November 2022 SAPWG Call

Issues & Trends

We report on the latest actions by the Statutory Accounting Principles Working Group.

December 2022

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1 Meeting highlights

During its call on November 16, 2022, the Statutory Accounting Principles Working Group (SAPWG) **exposed** the following:

- SSAP Nos. 26R and 43R to define investments in the scope of those standards eligible to be reported as a bond on Schedule D-1. The exposure also includes related revisions to SSAP No. 2R to remove asset backed securities (ABS) from the cash equivalent classification and SSAP No. 21R to establish guidance for debt securities that do not qualify as bonds. Comments are due February 10, 2023.

- INT 22-02 to extend the deferral of recognition of the effects of the Corporate Alternative Minimum Tax (CAMT) in the financial statements through the first quarter of 2023. Comments were due December 1, 2022.

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Accounting highlights

Proposed bond definition

Action. SAPWG reexposed revisions to SSAP Nos. 26R and 43R to define investments in the scope of those standards eligible to be reported as a bond on Schedule D-1.[1] The exposure also includes related revisions to SSAP No. 2R to remove ABS from the cash equivalent classification and SSAP No. 21R to establish guidance for debt securities that do not qualify as bonds.[2] These revisions would be effective January 1, 2025. Comments are due February 10, 2023.

The proposed revisions are a result of comments received in response to exposed revisions at the Summer meeting to reflect the proposed principles-based bond definition in statutory accounting guidance.

Revisions to SSAP 26R include:

- combining the definition of a bond, previously included in SSAP No. 26R and 43R, within SSAP No. 26R to prevent duplication and potential inconsistencies between the standards;
- stating that investments specifically addressed within other SSAPs are excluded from the scope of SSAP Nos. 26R and 43R, including working capital finance investments under SSAP No. 105R;[3]
- clarifying that guidance excluding a security from being classified as a bond when interest or principal varies based on the performance of an underlying collateral value or variable, is not intended to restrict variables that are commonly related to debt instruments, including but not limited to 'plain vanilla' inflation adjustment mechanisms or benchmark interest rates;
- clarifying that an issuer credit obligation is a bond where the creditworthiness of the entity through direct or indirect recourse, is the primary source of repayment; and
- removing the glossary terms because definitions are included throughout the standard and defining bank loans within the footnote of the bond definition.

Revisions to SSAP 43R include:

- referencing SSAP No. 26R for the definition of a bond within the scope of SSAP No. 43R;

[1] SSAP No. 26R, Bonds; SSAP No. 43R, Loan-Backed and Structured Securities;

[2] No. 2R, Cash, Cash equivalents, Drafts, and Short-Term Investments; SSAP No. 21R, Other Admitted Assets

[3] SSAP No. 105R, Working Capital Finance Investments

- allowing an insurer to:
  - elect the retrospective method when estimating cash flows for securities of high credit quality at the time of acquisition; and
  - continue to apply the retrospective method if the investment is subsequently downgraded unless the investment is other-then-temporarily impaired (OTTI);
- clarifying that OTTI would be recognized when there is an adverse change in expected cash flows when the investment is impaired unless the adverse change is due solely to a 'plain-vanilla' variable-rate ABS; and
- stating that ABS reported at lower of amortized cost or fair value would report changes from the prior reporting period as unrealized gains and losses unless OTTI has occurred.

SAPWG proposed that revisions to SSAP Nos. 26R and 43R be effective January 1, 2025 and included transition guidance that prescribes the approach for reclassifying securities from Schedule D-1 that would no longer qualify as bonds. The guidance directs insurers to:

- report securities that no longer qualify under the bond definition as disposals from Schedule D-1 at amortized cost, with any previously reported unrealized losses reversed before recording the disposal to prevent recognizing gains or losses at the time or reclassification;
- include reclassified securities on the appropriate schedule (e.g. Schedule BA) at cost equal to the disposal value (amortized cost) and immediately, subsequent to recognition on the new schedule, measure the security in accordance with measurement method prescribed by the applicable SSAP;
- reclassify ABS previously reported as repurchase and reverse repurchase agreements on Schedule DA or as cash equivalents on Schedule E2 to Schedule D-1-2 at amortized cost and recognize an unrealized loss if the security was required be recorded at fair value under the lower of cost or fair value measurement method;
- report changes in measurement for reclassified securities as a change in unrealized capital gains (losses) in the first quarter 2025 financial statements, unless sold in the interim with a realized gain or loss, and not as a change in accounting principle; and
- disclose the following in the first quarter of 2025 financial statements for all securities reclassified from Schedule D-1:
  - aggregate book adjusted carrying value;
  - aggregate book adjusted carrying value after transition if the security resulted in a change in measurement basis; and
  - aggregate effect on surplus.

Interested parties were supportive of the proposed revisions. However, they stated that additional discussions may be needed about guidance for embedded derivatives in SSAP No. 26R that restricts securities from qualifying as a bond when principal and interest may vary based on performance of the bonds' underlying collateral value or another variable. Interested parties said that reclassification of some of these assets to Schedule BA may result in an adverse effect to capital because many states have limits on the aggregate amount of investments that can be reported on Schedule BA. They recommended a timely referral for the development of risk-based capital factors for Schedule BA investments to be finalized at the same time as the bond definition.

Revisions to SSAP No. 2R preclude ABS, in the scope of SSAP No. 43R, from being reported as cash equivalents or short-term investments and identify investments to be reported on Schedule BA as non-bond securities.

Revisions to SSAP No. 21R establish guidance for debt securities that do not qualify as bonds within the scope of SSAP Nos. 26R or 43R including requirements to:

- record debt securities as admitted invested assets, when the source of repayment is derived through rights to underlying collateral, only to the extent they are secured by admitted invested assets;
- report debt securities that do not qualify as bonds, solely due to a lack of meaningful cash flows, on Schedule BA using the same accounting and measurement guidance in SSAP No. 43R, including using a carrying value method determined by NAIC designations;
- report all other debt securities in the scope of SSAP No. 21R at acquisition at cost, including brokerage and other fees on Schedule BA, as admitted assets, and subsequently measure them at the lower of amortized cost or fair value with changes recorded as unrealized gain or losses;
- follow the measurement guidance in SSAP 43R for all debt securities that do not qualify as bonds in the scope of SSAP No. 21R to calculate amortized cost, determine OTTI and allocate unrealized and realized gains and losses between asset valuation reserve and interest maintenance reserve; and
- disclose information for all debt securities in the scope of SSAP No. 21R consistent with disclosures required by SSAP Nos. 26R and 43R.

Revisions to SSAP Nos. 2R and 21R would also be effective January 1, 2025.

SAWPG also discussed changes to the general instructions and Schedule D-1 stating that they are working on making revisions in response to most of the interested party comments, including:

- clarifying that convertible bonds are included with corporate bonds, with the exception of mandatory convertible bonds;
- identifying the lines for which affiliated investments are not reported;

- expanding the definition of financial ABS that are not self-liquidating; and updating coding, referencing, and data capturing, and other procedural items in Schedule D-1.

SAPWG is also working on updating the Issue Paper to clarify that a feeder fund structure that predominantly holds debt may be in substance a debt investment, despite the direct holding being a fund investment. The clarified language would identify elements that may call into question the determination that an investment is in substance debt. The Issue Paper would continue to state that a feeder fund that relies on equity interests for repayment would have to meet the requirements to determine if the structure is in substance debt and permitted for bond reporting.

Next step. SAPWG plans to reexpose the general instructions, Schedule D-1 and the revised Issue Paper at the Fall NAIC Meeting.

Inflation Reduction Act

Action. SAPWG exposed revisions to INT 22-02 to extend the deferral of recognition of CAMT in the financial statements through the first quarter of 2023.[4] Comments were due December 1, 2022

The Inflation Reduction Act (IRA) was enacted on August 16, 2022 and included a new corporate alternative minimum tax (CAMT). IRA and the CAMT are effective for tax years beginning after 2022.

On a previous call, SAPWG exposed INT 22-03 that included 2022 year-end guidance for insurers that are aware they will be subject to CAMT.[5] However, interested parties expressed concern about the proposed guidance stating that insurers would be unable to reasonably estimate the effect of CAMT for the 2022 reporting period.

In response, SAPWG exposed revisions to INT 22-02 stating that a reasonable estimate is not determinable for both year-end 2022 and the first quarter of 2023. Therefore, reporting the effects related to CAMT are not required in those financial statements.

However, INT 22-03 would require insurers to disclose:

- that IRA was enacted during the reporting period on August 16, 2022;
- a statement regarding expected subjectability to the CAMT in 2023; and
- if, based on information regarding the projected adjusted financial statement income for 2023, the entity or the controlled group of corporations of which the reporting entity is a member has determined if it is an ‘applicable corporation’ to determine if CAMT exceeds the regular federal income tax payable.

[4] INT 22-02, Third Quarter 2022 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax

[5] INT 22-03, Inflation Reduction Act – Corporate Alternative Minimum Tax

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