated to this statement to adopt ASU 2009-12: Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent) and ASU 2015-07: Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent). These substantive revisions incorporated new guidance allowing reporting entities to utilize net asset value per share as a practical expedient to fair value when certain conditions are met.

60-61. Paragraphs 53-56 adopt FAS 107 as amended by FASB Statement No. 119, Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments (FAS 119), except that paragraph 15(c) of FAS 119 relating to disclosure of financial instruments held or issued for trading is rejected and FASB Emerging Issues Task Force No. 85-20, Recognition of Fees for Guaranteeing a Loan. Financial instruments named within paragraph 8 of FAS 107 that are exempt from disclosure are adopted to the extent applicable for statutory accounting and are reflected in paragraph 54. This standard also adopts revisions to FAS 107 reflected in FSP FAS 107-1 and APB-1, Interim Disclosures about Fair Value of Financial Instruments (FSP FAS 107-1 and APB-1), and thus requires disclosure in both annual and quarterly financial statements. In addition, this standard rejects FASB Statement No. 126, Exemptions from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities, an amendment of FAS 107. FAS 119 is addressed in SSAP No. 31.


Staff Review Completed by:
Julie Gann, NAIC Staff – September 2018
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### Issue: ASU 2018-14, Changes to the Disclosure Requirements for Defined Benefit Plans

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**Description of Issue:** 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.)

Existing Authoritative Literature:

Guidance for pensions and other postretirement plans (OPEB plans) are captured in SSAP No. 92—Postretirement Plans Other Than Pensions and SSAP No. 102—Pensions. The guidance in these SSAPs adopt with modification U.S. GAAP guidance for OPEBs and pensions. A key modification in both SSAP No. 92 and SSAP No. 102 was the statutory rejection of the U.S. GAAP reduced disclosure requirements for nonpublic entities. Rather, both SSAP No. 92 and SSAP No. 102 adopt the U.S. GAAP disclosure requirements for public entities as reflected in the SSAPs.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

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

Convergence with International Financial Reporting Standards (IFRS): IAS 19, Employee Benefits establishes recognition, measurement, and disclosure requirements for financial statements prepared in conformity with IFRS. Must of the current disclosure guidance in ASC 710-20 is the same as, or is similar to, that in IAS 19. However, there are differences based on the FASB’s and the IASB’s differing assessments on financial statement users’ needs and the differences in the recognition and measurement principles applied to defined benefit pension and other postretirement plans. The amendments in ASU 2018-14 are the results of the FASB’s application of the concepts in the Concepts Statement as they related to defined benefit pension and other postretirement plans and are narrow in scope. As a result, significant convergence with IAS 19 is not expected to be achieved from these amendments.

Staff Recommendation:

NAIC staff recommends that the Working Group move this item to the nonsubtantive 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)

- 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)

**Proposed Revisions to SSAP No. 92:**

**Disclosures - Single-Employer Defined Postretirement Plans**

66. An employer that sponsors one or more other defined benefit postretirement plans shall provide the following information for postretirement benefit plans other than pensions. Amounts related to the employer’s results of operations shall be disclosed for each period for which a statement of income is presented. Amounts related to the employer’s statement of financial position, shall be disclosed as of the date of each statement of financial position presented.

   a. A reconciliation of beginning and ending balances of the benefit obligation showing separately, if applicable, the effects during the period attributable to each of the following: service cost, interest cost, contributions by plan participants, actuarial gains and losses, foreign currency exchange rate changes, benefits paid, plan amendments, business combinations, divestitures, curtailments, settlements, and special termination benefits.

   b. A reconciliation of beginning and ending balances of the fair value of plan assets showing separately, if applicable, the effects during the period attributable to each of the following: actual return on plan assets, foreign currency exchange rate changes, contributions by the employer, contributions by plan participants, benefits paid, business combinations, divestitures, and settlements.

   c. The funded status of the plans and the amounts recognized in the statement of financial position, showing separately the assets (nonadmitted) and liabilities recognized.

   d. The objectives of the disclosures about postretirement benefit plan assets are to provide users of financial statements with an understanding of:

      i. How investment allocation decisions are made, including the factors that are pertinent to an understanding of investment policies and strategies

      ii. The classes of plan assets
iii. The inputs and valuation techniques used to measure the fair value of plan assets

iv. The effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets for the period

v. Significant concentrations of risk within plan assets.

An employer shall consider those overall objectives in providing the following information about plan assets:

(a) A narrative description of investment policies and strategies, including target allocation percentages or range of percentages considering the classes of plan assets disclosed pursuant to (b) below, as of the latest statement of financial position presented (on a weighted-average basis for employers with more than one plan), and other factors that are pertinent to an understanding of those policies and strategies such as investment goals, risk management practices, permitted and prohibited investments including the use of derivatives, diversification, and the relationship between plan assets and benefit obligations. For investment funds disclosed as classes as described in (b) below, a description of the significant investment strategies of those funds shall be provided.

(b) The fair value of each class of plan assets as of each date for which a statement of financial position is presented. Asset classes shall be based on the nature and risks of assets in an employer’s plan(s). Examples of classes of assets include, but are not limited to, the following: cash and cash equivalents; equity securities, (segregated by industry type, company size, or investment objective); debt securities, issued by national, state, and local governments; corporate debt securities; asset-backed securities; structured debt; derivatives on a gross basis (segregated by type of underlying risk in the contract, for example, interest rate contracts, foreign exchange contracts, equity contracts, commodity contracts, credit contracts, and other contracts); investment funds (segregated by type of fund); and real estate. Those examples are not meant to be all inclusive. An employer should consider the overall objectives in paragraph 66.d. in determining whether additional classes of plan assets or further disaggregation of classes should be disclosed.

(c) A narrative description of the basis used to determine the overall expected long-term rate-of-return-on-assets assumption, such as the general approach used, the extent to which the overall rate-of-return-on-assets assumption was based on historical returns, the extent to which adjustments were made to those historical returns in order to reflect expectations of future returns, and how those adjustments were determined. The description should consider the classes of assets described in (b) above, as appropriate.

(d) Information that enables users of financial statements to assess the inputs and valuation techniques used to develop fair value measurements of plan assets at the reporting date. For fair value measurements using significant unobservable inputs, an employer shall disclose the effect of the measurements on changes in plan assets for the period. To meet those objectives, the employer shall disclose the following information for each class of plan assets disclosed pursuant to (b) above for each annual period:
(1) The level within the fair value hierarchy in which the fair value measurements in their entirety fall,\(^1\) segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3).

(2) Information about the valuation technique(s) and inputs used to measure fair value and a discussion of changes in valuation techniques and inputs, if any, during the period.

e. The benefits (as of the date of the latest statement of financial position presented) expected to be paid in each of the next five fiscal years, and in the aggregate for the five fiscal years thereafter. The expected benefits should be estimated based on the same assumptions used to measure the company’s benefit obligation at the end of the year and should include benefits attributable to estimated future employee service.

f. The employer’s best estimate, as soon as it can reasonably be determined, of contributions expected to be paid to the plan during the next fiscal year beginning after the date of the latest statement of financial position presented. Estimated contributions may be presented in the aggregate combining (1) contributions required by funding regulations or laws, (2) discretionary contributions, and (3) noncash contributions.

g. The amount of net periodic benefit cost recognized, showing separately the service cost component, the interest cost component, the expected return on plan assets for the period, the gain or loss component, the prior service cost or credit component, the transition asset or obligation component, and the gain or loss recognized due to settlements or curtailments.

h. Separately the net gain or loss and net prior service cost or credit recognized in unassigned funds (surplus) for the period pursuant to paragraphs 42 and 46, and reclassification adjustments of unassigned funds (surplus) for the period, as those amounts, including amortization of the net transition asset or obligation, are recognized as components of net periodic benefit cost.

i. The amounts in unassigned funds (surplus) that have not yet been recognized as components of net periodic benefit cost, showing separately the net gain or loss, net prior service cost or credit, and net transition asset or obligation.

j. On a weighted-average basis, the following assumptions used in the accounting for the plans: assumed discount rates, rates of compensation increase (for pay-related plans), and expected long-term rates of return on plan assets specifying, in a tabular format, the assumptions used to determine the benefit obligation and the assumptions used to determine net benefit cost, and interest crediting rates (for cash balance plans and other plans with promised interest crediting rates).

k. The assumed health care cost trend rate(s) for the next year used to measure the expected cost of benefits covered by the plan (gross eligible charges), and a general description of the direction and pattern of change in the assumed trend rates thereafter, together with the ultimate trend rate(s) and when that rate is expected to be achieved.

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\(^1\) In some cases, the inputs used to measure fair value might fall in different levels of the fair value hierarchy. The level in the fair value hierarchy within which the fair value measurement in its entirety falls shall be determined based on the lowest level input that is significant to the fair value measurement in its entirety. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability.
The effect of a one-percentage-point increase and the effect of a one-percentage-point decrease in the assumed health care cost trend rates on (1) the aggregate of the service and interest cost components of net periodic postretirement health care benefit costs and (2) the accumulated postretirement benefit obligation for health care benefits. (For purposes of this disclosure, all other assumptions shall be held constant, and the effects shall be measured based on the substantive plan that is the basis for the accounting.)

If applicable, the amounts and types of securities of the employer and related parties included in plan assets, the approximate amount of future annual benefits of plan participants covered by insurance contracts issued by the employer or related parties, and any significant transactions between the employer or related parties and the plan during the period.

If applicable, any alternative method used to amortize prior service amounts or net gains and losses pursuant to paragraphs 43 and 50.

If applicable, any substantive commitment, such as past practice or a history of regular benefit increases, used as the basis for accounting for the benefit obligation.

If applicable, the cost of providing special or contractual termination benefits recognized during the period and a description of the nature of the event.

An explanation of the following information: any significant change in the benefit obligation or plan assets not otherwise apparent in the other disclosures required by this statement.

The reasons for significant gains and losses related to changes in the defined benefit obligation for the period.

Any other significant change in the benefit obligation or plan assets not otherwise apparent in the other required disclosures in this statement.

The amounts in unassigned funds (surplus) expected to be recognized as components of net periodic benefit cost over the fiscal year that follows the most recent annual statement of financial position presented, showing separately the net gain or loss, net prior service cost or credit, and net transition asset or obligation.

The amount and timing of any plan assets expected to be returned to the employer during the 12-month period, or operating cycle if longer, that follows the most recent annual statement of financial position presented.

Disclosures – Employers with Two or More Defined Benefit Plans

The disclosures required by this statement shall be aggregated for all of an employer’s other defined benefit postretirement plans unless disaggregating in groups is considered to provide useful information or is otherwise required by this paragraph and paragraph 70 of this statement. Disclosures shall be as of the date of each statement of financial position presented. If aggregate disclosures are presented, an employer shall disclose as of the date of each statement of financial position presented:

The accumulated aggregate benefit obligation and aggregate fair value of plan assets for plans with accumulated benefit obligations in excess of plan assets as of the measurement date of each statement of financial position presented.

A U.S. reporting entity may combine disclosures about pension plans or other postretirement benefit plans outside the United States with those for U.S. plans unless the benefit obligations of
the plans outside the United States are significant relative to the total benefit obligation and those plans use significantly different assumptions.

102. This statement adopts with modification paragraphs 1-7 and 16-18 as well as Appendix D – Amendments to Statement 106 and Appendix E – Amendments to Statement 132(R) of FASB Statement No. 158, Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R) (FAS 158). Paragraphs 8-10 and D2.u providing specific guidance for not-for-profit organizations are rejected. Paragraphs 11-15 regarding the effective dates for FAS 158 are rejected and paragraph 19 providing an alternative method for remeasuring plan assets and benefits obligations as of the fiscal year the measurement date provisions are applied is also rejected. The disclosure included within FAS 132 (R), as amended by FAS 158, pertaining specifically to pensions (paragraph 5.e.) has been rejected for inclusion within this standard. This Statement adopts the revisions to paragraph 5.d. of FAS 132(R) as amended by FASB Staff Position FAS 132(R)-1, Employers’ Disclosures about Postretirement Benefit Plan Assets (FSP FAS 132(R)-1) and ASU 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements (ASU 2010-06). Other revisions to disclosure requirements as amended by FSP FAS 132(R)-1 relate to nonpublic entities and are rejected. This statement adopts EITF 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements. This statement adopts by reference revisions to ASC 715-80 as detailed in ASU 2011-09, Compensation – Retirement Benefits – Multiemployer Plans with limited additional disclosures required within statutory financial statements. This statement adopts by reference FSP FASB 158-1, Conforming Amendments to the Illustrations in FASB Statements No. 87, No. 88, and No. 106 and to the Related Staff Implementation Guides (FSP FAS 158-1) to the extent that the examples and related implementation guides comply with the adopted GAAP guidance previously identified within this statement, as modified for statutory accounting. This statement adopts with modification the disclosure revisions reflected in ASU 2018-14, Changes to the Disclosure Requirements for Defined Benefit Plans, consistent with the modifications from the adoption of FAS 158 and FAS 106. The following modifications from the adopted paragraphs of FAS 158 and FAS 106 have been incorporated within this standard:

a. All references to “other comprehensive income” or “accumulated other comprehensive income” within FAS 158 have been revised to reflect “unassigned funds (surplus).”

b. Any prepaid asset resulting from the excess of the fair value of plan assets over the accumulated postretirement benefit obligation shall be nonadmitted. Furthermore, any asset recognized from the cost of a “participation right” of an annuity contract per paragraph 59 shall also be nonadmitted.

c. Provisions within paragraph 57 and 58 of FAS 106, as amended by FAS 158, permitting a calculated market-related value of plan assets has been eliminated with only the fair value measurement method for plan assets retained.

d. The reduced disclosure requirements for nonpublic entities described in paragraph 8 of FAS 132(R), as amended by FAS 158, are rejected. All reporting entities shall follow the disclosure requirements within this statement which have been adopted from paragraph 5 of FAS 132(R), as amended by FAS 158.

e. Clarification has been included within this standard to ensure both vested and nonvested employees are included within the recognition of net postretirement benefit cost and in the accumulated postretirement benefit obligation. Although this is consistent with GAAP, this is a change from previous statutory accounting. As nonvested employees were excluded from statutory accounting under SSAP No. 14, guidance has been included to indicate that the unrecognized prior service cost attributed to nonvested individuals is not required to be included in net postretirement benefit cost entirely in the year this standard is adopted. The unrecognized prior service cost for nonvested employees shall be amortized as a component of net postretirement benefit cost by assigning an equal
amount to each expected future period of service before vesting occurs for nonvested employees active at the date of the amendment. Unassigned funds (surplus) is then adjusted each period as prior service cost is amortized. (Guidance is included within the transition related to the recognition of the prior service cost for nonvested employees through unassigned surplus.)

f. Conclusion of Interpretation 99-26: Offsetting Pension Assets and Liabilities (INT 99-26) prohibiting the offset of defined benefit liabilities of one plan with prepaid assets of another plan has been incorporated within paragraph 33 of this statement.

g. Provisions within paragraph 44B of FAS 106, as amended by FAS 158, regarding the classification of underfunded liabilities as current or noncurrent liabilities and the classification of assets from overfunded plans as noncurrent assets has been rejected as inconsistent with statutory accounting.

h. Provisions within paragraph 65 of FAS 106, as amended by FAS 158, defining the fair value of investments have been rejected. Fair value definitions and measurement for investments shall be determined in accordance with statutory accounting guidance.

i. Provisions within paragraph 72 of FAS 106, as amended by FAS 158, regarding the plan assets measurement date for consolidating subsidiaries or entities utilizing the equity method under APB Opinion No. 18 has been rejected. For statutory accounting, all entities shall follow the measurement date guidance within paragraph 62 of this statement.

j. The disclosure requirement included within paragraph 5.e. of FAS 132(R) has been rejected for this statement as it specifically pertains to pensions.

k. Transition under FAS 158 is different from the requirements of this statement. FAS 158 requires publicly traded equity securities to initially apply the requirement to recognize the funded status of a postretirement benefit plan; the gains/losses, prior service costs/credits and transition obligations/assets that have not yet been included in net periodic benefit cost; and the disclosure requirements as of the end of the fiscal year ending after December 15, 2006. Transition guidelines for statutory accounting are defined in paragraphs 105-116 of this statement.

l. FAS 158 provided two approaches for an employer to transition to a fiscal year-end measurement date. For purposes of statutory accounting, the second approach permitting reporting entities to use earlier measurements determined for year-end reporting as of the fiscal year immediately preceding the year that the measurement date provisions is rejected. For consistency purposes, all reporting entities shall follow the first approach and remeasure plan assets and benefit obligations as of the beginning of the fiscal year that the measurement date provisions are applied.

Proposed Revisions to SSAP No. 102:

Disclosures – Single-Employer Defined Benefit Plans

68. An employer that sponsors one or more defined benefit pension plans or one or more other defined benefit postretirement plans shall provide the following information, separately for pension plans and other postretirement benefit plans. Amounts related to the employer’s results of operations shall be disclosed for each period for which a statement of income is presented. Amounts related to the employer’s statement of financial position, shall be disclosed as of the date of each statement of financial position presented.

a. A reconciliation of beginning and ending balances of the benefit obligation showing separately, if applicable, the effects during the period attributable to each of the following:
service cost, interest cost, contributions by plan participants, actuarial gains and losses, foreign currency exchange rate changes, benefits paid, plan amendments, business combinations, divestitures, curtailments, settlements, and special termination benefits.

b. A reconciliation of beginning and ending balances of the fair value of plan assets showing separately, if applicable, the effects during the period attributable to each of the following: actual return on plan assets, foreign currency exchange rate changes, contributions by the employer, contributions by plan participants, benefits paid, business combinations, divestitures, and settlements.

c. The funded status of the plans and the amounts recognized in the statement of financial position, showing separately the assets and liabilities recognized.

d. The objectives of the disclosures about postretirement benefit plan assets are to provide users of financial statements with an understanding of:

i. How investment allocation decisions are made, including the factors that are pertinent to an understanding of investment policies and strategies

ii. The classes of plan assets

iii. The inputs and valuation techniques used to measure the fair value of plan assets

iv. The effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets for the period

v. Significant concentrations of risk within plan assets.

An employer shall consider those overall objectives in providing the following information about plan assets:

(a) A narrative description of investment policies and strategies, including target allocation percentages or range of percentages considering the classes of plan assets disclosed pursuant to (b) below, as of the latest statement of financial position presented (on a weighted-average basis for employers with more than one plan), and other factors that are pertinent to an understanding of those policies and strategies such as investment goals, risk management practices, permitted and prohibited investments including the use of derivatives, diversification, and the relationship between plan assets and benefit obligations. For investment funds disclosed as classes as described in (b) below, a description of the significant investment strategies of those funds shall be provided.

(b) The fair value of each class of plan assets as of each date for which a statement of financial position is presented. Asset classes shall be based on the nature and risks of assets in an employer’s plan(s). Examples of classes of assets could include, but are not limited to, the following: cash and cash equivalents; equity securities, (segregated by industry type, company size, or investment objective); debt securities, issued by national, state, and local governments; corporate debt securities; asset-backed securities; structured debt; derivatives on a gross basis (segregated by type of underlying risk in the contract, for example, interest rate contracts, foreign exchange contracts, commodity contracts, equity contracts, credit contracts, and other contracts); investment funds (segregated by type of fund); and real estate. Those examples are not meant to be all inclusive. An employer should consider the overall
objectives in paragraph 68.d. in determining whether additional classes of plan assets or further disaggregation of classes should be disclosed.

(c) A narrative description of the basis used to determine the overall expected long-term rate-of-return-on-assets assumption, such as the general approach used, the extent to which the overall rate-of-return-on-assets assumption was based on historical returns, the extent to which adjustments were made to those historical returns in order to reflect expectations of future returns, and how those adjustments were determined. The description should consider the classes of assets described in (b) above, as appropriate.

(d) Information that enables users of financial statements to assess the inputs and valuation techniques used to develop fair value measurements of plan assets at the reporting date. For fair value measurements using significant unobservable inputs, an employer shall disclose the effect of the measurements on changes in plan assets for the period. To meet those objectives, the employer shall disclose the following information for each class of plan assets disclosed pursuant to (b) above for each annual period:

(1) The level within the fair value hierarchy in which the fair value measurements in their entirety fall,² segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3).

(2) Information about the valuation technique(s) and inputs used to measure fair value and a discussion of changes in valuation techniques and inputs, if any, during the period.

e. For defined benefit pension plans, the accumulated benefit obligation.

f. The benefits (as of the date of the latest statement of financial position presented) expected to be paid in each of the next five fiscal years, and in the aggregate for the five fiscal years thereafter. The expected benefits should be estimated based on the same assumptions used to measure the company's benefit obligation at the end of the year and should include benefits attributable to estimated future employee service.

g. The employer's best estimate, as soon as it can reasonably be determined, of contributions expected to be paid to the plan during the next fiscal year beginning after the date of the latest statement of financial position presented. Estimated contributions may be presented in the aggregate combining (1) contributions required by funding regulations or laws, (2) discretionary contributions, and (3) noncash contributions.

h. The amount of net benefit cost recognized, showing separately the service cost component, the interest cost component, the expected return on plan assets for the period, the gain or loss component, the prior service cost or credit component, the transition asset or obligation component, and the gain or loss recognized due to settlements or curtailments.

² In some cases, the inputs used to measure fair value might fall in different levels of the fair value hierarchy. The level in the fair value hierarchy within which the fair value measurement in its entirety falls shall be determined based on the lowest level input that is significant to the fair value measurement in its entirety. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability.
i. Separately the net gain or loss and net prior service cost or credit recognized in unassigned funds (surplus) for the period pursuant to paragraphs 15 and 19 and reclassification adjustments of unassigned funds (surplus) for the period, as those amounts, including amortization of the net transition asset or obligation, are recognized as components of net periodic benefit cost.

j. The amounts in unassigned funds (surplus) that have not yet been recognized as components of net periodic benefit cost, showing separately the net gain or loss, net prior service cost or credit, and net transition asset or obligation.

k. On a weighted-average basis, the following assumptions used in the accounting for the plans: assumed discount rates, rates of compensation increase (for pay-related plans), and expected long-term rates of return on plan assets specifying, in a tabular format, the assumptions used to determine the benefit obligation and the assumptions used to determine net benefit cost, and interest crediting rates (for cash balance plans and other plans with promised crediting rates).

l. If applicable, the amounts and types of securities of the employer and related parties included in plan assets, the approximate amount of future annual benefits of plan participants covered by insurance contracts issued by the employer or related parties, and any significant transactions between the employer or related parties and the plan during the period.

m. If applicable, any alternative method used to amortize prior service amounts or net gains and losses pursuant to paragraphs 16 and 23.

n. If applicable, any substantive commitment, such as past practice or a history of regular benefit increases, used as the basis for accounting for the benefit obligation.

o. If applicable, the cost of providing special or contractual termination benefits recognized during the period and a description of the nature of the event.

p. An explanation of the following information: any significant change in the benefit obligation or plan assets not otherwise apparent in the other disclosures required by this statement.

i. The reasons for significant gains and losses related to changes in the defined benefit obligation for the period.

ii. Any other significant change in the benefit obligation or plan assets not otherwise apparent in the other disclosures required by this statement.

q. The amounts in unassigned funds (surplus) expected to be recognized as components of net periodic benefit cost over the fiscal year that follows the most recent annual statement of financial position presented, showing separately the net gain or loss, net prior service cost or credit, and net transition asset or obligation.

r. The amounts and timing of any plan assets expected to be returned to the employer during the 12-month period, or operating cycle if longer, that follows the most recent annual statement of financial position presented.

Disclosures – Employers with Two or More Defined Benefit Plans

69. The disclosures required by this statement shall be aggregated for all of an employer’s defined benefit pension plans and for all of an employer’s other defined benefit postretirement plans unless disaggregating in groups is considered to provide useful information or is otherwise required by this paragraph and paragraph 70. Disclosures shall be as of the date of each statement of financial position presented. Disclosures about pension plans with assets in excess
of the accumulated benefit obligation generally may be aggregated with disclosures about pension plans with accumulated benefit obligations in excess of assets. The same aggregation is permitted for other postretirement benefit plans. If aggregate disclosures are presented, an employer shall disclose, as of the date of each financial statement position presented:

a. The aggregate projected benefit obligation and aggregate fair value of plan assets for plans with projected benefit obligations in excess of plan assets as of the measurement date of each statement of financial position presented.

b. The aggregate pension accumulated benefit obligation and aggregate fair value of plan assets for pension plans with accumulated benefit obligations in excess of plan assets.

70. A U.S. reporting entity may combine disclosures about pension plans or other postretirement benefit plans outside the United States with those for U.S. plans unless the benefit obligations of the plans outside the United States are significant relative to the total benefit obligation and those plans use significantly different assumptions.

87. This statement adopts with modification paragraphs 1-7 and 16-17 as well as Appendix C – Amendments to Statements 87 and 88 and Appendix E – Amendments to Statement 132(R) of FASB Statement No. 158, Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R) (FAS 158). Paragraphs 8-10 providing specific guidance for not-for-profit organizations is rejected. Paragraphs 11-15 regarding the effective dates for FAS 158 is rejected and paragraph 19 providing an alternative method for remeasuring plan assets and benefits obligations as of the fiscal year the measurement date provisions are applied is also rejected. Appendix D – Amendments to Statement 106 has not been incorporated within this statutory statement as it will be considered in accordance with revisions to SSAP No. 14—Postretirement Benefits Other Than Pensions (SSAP No. 14). Disclosures included within FAS 132(R), as amended by FAS 158, pertaining to health care (paragraphs 5.l. and 5.m.) have been rejected for inclusion within this standard, but will also be considered in accordance with revisions to SSAP No. 14. This statement adopts the revisions to paragraph 5.d. of FAS 132(R) as amended by FASB Staff Position FAS 132(R)-1, Employers’ Disclosures about Postretirement Benefit Plan Assets (FSP FAS 132(R)-1) and ASU 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements (ASU 2010-06). Other revisions to disclosures requirements as amended by FSP FAS 132(R)-1 relate to nonpublic entities and are rejected. This statement adopts by reference revisions to ASC 715-80 as detailed in ASU 2011-09, Compensation – Retirement Benefits – Multiemployer Plans with limited additional disclosures required within statutory financial statements. This statement adopts by reference FSP FASB 158-1, Conforming Amendments to the Illustrations in FASB Statements No. 87, No. 88, and No. 106 and to the Related Staff Implementation Guides (FSP FAS 158-1) to the extent that the examples and related implementation guides comply with the adopted GAAP guidance previously identified within this statement, as modified for statutory accounting. **This statement adopts with modification the disclosure revisions reflected in ASU 2018-14, Changes to the Disclosure Requirements for Defined Benefit Plans, consistent with the modifications from the adoption of FAS 158 and FAS 106.** The following modifications from the adopted paragraphs of FAS 158 have been incorporated within this standard:

a. All references to ‘other comprehensive income’ or ‘accumulated other comprehensive income’ within FAS 158 have been revised to reflect unassigned funds (surplus).

b. Any prepaid asset resulting from the excess of the fair value of plan assets over the projected benefit obligation shall be nonadmitted. Furthermore, any asset recognized from the cost of a ‘participation right’ of an annuity contract per paragraph 54 shall also be nonadmitted.
c. Provisions within paragraph 30 of FAS 87, as amended by FAS 158, permitting a market-related value of plan assets have been eliminated with only the fair value measurement method for plan assets being retained.

d. The reduced disclosure requirements for nonpublic entities described in paragraph 8 of FAS 132(R), as amended by FAS 158, are rejected. All reporting entities shall follow the disclosure requirements included in paragraph 5 of FAS 132(R) as amended by FAS 158.

e. Clarification has been included within this standard to ensure both vested and nonvested employees are included within the recognition of net periodic pension cost and in the pension benefit obligation. Although this is consistent with GAAP, this is a change from previous statutory accounting. As nonvested employees were excluded from statutory accounting under SSAP No. 89, guidance has been included to indicate that the unrecognized prior service cost attributed to nonvested individuals is not required to be included in net periodic pension cost entirely in the year this standard is adopted. The unrecognized prior service cost for nonvested employees shall be amortized as a component of net periodic pension cost by assigning an equal amount to each expected future period of service before vesting occurs for nonvested employees active at the date of the amendment. Unassigned funds (surplus) is then adjusted each period as prior service cost is amortized. (Guidance is included within the transition related to the recognition of the prior service cost for nonvested employees through unassigned funds (surplus).)

f. Conclusion of Interpretation 04-12: EITF 03-4: Determining the Classification and Benefit Attribution Method for a “Cash Balance” Pension Plan (INT 04-12) indicating that ‘cash balance’ plans are considered defined benefit plans has been incorporated within paragraph 3 of this statement.

g. Conclusion of Interpretation 99-26: Offsetting Pension Assets and Liabilities (INT 99-26) prohibiting the offset of defined benefit liabilities of one plan with prepaid assets of another plan has been incorporated within paragraph 26 of this statement.

h. Provisions within paragraph 36 of FAS 87, as amended by FAS 158, regarding the classification of underfunded liabilities as current or noncurrent liabilities and the classification of assets from overfunded plans as noncurrent assets has been rejected as inconsistent with statutory accounting.

i. Provisions within paragraph 49 of FAS 87, as amended by FAS 158, defining the fair value of investments have been rejected. Fair value definitions and measurement for investments shall be determined in accordance with statutory accounting guidance.

j. Provisions within paragraph 52 of FAS 87, as amended by FAS 158, regarding the plan assets measurement date for consolidating subsidiaries or entities utilizing the equity method under APB Opinion No. 18 has been rejected. For statutory accounting, all entities shall follow the measurement date guidance within paragraph 45 of this statement.

k. Transition under FAS 158 is different from this statement. FAS 158 requires entities with publicly traded equity securities to initially apply the requirement to recognize the funded status of a benefit plan; the gains/losses, prior service costs/credits and transition obligations/assets that have not yet been included in net periodic benefit cost; and the disclosure requirements as of the end of the fiscal year ending after December 15, 2006. Transition guidelines for statutory accounting are defined in paragraphs 90-101.

l. FAS 158 provided two approaches for an employer to transition to a fiscal year-end measurement date. For purposes of statutory accounting, the second approach permitting reporting entities to use earlier measurements determined for year-end
reporting as of the fiscal year immediately preceding the year that the measurement date provisions is rejected. For consistency purposes, all reporting entities shall follow the first approach and remeasure plan assets and benefit obligations as of the beginning of the fiscal year that the measurement date provisions are applied.

Staff Review Completed by:
Julie Gann, NAIC Staff – September 2018
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Prepayments to Service and Claims Adjusting Providers

Check (applicable entity):

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Description of Issue:
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.

Roadside assistance is a common feature or rider to many automobile insurance policies that has been available for several years. Roadside assistance provides towing and other services such as jumpstarting car batteries, unlocking doors and gas refills for the insured. 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 guidance in SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses, paragraphs 4 and 5 (excerpted in the Authoritative Literature section) are relevant to the timing of claims recognition and payment of loss adjustment expenses. The guidance provides that claims are recognized when incurred. This existing guidance indicates that paying a third party in advance to adjust claims in the future does not decrease the claims adjustment liability. The claim adjustment liability is only reduced when the claim has been adjusted, not when it is prepaid. In accordance with SSAP No. 64—Offsetting and Netting of Assets and Liabilities, prepayments to a third party do not meet the right of offset requirements.

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 adjusting expense.

Existing Authoritative Literature:

- SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses, paragraphs 4 and 5 includes the following:

  SUMMARY CONCLUSION

4. Claims, losses, and loss/claim adjustment expenses shall be recognized as expenses when a covered or insured event occurs. In most instances, the covered or insured event is the occurrence of an incident which gives rise to a claim or the incurring of costs. For claims-made type policies, the covered or insured event is the reporting to the entity of the incident that gives rise to a claim. Claim payments and related expense payments are made subsequent to the occurrence of a covered or insured event, and in order to recognize the expense of a covered or insured event that has occurred, it is necessary to establish a liability. Liabilities shall be established for any unpaid claims and unpaid losses (loss reserves), unpaid loss/claim adjustment expenses (loss/claim adjustment expense reserves) and incurred costs, with a corresponding charge to income. Claims related extra contractual obligations losses and bad-faith losses shall be included in losses. See individual business types for the accounting treatment for adjustment expenses related to extra contractual obligations and bad-faith lawsuits.

5. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts. The liability for claims adjustment expenses on non-capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments made to third-party administrators, etc. The liability for claims adjustment expenses on capitated payments under managed care contracts 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 providers.

General

10. The liability for claim reserves and claim liabilities, unpaid losses, and loss/claim adjustment expenses shall be based upon the estimated ultimate cost of settling the claims (including the effects of inflation and other societal and economic factors), using past experience adjusted for current trends, and any other factors that would modify past experience. These liabilities shall not be discounted unless authorized for specific types of claims by specific SSAPs, including SSAP No. 54R and SSAP No. 65—Property and Casualty Contracts.

The guidance in SSAP No. 55, paragraph 5 was incorporated from INT 02-21: Accounting for Prepaid Loss Adjustment Expenses and Claim Adjustment Expenses, which was nullified when the guidance was moved to SSAP No. 55.
• **SSAP No. 64—Offsetting and Netting of Assets and Liabilities** provides the following:

2. Assets and liabilities shall be offset and reported net only when a valid right of setoff exists except as provided for in paragraphs 3 and 4. A right of setoff is a reporting entity's legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying an amount that the other party owes to the reporting entity against the debt[^INT 09-08]. A valid right of setoff exists only when all the following conditions are met:

a. Each of the two parties owes the other determinable amounts. An amount shall be considered determinable for purposes of this provision when it is reliably estimable by both parties to the agreement;

b. The reporting party has the right to set off the amount owed with the amount owed by the other party;

c. The reporting party intends to setoff; and

d. The right of setoff is enforceable at law.

• **Property and Casualty Annual Statement Instructions Underwriting and Investment Exhibit Part 3 – Expenses** provides the following:

A company that pays any affiliated entity (including a managing general agent) for the management, administration, or service of all or part of its business or operations shall allocate these costs to the appropriate expense classification items (salaries, rent, postage, etc.) as if these costs had been borne directly by the company. Management, administration, or similar fees should not be reported as a one-line expense. The company may estimate these expense allocations based on a formula or other reasonable basis.

A company that pays any non-affiliated entity (including a managing general agent) for the management, administration, or service of all or part of its business or operations shall allocate these costs to the appropriate expense classification item as follows:

a. Payments for claims handling or adjustment services are allocated to Loss Adjustment Expenses (Column 1) in the Underwriting and Investment Exhibit, Part 3. If the total of such expenses incurred equals or exceeds 10% of the total incurred Loss Adjustment Expenses (Line 25, Column 1), the company shall allocate these costs to the appropriate expense classification items as if these costs had been borne directly by the company. If such expenses are less than 10% of the total, they may be reported on Line 1 of Column 1.

b. Payments for services other than claims handling or adjustment services are allocated to the appropriate expense classification items as if these costs had been borne directly by the company, if the total of such fees paid equals or exceeds 10% of the total incurred Other Underwriting Expenses (Line 25, Column 2). If the total is less than 10%, the payments may be reported on Line 2 if the fees are calculated as a percentage of premiums, or on Line 3 if the fees are not calculated as a percentage of premiums.

The total management and service fees incurred attributable to affiliates and non-affiliates is reported in the footnote to the Underwriting and Investment Exhibit, Part 3 of the annual statement, and the method(s) used for allocation shall be disclosed in the Notes to the Financial Statements. The company shall use the same allocation method(s) on a consistent basis. Refer to **SSAP No. 70—Allocation of Expenses** for accounting guidance.

Exclude from investment expenses brokerage and other related fees, to the extent they are included in the actual cost of a bond upon acquisition. Refer to **SSAP No. 26R—Bonds** for accounting guidance.
Include all other internal costs or costs paid to an affiliated company related to origination, purchase or commitment to purchase bonds.

For the purpose of establishing uniformity in classifications of expenses in reporting entities’ statements and reports filed with the Insurance Departments, the company shall observe the instructions contained in the Appendix of these instructions for the Uniform Classification of Expenses.

Activity to Details of Write-ins Aggregated at Line 24 for Miscellaneous Expenses

List separately each category of miscellaneous expenses for which there is no pre-printed line on Underwriting and Investment Exhibit, Part 3.

- Property and Casualty Annual Statement Instructions Underwriting Appendix Instructions for Uniform Classifications of Expenses of Property and Casualty Insurers provides the following:

1.1 Direct

Include: The Following Expenses When in Connection with the Investigation and Adjustment of Policy Claims:

Independent Adjusters: Fees and expenses of independent adjusters or settling agents

Legal: Fees and expenses of lawyers for legal services in the defense, trial, or appeal of suits, or for other legal services

Bonds: Premium costs of bonds

Appeal Costs and Expenses: Appeal bond premiums, charges for printing records, charges for printing briefs, court fees and incidental to appeals

General Court Costs and Fees: Entry fees and other court costs, and other fees not includible in Losses (Note: Interest and costs assessed as part of or subsequent to judgment are includible in Losses.)

Medical Testimony: Fees and expenses of medical witnesses of attendance or testimony at trials or hearings (“Medical” includes physicians, surgeons, chiropractors, chiropodists, dentists, osteopaths, veterinarians, and hospital representatives.)

Expert Witnesses: Fees and expenses of expert witnesses for attendance or testimony at trials or hearings

Lay Witnesses: Fees and expenses of lay witnesses for attendance or testimony at trials or hearings

Services of Process: Constables, sheriffs, and other fees and expenses for service of process, including subpoenas

Transcripts of Testimony: Stenographers’ fees and fees for transcripts of testimony

Medical Examinations: Fees for medical examinations, fees for performing autopsies, fees for impartial examination, x-rays, etc., for the purpose of trial and determining questions of liability (This does not include fees for medical examinations, x-rays, etc., made to determine necessary treatment, or made solely to determine the extent or continuation of disability, or first aid charges, as such fees and charges are includible in Losses.)

Miscellaneous: Costs of appraisals, expert examinations, surveys, plans, estimates, photographs, maps, weather reports, detective reports, audits, credit or character reports, watchmen (Charges for hospital records and records of other kinds, notary fees, certified copies of certificates and legal documents, charges for Claim Adjustment Services by underwriting syndicates, pools, and associations)
Exclude: Compensation to employees (see Salaries)

Expenses of salaried employees (see Travel and Travel Items)

Items includible in Allowances to Managers and Agents

Payments to State Industrial Commissions (see Taxes, Licenses, and Fees)

Payments to claim adjusting organizations except where the expense is billed specifically to individual companies (see Boards, Bureaus, and Associations)

Cost of services of medical examiners for underwriting purposes (see Surveys and Underwriting Reports)

Salvage and subrogation recovery expense, rewards, lost and found advertising, expenses for disposal of salvage (Such expenses shall be deducted from salvage.)

Any expenses which by these instructions are includible elsewhere

Separation of Claim Adjustment Services:

The Statistical Plans filed by certain rating bureaus contain definitions of “Allocated Loss Adjustment Expenses” which exclude for rating purposes certain types of claim adjustment services as defined herein. For the lines of business thus affected, companies that are members of such rating bureaus shall maintain records necessary to the reporting of Claim Adjustment Services—Direct, as follows:

a. As defined in Statistical Plans

b. Other than as defined in Statistical Plans

Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None.

Information or issues (included in Description of Issue) not previously contemplated by the Working Group: June 2017 updates to the AICPA Revenue Recognition Guide noted in Issue #9-1: Considerations for applying the scope exception in FASB ASC 606-10-15-2 and 606-10-15-4 to Contracts within the Scope of ASC 944 contains some discussion on roadside assistance that is tangential but does not address the prepayments under discussion. The updates were issued in response to questions regarding Accounting Standards Update (ASU) 2016-20: Technical Corrections and Improvements to Topic 606, Revenue from Contracts from Customers.

At issue was whether to bifurcate insurance contracts within the scope of Topic 944, Financial Services—Insurance that contain noninsurance elements and account for them within the scope of Topic 606, Revenue from Contracts from Customers. Roadside assistance provided with an automobile insurance policy was listed as an example of activities performed by an insurance entity, included in contracts within the scope of FASB Topic 944, that Financial Reporting Executive Committee (FinREC) believes generally should be considered fulfillment activities (that either mitigate risks to the insurer or contain costs related to services to fulfill the insurer’s obligation) that are not within the scope of FASB Topic 606, but should be considered part of the insurance contract within the scope of FASB Topic 944. Roadside assistance was noted as mitigating the risk of a further accident or damage to the insured automobile.

Convergence with International Financial Reporting Standards (IFRS): During the development of IFRS 17, Insurance Contracts, the International Accounting Standards Board (IASB) had discussions regarding classification for the revenue which are not on point to roadside assistance prepayments. Similar to the AICPA issue noted above, the issue was whether roadside assistance sold as part of an insurance policy should be included within the scope of insurance contracts or whether it should be accounted for separately as fee for
service. The IFRS 17 issued in May 2017 notes that some fixed-fee service contracts meet the definition of an insurance contract (for example, automobile roadside assistance) and IFRS 17 provides an option to use IFRS 15, Revenue from Contracts with Customers to account for as fee for service.

Staff Review Completed by:
Robin Marcotte
NAIC Staff
September 2018

Staff 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.

Proposed revisions to SSAP No. 55 recommended for November 2018 exposure:

4. Claims, losses, and loss/claim adjustment expenses shall be recognized as expenses when a covered or insured event occurs. In most instances, the covered or insured event is the occurrence of an incident which gives rise to a claim or the incurring of costs. For claims-made type policies, the covered or insured event is the reporting to the entity of the incident that gives rise to a claim. Claim payments and related expense payments are made subsequent to the occurrence of a covered or insured event, and in order to recognize the expense of a covered or insured event that has occurred, it is necessary to establish a liability. Liabilities shall be established for any unpaid claims and unpaid losses (loss reserves), unpaid loss/claim adjustment expenses (loss/claim adjustment expense reserves) and incurred costs, with a corresponding charge to income.

   a. Prepayments to third party administrators, management companies or other entities for unpaid losses/claims, except for capitated payments for manage care contracts, shall not reduce losses/claims and shall be initially reported as miscellaneous underwriting expenses. When incurred losses/claims are paid, claims prepayments to third party administrators, management companies or other entities (except for capitated payments for manage care contracts) are reclassified proportionately based on the losses/claims cost from miscellaneous underwriting expenses to loss/claim expenses paid. Flat fee minimum prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as miscellaneous underwriting expenses and not reclassified to loss/claim adjusting expenses.
b. Claims related extra contractual obligations losses and bad-faith losses shall be included in losses. See individual business types for the accounting treatment for adjustment expenses related to extra contractual obligations and bad-faith lawsuits.

5. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts. The liability for claims adjustment expenses on non-capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments made to third-party administrators, etc. The liability for claims adjustment expenses on capitated payments under managed care contracts 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 providers.

   a. Prepayments to third party administrators, management companies or other entities, except for capitated payments for manage care contracts, for unpaid losses/ claims adjusting expenses shall be initially reported as miscellaneous underwriting expenses.

   b. When incurred losses/claims adjusting expenses are paid, prepayments to third party administrators, management companies or other entities (except for capitated payments for manage care contracts) are reclassified proportionately based on the adjusting expenses from miscellaneous underwriting expenses to paid loss /claim adjusting expenses. Flat fee minimum prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as miscellaneous underwriting expenses and not reclassified to loss/claim adjusting expenses.
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Issue: Interest on Claims

Check (applicable entity):

<table>
<thead>
<tr>
<th>Modification of existing SSAP</th>
<th>P/C</th>
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<th>Health</th>
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<td>New Issue or SSAP</td>
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<td>Interpretation</td>
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Description of Issue:
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 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

Existing Authoritative Literature:

**SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses**
Life, Accident and Health

7. The following future costs relating to life and accident and health indemnity contracts, as defined in SSAP No. 50, shall be considered in determining the liability for unpaid claims and claim adjustment expenses:

   a. Accident and Health Claim Reserves: Reserves for claims that involve a continuing loss. This reserve is a measure of the future benefits or amounts not yet due as of the statement date which are expected to arise under claims which have been incurred as of the statement date. This shall include the amount of claim payments that are not yet due such as those amounts commonly referred to as disabled life reserves for accident and health claims. The methodology used to establish claim reserves is discussed in SSAP No. 54R.

   b. Claim Liabilities for Life/Accident and Health Contracts:
      i. Due and Unpaid Claims: Claims for which payments are due as of the statement date;
      ii. Resisted Claims in Course of Settlement: Liability for claims that are in dispute and are unresolved on the statement date. The liability either may be the full amount of the submitted claim or a percentage of the claim based on the reporting entity's past experience with similar resisted claims;
      iii. Other Claims in the Course of Settlement: Liability for claims that have been reported but the reporting entity has not received all of the required information or processing has not otherwise been completed as of the statement date;
      iv. Incurred But Not Reported Claims: Liability for which a covered event has occurred (such as death, accident, or illness) but has not been reported to the reporting entity as of the statement date.

   c. Claim Adjustment Expenses for Accident and Health Reporting Entities are those costs expected to be incurred in connection with the adjustment and recording of accident and health claims defined in paragraphs 7.a. and 7.b. Certain claim adjustment expenses reduce the number or cost of health services thereby resulting in lower premiums or lower premium increases. These claim adjustment expenses shall be classified as cost containment expenses.

   d. Claim Adjustment Expenses for Life Reporting Entities: Costs expected to be incurred (including legal and investigation) in connection with the adjustment and recording of life claims defined in paragraph 7.b. This would include adjustment expenses arising from claims-related lawsuits such as extra contractual obligations and bad-faith lawsuits.

Managed Care

8. The following costs relating to managed care contracts as defined in SSAP No. 50 shall be considered in determining the claims unpaid and claims adjustment expenses:

   a. Claims unpaid for Managed Care Reporting Entities:
      i. Unpaid amounts for costs incurred in providing care to a subscriber, member or policyholder including inpatient claims, physician claims, referral claims, other medical claims, resisted claims in the course of settlement and other claims in the course of settlement;
      ii. Incurred But Not Reported Claims: Liability for which a covered event has occurred (such as an accident, illness or other service) but has not been reported to the reporting entity as of the statement date;
iii. Additional unpaid medical costs resulting from failed contractors under capitation contracts and provision for losses incurred by contractors deemed to be related parties for which it is probable that the reporting entity will be required to provide funding;

b. Claim Adjustment Expenses for Managed Care Reporting Entities are those costs expected to be incurred in connection with the adjustment and recording of managed care claims defined in paragraph 8.a. Certain claim adjustment expenses reduce the number or cost of health services thereby resulting in lower premiums or lower premium increases. These claim adjustment expenses shall be classified as cost containment expenses.

c. Liabilities for percentage withholds ("withholds") from payments made to contracted providers;

d. Liabilities for accrued medical incentives under contractual arrangements with providers and other risk-sharing arrangements whereby the health entity agrees to share savings with contracted providers.

Managed Care and Accident and Health

9. Claim adjustment expenses for accident and health contracts and managed care contracts (identified in paragraphs 7.c. and 8.b.), including legal expenses, can be subdivided into cost containment expenses and other claim adjustment expenses:

a. Cost containment expenses: Expenses that actually serve to reduce the number of health services provided or the cost of such services. The following are examples of items that shall be considered "cost containment expenses" only if they result in reduced levels of costs or services:

i. Case management activities;

ii. Utilization review;

iii. Detection and prevention of payment for fraudulent requests for reimbursement;

iv. Network access fees to Preferred Provider Organizations and other network-based health plans (including prescription drug networks), and allocated internal salaries and related costs associated with network development and/or provider contracting;

v. Consumer education solely relating to health improvement and relying on the direct involvement of health personnel (this would include smoking cessation and disease management programs, and other programs that involve hands on medical education); and

vi. Expenses for internal and external appeals processes.

b. Other claim adjustment expenses: Claim adjustment expenses as defined in paragraph 7.c. or 8.b. that are not cost containment expenses. Examples of other claim adjustment expenses are:

i. Estimating the amounts of losses and disbursing loss payments;

ii. Maintaining records, general clerical, and secretarial;

iii. Office maintenance, occupancy costs, utilities, and computer maintenance;

iv. Supervisory and executive duties; and
v. Supplies and postage.
vi. This would include adjustment expenses arising from claims-related lawsuits such as extra contractual obligations and bad-faith lawsuits.

*Property and Casualty Annual Statement Instructions* for the Statement of Income provides the following (bolding added for emphasis):

Details of Write-ins Aggregated at Line 14 for Miscellaneous Income

Include: Miscellaneous items, such as:
- Income on annuities purchased to fund future payments. The income from annuities is the amount received on annuities purchased to fund future payments less the change in the value (i.e., present value) of these annuities.
- Premiums for life insurance on employees (less $\ldots$ increase in cash values). NOTE: Use this item only where the company is beneficiary.
- Receipts from Schedule BA assets, other than interest, dividends and real estate income, and other than capital gains on investments.
- Other sundry receipts and adjustments not reported elsewhere.

**Fines and penalties of regulatory authorities should be shown as a separate item.**
- Gain or loss from initial retroactive reinsurance and any subsequent change in the initial incurred loss and loss adjustment expense reserves transferred.
- As an expense, interest due or payable to assuming reinsurers on funds held by the reporting entity.
- As an offset to expense, interest due from ceding reinsurers on funds held by the ceding company on behalf of the reporting entity.
- Net realized foreign exchange capital gains and losses not related to investments. Refer to SSAP No. 23—*Foreign Currency Transactions and Translations* for accounting guidance.

Exclude: Investment foreign exchange gains/ (losses).

*Life Accident and Health Annual Statement Instructions* for the Summary of Operations provides the following (bolding added for emphasis):

Details of Write-ins Aggregated at Line 27 for Deductions

List separately each category of deductions for which there is no pre-printed line on Page 4.
Report the amount from the Form For Calculating the Interest Maintenance Reserve, Line 3.

**Include:**

**Fines and penalties of all regulatory authorities (not just the insurance regulatory authority) that should be shown here as a separate item.**
- As an expense, interest due or payable to assuming reinsurers on funds held by the reporting entity.
- Reserve adjustment on modified coinsurance assumed.

Exclude: Expenses to be recorded on a specific line on Exhibit 2, or on Exhibit 2, Line 9.3, Aggregate Write-ins for Expenses, e.g., general insurance expenses and other expenses.

*Health Annual Statement Instructions* for the Statement of Revenue and Expenses provides the following (bolding added for emphasis):

Details of Write-ins Aggregated at Line 29 for Other Income or Expenses

Include:
As income, interest due from ceding reinsurers on funds held by the ceding company on behalf of the reporting entity (assuming entity).

As an offset to expense, interest due from ceding reinsurers on funds held by the ceding company on behalf of the reporting entity.

Income or expense items not covered in any other account.

Net realized foreign exchange capital gains and losses not related to investments. Refer to SSAP No. 23—Foreign Currency Transactions and Translations for accounting guidance.

Fines and penalties of regulatory authorities.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

Information or issues (included in Description of Issue) not previously contemplated by the Working Group:

1. An internet search provided a listing of prompt payment laws for accident and health policies at the following link (NAIC staff did not verify the legal references):
2. Some of the concepts in the prompt payment laws relate to NAIC Model 180-Uniform Individual Accident and Sickness Policy Provision Law (UPPL) (#180).


Staff Review Completed by:
Robin Marcotte
NAIC Staff
October 2018

Staff 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;
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.

Proposed revisions to SSAP No. 55

Managed Care and Accident and Health

9. Claim adjustment expenses for accident and health contracts and managed care contracts (identified in paragraphs 7.c. and 8.b.), including legal expenses, can be subdivided into cost containment expenses and other claim adjustment expenses:
a. Cost containment expenses: Expenses that actually serve to reduce the number of health services provided or the cost of such services. The following are examples of items that shall be considered “cost containment expenses” only if they result in reduced levels of costs or services:

i. Case management activities;

ii. Utilization review;

iii. Detection and prevention of payment for fraudulent requests for reimbursement;

iv. Network access fees to Preferred Provider Organizations and other network-based health plans (including prescription drug networks), and allocated internal salaries and related costs associated with network development and/or provider contracting;

v. Consumer education solely relating to health improvement and relying on the direct involvement of health personnel (this would include smoking cessation and disease management programs, and other programs that involve hands on medical education); and

vi. Expenses for internal and external appeals processes.

b. Other claim adjustment expenses: Claim adjustment expenses as defined in paragraph 7.c. or 8.b. that are not cost containment expenses. Examples of other claim adjustment expenses are:

i. Estimating the amounts of losses and disbursing loss payments;

ii. Maintaining records, general clerical, and secretarial;

iii. Office maintenance, occupancy costs, utilities, and computer maintenance;

iv. Supervisory and executive duties; and

v. Supplies and postage.

vi. This would include adjustment expenses arising from claims-related lawsuits such as extra contractual obligations and bad-faith lawsuits.

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

Issue: ASU 2018-15, Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40) –  
Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a  
Service Contract  

Check (applicable entity):  
- Modification of existing SSAP  
- New Issue or SSAP  
- Interpretation  

P/C  
Life  
Health  

Description of Issue:  
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.

Existing Authoritative Literature:

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

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

10. This Statement adopts with modification FASB Codification 350-40, Internal Use Software (ASC 350-40) for statutory accounting terms and concepts. This Statement also adopts FASB Codification 350-50, Website Development Costs (ASC 350-50) in its entirety.

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

   a. ASC 350-40-15-4 states that the accounting for costs of reengineering activities, which often are associated with new or upgraded software applications, is not included within scope. This guidance is expanded to require that such costs be expensed as incurred.

   b. ASC 350-40-35-4 is amended to require entities to follow the amortization guidelines as established in paragraph 10 of SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements.

   c. ASC 350-40-35-5 is amended to require that capitalized operating system software shall be depreciated for a period not to exceed three years. Capitalized nonoperating system software shall be depreciated for a period not to exceed five years. This is consistent with paragraph 3 of this statement.

   d. ASC 350-40-35-9 is amended to require that if during the development of internal use software, an entity decided to market the software to others, the entity shall immediately expense any amounts previously capitalized.

   e. ASC 350-40-50-1 is amended to require entities to follow the disclosure provisions provided in paragraph 15 of this statement and paragraph 5 of SSAP No. 17.

   f. Any software costs capitalized in accordance with paragraphs 10 and 11 shall be deemed either operating or nonoperating system software costs. Entities shall make this determination in accordance with the definitions of operating and nonoperating system software contained in the Glossary. As noted in paragraph 2, nonoperating system software is a nonadmitted asset.

12. Entities that license internal-use computer software are required to follow the statutory accounting guidance in SSAP No. 22—Leases.

SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements

Leasehold Improvements Paid by the Reporting Entity as Lessee

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

5. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets established in SSAP No. 4. Within that definition, such items also meet the criteria defining nonadmitted assets. Accordingly, such assets shall be reported as nonadmitted assets and charged against surplus. These nonadmitted assets shall be amortized against net income over the shorter of their estimated useful life or the remaining life of the original asset.
lease excluding renewal or option periods. Leasehold improvements that do not meet the definition of assets shall be charged to expense when acquired.

6. In accordance with the reporting entity's written capitalization policy, amounts less than a predefined threshold of such assets shall be expensed when purchased. The reporting entity shall maintain a capitalization policy containing the predefined thresholds for each asset class to be made available for the department(s) of insurance.

Maintenance Costs Paid by Lessee

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

SSAP No. 22—Leases

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

3. Integral equipment subject to a lease shall be evaluated as real estate per SSAP No. 40R—Real Estate Investments. Integral equipment or property improvements for which no statutory title registration system exists, the criterion in this SSAP (that the lease transfers ownership of the property to the lessee by the end of the lease term) is met in lease agreements that provide that, upon the lessee's performance in accordance with the terms of the lease, the lessor shall execute and deliver to the lessee such documents (including, if applicable, a bill of sale for the equipment) as may be required to release the equipment from the lease and to transfer ownership thereto to the lessee. This criterion is also met in situations in which the lease agreement requires the payment by the lessee of a nominal amount (for example, the minimum fee required by statutory regulation to transfer ownership) in connection with the transfer of ownership. Notwithstanding the foregoing guidance, a provision in a lease agreement that ownership of the leased property is not transferred to the lessee if the lessee elects not to pay the specified fee (whether nominal or otherwise) to complete the transfer of ownership is a purchase option. Such a provision would not satisfy this SSAP.

Determining Whether an Arrangement Contains a Lease

4. Determining whether an arrangement contains a lease that is within the scope of this SSAP should be based on the substance of the arrangement. Separate contracts with the same entity or related parties that are entered into at or near the same time are presumed to have been negotiated as a package and should, therefore, be evaluated as a single arrangement in considering whether there are one or more units of accounting. That presumption may be overcome if there is sufficient evidence to the contrary.

Accounting and Reporting by Lessees

12. All leases shall be considered operating leases. Rent on an operating lease shall be charged to expense over the lease term as it becomes payable, except as provided in paragraphs 13 and 14.

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1 A service concession arrangement is an arrangement between a public sector entity grantor and an operating entity under which the operating entity operates the grantor’s infrastructure (for example, airports, roads, bridges, tunnels, prisons and hospitals) for a specified
Maintenance Costs Incurred by Lessee

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

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): Agenda item 2015-15 addresses the FASB issuance of ASU 2015-05, Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement, which was issued to evaluate the accounting for fees paid by a customer in a cloud computing arrangement by providing guidance for determining when the arrangement includes a software license. The Statutory Accounting Principles (E) Working Group adopted revisions to clarify that entities with leases involving internal-use computer software shall follow the guidance in SSAP No. 22—Leases.

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

Convergence with International Financial Reporting Standards (IFRS): None

Staff Recommendation:
Staff recommends that the Working Group move this item to the active listing, categorized as 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.)

Scenario:
A company is licensing cloud-based software through a hosting arrangement. The implementation costs to license a cloud-based software is $5 million, and the ongoing servicing cost for cloud hosting is $150K each month under a 10-year agreement.

Option 1 – Expense Costs as Incurred
If the implementation costs were considered part of the lease payments, SSAP No. 22 would require those costs to be expensed when incurred; if the costs are considered a leasehold improvement, they would be capitalized. This treatment impacts the income statement immediately and does not spread the expense over the useful life of the software.

<table>
<thead>
<tr>
<th>Year 1</th>
<th>DR</th>
<th>Lease Expense</th>
<th>5,000,000</th>
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<tbody>
<tr>
<td></td>
<td>CR</td>
<td>Cash</td>
<td>5,000,000</td>
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</table>
**Initial Implementation Cost – Expensed as Incurred**

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<th>DR</th>
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<tbody>
<tr>
<td>Lease Expense</td>
<td>Cash</td>
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<tr>
<td>150,000</td>
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</table>

**Monthly Servicing Expense for Cloud hosting**

**Option 2 – Capitalize Over the Life of the Asset**

If statutory accounting principles adopts ASU 2018-15, in a manner consistent with SSAP No. 16R, the implementation costs would be capitalized and expensed over the useful life of the asset, limited to 5 years as nonoperating system software. This spreads out the cost over five years, as opposed to hitting the income statement with a large expense each year.

**Year 1**

<table>
<thead>
<tr>
<th>DR</th>
<th>CR</th>
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<tbody>
<tr>
<td>Capitalized Cloud Licensing</td>
<td>Cash</td>
</tr>
<tr>
<td>Costs 5,000,000</td>
<td>5,000,000</td>
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<tr>
<td>Unassigned Funds</td>
<td>Change in Nonadmitted</td>
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<td>5,000,000</td>
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**Initial Implementation Cost – Capitalized and Nonadmitted. The impact is surplus neutral.**

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<tbody>
<tr>
<td>Hosting Service Expense</td>
<td>Cash</td>
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<td>150,000</td>
<td>150,000</td>
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**Monthly Expense for Use of Cloud**

**Year 2**

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<tbody>
<tr>
<td>Amortization Cap Implementation Costs</td>
<td>Capitalized Implementation Costs</td>
</tr>
<tr>
<td>1,000,000</td>
<td>1,000,000</td>
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<tr>
<td>Change in Nonadmitted</td>
<td>Unassigned Funds</td>
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<td>1,000,000</td>
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**Recognizes amortization of capitalized costs. The impact is surplus neutral. (This would occur over the course of five years.)**

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<tbody>
<tr>
<td>Hosting Service Expense</td>
<td>Cash</td>
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<td>150,000</td>
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**Staff Review Completed by:**

**Fatima Sediqzad – October 2018**
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
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Issue: ASU 2017-13—Amendments to SEC Paragraphs

Check (applicable entity):

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<td>New Issue or SSAP</td>
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<td>Interpretation</td>
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Description of Issue:
FASB issued 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, which effects the codification in Revenue Recognition (Topic 605), Revenue from Contracts with Customers (Topic 606), Leases (Topic 840), and Leases (Topic 842). This ASU provides updated transition guidance for public reporting entities and is a result of the July 20, 2017 Emerging Issues Task Force (EITF) meeting. There are three main updates to the guidance from this 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 after-tax cash flows arising from the change in the tax law (Tax Cuts and Jobs Act), including revised tax rates.

The updated guidance clarifies when public business entities 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.

A public business entity is defined as one that is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC including other entities whose financial statements or financial information are required to be or are included in a filing; or an entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity’s filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

The existing transition guidance related to revenue stated that a public business entity and certain other specified entities adopt ASC Topic 606 for annual reporting periods beginning after Dec. 15, 2017, including interim reporting periods within that reporting period. All other entities are required to adopt ASC Topic 606 for annual reporting periods beginning after Dec. 15, 2018, and interim reporting periods within annual reporting periods beginning after Dec. 15, 2019. For leases, the transition guidance requires that a public business entity and certain
other specified entities adopt ASC Topic 842 for fiscal years beginning after Dec. 15, 2018, and interim periods within those fiscal years. All other entities are required to adopt ASC Topic 842 for fiscal years beginning after Dec. 15, 2019, and interim periods within fiscal years beginning after Dec. 15, 2020.

ASU 2017-13 updates to the transition guidance states that “SEC staff would not object to a public business entity that otherwise would not meet the definition of a public business entity except for a requirement to include or the inclusion of its financial statements or financial information in another entity’s filing with the SEC adopting (1) ASC Topic 606 for annual reporting periods beginning after Dec. 15, 2018, and interim reporting periods within annual reporting periods beginning after Dec. 15, 2019, and (2) ASC Topic 842 for fiscal years beginning after Dec. 15, 2019, and interim periods within fiscal years beginning after Dec. 15, 2020.” This guidance is included in Topic 606 and Topic 842.

Existing Authoritative Literature:
Leases are covered in SSAP No. 22—Leases. Basic discussion of the nature of assets, and specifically admitted assets, is covered in SSAP No. 4—Assets and Nonadmitted Assets.

Refer to Appendix D—GAAP Cross Reference to Statutory Accounting Principles for GAAP Pronouncements and Working Groups actions pertaining to ASC Topic 605 and 606. Premium revenue recognition is detailed throughout the SSAPs, including the following: SSAP No. 51—Life Contracts; SSAP No. 53—Property Casualty Contracts – Premiums; SSAP No. 54—Individual and Group Accident and Health Contracts and SSAP No. 57—Title Insurance.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

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

Convergence with International Financial Reporting Standards (IFRS):
ASU 2014-09, which created ASC Topic 606, and IFRS 15 are the result of the joint project between the FASB and IASB to improve financial reporting by creating common revenue recognition guidance. The leases project began as a joint project with the IASB and many of the requirements in Topic 842 are the same as the requirements in IFRS 16.

Staff 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 Recission of Prior SEC Staff Announcements and Observer Comments as not applicable to statutory accounting.

This item is proposed to be rejected as not applicable as ASU 2017-13 is specific to deletion of SEC paragraphs, which are not applicable for statutory accounting purposes.

Staff Review Completed by: Jake Stultz – October 2018
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
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Issue: ASU 2018-02: Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income

Check (applicable entity):  
- Modification of existing SSAP: ☑️ ☑️ ☑️  
- New Issue or SSAP: ☑️ ☑️ ☑️  
- Interpretation: ☑️ ☑️ ☑️

Description of Issue: 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.

Existing Authoritative Literature:

SSAP No. 101—Income Taxes

8. Changes in DTAs and DTLs, including changes attributable to changes in tax rates and changes in tax status, if any, shall be recognized as a separate component of gains and losses in unassigned funds (surplus).FN. Admitted adjusted gross DTAs and DTLs shall be offset and presented as a single amount on the statement of financial position.

Footnote: Changes in DTAs and DTLs due to changes to tax rates and tax status shall be recorded as a “change in net deferred income tax,” excluding any change reflected in unrealized capital gains. Tax effects previously reflected in unrealized capital gains (to present unrealized gains and losses “net of tax”) shall be re-measured for the change in the tax rate in the same reporting line. Changes in net deferred tax shall not include changes in nonadmitted DTAs, as changes in nonadmittance are reported on a separate reporting line.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): Agenda item 2018-01 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.

Assessment included in Agenda Item 2018-02:

On January 18, 2018, the FASB exposed a proposed ASU “Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income” for a comment period ending February 2, 2018. This proposed ASU was exposed to address concerns that deferred tax impacts from the effect of a change in tax laws or rates would be included in income from continuing operations in the reporting periods that includes the enacted date although the tax effect was originally charged to other comprehensive income, and is reflected in accumulated other comprehensive income. The amendments in the proposed ASU would require a reclassification from accumulated other comprehensive income to retained earnings for the “stranded” tax effects from the newly enacted federal corporate income tax rate. The amount of the reclassification would be the difference between the historical corporate tax rate and the newly enacted 21% corporate tax rate.

Statutory Assessment: Existing guidance in SSAP No. 101 prescribes that changes in deferred tax assets and liabilities shall be recognized as a separate component of surplus. (This guidance was a modification from U.S. GAAP, which requires these changes to be reported in income from continuing operations.) As such, with the existing guidance in SSAP No. 101, 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.

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


Staff 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.

Staff Review Completed by:
Julie Gann, NAIC Staff – August 2018
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: ASU 2018-04: Investments—Debt Securities (Topic 320) and Regulated Operations (Topic 980)

Check (applicable entity):

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<th>Modification of existing SSAP</th>
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<th>Health</th>
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<td>New Issue or SSAP</td>
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<td>Interpretation</td>
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**Description of Issue:** 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). The ASU was issued by the Financial Accounting Standards Board (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.

**Existing Authoritative Literature:** SSAP No. 26R—Bonds and SSAP No. 43R—Loan-Backed and Structured Securities include extensive guidance on debt securities, including impairment and disclosures.

**Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):** None

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

**Convergence with International Financial Reporting Standards (IFRS):** None.

**Staff 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: 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 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 for statutory accounting purposes.

**Staff Review Completed by:** Jake Stultz – August 2018
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Statutory Accounting Principles (E) Working Group
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Issue: ASU 2018-05 - Income Taxes (Topic 740), Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118

Check (applicable entity):

- Modification of existing SSAP: P/C
- New Issue or SSAP: Life
- Interpretation: Health

Description of Issue:

Existing Authoritative Literature:
SSAP No. 101—Income Taxes provides the basis of statutory accounting for income taxes.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):
Agenda items 2018-01 and 2018-02 include discussion of the statutory accounting impact of the Tax Cuts and Jobs Act.

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

Convergence with International Financial Reporting Standards (IFRS):
The Tax Cuts and Jobs Act is U.S. legislation. It will have an impact on companies with U.S. operations that use IFRS as their basis of accounting, but there are no convergence issues.

Staff 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 for statutory accounting purposes.

Staff Review Completed by:
Jake Stultz, NAIC Staff
September 2018
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**Statutory Accounting Principles (E) Working Group**

**Maintenance Agenda Submission Form**

**Form A**

**Issue: ASU 2018-06 - Codification Improvements to Topic 942, Financial Services—Depository and Lending**

**Check (applicable entity):**

- Modification of existing SSAP
- New Issue or SSAP
- Interpretation

**Description of Issue:**


**Existing Authoritative Literature:**

SSAP No. 101—*Income Taxes* includes the statutory accounting guidance for income taxes, but does not include any specific guidance for savings and loans or other qualified thrift lenders.

**Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):** None

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

**Convergence with International Financial Reporting Standards (IFRS):** None

**Staff 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.

**Staff Review Completed by:** Jake Stultz – August 2018

**Status:**
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MEMORANDUM

TO: Dale Bruggeman, Chair Statutory Accounting Principles (E) Working Group
FROM: Kevin Fry, Chair Valuation of Securities (E) Task Force
CC: Bob Carcano, Senior Counsel, NAIC Investment Analysis Office
Julie Gann, Senior Manager, NAIC Financial Regulatory Division
DATE: October 23, 2018
RE: Referral on Working Capital Finance Investments

1. **Background and Response** – The Valuation of Securities (E) Task Force (VOS TF) was asked to consider whether Working Capital Finance Investments (WCFI) could be facilitated if SVO were giving analytical discretion in interpreting the guidance on two issues and a referral was made to the Statutory Accounting Principles (E) Working Group (Working group) on two other requirements, as discussed below.

1) SVO originally recommended Schedule BA reporting to reflect that the designation applies to the long-term program. Industry and the VOS TF agreed with that approach. SVO agrees this is a reporting issue.

2) SSAP No. 105 requires that insurers obtain prior approval from their domestic regulators before investing in WCFI. Because SSAP No. 105 is part of the Accounting Practices and Procedures Manual which is an NAIC standard incorporated by accreditation into state law the requirement of state approval is anomalous. The requirement seems motivated by a desire to exclude small companies from this investment. SVO noted that as a practical matter small insurers are not suitable partners to the large banks engaged in WCFI.

3) SVO evaluated whether analytical discretion would enable it to designate WCFI programs with unrated obligor’s of a rated or designated parent. SVO evaluated whether operational and strategic linkages between a rated parent and unrated obligor can provide a basis to attribute the credit rating of one entity to the other. It concluded that no principle exists to permit an assumption that a legal entity can be held responsible for the debt of another without having contractually agreed to do so. While WCFI arrangements may be inherently different than the credit situations SVO assesses SVO lacks the experiential basis to opine on the idea that there difference permits attribution. SVO recommended that the Task consider adopting the attribution concept as policy and directing the SVO to apply it but noted that approach would require an amendment of the P&P Manual and SSAP No. 105.

4) SVO evaluates whether analytical discretion can facilitate the application of requirements involving the flow of insurer owned funds. The definition of Finance Agent requires that payment be made directly to the insurer with no commingling of funds. The SVO either determines that an international finance agent’s regulator is the functional equivalent of specified US federal bank regulators or verifies that payments due to the investor are not commingled. Determining functional equivalence is not an analytical issue. Therefore, programs are evaluated on the commingling standard. However, the prohibition of commingling is a requirement so the SVO verifies that commingling can never occur or fails the program. SVO stated if commingling were not a requirement it would consider commingling risk, when present, as a structural deficiency and balance it against the requirement that the Finance Agent be NAIC 1 or NAIC 2. The SVO recommend that the Working Group consider restructuring the definition.
2. **Referral** – The Task Force released the SVO memoranda attached to this memorandum for a 30-day comment period. ACLI members may present a marked up version of SSAP No. 105 to identify requested changes with an explanation of the reasons for the request. Accordingly, SVO was directed to send the memorandum to the Working Group to reflect indications a possible need to further examine the four issues discussed and perhaps others.
MEMORANDUM

To: Kevin Fry, Chair, Valuation of Securities (E) Task Force
   Members of the Valuation of Securities (E) Task Force

From: Robert Carcano, Senior Counsel, NAIC Investment Analysis Office

Cc: Charles A. Therriault, Director, NAIC Securities Valuation Office (SVO)
    Eric Kolchinsky, Director, NAIC Structured Securities Group and Capital Market Bureau

Date: August 31, 2018

Re: Working Capital Finance Notes

1. Introduction – As requested, the SVO developed a chronology of the working capital finance investments (WCFI) to identify the context in which certain requirements (discussed below) were adopted. The chronology is presented in a companion memorandum and applicable context identified by reference to the relevant paragraph number(s) in the chronology.

2. Staff Report

   WCFI programs are to be reported on Schedule BA – Schedule BA reporting was recommended by the SVO with industry agreement. It reflected that a WCFI program is a long-term investment platform (see Chronology paragraphs 1, 2, 10 and 15). The issue was reconsidered in September 2012. CA, NE, NY and WI preferred Schedule BA. The American Council of Life Insurers (ACLI) did not oppose Schedule BA reporting and Conning Asset Management said it preferred Schedule DA but would not object to Schedule BA reporting. The SVO agreed that reporting is strictly a regulatory decision.

   Insurers must obtain prior approval from their domestic regulators to invest in WCFI – This requirement originated relatively late in the process (please refer to Chronology paragraphs 2, 17 and 18) and seems to reflect a desire to keep small companies from engaging in this investment. Industry argued that an NAIC standard such as an Statement of Statutory Accounting Principles (SSAP) is typically understood to eliminate the need for individual states to approve an activity and a state could opt out of the NAIC standards by amending its investment laws. IL, OH (Chair) and PA agreed. New York argued for keeping the requirement. Looking at this issue today, the SVO agrees that the industry correctly stated the underlying concept of the NAIC standard setting process. An investment standard published in the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) would be incorporated by reference into state law under the accreditation program standards. To the extent the requirement hinges on a concern with small companies, the SVO would urge reconsideration of the requirement. The SVO consistently advised that small insurers were unlikely to be considered suitable partners by a large bank or pay the costs of setting up the necessary documentation and internal processes.

   Payments due to insurers cannot be commingled with funds of any other entity – The P&P Manual defines a Finance Agent as a “… bank, financial institution, financial intermediary or service provider that facilitates the Working Capital Finance...
Program that arranges the sale, assignment or transfer of the Confirmed Supplier Receivable to the Investor and administers payment.” The P&P Manual also provides that a finance agent must “…be an entity regulated or supervised by a financial regulator in one of the countries in the List of Foreign (non-US) Jurisdictions Eligible for Netting for Purposes of Determining Exposures to Counterparties for Schedule DB, Part D, Section 1 in Part Six, Section 3 (d) of this Manual and that the regulator is the functional equivalent of the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency (OCC) or the Federal Deposit Insurance Corporation (FDIC). In the alternative, the SVO shall verify that payments due the Investor are made directly by the Obligor with no commingling of funds or assets with those of the Obligor, Supplier, Servicer or Trust Administrator or other Investors.”

Ascertaining who regulates a financial institution and the functional equivalent of that regulator to an enumerated list of U.S. federal regulators is not a function the SVO could ever implement – as we advised when the requirement was imposed. That means that as a practical matter a program submitted to the SVO would fail if the SVO could not confirm that a finance agent must transmit obligor payments directly to the insurer without commingling with other investor assets. The SVO advised against the commingling requirement because it is a legal issue for the investor’s lawyer and a structural issue for the SVO to consider in its assessment. The existence of commingling could be a structural deficiency or may not be an issue at all. SVO comments on this point are not preserved in the NAIC Proceedings because they would have been made to other staff elements as part of the directions for the different staff elements to reconcile their proposals.

Commingling is a generic concern in many transactions. It arises when a third party holds property that belongs to another with its own property and files for bankruptcy. When that happens it is possible that the identity of the owner of that property can be blurred. In that case owners have the practical problem of identifying their cash property in the bankrupt entity’s possession. There was a point in time when it was not clear (as a legal matter) if a secured interest in cash proceeds commingled in property of a bankrupt would survive the filing. The SVO never considered commingling to be a practical or a legal concern in WCFIs. Commingling risk is always managed with structural mechanisms – which can be as simple as requiring funds to be held in a trust account because funds held in trust are legally understood to belong to the beneficiary of the trust and not to the trust itself. The lower the credit quality of an obligor, the higher the reliance would be on structural mechanisms.

Commingling risk is eliminated for WCFI because banks and other program participants in SVO approved WCFI must be NAIC 1 or 2. In addition, WCFI paper is short term. Under the rules the SVO would de-designate a WCFI obligor than dropped to an NAIC 3. Before that happens the investor can protect itself by letting the short term (i.e., 30, 60, 90, or 365 day) obligations mature and not buy any more. If funds are in fact commingled in an NAIC 1 or 2 entity that contrary to expectations files for bankruptcy, UCC Section 9 – 315 makes it clear that the secured interest in commingled property survives the bankruptcy filing and that Courts have authority and a procedure to identify and segregate property of a secured party. It would have been noted at the time that WCFI programs are conducted on electronic platforms (as Mr. Ahearn of Citibank testified to the Invested Asset (E) Working Group - see Chronology paragraph 6 , 14 and 17). Industry has more recently expressed concerns to the SVO (which we have previously shared with the Task Force) that finance agents who are service providers use electronic platforms that automatically debit obligor’s account and credits a collection account held at a financial institution which disburses payment to investors. Insurers want regulators to confirm that these platforms do not violate the commingling prohibition. Insurers with experience in WCFI also state that commingling is not a practical or legal concern in WCFI programs because: service providers set up trust accounts with regulated financial institutions for investors. All obligor payments are sent directly to the financial institution and deposited in the trust accounts. Investors have first priority security interests in the trust accounts. Funds in the trust accounts are not commingled with financial institution assets and unless there is an exception on settlement trust accounts will have “zero balance” daily meaning they will not hold or commingle funds unless a delay or exception occurs (e.g., if a bank account used to pay an investor fails or multiple settlements occur on the same day). The SVO believes that a number of legal issues were made requirements in the P&P Manual because they were made governing standards in SSAP No. 105. The SVO continues to agree with industry comments reflected in Chronology paragraph 14.
The WCFI Obligor must be NAIC 1 or 2 and key participants must have at least the same Designation – The SVO’s original proposal was intentionally conservative, not because of concerns with the quality of the trade receivables as the basis for a purchase of a right to payment, but because a long term investing platform to buy short-term paper, potentially on a revolving basis, was a novel proposition. The SVO focused on obligors (and related entities) with high credit worth – the industry team we worked with agreed to that approach. We understand that industry experience since then is that WCFI programs can involve: 1) a rated obligor and/or its rated subsidiaries; 2) an unrated subsidiary obligor of a rated entity; or 3) a rated obligor and its unrated subsidiaries. The industry’s concern is that because other investors can purchase all three program types, insurers lose investment opportunities since markets have no incentive to identify different program types. The SVO was asked to consider whether the designations of arrangements involving the situations described in 2 and 3 could be managed though the exercise of analytical discretion.

Analytical discretion refers to a process where credit negative aspects of a transaction are balanced against credit positive aspects of a transaction by an analyst exercising professional judgment against given criteria and methodology. An example would be the discussion above that an analyst would not worry about commingling risk with a highly rated well run obligor because the documentation would specify how assets that belong to the investor are administered and it is unlikely that the obligor would file for bankruptcy in the time needed to let a WCFI program unwind.

Industry’s concern raises two distinct questions. In the first situation (item 2 above) an unrated obligor would be a subsidiary of a rated entity. The rated entity may or may not be in the transaction as a key participant. The question, then, is whether and how the credit strength of the rated entity could be attributed to the unrated obligor.

The unrated subsidiary obligor could apply to be designated by the SVO but if it cannot attain an NAIC 1 or 2 on a stand-alone basis, the program would be ineligible for designation. One analytical alternative – which is also the cleanest way to handle the issue - is for the parent to promise, in a legally enforceable manner (such as in a guaranty) to pay the obligations of the unrated obligor. In that case the designation would be based on credit substitution methodology. Some believe that another analytical alternative is to focus on the operational and strategic linkages between the rated parent and the unrated obligor on the premise that the interest of the rated entity is so entwined with the survival and success of the unrated entity that the rated entity has no choice but to financially support the unrated entity. The SVO examined this proposition.

SVO assessments typically involve stand-alone legal entities with independent economic operations that are independently engaged in financing activities related to those operations. Conceptually, the WCFI context differs from that because in WCFI the operational and strategic linkages relate to the purchase of goods for resale which goes to the heart of the economic viability of the buyer and of any affiliates engaged with the buyer in the process of buying goods for resale. Lacking information on that paradigm, we examined literature that involves the factual circumstances we know best – which is not WCFI – in the belief that it provides insight into the issue.

The literature we reviewed indicates that, at best, an analysis of operational and strategic linkages provide a basis to upward notch the stand-alone credit worth of the unrated subsidiary but could not be a basis to attribute the credit worth of the rated obligor to the unrated subsidiary. This is because in the absence of a legally enforceable obligation, rated parent entities can (and have) abandoned financial support of its subsidiary even in the face of previous public statements to the contrary because the cost of providing the support is too expensive relative to other alternatives. Based on this reasoning, and in the

1 Moody’s notes that in one year, “…there were four instances in which highly rated parent companies opted to … (curtail) … investment in wholly or partially owned subsidiaries … As a consequence, the subsidiaries ultimately defaulted on their debt despite, in several cases, public assurances by the parent of continuing support given the ongoing strategic importance of the underlying subsidiary to its parent ... These defaults illustrate the difficulty of giving ratings benefit for the perceived strategic importance of a subsidiary to its parent in the absence of legally binding support ... in the absence of a guarantee or a legally binding support mechanism, the parent has the ability to insulate its own financial position without material adverse consequences to its own operations by discontinuing financial support to the subsidiary should results not turn out as envisioned.” Moody’s Investors Service, Cross-Sector Rating Methodology, December 2003; Rating Non-Guaranteed Subsidiaries: Credit Considerations in Assigning Subsidiary Ratings in The Absence of Legally Binding Parent Support. The following is a distillation of the above criteria and methodology piece. Financially weak subsidiaries with high business risk profiles, limited operating histories, with weak performance as to profitability and free cash flow and need for periodic parental funding where there is no guarantee or legally binding support mechanism from the parent would in all likelihood be rated at or close to the subsidiary’s intrinsic stand-alone rating.
absence of information specific to the WCFI context, an evaluation of operational and strategic linkages would not provide the SVO with criteria and methodology to reliable measure the obligor’s ability and willingness to pay. It is entirely possible that the economic realities of WCFI programs provide a markedly different operational and strategic dynamic from that in the situations the SVO normally assesses. It is also entirely possible that analytical criteria and methodology can be developed responsive to that dynamic. For example, attribution of the credit rating of the rated entity to the unrated subsidiary is possible if some high percentage of the rated entity’s revenue is derived from the unrated entity. But establishing such a methodology requires information and insights the SVO does not currently have. The very small number of WCFIs seen by the SVO since the program was permitted (7) does not permit the development of a knowledge base from which we could evaluate the dynamic or recommend analytical guidelines. We would welcome industry input on this issue.

The second situation (item 3 above) involves a rated obligor and an unrated subsidiary deemed to be a key transaction participant (but not the obligor). The SVO believes that it should be possible to develop performance criteria to evaluate the ability of the unrated entity to perform the functions expected of it. The goal would be to identify performance factors that could be evaluated in the exercise of analytical discretion to determine that the unrated entity could reliably perform the role expected of it.

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The parent has the motivation and ability and to insulate its own financial position without material adverse consequences to its own operations by discontinuing financial support to the subsidiary. If the subsidiary is a financially and operationally established lower-risk subsidiary with modest future reliance on parent funding whose operations are critical to those of the parent and for which incremental investment would meet parental return objectives, Moody’s begins with the intrinsic stand-alone rating and, after review a number of factors (such as the subsidiary’s financial track record and the parent/subsidiary support relationship) may opt to lift or “notch” the rating higher. Any “ratings lift” based on the parent’s willingness and ability to provide support could be limited to only one or two notches above the stand-alone rating. See also, Fitch Ratings, Cross-Sector Criteria, Parent and Subsidiary Rating Linkage – Fitch’s Approach to Rating Entities within a Corporate Group Structure, July, 16, 2018.
MEMORANDUM

TO: Kevin Fry, Chair, Valuation of Securities (E) Task Force
    Members of the Valuation of Securities (E) Task Force

FROM: Robert Carcano, Senior Counsel, NAIC Investment Analysis Office

Cc: Charles A. Therriault, Director, NAIC Securities Valuation Office
    Eric Kolchinsky, Director, NAIC Structured Securities Group and Capital Market Bureau

DATE: August 31, 2018


1. Introduction – The SVO was asked to develop a chronology of working capital finance investment (WCFI) which would help identify the context in regulatory requirements were adopted.

2. Chronology

1. March, 27, 2011 (VOS TF) – Nebraska asked SVO if working capital finance notes (WCFN or notes) were trade receivables. SVO conducted a detailed study after which it replied that the transaction between a supplier and an obligor generates a trade receivable. However, the transaction in which a bank purchases the supplier’s right to payment and the obligor acknowledges the purchase and its obligation to pay the amount of the receivable to the bank is a second and distinct transaction. In that transaction the bank owns a legally enforceable obligation due from the obligor to pay a sum certain on a date certain. The challenge was to create an investment platform where short term individual obligations would be purchased through a long term revolving platform. The SVO identified uniform standards and a methodology to build the platform. SVO then proposed that this WCFN program be an NAIC standard. Pacific Life representatives testified to the safety of a properly structured program like the SVO was proposing and explained the mechanics of such programs. National scale rated obligors set up programs with their banks so picked suppliers can sell the obligor’s receivables to the bank instead of waiting for the obligor to pay it. The bank confirms with the obligor that the obligor has no defenses to payment of the obligation the date of the obligation’s maturity and then buys the receivable at a discount; i.e., pays say 85 cents on the dollar and waits to collect 100 cents on the dollar from the obligor. The bank may not always want to hold all of the paper generated by the program and seeks third-party investors (traditionally other banks) as insurers as partners which it can offer the opportunity to buy any paper the bank does not want to hold. The investor has the option but not the obligation to buy offered notes. The supplier’s discount creates a higher return opportunity for the investor. The SVO proposal was released for a 45-day comment period.

2. May 19, 2011 (SAP WG) – Pacific Life representatives said that the WCFN sets standards for the second tier transaction – the one between the bank and the obligor relative to the supplier’s receivable. The designation applies to the program not to the individual notes. Individual notes have stated maturities but the program does not have a maturity date. Schedule BA reporting was recommended because the program is long-term even if the notes are short-term. Q – The higher
yield must reflect legal, execution, extension or other risk. A - The supplier’s discount supplies the extra yield. Q – Aren’t banks pulling out of this activity? A – No. Banks wants insurers as partners to better manage their business. Insurers are not competitors and banks and insurers already work together on bank loans and private placements. Q – Can an obligor extend payment on a note? A – Failure to pay on the due date is an event of default. Q - What is the longest maturity date in the programs? A - 365 days. Q - How are the rights of setoff addressed? A - Setoff rights are eliminated when the obligation is confirmed under the program. Q - What is the piece of paper the investor buys? A - The insurer buys and therefore owns the right to payment that the supplier formerly held – a right specified in the contract with the obligor and bank in which the insurer is a signatory. Q - Is this a trade receivable? A – The transaction between the supplier and the obligor generates a receivable. The transaction between the bank, obligor and supplier to transfer the right to receive payment of the amount of the receivable to the bank creates a direct obligation distinct from the underlying trade receivable. This is the same legal process used to transfer ownership of credit card receivables and automobile loans to trusts for use in securitization pools. Q – What has been Pacific Life’s experience with this asset class – including in the financial crisis? A - Pacific Life’s non-insurance affiliate invested around $1.5 billion over 10 years and experienced zero losses. Pacific Life unwound its position in 2009 (during the financial crisis) receiving 100% of principal and interest. Q - Have banks suffered losses? A - Not sure. Q - What number and size of banks are involved? A - About 20 of the world’s largest banks. Q – I am concerned about small companies participating. A – Small insurers would not have the expertise or incentive to structure a program with a major bank; especially not one with the standards developed by the SVO. Q - Is it a promissory note, which is a negotiable instrument under the uniform commercial code?* A - Yes. Q - Who oversee the (bank) agent involved? A - Not sure if only one overseer.

* [NOTE: The answer accurately summarizes the response in the record. However, the speaker was not an attorney that specializes in Uniform Commercial Code law. While the response is accurate for some programs, most programs are not structured to result in the transfer of a promissory note. Most programs involve the transfer of “accounts” which the UCC recognizes and treats differently than it treats promissory notes. None of the possible structures implies a difference as to enforceability – only a difference of the mechanics by which that obligation is recognized, noticed to third parties and the right to payment enforced.]

3. September 1, 2011 (VOS TF)³ – The Task Force referred WCFNs to the Invested Asset (E) Working Group (IAWG) and charged it with determining if WCFNs should be an invested asset using the work done by the SVO as a starting point.

4. October 17, 2011 (IAWG Conference Call)⁴ – The WG released a list of issues for a two-week comment period.

5. November 4, 2011 (Conference Call of the IAWG)⁵

November 4, 2011 – The WG wanted to discuss remedies under contract law or the Uniform Commercial Code for non-payment and treatment accorded to these programs by federal banking regulators.

WG - Basal III imposes a charge for operational risk to recognize bank business that entail large volumes. IND – An insurer would be an investor and not an administrator of WCFN programs. Asset-level operational risk is addressed in the contract.

WG - Should NAIC develop separate RBC regimes when the insurers would manage and when the bank would manage operational risk? IND - Operational risk applies to the balance sheet and asset structure; is addressed in C-4 and is not associated solely with this investment.

WG - Do WCFNs fit NAIC Model #280 or #283 definitions? IND - WCFNs are not mentioned in the Models but WCFNs have the same characteristics as many instruments that are mentioned.

WG – What rights does the insurer have if an obligor does not pay on the maturity date? IND – The same as with any other defaulted security - the insurer owns the “note”* and would have to enforce its contract in court.
*[[NOTE: The writer chose the word “note” to summarize the sense of the response. However, a program may not result in the issuance of a physical note. In all cases ownership of the right to payment is expressed in the transaction documentation which ensures the insurer has a first priority security interest in the right to payment.]}

WG - What is a reasonable basis for valuing trade receivables? **IND** – As private transactions WCFIs are deemed to be illiquid. But because they are short-term obligations, they self-liquidate which reduces illiquidity. Mark to market is not useful. Amortized cost should be used to value at the end of a period for impairment. **WG** - GAAP provides a write-down procedure upon default. What should NAIC do for valuation. **IND** – Insurers should apply the same NAIC valuation and impairment guidance used for bonds. INT-06-7 is similar to GAAP and the rights and steps in the contract provide the basis for applying impairment guidance.

WG - How big was the market with factoring and bank purchases. **IND** - WCFNs do not involve factoring. The potential size (derived by estimating the value of all US purchase activity) could be about $13 trillion but is much less for high quality issuers.

WG – The SVO proposal addresses rights of set-off and imposes a single obligor limit. We would exclude receivables of an insurance company affiliate to foreclose money being pulled out of the legal entity. **IND** – Agreed. **WG** - Affiliates of any of the other parties (agents and servicers) involved in the transaction would be excluded to avoid conflicts of interest. **IND** – Agreed.

WG - Receivables would be from new sales only not from roll-over; insurer would enforce this. **IND** – The WCFN program between bank and obligor transfers ownership of the right to payment of the receivable amount to the insurer; it is fixed at that point so the receivable cannot be retroactively modified.

6. **February 7, 2012 (IAWG Conference Call)**

WG – The WG said it met in closed door session with FDIC representatives and made a brief comment on what was discussed. The Chair introduced Mr. Ahearn of Citibank to provide testimony on WCFI programs. Mr. Ahearn has 30 years-experience in the trade receivable business. He runs Citibank’s global $57 billion trade receivable business (more than 57,000 suppliers) which yields Citibank $1.7 billion in annual revenues. Mr. Ahearn regularly consults with the FDIC, OCC, SEC and others; and advises US government and international regulatory projects. Mr. Ahearn made the following comments:

**Purpose** - Trade receivable financing permit large buyers (obligors) to offer suppliers liquidity in exchange for extending payment terms. **Mechanics** - The trade receivable is created when a supplier transfers goods to a buyer. Supplier’s payment request goes through the buyer’s accounts payable process. Payment to the supplier is approved in that process and electronically confirmed to the bank via a future-dated payment instruction. When the bank receives the payment instruction, it sends the supplier electronic notification that the receivable has been accepted. Usually the supplier leaves standing instructions to sell the receivable to the bank at that time. **Legal Rights** - The payment instruction is irrevocable, eliminates the risk of not being paid or being paid a smaller amount than agreed. Purchase on the basis of the payment instruction makes the bank a holder of the receivable in due course and the actual owner of it placing it in the exact standing as a secured bond holder. **Safety** - International Chamber of Commerce studies conclude trade receivable finance performs much better than any other bank asset class. Citibank has not suffered any losses or defaults in more than seven years.

WG - How does the insurance company protects its interest? **Ahearn** - The insurance company owns the receivable* and so is a trade creditor with the same status as a secured bond holder.

*[[NOTE: The answer shown accurately summarizes the response in the record. However, the answer does not fully reflect that the structure of every investment differs. The better way to express the concept is insert the phrase “right to payment” whenever in this chronology the word “receivable” is used. Chronology paragraph 1 and subsequent paragraphs sought to...]]
distinguish the transaction between the buyer and supplier that creates the receivable and the transaction between the bank and the supplier in which the right to payment of the amount of the receivable is transferred and the obligor’s obligation to pay is created. With respect to the right to payment, sometimes the account that represents that right is transferred, sometimes a note is created to represent that right. At all times, the transaction documentation identifies the investor’s right to payment and provides for a first priority perfected security interest in the right to payment.]

WG - Does the much higher yield on a trade receivable suggest a difference in safety? Ahearn - The yield reflects that the supplier’s standalone cost of financing would be about prime + 200 basis points instead of about 85 basis points under a trade receivable program. Despite the higher yield the supplier is getting a significant liquidity benefit.

WG – When you said these programs were rated low for operational risk you meant Citibank’s program? Ahearn – No. I meant for everyone engaged in trade receivables. Comments attributed to the FDIC by the WG indicate they were discussing factoring which does not involve a buyer accepting and providing payment instruction to its bank as is done in the trade receivables business.

WG - How does an investor in the trust structure exit the program? Ahearn - The investor refuses further investment opportunities and waits for current holdings to mature.

7. March 4, 2012 (IAWG Conference Call)7 - The WG determined that WCFNs should be a permitted invested asset. CT’s insurance department compiled a list of proposed criteria to be used in statutory accounting guidance reflecting its view that trade receivables have different names, at least five different structures, are described in at least four different ways, provide different results as to insurer rights, remedies and priority; are unperfected, unsecured, illiquid junior securities with no market value and no standard terms or legal norms. Technical legal issues pertaining to documentation shift payment risk to the insurer. Insurers (must be) required to have a perfected interest in the payment obligations. Concern was expressed that the criteria would modify the SVO methodology and ignores that technical issues at the program level can be managed or mitigated in many different ways. The WG Chair responded that the list of criteria is not intended as a revision of the SVO methodology but as limits in the accounting guidance. The criteria8 was released for comment.

8. March 21, 2012 IAWG Conference Call: Report to the VOS TF)9 - The WG received comment letters, adopted the proposed criteria and referred the project back to the Task Force.

9. August 12, 2012 (VOS TF)10 - The Task Force noted that the WG completed its assignment. In a separate item the Task Force said it had instructed NAIC and SVO staff to develop joint recommendations based on the work to date. A joint staff recommendation was discussed in a regulator-to-regulator conference call and NY proposed to develop a proposal to reconcile a number of remaining concerns. The objective is to develop a proposal to the Statutory Accounting Principles (E) Working Group and to the Capital Adequacy (E) Task Force. The Task Force received the New York proposal for a comment period of 15 days.

10. September 6, 2012 (VOS TF Conference Call)11 – The NAIC and SVO staff proposal (which revised the original SVO proposal) was adopted. NY moved adoption of the NY WCFI proposal and a referral to the Statutory Accounting Principles (E) Working Group and the Capital Adequacy (E) Task Force. A discussion ensued on the reporting Schedule to recommend on WCFIs. Schedule BA includes reporting categories for NAIC designations on the life schedule but not on the P/C schedule; Schedule DA does not have a designation column, but the credit designations are manually bucketed when completing the RBC report. WCFI involves the purchase of short-term obligations which could suggest Schedule DA. But WCFIs are clearly other invested assets so Schedule BA provides enhanced disclosure. NY leaned toward Schedule DA. CA, NE and WI preferred Schedule BA. NY noted that Schedule BA reporting requires the company to disclose its maximum investment and agreed to amend his motion to recommend Schedule BA treatment. ACLI did not oppose Schedule BA and Conning Asset Management preferred Schedule DA but would not object to Schedule BA reporting.
11. November 30, 2012 (VOS TF)\textsuperscript{12} – Reported the referral to the Statutory Accounting Principles (E) Working Group, the Blanks (E) Working Group and the Capital Adequacy (E) Task Force. NY noted the WG could create a new SSAP or amend SSAP No. 20.

12. November 29, 2012 (SAP WG)\textsuperscript{13} - The WG received the Task Force’s recommendations on WCFNs; noted it has worked with the Task Force so was close to finalizing the issues and indicated it would need to develop an SSAP.

13. March 7, 2013 (SAP WG)\textsuperscript{14} – WCFI was introduced and an exposure of a new issue paper and SSAP to address accounting requirements for WCFI recommended by the Task Force was introduced. The item was moved to the substantive active listing and the issue paper and SSAP were released for comment ending March 26.

14. April 6, 2013 (SAP WG)\textsuperscript{15} - Comments received from the ACLI put forth two different redrafts of the proposed SSAP. Key comments from the ACLI:\textsuperscript{16}

“…Traditionally, SSAPs … avoid directing explicit legal language … legal requirements (should be separated from) accounting guidance … for three primary reasons. One, legal standards, interpretations of the law and the law itself have the tendency to change … Secondly, is the possibility of “unintended consequences”. … (expressed) legal requirements (may be) insufficient or unwittingly preclude an investor from participating in an investment that would otherwise be acceptable. Lastly, the inclusion of exacting legal language gives the inference that the language must appear verbatim in program documents for the program to qualify as admissible; a requirement that would not be possible to accomplish.” … you can (instead place) … legal parameters … in the (P&P Manual) … which has traditionally described the analytical and legal requirements for invested assets. Or two, … (instead of) specifically drafted representations and warranties, (use) … conceptual terminology in the SSAP that still conveys the same legal principle … this … provides drafting flexibility to the insurer to meet the requirements of the SSAP and … a basis for the regulator and auditor to analyze the reasonableness of the judgment of the insurance investor. The impact of not providing clarity or flexibility around how insurers obtain the legal protection required in the SSAP will ultimately result in no programs qualifying for admissibility, which is not the intent of this committee. In consideration of the above, we have included two revised versions of the SSAP, which are redlined against the original draft of the SSAP exposed on March 6. The revised versions employ the two alternative options that we discuss above.

15. April 7, 2013 (VOS TF)\textsuperscript{18} – The Chair noted that the Statutory Accounting Principles (E) Working Group will met on April 18 to consider the SSAP proposal; that Blanks adopted a proposal to include lines in Schedule BA for WCFIs, but the proposed WCFI disclosure in the Notes to Financial Statements was only exposed and will be pending activity from the Working Group. RBC “blanks” changes would be considered for adoption by the Capital Adequacy (E) Task Force and needed to be adopted by the end of April, but the appropriate RBC factor to apply to WCFIs will continue to be debated. The Task Force will not have any action to consider until the Statutory Accounting Principles (E) Working Group concludes its adoption of the SSAP.

16. August 24, 2013 (SAP WG)\textsuperscript{19} – The WG noted it directed NAIC staff to work with regulators and interested parties on the comments received to its March exposure. A new draft of the SSAP was prepared with a Dec. 31, 2013 effective date, but that differences of opinion on some issues still remain. The draft SSAP was released for a comment period ending Sept. 13.

17. October 4, 2013 (SAP WG)\textsuperscript{20}

PA expressed concern that the issue not continue to be delayed; that there have been 3 years of discussion and that he has never seen an investment more studied, particularly one that does not have extensive risk, while more-risky investments have not received this level of scrutiny and are admitted in the financial statements. A discussion ensued over the following remaining issues.
Industry requested terminology changes to replace “represent and warrant” with “commit and state,” and to replace “represent” with “certify” in various locations throughout the proposed SSAP.

In Paragraph 13 – Industry is concerned that proposed SSAP requires the agent to express a legal opinion that there is a first priority perfected interest an issue out of its competence. This contradicts areas where the investor certifies it has a reasonable belief that there is a first priority perfected interest. NY said structures for participations vary. The first priority perfected interests requirement was deliberately inserted with this in mind. The language has already been “softened” from prior versions while it should have always been clear a first priority perfected interest requirement would be included. Industry responded that safeguards exist to protect the insurer’s interests. The point here is that an agent can’t make legal representation regarding the existence of such protections. WCFI documents do not include these items as representations or warranties. As a compromise, industry can certify they worked to provide these protections. NY responded that the problem is it would not be apparent that the legal representations do not exist until an event of default. In response to an inquiry from the Chair, NY agreed the objective is to document an intent to achieve a first priority perfected interest.

Re Paragraph 15, industry said audited consolidated group financial statements will not meet the requirement for “audited financials of the finance agent.” Divisions within the banks offering WCFI programs are not separately audited as subsidiaries, but are included within the audited consolidated financial statements.

Re Paragraph 17, industry said the requirement for explicit domestic state regulatory approval for WCFI investments should be eliminated. An NAIC SSAP is not needed if states have to approve this activity. States can individually exclude WCFI in their investment laws. PA noted other statutory accounting provisions require state approval but none involve investments. He also said there are riskier investments that are allowed that do not require such approval. He supported removing this requirement from the proposed SSAP. IL agreed and said WCFIs will already be pre-approved by the SVO and no one has asserted that these investments are high-risk. The Chair agreed that perhaps explicit permission is not warranted. NY said statements about the low risk of these instruments ignore FDIC and Office of the Comptroller of Currency (OCC) comments. These investments originated as a means to avoid restructurings...

Industry said there is confusion regarding the guidance. It seems that assets within the SSAP and reviewed by the SVO would be nonadmitted. He recommended explicit guidance that WCFI assets meeting the requirements of the SSAP would be admitted.

18. **November 12, 2013 (SAP WG)** - The most significant changes were made in paragraphs 13-15 regarding documentation of first priority perfected interest. The Working Group discussed whether to make changes proposed by the ACLI that would allow more flexibility in using the consolidated group audit report and reviewed proposed language from SVO regarding the materiality of audit report findings. The WG agreed to proposed changes regarding the audit report requirements and discussed the ACLI request to delete the current language in the draft which noted that permission to invest in WCFI programs is required from the domiciliary commissioner. WI voiced concern that smaller, less sophisticated investors may not have the expertise needed to invest in this asset class and that trade receivables have been a nonadmitted asset class and that such assets were not contemplated by the model investment laws. WI requested the requirement be maintained. After discussion, existing language was modified to note that permission may be required from the domiciliary commissioner. The SSAP and Issue Paper (with conforming changes) were released for a comment period ending Dec. 3, 2013. (See the Issue Paper at 10-496 - Attachment One-L of the 12/16/13 minutes of the Accounting Practices and Procedures (E) Task Force).

19. **December 5, 2013 (SAP WG)** - The WG adopted SSAP No. 105 — *Working Capital Finance Investments* with a Jan. 1, 2014 effective date and the corresponding issue paper No. 147. PA questioned whether all of the lingering issues had been addressed given that the issue has received a lot of discussion.

20. **December 2, 2013 (VOS TF)** - The Task Force received the proposed amendment to the P&P Manual to add WCFI. The proposal was received and released for a two-week comment period.

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1. NAIC Proceedings, Spring 2011; 1Q V2 page 10-937 for meeting of the VOS TF; SVO proposal at 10-1036 (Attachment Eight)
2. NAIC Proceedings –Summer 2011; 2Q V2; page 10-432; Statutory Accounting Principles (E) Working Group, Conference Call of May 19, 2011
3. NAIC Proceedings – Summer 2011 2Q V2 - 2; page 10-1287
4. NAIC Proceedings, Fall 2011 3Q V2; October 17, 2011 Conference Call minutes of the IAWG at page 10-554;
5. NAIC Proceedings, Fall 2011 3Q V2; Report of the IAWG to the VOS TF at page 10-518; November 4, 2011 minutes of the IAWG meeting at 10-568
6. NAIC Proceedings – Spring 2012 1Q V2; February 7, 2012 minutes at page 10-846
7. NAIC Proceedings –Spring 2012 1Q V2; March 4, 2012 Conference Call minutes of the IAWG at page 10-844
8. Connecticut Insurance Department proposal for treatment of trade receivables as admitted assets

For Discussion Purposes - Draft

1. Program documents must be reviewed and approved as noted by SVO. Any amendments to the program documents must be re-filed prior to any purchases. 2. Programs should be restricted to a single recognized obligor and not any affiliates thereof. Each program should be separate, as a distinguishing characteristic from “factoring”. 3. Eligible obligors to not include any affiliates, subsidiaries or controlled entities of the insurer. This should explicitly exclude any receivables that are insurance premiums, agents balances, commissions reinsurance related items. 4. Eligible trade receivables must require a confirmation from the obligor that all requirements of the vendor/seller have been fully and completely satisfied, that all rights of set-off have been waived and all obligations of the obligor have been confirmed. 5. Eligible trade receivables should be limited to those arising from an actual transaction between the seller/vendor and the obligor and purchased within 30 days of the transaction. 6. Insurer must maintain, or have available to it from a third party servicer, a detailed ledger recording details of each trade receivable purchased, including but not limited to - origination date, purchase date, confirmed payment date, seller/vendor and the obligor and purchased within 30 days of the transaction. 6. Insurer must maintain, or have available to it from a third party servicer, a detailed ledger recording details of each trade receivable purchased, including but not limited to - origination date, purchase date, confirmed payment date, actual dates when payments are received, face value and purchase cost. Ledger should be submitted to SVO on a quarterly basis for review. 7. Programs are subject to an annual Statement on Standards for Attestation Engagements (SSAE) #16 audit, with audit reports filed with the SVO. 8. Obligors should be restricted to investment grade corporate entities. 9. Program documents should contain covenants stating that disputes arising out of the transactions are to be resolved pursuant to US law (“choice of law”), to be resolved in the courts of the state of the insurance company’s domicile or the courts state thereof ("jurisdiction"), and consent by all parties to venue in the state of the insurance company’s domicile. 10. Trade receivables should be denominated in US dollars. 11. Trade receivables are recognized as non-recourse to the seller/vendor but should be recognized as true sales. 12. The instruments and transactions must: • Create for the insurer a first priority perfected security interest; and • Assure that payments will not be stopped because of supplier or obligor noncompliance with regulations. 13. Servicers and trust administrators must be regulated US financial institutions. 14. The insurance company must have policies, procedures, internal controls, personnel and underwriting or investing guidance to assess obligor’s business, courses of dealing, and the usages of trade within that business. 15. The insurance company must have management information systems to provide timely and useful information to evaluate risk levels and trends. 16. The insurance company must have polices, procedures, and operations, depending upon the form in which the insurer’s interests are held or maintained to: • Hold legal title to the trade receivables or to an individual trust established solely to hold the receivables specifically and individually for the benefit of the insurer; • Assure that it has first priority perfected security interest in the instruments and their proceeds and the ability to enforce those interests; and • Monitor collateral and proceeds. 17. The insurance company must have legal policies, procedures, and operations to identify and control or mitigate: preference risk (risk that payments would be deemed a voidable preferential transfer were payer to enter bankruptcy); and stay risk (risk that payments would be stayed in bankruptcy). 18. Where the insurance company holding interests in a conduit or cash flow there from, the agreements must state that the conduit need not pay any other entities until obligations to insurer are paid; and what recourse the liquidity facilities would have to the conduit. In addition, counterparties (other than investors) must agree not to institute or join any filing of the conduit into bankruptcy for one year and one day after last maturing obligation is retired. The insurance company must file with the SYO copies of the legal opinions concerning true sale, non-consolidation, perfection, and taxes. 20. Assets must be legally segregated for the benefit of the insurer. Program documents should require that cash payments from the obligor be paid directly to the insurer, or into a lockbox. There should be no commingling of cash with the servicer/trust administrator or other investors. 21. Participations are not permitted. 22. Obligors must maintain a cash account with the servicer/trust administrator from which cash payments can be directly debited to satisfy payments to the insurer. 23. US law and United Nations Convention on the Assignment of Receivables in International Trade states that the law governing priority is that of the assignor. Suppliers (those assigning buyer’s obligations to insurance companies, banks, or other intermediaries) must be U.S. entities.

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