Statement of Statutory Accounting Principles No. 93

Investments in Tax Credit Structures

STATUS

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Affects	No other pronouncements
Affected by	No other pronouncements
Interpreted by	INT 06-07
Relevant Appendix A Guidance	None

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for qualifying tax credit investments[1] in programs made primarily for the purpose of receiving allowable general business federal tax credits and/or state tax credits, including state premium tax credit programs. Although these investments are often in the form of equity, this statement shall be applied to all investments (regardless of the structure of the investment) that qualify pursuant to paragraph 2.

[1] The scope of *ASC 323-740—Investments—Equity Method and Joint Ventures—Income Taxes—Proportional Amortization Method* only extends to income tax equity investments, whereas this statement is intended to capture all tax credit investments which meet the criteria in paragraph 2, regardless of structure. This includes, but is not limited to, tax equity investments and tax credit debt investments.

2. A reporting entity that invests in projects or programs that generate general business federal tax credits, corresponding state tax credits or state premium tax credits that meet the following conditions at the time of initial investment are required to capture the investment in scope of this statement:

a. It is probable that the tax credits allocable to the investor will be available.

b. Reporting entity investor does not have the ability to exercise significant influence over the operating and financial policies of the underlying projects.

c. Substantially all the projected benefits are from tax credits and other tax benefits, determined on a discounted basis using a discount rate that is consistent with the cash flow assumptions utilized by the reporting entity for the purpose of deciding to invest in the project.

d. The reporting entity's projected yield based solely on the cash flows from the tax credits and other tax benefits is positive.

3. Tax credit investments that do not meet the conditions in paragraph 2 shall be captured within the statutory accounting statement that addresses the underlying investment structure. Equity structured tax credit investments would generally fall within *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*. Debt structured tax credit investments should be assessed in accordance with *SSAP No. 26—Bonds* to determine eligibility for reporting as a bond.

4. Investments in a CAPCO (Certified Capital Company), organized as a partnership or an LLC, which is a company, authorized by state statute that borrows from investors, to make venture capital investments in "qualified" businesses, are not within the scope of this statement. Although associated with tax credits, the reporting entity is paid principal and interest on its investment with the CAPCO. Depending upon the terms of the CAPCO offering, principal and interest payments to the reporting entity will come from the CAPCO and/or the state. The CAPCO will make cash payments directly to the investors while the state will make payments in the form of premium or income tax credits. Investments in a CAPCO shall be accounted for in accordance with *Interpretation (INT) 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)* and specific statutory accounting guidance addressing CAPCOs.

SUMMARY CONCLUSION

5. Investments in tax credit structures are generally acquired to obtain a positive yield through tax credits and other tax benefits. The value of the investment is primarily based on the value of the remaining stream of tax credits and deductible expenses available to the reporting entity investor. The primary purpose of investing in these tax credit structures is to generate tax credits which benefit reporting entities, most commonly through a reduction in tax liability, or when permitted by IRS or state tax provisions, through the sale of certificated/transferable tax credits.

6. Investments in tax credit structures held by reporting entities meet the definition of an asset as specified in *SSAP No. 4—Assets and Nonadmitted Assets* and are admissible assets to the extent that they comply with the requirements of this statement.

Accounting

7. This guidance addresses the methodology for measuring an investment that is accounted for using the proportional amortization method. At initial recognition, investments in scope of this statement shall be recorded at cost.

8. Subsequent to initial recognition, the investment shall be carried at proportional amortized cost. Under the proportional amortization method, the reporting entity amortizes the initial cost of the investment

in proportion to the tax credits and other tax benefits allocated to the investor. The amortization amount shall be calculated as follows:

a. The initial investment balance less any expected residual value of the investment, multiplied by;

b. The percentage of actual tax credits and other tax benefits allocated to the reporting entity in the current period divided by the total estimated tax credits and other tax benefits expected to be received by the reporting entity over the amortization timeframe (life of the investment).

9. Reporting entities shall recognize tax credits in the period they are allocated to the investor for tax purposes. Unless all tax credits are allocated to the reporting entity at the date of initial investment, immediate recognition of the entire benefit of the tax credits to be received during the term of the investment project that generates tax credits and other tax benefits is not permitted. Tax credits shall not be recognized in the financial statements before the year in which the tax credits are allocated.

10. Any expected residual value of the investment shall be excluded from the proportional amortization calculation. Non tax-related benefits received from the investment shall be included as a component of net investment income when realized or realizable. Gains or losses on the sale of the investment, if any, shall be included as a capital gain or loss at the time of the sale. Determination of gain or loss will depend on the reported value (e.g., residual value at the end of the amortization timeframe) compared to the amount received in exchange for the investment. Liquidation of the investment commonly occurs at the end of the tax credit timeframe through a put or call agreement, often reflecting a nominal residual value that was established at the time of acquisition. The liquidation amount from such agreements shall reflect the expected residual value when available.

11. At the end of the amortization timeframe, if the reporting entity retains the investment, the investment shall be subsequently measured and assessed within the statutory accounting statement applicable to the investment held. Retained investments will remain on Schedule BA until disposal and cannot exceed the initial expected residual value.

12. Exhibit A illustrates the application of accounting guidance in two examples that generate tax credits and tax benefits using the proportional amortization method. The first example illustrates the application of a standard project. The second example illustrates the application of accounting guidance in a project that has expected residual value and generates non-tax related benefits in addition to tax credits and other tax benefits using the proportional amortization method.

Application of Proportional Amortization Method

13. Under the proportional amortized cost method, the amortization of the investment is to be recognized in the income statement as an expense component of the net investment income calculation. Non-tax related benefits received from operations, or sale of the investment should be accounted for in accordance with paragraph 10.

14. Tax credits and other tax benefits, not to include amortization of the investment, shall be reflected as follows:

a. Tax credits shall be recognized in the period that they are allocated to the reporting entity for tax purposes:

i. If utilized in the same year allocated, federal tax credits shall be recognized and reported as a reduction to federal income tax liabilities and federal income tax expense. If the allocated tax credits are not utilized in the year allocated, they shall be reported as a deferred tax asset (DTA) and change in DTA in accordance with *SSAP No. 101—Income Taxes*.

ii. If utilized in the same year allocated, state tax credits shall be recognized and reported as a reduction to the related state tax liability and state premium tax or state income tax, whichever is applicable. If the allocated tax credits are not utilized in the year allocated, they shall be reported gross of the related state tax liability in the category of other-than-invested assets (not to be reported net).

iii. Utilization of tax credits in settlement of tax liabilities shall be reflected net of the corresponding income or premium tax liability in the reporting period in which the tax credit is utilized.

iv. Tax credits allocated from tax credit investments, as defined within this SSAP, and held by reporting entities meet the definition of assets as specified in SSAP No. 4 and are admitted assets to the extent that they comply with the requirements of this statement. The admissibility of tax credits is subject to SSAP No. 101.

b. Federal tax benefits other than tax credits (e.g., tax benefits from investment depreciation) shall be recognized in the year allocated pursuant to SSAP No. 101. When utilized, the federal tax benefits are recognized as a component of income tax expense.

c. State tax benefits other than tax credits shall be recognized in the year allocated gross of any related state tax liabilities pursuant to SSAP No. 101. When utilized, the state tax benefits are recognized as a component of taxes, licenses, and fees.

Admittance of Tax Credit Investments

15. Although investments in tax credit programs do not represent investments that can be readily liquidated for policyholder claims, the reduction of tax liability or sale of allocated tax credits represents a benefit that supports admittance of these investments, but only if the tax credits will be received and can be utilized by the reporting entity. Investments in tax credit programs that will not result in any of the anticipated tax credits or that will result in tax credits which cannot be utilized or sold by the reporting entity shall be considered impaired and should refer to paragraphs 27 and 28.

16. Reporting entities shall, at initial investment, obtain a clean[2] fund level tax opinion[3] on the validity of the credits and structure of the underlying program and investment fund. Investments not supported by an initial tax opinion shall be nonadmitted. If the program is a permitted syndicated program with a yield guarantee, the opinion must verify that the investment and guarantee have been properly structured under IRS or state tax provisions and the guarantee does not disqualify the reporting entity from obtaining the tax credits.

17. Reporting entities shall annually obtain U.S. GAAP or U.S. tax basis audited financial statements on the investment fund. In the event audited U.S. GAAP or U.S. tax basis financial statements are not obtained or the audit receives an opinion other than unqualified, the asset shall be nonadmitted. If the audited financial statements are in-process but not completed as of the annual statement filing deadline, the

[2] While not quantified or defined in either the Internal Revenue Code or state regulations, common industry standards consider a "should" opinion to be the minimum degree of confidence associated with a clean tax opinion. For the purposes of this statement, a "should" opinion must represent a probability of success no less 70%. Any tax credit investment which receives a tax opinion with a degree of confidence less than "should" is to be nonadmitted.

[3] A fund level tax opinion for the purposes of this statement is defined as a full IRS Circular 230 tax opinion which covers from the fund level through to the underlying assets generating the tax credit benefits. The fund level is defined as the entity, or level, at which the investor comes directly into the investment without any intermediaries.

reporting entity may admit the investment based on the results of the immediately preceding prior year audited financial statements. A lag in reporting shall be consistent from period to period.

a. Other tax credit investments – If the reporting entity has a tax credit investment which by virtue of its structure cannot be audited, the investment is exempt from the annual audit requirement. One example of this type of investments would be tax credit debt investments[4] which do not involve any amount of equity ownership as a component of the investment. This type of tax credit debt investment is exempt from the annual audit requirement, but the reporting entity is still required to obtain a clean tax opinion, in accordance with paragraph 16, to support admittance at initial investment.

Prospective Utilization Assessment

18. The prospective utilization assessment, as detailed below in paragraphs 19-21, must be performed annually by the reporting entity if any of the following circumstances exist in either the current or prior reporting period:

a. Reporting entity records a valuation allowance against a deferred tax asset (DTA) balance.

b. Reporting entity becomes aware of other facts and circumstances which indicate that it will, more likely than not, be unable to substantially utilize the unallocated tax credits. Such instances include, but are not limited to:

i. If the reporting entity holds an investment which allocates state premium tax credits and intends to decrease premium volume in that state, it may affect whether or not the unallocated tax credits in that state can be utilized.

ii. If the reporting entity holds an investment allocating state income tax credits and records a valuation allowance in its U.S. GAAP financial statements against state DTA balances, including the same state as the tax credit investment, it cannot ignore the circumstances that led to the valuation allowance, even though statutory accounting does not permit state DTAs.

19. Prospective Utilization Assessment – If any of the circumstances detailed in paragraph 18 exist, the reporting entity is required to assess the future utilization of the investment's unallocated tax credits against estimated tax liabilities and determine the extent to which it will be able to utilize the investment's unallocated tax credits over the life of the tax credits. If assessment projections identify that the investment's unallocated tax credits will exceed what can be utilized under IRS or state tax provisions, the reporting entity shall nonadmit investments as necessary so that investments in scope of this statement (in aggregate) are only admitted to the extent tax credits are expected to be utilized within current, carryback, and carryforward periods. In making this assessment, the reporting entity is not permitted to assume increased operations (e.g., expanded product sales) beyond those allowed under prudent and feasible tax-planning strategies to conclude that additional federal or state tax liability will exist that would allow additional utilization of tax credits. A reporting entity may subsequently admit a previously nonadmitted tax credit investment, based on subsequent assessments in which the reporting entity determines that they will be able to utilize the unallocated tax credits.

20. Additional Admittance to Prospective Utilization Assessment – If the tax credit investment allocates tax credits with the following features, the reporting entity may perform a secondary assessment

[4] Common examples of tax credit debt investments are Tax Credit Strips derived from tax credit bonds, Qualified Tax Credit Bonds, and Build America Tax Credit Bonds. Tax opinions received on these tax credit investments are also referred to as "bond counsels." Tax Credit Strips derived from tax equity investments would not qualify for the paragraph 17.a carve out as the source of the stripped tax credits is auditable.

to determine if additional amounts of the tax credit investment nonadmitted under paragraph 19 can be admitted:

a. Tax credit investments which allocate tax credits which are certificated or transferable in accordance with permitted IRS or state tax provisions shall admit up to the lesser of the proportional amortized cost or fair value of the unallocated tax credits.

b. Tax credit investments which allocate tax credits eligible for direct payment shall admit up to the lesser of the proportional amortized cost or the estimated proceeds from unallocated tax credits.

21. For tax credit investments which have an amortization timeframe greater than the tax credit allocation timeframe (as demonstrated in Exhibit A), the reporting entity would still, if required, perform the prospective utilization assessment but on the reporting entity's ability to utilize the remaining stream of anticipated tax benefits.

Future Contributions and Additional Tax Credits

22. Many tax credit investments require future contributions by the investor, that may be contingent on a variety of conditions, such as receiving representations, contract performance, meeting occupancy requirements, etc. A liability shall be recognized for delayed contributions which result in additional tax credits that are unconditional and legally binding, and a liability shall also be recognized for contributions which result in additional tax credits that are contingent upon a future event when that contingent event becomes probable pursuant to the loss contingency guidance in *SSAP No. 5—Liabilities, Contingencies and Impairments of Assets*. Liabilities or loss contingencies recognized for future contributions which result in additional tax credits shall be reported as 'Payable for Securities' until remitted or until the obligation is otherwise eliminated.

23. If a commitment to provide future contributions is not required to be recognized pursuant to paragraph 22, the commitment shall be disclosed in the notes to the financial statements with other commitments.

24. Additional contributions that do not result in additional tax credits for the reporting entity investor shall be immediately expensed as a component of net investment income.

25. If additional contributions result in additional tax credits for the reporting entity, the proportional amortization method for the tax credit investment shall be adjusted, on a prospective basis, to reflect the increased cost with the revised expected tax credits and other tax benefits.

26. In the event a reporting entity obtains additional tax credits without the reporting entity making additional contributions, the reporting entity shall not adjust the book/adjusted carrying value of the tax credit investment. (The proportional amortization method shall not be adjusted to reflect the expected additional tax credits.) Rather, the tax credit shall be recognized when allocated pursuant to paragraph 14.

Impairment of Tax Credit Investments

27. Reporting entities with investments in tax credit programs shall complete and document an impairment analysis at each reporting period. For this analysis, the reporting entity shall compare the current book/adjusted carrying value to the fair value of the investment. (If fair value is not determinable, an entity can compare book/adjusted carrying value to the present value of future tax credits and other tax benefits discounted at a risk-free rate of return.) If book/adjusted carrying value is higher, the difference between book/adjusted carrying value and fair value shall be recognized as an other-than-temporary impairment (INT 06-07) to the tax credit investment. This will result in a new cost basis and the amount of the write-down shall be accounted for as a realized loss. The new cost basis shall not be changed for subsequent recoveries in fair value.

28. An other-than-temporary impairment shall also be considered to have occurred if a previously allocated tax credit has been recaptured or if it is probable that future tax credits will not be allocated as expected. If a project no longer qualifies for tax credits, the entire investment, less any residual established at initial recognition, shall be written off as other-than-temporarily impaired. If the reporting entity experiences a tax credit recapture, the reporting entity shall assess whether future tax credits and other benefits will qualify for use by the reporting entity. If future credits will not be generated or will be subject to future recapture, then the reporting entity shall write-off the investment as other-than-temporarily impaired so that the resulting investment value only reflects expected qualifying tax credits and other benefits expected to be allocated. This will result in a new cost basis and the amount of the write-down shall be accounted for as a realized loss. The new cost basis shall not be changed for subsequent recoveries or revision to tax credit expectations.

29. Certain tax credit programs allocate variable amounts of tax credits (for example, clean energy production tax credit programs) which will result in regular differences between actual allocated tax credits and estimated tax credit allocations as calculated upon acquisition of the investment. Variable tax credits allocated in excess of estimates should be accounted for in accordance with paragraph 26. If the allocated variable tax credits are less than estimates by more than 10% or consistently allocate less than the estimated amounts over multiple allocation periods, then the reporting entity must either recognize an other-than-temporary impairment or specifically address within its impairment analysis the reason why consistently diminished tax credit returns do not represent an impairment event. Note that if the company determines it is probable that the total amount of anticipated variable tax credits will not be received, it would still be considered an other-than-temporary impairment in accordance with paragraph 28.

Disclosures

30. A reporting entity shall disclose information that enables users of its financial statements to understand the following information about its investments in projects that generate tax credits and other tax benefits from tax programs captured in scope of this statement:

a. The nature of its investments in projects that generate tax credits and other tax benefits.

b. The effect of the recognition and measurement of its investments in projects that generate tax credits and other tax benefits and the related tax credits on its financial position and results of operations.

31. To meet the objective of paragraph 30, a reporting entity shall disclose the following information about its investments in projects that generate tax credits and other tax benefits from a tax credit program in scope of this statement:

a. The amount of tax credits and other tax benefits recognized during the reporting period(s).

b. The balance of the investments recognized in the statement of financial position for the reporting period(s) presented.

c. The amount of investment amortization and non-income tax related activity recognized as a component of net investment income, and other returns allocated that were recognized outside of income tax expense.

d. An aggregate schedule of tax credits expected to be generated each year for the subsequent five years and thereafter, disaggregated by transferable/certificated and non-transferable.

e. Any commitment or contingent commitment (e.g., guarantees or commitments to provide additional capital contributions) including the amount of contributions that are contingent commitments related to tax credit investments and the year(s) that contingent commitments are expected to be paid shall be disclosed.

32. The following disclosures shall be included if applicable to tax credit investments:

a. If the underlying project is currently subject to any regulatory reviews and the status of such review. (Example: Investigations by the housing authority.)

b. Significant modifications or events that resulted in a change in the nature of the investment or a change in the relationship with the underlying project for investments in scope.

33. A reporting entity that recognizes an impairment loss shall disclose the following in the financial statements that include the period of the impairment write-down:

a. A description of the impaired assets and the facts and circumstances leading to the impairment; and

b. The amount of the impairment and how fair value was determined.

34. The following disclosures pertain only to those tax credits allocated from tax credit investments and are unused as of the reporting period(s). For purposes of this disclosure, total unused tax credits represent the entire amount of tax credits available:

a. Carrying value of tax credits, disaggregated by transferable/certificated and non-transferable, gross of any related tax liabilities by jurisdiction and in total.

b. Total unused tax credits by jurisdiction, disaggregated by transferable/certificated and non-transferable.

c. Method of estimating utilization of remaining tax credits or other projected recovery of the current carrying value.

d. Impairment amount recognized in the reporting period(s), if any.

e. Identify tax credits by transferable/certificated and non-transferable classifications and identify the admitted and nonadmitted portions of each classification.

35. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

36. This statement adopts with modification *Accounting Standards Update (ASU) 2023-02, Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method*. The ASU is modified for the following statutory concepts:

a. This statement is applicable to all federal and state tax credit programs earned through any tax credit investment structure that meets the requirements in paragraph 2. Under the ASU, use of the proportional amortization method is an election and only pertains to income tax equity investment structures in which the reporting entity does not exercise significant influence. With this statement, the U.S. GAAP election to use the proportional amortization method is rejected and use of proportional amortization for investments within the scope of this statement is required. The guidance is expanded for state premium tax credits.

b. Investments that meet the criteria of this statement are required to use a proportional amortization method as prescribed in this statement. This method requires the tax credits and benefits to be recognized in proportion to the percentage of actual tax credits and other tax benefits allocated to the reporting entity in the current period divided by the total estimated tax credits and other tax benefits expected to be allocated by the reporting entity over the life of the investment. This statement requires a gross presentation on the financial statements. Under the ASU, a practical expedient is allowed for the calculation of proportional amortization but has been rejected with this statement.

c. Federal tax credits shall be recognized in the income statement as an offset to federal income taxes in the tax reporting year in which the tax credit is utilized in accordance with SSAP No. 101. State tax credits shall be recognized in the income statement as an offset to state premium tax or state income tax, whichever is applicable, in the tax reporting year in which the credit is utilized.

d. Tax benefits allocated, other than tax credits, shall be accounted for pursuant to SSAP No. 101. Amortization shall be reported as a component of net investment income.

e. Reporting entities shall follow the guidance in paragraphs 22 and 23 regarding the recognition of contingent commitments from SSAP No. 5 to equity contributions.

f. This statement has specific impairment and nonadmittance requirements.

g. For statutory accounting purposes, deferred taxes are not reported as a component of income from continuing operations in the income statement; rather, deferred taxes are recognized as a separate component of gains and losses in unassigned funds (surplus).

h. Disclosures should be followed as indicated in the disclosures section in this statement.

i. The examples detailed in Exhibit A were modified to better illustrate the statutory accounting method for tax credit investments.

Effective Date and Transition

37. This statement is effective for reporting periods beginning on or after January 1, 2006. Early adoption is permitted. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3–Accounting Changes and Corrections of Errors*. The guidance previously in paragraph 3 of this statement superseded paragraph 1 of SSAP No. 48. In 2011, this guidance was moved to SSAP No. 48 and deleted from this statement. The original guidance included in this standard is retained for historical purposes in Issue Paper No. 125. The guidance from ASU 2014-01 is effective for reporting periods beginning on or after January 1, 2015, with early adoption permitted.

38. In March 2024, new SAP concept revisions were adopted. These revisions, effective January 1, 2025, expanded the scope of SSAP No. 93 to include all federal and state tax credit investment structures and provide new guidance on the accounting, recognition, and reporting of tax credit investment structures. As of the effective date, reporting entities shall prospectively modify the recognition, accounting, and reporting of tax credit investment structures to reflect the guidance in the conceptual revisions. Additionally, all tax credit investment structures which fall within the scope of this statement not currently reported on Schedule BA are to be transferred to Schedule BA as of the effective date.

Glossary

39. The following definitions are provided for the purposes of this statement.

a. Unallocated Tax Credits – The portion of tax credits expected to be earned and allocated to the reporting entity through the tax credit investment structure.

b. Transferable/Certificated – The tax credits are certified for sale (certificated tax credits) or saleable through the execution of a state or federal transfer form (transferable tax credits).

c. More Likely Than Not – Refers to a likelihood of more than 50%.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 125—Accounting for Low-Income Housing Tax Credit Property Investments*

EXHIBIT A – APPLICATION OF PROPORTIONAL AMORTIZATION METHOD

Example 1: Qualifying Tax Credit Investment Structure

On January 1, 20X1, ABC Insurance Company purchases a 5% equity stake in a tax credit investment structure for $100,000. The allocated tax credits are transferable, and ABC anticipates that all tax credits received will be fully utilized prior to expiration of the tax credit carryover period.

Assumptions:

1. All cash flows (except initial investment) occur at the end of each year.

2. Depreciation expense is computed, for book and tax purposes, using the straight-line method with a 27.5-year life (the same method is used for simplicity).

3. The investor made a $100,000 investment for a 5% limited partnership interest in the project at the beginning of the first year of eligibility for the tax credit.

4. The partnership finances the project cost of $4,000,000 with 50% equity and 50% debt.

5. The annual tax credit allocation (equal to 4% of the project's original cost) will be received for a period of 10 years.

6. The investor's tax rate is 40%.

7. For simplicity, the project will operate with break-even pretax cash flows including debt service during the first 15 years of operations.

8. The project's taxable loss will be equal to depreciation expense. The cumulative book loss (and thus the cumulative depreciation expense) recognized by the investor is limited to the $100,000 investment.

9. It is assumed that all requirements are met to retain allocable tax credits so there will be no recapture of tax credits.

10. The investor expects that the estimated residual value of the investment will be zero.

Proportional Amortization Method with Statutory Modifications

Year	Net Investment (1)	Amortization of Investment (2)	Tax Credits (3)	Net Losses/Tax Depreciation (4)	Other Tax Benefits from Tax Depreciation (5)	Tax Credits and Other Tax Benefits (6)
	100,000					
1	90,909	9,091	8,000	7,273	2,909	10,909
2	81,818	9,091	8,000	7,273	2,909	10,909
3	72,727	9,091	8,000	7,273	2,909	10,909
4	63,636	9,091	8,000	7,273	2,909	10,909
5	54,545	9,091	8,000	7,273	2,909	10,909
6	45,454	9,091	8,000	7,273	2,909	10,909
7	36,363	9,091	8,000	7,273	2,909	10,909
8	27,272	9,091	8,000	7,273	2,909	10,909
9	18,181	9,091	8,000	7,273	2,909	10,909
10	9,090	9,091	8,000	7,273	2,909	10,909
11	6,666	2,424		7,273	2,909	2,909
12	4,242	2,424		7,273	2,909	2,909
13	1,818	2,424		7,273	2,909	2,909
14	0	1,818		5,451	2,183	2,183
15	0					0
Total		100,000	80,000	100,000	40,000	120,000

(1) End-of-year investment for a 5% limited liability interest in the project net of amortization in Column (2).

(2) Initial investment of $100,000 x (total tax benefits allocated during the year in Column (6) / total anticipated tax benefits over the life of the investment of $120,000).

(3) Annual 4% tax credit on $200,000 tax basis of the underlying assets.

(4) Depreciation (on $200,000 tax basis of the underlying assets) using the straight-line method over 27.5 years up to the amount of the initial investment of $100,000.

(5) Column (4) x 40% tax rate.

(6) Column (3) + Column (5).

Initial Year			
	Tax credit investment	100,000	
	Cash		100,000
	To record the purchase of tax credit investment		
Years 1-10			
	Amortization expense	9,091	
	Tax credit investment		9,091
	Federal tax credits	8,000	
	Income tax expense		8,000
	To record annual receipt of allocated tax credits and proportional amortization of investment.		
	Income taxes payable	8,000	
	Federal tax credits		8,000
	To record annual utilization of allocated tax credits.		
Year 11-13			
	Amortization expense	2,424	
	Tax credit investment		2,424
	To record annual proportional amortization of tax credit investment.		
Year 14			
	Amortization expense	1,818	
	Tax credit investment		1,818
	To record annual proportional amortization of tax credit investment.		

Example 2: Qualifying Tax Credit Investment Structure with Non-Income Tax Related Benefits

On January 1, 20X1, J&K Insurance Company purchased a 5% equity stake in a tax credit investment structure for $100,000. The allocated tax credits are non-transferable, and J&K anticipates that all tax credits received will be fully utilized prior to expiration of the tax credit carryover period.

Assumptions:

1. All cash flows (except initial investment) occur at the end of each year.

2. Depreciation expense is computed, for book and tax purposes, using the straight-line method with a 27.5-year life (the same method is used for simplicity).

3. The investor made a $100,000 investment for a 5% limited partnership interest in the project at the beginning of the first year of eligibility for the tax credit.

4. The partnership will receive production tax credits based on the energy the project produces. The credits will be allocated over a four-year period.

5. The tax equity investor will receive cash proceeds based on 2% of the project's cash generated during the life of the investment.

6. The investor's tax rate is 40%.

7. All requirements are met to retain allocable income tax credits such that there will be no recapture of income tax credits.

8. All of the conditions are met to require use of the proportional amortization method.

9. After 10 years, the tax equity investor has a right to require that the project sponsor purchase the tax equity investor's equity interest for a nominal amount. It is assumed that the Put option will be exercised and has a contractually agreed upon residual value of $1,000.

10. In Years 1-3 the investor is able to utilize all allocated tax credits in the same period they were received. In Year 4, the investor is only able to utilize half of that year's allocated tax credit and defers the remainder for utilization in Year 5.

Proportional Amortization Method with Statutory Modifications

Year	Net Investment (1)	Amortization of Investment (2)	Tax Credits (3)	Net Losses/Tax Depreciation (4)	Other Tax Benefits from Tax Depreciation (5)	Tax Credits and Other Tax Benefits (6)	Non-Tax Related Cash Returns (7)
	100,000						
1	79,605	20,395	20,000	8,300	3,320	23,320	58
2	59,210	20,395	20,000	8,300	3,320	23,320	58
3	38,815	20,395	20,000	8,300	3,320	23,320	58
4	18,420	20,395	20,000	8,300	3,320	23,320	58
5	15,516	2,904		8,300	3,320	3,320	58
6	12,612	2,904		8,300	3,320	3,320	58
7	9,708	2,904		8,300	3,320	3,320	58
8	6,804	2,904		8,300	3,320	3,320	58
9	3,900	2,904		8,300	3,320	3,320	58
10	1,000	2,900		8,300	3,320	3,320	58
Total	1,000	99,000	80,000	83,000	33,200	113,200	580

(1) End-of-year investment for a 5% limited liability interest in the project net of amortization in Column (2).

(2) Initial investment, less residual value of $1,000, of $99,000 x (total tax benefits allocated during the year in Column (6) / total anticipated tax benefits over the life of the investment of $113,200).

(3) These tax credits have been generated through the production of electricity, which generates production tax credits. The tax equity investor is not receiving renewable energy credits or carbon offsets.

(4) Depreciation /other tax losses passed on to the investor.

(5) Column (4) x 40% tax rate.

(6) Column (3) + Column (5).

(7) Non-income-tax-related benefits recognized in current-period pre-tax earnings when allocated. This represents the cash proceeds allocated by the tax equity investor based on the cash generated from the project

Initial Year

Tax credit investment	100,000	
Cash		100,000
To record the purchase of tax credit investment		

Years 1-3

Amortization expense	20,395	
Tax credit investment		20,395
Federal tax credits	20,000	
Income tax expense		20,000
Cash	58	
Investment Income		58
To record annual receipt of allocated tax credits, proportional amortization of investment, and receipt of non-tax cash returns.		
Income taxes payable	20,000	
Federal tax credits		20,000
To record annual utilization of allocated tax credits.		

Year 4

Amortization expense	20,395	
Tax credit investment		20,395
Federal tax credits	20,000	
Income tax expense		20,000
Cash	58	
Investment Income		58
To record annual receipt of allocated tax credits, proportional amortization of investment, and receipt of non-tax cash returns.		
Income taxes payable	10,000	
Federal tax credits		10,000
Income tax expense	10,000	
Deferred tax expense		10,000
To record the portion of allocated tax credits utilized in the current year and defer the remainder. (Federal tax credit account should be mapped to the DTA reporting line as any balance remaining at year-end would be a DTA)		

Year 5

Amortization expense	2,904	
Tax credit investment		2,904
Cash	58	
Investment Income		58
To record annual proportional amortization of tax credit investment and receipt of non-tax cash returns.		
Income taxes payable	10,000	
Federal tax credits		10,000
Deferred tax expense	10,000	
Income tax expense		10,000
To record utilization of deferred tax credit.		

Years 6-9			
	Amortization expense	2,904	
	Tax credit investment		2,904
	Cash	58	
	Investment Income		58
	To record annual proportional amortization of tax credit investment and receipt of non-tax cash returns.		
Year 10			
	Amortization expense	2,900	
	Tax credit investment		2,900
	Cash	58	
	Investment Income		58
	To record annual proportional amortization of tax credit investment and receipt of non-tax cash returns.		
	Cash	1,000	
	Tax credit investment		1,000
	To record sale of interest in tax credit investment at stated residual value.		

Statement of Statutory Accounting Principles No. 94

State and Federal Tax Credits

STATUS

Type of Issue	Common Area
Issued..	June 2006; Substantively revised December 2011 and March 2024
Effective Date	December 31, 2006; December 31, 2011; January 1, 2025
Affects	No other pronouncements
Affected by	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for state and federal tax credits that are purchased[1] by the reporting entity. Tax credits allocated from investments NOT within the scope of *SSAP 93—Investments in Tax Credit Structures* should refer to this statement for tax credit accounting guidance. Tax credits which have been awarded[2] to the reporting entity are not within the scope of this statement and should refer to *SSAP No. 101—Income Taxes*.

[1] The process to purchase a tax credit typically involves the acquisition of a tax credit certificate (certificated tax credits) or the execution of a state or federal transfer form (transferable tax credits). Tax credits which have been received through other means are indicative of tax credits allocated from an investment (For example, if the tax credits are received through a schedule K-1) and may be within scope of SSAP No. 93.

[2] For the purposes of this statement, awarded tax credits are tax credits issued to the reporting entity which were neither purchased nor allocated from an investment structure. A common example of an awarded tax credit are Job Creation tax credits which are a type of performance-based tax credit program.

2. Tax credits allocated from, and investments in, tax credit structures, as discussed in SSAP No. 93, which involve investments in projects or programs that generate general business federal tax credits or state tax credits, are not within the scope of this statement.

3. Investments in a CAPCO (Certified Capital Company), organized as a partnership or an LLC, which is a company, authorized by state statute that borrows from investors, in order to make venture capital investments in "qualified" businesses, are not within the scope of this statement. Although associated with tax credits, the insurance company is paid principal and interest on its investment with the CAPCO. Depending upon the terms of the CAPCO offering, principal and interest payments to the investors will come from the CAPCO and/or the state. The CAPCO will make cash payments directly to the investors while the state will make payments in the form of premium or income tax credits. Investments in a CAPCO shall be accounted for in accordance with *Interpretation (INT) 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)* and specific statutory accounting guidance addressing CAPCOs.

SUMMARY CONCLUSION

4. Both state and federal governments have enacted laws that create programs by which tax credits are granted to entities under certain specified conditions. The terms of these tax credits vary based on the issuing jurisdiction and from program to program.

5. For the purposes of this statement, "tax credits" must be issued by either a federal or state governmental entity and must be refundable[3] or can be applied against income tax or premium tax in accordance with permitted IRS or state tax provisions. Tax credits which may be sold or otherwise transferred to another entity are referred to as "transferable tax credits" whereas all other tax credits are referred to as "non-transferable."

6. When a reporting entity purchases a transferable or certificated tax credit from another entity, the transaction does not result in a continuing investment in a business entity (i.e., limited partnership). Direct payment elections are non-revocable and supersede the transferability of tax credits, as such, once the election has been made the tax credit would be considered a non-transferable tax credit.

Accounting

7. All tax credits within the scope of the statement must be recognized in the period they are allocated to or purchased by the reporting entity for tax purposes and must be recorded at face value upon receipt. Tax credits acquired at a premium or discount to their face value must record the gain/loss as follows:

a. Tax credits acquired at a discount must defer the gain as a miscellaneous liability upon receipt of the tax credit.

b. Tax credits acquired at a premium must realize the loss within the income statement upon receipt of the tax credit.

8. Deferred gains on tax credits are deferred until the value of the tax credits utilized exceeds the initial acquisition cost of the tax credits, or until the tax credits are transferred to other entities or the direct payment election is utilized, and the payment(s) or refund exceed the initial acquisition cost.

9. Tax credits shall be recognized in the period that they are purchased or allocated to the reporting entity for tax purposes:

[3] Direct payment tax credits are synonymous with refundable tax credits, as such the terms are used interchangeably within this statement.

a. Federal tax credits are to be recognized and reported as a deferred tax asset (DTA) in accordance with SSAP No. 101.

b. State tax credits are to be recognized and reported gross of any related state tax liabilities in the category of other-than-invested assets (not to be reported net).

10. Utilization of tax credits in settlement tax liabilities shall be reflected net of the corresponding income or premium tax liability in the reporting period in which the tax credit is utilized.

11. Gains and losses on tax credits are reflected in other income when realized.

12. A tax credit asset is considered purchased or allocated once the tax credit is received and available for use. If the reporting entity determines a commitment to purchase tax credits has met the definition of a liability, then the asset would be reported in other-than-invested assets as tax credits receivable.

Admittance

13. Tax credits as defined within this SSAP held by reporting entities meet the definition of assets as specified in SSAP *No. 4—Assets and Nonadmitted Assets* and are admissible assets to the extent that they comply with the requirements of this statement. The admissibility of tax credits is subject to SSAP No. 101.

Impairment

14. An impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to recover the book/adjusted carrying value of the tax credits. Tax credits should be evaluated for impairment at each reporting date.

15. When there is a decline in the realizability of a tax credit owned by the reporting entity that is other-than-temporary[INT 06-07], the asset shall be written down to the expected realizable amount and the amount of the write down shall be accounted for as a realized loss. The expected realizable value is the new cost basis.

16. The new cost basis shall not be changed for subsequent recoveries in realizability.

Disclosures

17. The following disclosures shall be made in the financial statements for the reporting period(s) presented. For purposes of this disclosure, total unused tax credits represent the entire amount of tax credits available:

a. Carrying value of tax credits, disaggregated by transferable/certificated and non-transferable, gross of any related tax liabilities by jurisdiction and in total.

b. Total unused tax credits by jurisdiction, disaggregated by transferable/certificated and non-transferable.

c. Method of estimating utilization of remaining tax credits or other projected recovery of the current carrying value.

d. Impairment amount recognized in the reporting period(s), if any.

e. Identify tax credits by transferable/certificated and non-transferable classifications and identify the admitted and nonadmitted portions of each classification.

18. Any commitment or contingent commitment to purchase tax credits shall be disclosed.

Effective Date and Transition

19. This statement is effective for reporting periods ending on or after December 31, 2006. Early adoption is permitted. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. Substantive revisions to, 1) revising the title; 2) incorporating the criteria for non-transferable state tax credits as described in paragraphs 7 and 8; 3) adding a disclosure; and 4) updating terminology throughout the document as appropriate, are effective for reporting periods ending on or after December 31, 2011.

20. In March 2024, new SAP concept revisions were adopted. These revisions, effective January 1, 2025, with early adoption permitted, expanded the scope of SSAP No. 94 to include all purchased, and certain allocated, state and federal income or premium tax credits and provide new guidance on the accounting, recognition, and reporting for state and federal tax credits within the scope of this statement. As of the effective date, reporting entities shall prospectively modify the recognition, accounting, and reporting of tax credits within the scope of this statement to reflect the guidance in the conceptual revisions. For unutilized tax credits which were carried forward from prior to the effective date:

a. Federal tax credits in other-than-invested assets are to be transferred and reported as a DTA in accordance with SSAP No. 101.

b. Tax credits previously recorded at acquisition cost should be adjusted to reflect the face value of the acquired tax credits with the corresponding loss immediately recognized or the gain deferred.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 126—Accounting for Transferable State Tax Credits*
- *Issue Paper No. 145—Accounting for Transferable and Non-Transferable State Tax Credits*

EXHIBIT A – ACCOUNTING FOR TRANSFERABLE TAX CREDITS

On 1/1/X1, SAM Insurance Company purchased transferable state tax credits for a cost of $100,000. The transferable state tax credits are redeemable for $160,000 and expire at the end of 12/31/X4. SAM initially expects to utilize the tax credits before expiration in their state of domicile in the amount of $40,000 per year. In year X4, SAM sells the remaining $30,000 in transferable state tax credits for $20,000.

1/1/x1	Transferable state tax credits	160,000	
	Deferred gains on acquired tax credits		60,000
	Cash		100,000
	To record the purchase of the tax credits		
6/30/x1	Premium tax expense	40,000	
	Premium taxes payable to domiciliary state		40,000
	To record premium tax expense and accrue the liability in Year 1.		
10/1/x1	Premium tax payable	40,000	
	Transferable state tax credits		40,000
	To record the use of tax credits in Year 1. The reporting entity expects to be able to utilize remaining tax credits before expiration.		
6/30/x2	Premium tax expense	60,000	
	Premium taxes payable to domiciliary state		60,000
	To record premium tax expense and accrue the liability in Year 2.		
9/30/x2	Premium tax payable	60,000	
	Transferable state tax credits		60,000
	To record the use of taxes credits in Year 2. The reporting entity expects to be able to utilize remaining tax credits before expiration.		
6/30/x3	Premium tax expense	30,000	
	Premium taxes payable to domiciliary state		30,000
	To record premium tax expense and accrue the liability in Year 3.		
9/30/x3	Premium tax payable	30,000	
	Transferable state tax credits		30,000
	Deferred gains on acquired tax credits	30,000	
	Other income		30,000
	To record the use of premium tax credits in excess of cost and recognize a gain on premium tax credits in other income. The Company intends to sell the remaining tax credits in year 4.		
6/30/x4	Cash	20,000	
	Other income	10,000	
	Transferable state tax credits		30,000
	Deferred gains on acquired tax credits	30,000	
	Other income		30,000
	To record the sale of the remaining tax credits.		

EXHIBIT B – ACCOUNTING FOR NON-TRANSFERABLE TAX CREDITS

On 7/1/X1, LJW Insurance Company purchased non-transferable federal tax credits for a cost of $100,000. The federal tax credits are redeemable for $110,000 and expire on April 15, 20x2. LJW expects to utilize the tax credits before expiration in the amount of $110,000. Tax credits are utilized pro-rata, approximately $36,666 every quarter, from acquisition date to expiration date. The illustration below assumes that LJW Insurance Company's quarterly income tax liability equals the amount of credits that were purchased.

7/1/x1	Federal tax credits	110,000	
	Deferred gains on acquired tax credits		10,000
	Cash		100,000
	To record the purchase of the tax credits		
9/30/x1	Income tax expense	36,666	
	Income taxes payable		36,666
	To record quarterly income tax liability.		
10/1/x1	Income taxes payable	36,666	
	Federal tax credits		36,666
	To record the use of tax credits in the quarter.		
12/31/x1	Income tax expense	36,666	
	Income taxes payable		36,666
	To record quarterly income tax liability.		
1/1/x2	Income taxes payable	36,666	
	Federal tax credits		36,666
	To record the use of tax credits in the quarter.		
3/31/x2	Income tax expense	36,668	
	Income taxes payable		36,668
	To record quarterly income tax liability.		
4/1/x2	Income taxes payable	36,668	
	Deferred gains on acquired tax credits	10,000	
	Other Income		10,000
	Federal tax credits		36,668
	To record the use of tax credits in the quarter.		

Statement of Statutory Accounting Principles No. 95

Nonmonetary Transactions

STATUS

Type of Issue	Common Area
Issued	September 11, 2006
Effective Date	January 1, 2007
Affects	Supersedes SSAP No. 28; Nullifies and incorporates INT 00-29, INT 02-19 and INT 03-16; Nullifies INT 99-21
Affected by	No other pronouncements
Interpreted by	INT 00-26; INT 06-13; INT 08-05
Relevant Appendix A Guidance	None

SCOPE OF STATEMENT

1. The statement establishes statutory accounting principles for nonmonetary transactions. Specific statutory requirements for certain types of nonmonetary transactions are addressed in other statements.

2. This statement supersedes the conclusions reached in *SSAP No. 28—Nonmonetary Transactions* by updating conclusions reached in SSAP No. 28 related to APB 29 with those included in FAS 153. Consequently, this statement adopts with modification FAS 153 to change GAAP references to those applicable to statutory accounting. In addition, references made to APB 29 within SSAP No. 28 will be replaced with the actual amended guidance resulting from FAS 153.

SUMMARY CONCLUSION

Definitions

3. The definitions of certain terms used in this statement are:

a. **Monetary assets and liabilities** are assets and liabilities whose amounts are fixed in terms of units of currency by contract or otherwise. Examples are cash; amounts due from agents, brokers, and intermediaries; policy loans; accounts payable; and other amounts receivable or payable in cash;

b. **Nonmonetary assets and liabilities** are assets and liabilities other than monetary ones. Examples are common stocks; furniture, fixtures, and equipment; real estate and liabilities for rent collected in advance;

c. **Exchange (or exchange transaction)** is a reciprocal transfer between a reporting entity and another entity that results in the reporting entity acquiring assets or services or satisfying liabilities by surrendering other assets or services or incurring other obligations. A reciprocal transfer of a nonmonetary asset shall be deemed an exchange only if the transferor has no substantial continuing involvement in the transferred asset such that the usual risks and rewards of ownership of the asset are transferred;

d. **Nonreciprocal transfer** is a transfer of assets or services in one direction, either from a reporting entity to its owners (whether or not in exchange for their ownership interests) or another entity, or from owners or another entity, to the reporting entity. An insurance company's reacquisition of its outstanding stock is an example of a nonreciprocal transfer.

4. Nonmonetary transactions shall be accounted for in accordance with this statement, except as addressed by other statements or interpretations including but not limited to *SSAP No. 12—Employee Stock Ownership Plans*, *SSAP No. 25—Affiliates and Other Related Parties*, *SSAP No. 68—Business Combinations and Goodwill*, *SSAP No. 72—Surplus and Quasi-Reorganizations*, *SSAP No. 103~~R~~—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, *SSAP No. 104~~R~~—Share-Based Payments*, and *INT 00-26: EITF 98-3: Determining Whether a Nonmonetary Transactions Involves Receipt of Productive Assets or of a Business*.

Basic Principle

5. Accounting for nonmonetary transactions shall generally be based on the fair values of the assets (or services) involved, as defined in paragraph 13, which is the same basis as that used in monetary transactions. Thus, the cost of a nonmonetary asset acquired in exchange for another nonmonetary asset (reciprocal transactions) is the fair value of the asset surrendered to obtain it, and a gain or loss should be recognized on the exchange. The fair value of the asset received should be used to measure the cost if it is more clearly evident than the fair value of the asset surrendered. Similarly, a nonmonetary asset received in a nonreciprocal transfer should be recorded at the fair value of the asset received as defined in paragraph 6. A transfer of a nonmonetary asset to a stockholder or to another entity in a nonreciprocal transfer should be recorded at the fair value of the asset transferred, and a gain or loss should be recognized on the disposition of the asset. The fair value of a reporting entity's own stock reacquired may be a more clearly evident measure of the fair value of the asset distributed in a nonreciprocal transfer if the transaction involves distribution of a nonmonetary asset to eliminate a disproportionate part of owners' interests (that is, to acquire stock for the treasury or for retirement).

6. Fair value of assets received or transferred in a nonreciprocal transfer shall be measured based on statutory accounting principles for the type of asset transferred. Accordingly, the value shall be determined in accordance with *SSAP No. 26~~R~~—Bonds*, *SSAP No. 30~~R~~—Unaffiliated Common Stock*, *SSAP No. 32~~R~~—Preferred Stock*, SSAP No. 37—*Mortgage Loans*, *SSAP No. 39—Reverse Mortgages*, *SSAP No. 40~~R~~—Real Estate Investments*, *SSAP No. 43~~R—Loan-Backed and Structured~~Asset-Backed Securities*, *SSAP No. 90—Impairment or Disposal of Real Estate Investments* or other applicable statements. The guidance provided in SSAP No. 25 shall be followed in accounting for nonreciprocal transactions with affiliates and other related parties as defined in that statement.

Modifications of the Basic Principle

7. A nonmonetary exchange shall be measured based on the recorded amount (after reduction, if appropriate, for an indicated impairment of value) of the nonmonetary asset(s) relinquished, and not on the fair values of the exchanged assets, if any of the following conditions apply:

a. *Fair Value Not Determinable*. The fair value of neither the asset(s) received nor the asset(s) relinquished is determinable within reasonable limits (paragraph 14).

b. *Exchange Transaction to Facilitate Sales to Customers*. The transaction is an exchange of a product or property held for sale in the ordinary course of business for a product or property to be sold in the same line of business to facilitate sales to customers other than the parties to the exchange.

c. *Exchange Transaction That Lacks Commercial Substance*. The transaction lacks commercial substance (paragraph 8).

Commercial Substance

8. A nonmonetary exchange has commercial substance if the entity's future cash flows are expected to significantly change as a result of the exchange. The entity's future cash flows are expected to significantly change if either of the following criteria is met:

a. The configuration (risk, timing, and amount)[1] of the future cash flows of the asset(s) received differs significantly from the configuration of the future cash flows of the asset(s) transferred.

b. The entity-specific value[2] of the asset(s) received differs from the entity-specific value of the asset(s) transferred, and the difference is significant in relation to the fair values of the assets exchanged.

A qualitative assessment will, in some cases, be conclusive in determining that the estimated cash flows of the entity are expected to significantly change as a result of the exchange.

9. In the United States and some other tax jurisdictions, a transaction is not given effect for tax purposes unless it serves a legitimate business purpose other than tax avoidance. In assessing the commercial substance of an exchange, tax cash flows that arise solely because the tax business purpose is based on achieving a specified financial reporting result shall not be considered.

Additional Guidance

10. Stock received in the form of a stock dividend or stock split shall not result in the recognition of income. The cost basis of stock held shall be reallocated ratably to the total shares held after receipt of the stock dividend or stock split.

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[1] The configuration of future cash flows is composed of the risk, timing, and amount of the cash flows. A change in any one of those elements would be a change in configuration.

[2] An entity-specific value (referred to as an entity-specific measurement in Concepts Statement 7) is different from a fair value measurement. As described in paragraph 24.b. of Concepts Statement 7, an entity-specific value attempts to capture the value of an asset or liability in the context of a particular entity. For example, an entity computing an entity-specific value of an asset would use its expectations about its use of that asset rather than the use assumed by marketplace participants. If it is determined that the transaction has commercial substance, the exchange would be measured at fair value, rather than at the entity-specific value.

11. The exchanges of nonmonetary assets that would otherwise be based on recorded amounts (paragraphs 7 and 8) may include an amount of monetary consideration. The recipient of the monetary consideration has realized gain on the exchange to the extent that the amount of the monetary receipt exceeds a proportionate share of the recorded amount of the asset surrendered. The portion of the cost applicable to the realized amount should be based on the ratio of the monetary consideration to the total consideration received (monetary consideration plus the estimated fair value of the nonmonetary asset received) or, if more clearly evident, the fair value of the nonmonetary asset transferred. However, the entity paying the monetary consideration should not recognize any gain on a transaction covered in paragraphs 7 and 8, but should record the asset received at the amount of the monetary consideration paid plus the recorded amount of the nonmonetary asset surrendered. If a loss is indicated by the terms of a transaction described in this paragraph or in paragraphs 7 and 8, the entire indicated loss on the exchange should be recognized.

12. *Nonreciprocal Transfers to Owners*. Accounting for the distribution of nonmonetary assets to owners of an enterprise in a spin-off [(INT 06-13 and INT 08-05)] or other form of reorganization or liquidation or in a plan that is in substance the rescission of a prior business combination should be based on the recorded amount (after reduction, if appropriate, for an indicated impairment of value) (An indicated impairment of value of a long-lived asset covered by SSAP No. 90 shall be determined in accordance with paragraph 4 of SSAP No. 90) of the nonmonetary assets distributed. A pro rata distribution to owners of an enterprise of shares of a subsidiary or other investee company that has been or is being controlled or that has been or is being accounted for under the equity method is to be considered to be equivalent to a spin-off. Other nonreciprocal transfers of nonmonetary assets to owners should be accounted for at fair value if the fair value of the nonmonetary asset distributed is objectively measurable and would be clearly realizable to the distributing entity in an outright sale at or near the time of the distribution

Applying the Basic Principle

13. Fair value of a nonmonetary asset transferred to or from a reporting entity in a nonmonetary transaction should be determined in accordance with *SSAP No. 100~~R~~—Fair Value*. If one of the parties in a nonmonetary transaction could have elected to receive cash instead of the nonmonetary asset, the amount of cash that could have been received may be evidence of the fair value of the nonmonetary assets exchanged.

14. Fair value should be regarded as not determinable within reasonable limits if major uncertainties exist about the realizability of the value that would be assigned to an asset received in a nonmonetary transaction accounted for at fair value. An exchange involving parties with essentially opposing interests is not considered a prerequisite to determining a fair value of a nonmonetary asset transferred; nor does an exchange insure that a fair value for accounting purposes can be ascertained within reasonable limits. If neither the fair value of a nonmonetary asset transferred nor the fair value of a nonmonetary asset received in exchange is determinable within reasonable limits, the book adjusted carrying value of the nonmonetary asset transferred from the enterprise may be the only available measure of the transaction.

15. A difference between the amount of gain or loss recognized for tax purposes and that recognized for accounting purposes may constitute a temporary difference to be accounted for according to *SSAP No. 101—Income Taxes*.

16. Involuntary conversions of nonmonetary assets to monetary assets (for example, as a result of total or partial destruction, theft, seizure, or condemnation) are monetary transactions for which gain or loss shall be recognized even though a reporting entity reinvests or is obligated to reinvest the monetary assets in replacement nonmonetary assets. In some cases, a nonmonetary asset may be destroyed or damaged in one accounting period, and the amount of monetary assets to be received is not determinable until a subsequent accounting period. In those cases, gain or loss shall be recognized in accordance with the conclusions in *SSAP No. 5~~R~~—Liabilities, Contingencies and Impairments of Assets*. Gain or loss resulting from an involuntary conversion of a nonmonetary asset to monetary assets shall be reported

consistently with the reporting entity's reporting of continuing operations and disclosed in the notes to financial statements in accordance with *SSAP No. 24—Discontinued Operations and Unusual or Infrequent Items*.

Accounting for a Convertible Instrument Granted or Issued to a Nonemployee for Goods or Services, or Services and Cash (in Combination or Individually), or as Consideration Payable to a Customer

17. The guidance in paragraph 18 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, or consideration payable to a customer. The convertible instrument contains a nondetachable conversion option that permits the holder to convert the instrument into the issuer's stock.

18. Once an instrument is considered "issued" for accounting purposes, pursuant to SSAP No. 104~~R~~, distributions paid or payable should be characterized as financing costs (that is, as interest or dividends). Before that time, distributions paid or payable under the instrument should be characterized as a cost of the underlying goods or services. 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.

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 or as consideration payable to a customer 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. 104~~R~~.

20. The requirements of this statement shall then be applied such that the fair value determined pursuant to SSAP No. 104~~R~~ 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) shall then be computed by comparing the proceeds received for the instrument (the instrument's fair value under SSAP No. 104~~R~~) 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, 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.

21. SSAP No. 104~~R~~ shall be used 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 the 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, 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. Both of the following guidelines for determining the fair value of convertible instruments shall be used:

a. 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.

b. If reliable information about paragraph 21.a. 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.

22. In cases where a 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 situation, the terms of the respective transactions should be adjusted by measuring the convertible instrument initially 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.

Disclosures

23. A reporting entity that engages in a nonmonetary transaction during a period shall disclose the following in the financial statements:

a. The nature of the transaction;

b. The basis of accounting for the assets transferred; and

c. Gains or losses recognized on transfers.

24. Refer to the Preamble for further discussion regarding disclosure requirements. The disclosure in paragraph 23 shall be included in the annual audited statutory financial reports only.

25. Entities shall disclose the amount of revenue and expense recognized from advertising barter transactions for each income statement period presented. In addition, if an entity engages in advertising barter transactions for which the fair value is not determinable within the limits of this Issue, information regarding the volume and type of advertising surrendered and received (such as the number of equivalent pages, the number of minutes, or the overall percentage of advertising volume) shall be disclosed for each income statement period presented.

Relevant Literature

26. Although not meant to be all inclusive, accounting for specific nonmonetary transactions and unique circumstances is addressed in the following statements of statutory accounting principles:

- *SSAP No. 12—Employee Stock Ownership Plans*
- *SSAP No. 25—Affiliates and Other Related Parties*
- *SSAP No. 68—Business Combinations and Goodwill*
- *SSAP No. 72—Surplus and Quasi-Reorganizations*
- *SSAP No. 103~~R~~—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
- *SSAP No. 104~~R~~—Share-Based Payments*
- *INT 00-26: EITF 98-3: Determining Whether a Nonmonetary Transactions Involves Receipt of Productive Assets or of a Business*

27. This statement updates general statutory guidance for accounting for nonmonetary transactions not specifically addressed in the statements of statutory accounting principles noted above and carries forward current statutory guidance for stock dividends and stock splits received, other types of nonmonetary transactions and involuntary conversions of nonmonetary assets to monetary assets. The guidance in this statement remains consistent with the guidance provided in SSAP No. 30~~R~~, which addresses cash dividends and requires that dividends on common stock be recorded as investment income when declared with a corresponding receivable to be extinguished upon receipt of cash. This statement carries forward the disclosure requirements related to nonmonetary transactions from SSAP No. 28.

28. This statement adopts *Accounting Principles Board Opinion No. 29, Accounting for Nonmonetary Transactions* (APB 29) as modified by *FASB No. 153: Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29* (FAS 153).

29. This statement adopts FAS 153 with modifications for references to statements of statutory accounting principles.

30. This statement continues the adoption of *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins* (ARB 43), Chapter 7, Section B, *Stock Dividends and Stock Split-ups* paragraphs 1-9 as such relates to the receipt of stock in the form of a stock in the form of a stock dividend or stock split. This conclusion is consistent with the recognition concept included in the Statement of Concepts, which states, "Revenue should be recognized only as the earnings process of the underlying underwriting or investment business is completed".

31. This statement continues the adoption of *FASB Interpretation No. 30, Accounting for Involuntary Conversions of Nonmonetary Assets to Monetary Assets* (FIN 30) with modification to provide that gain or loss contingencies be recognized in accordance with the conclusion in SSAP No. 5~~R~~ and that gain or loss resulting from an involuntary conversion of nonmonetary assets to monetary assets be accounted for in continuing operations and disclosed in accordance with SSAP No. 24.

32. This statement continues the adoption of *FASB Emerging Issues Task Force Issue No. 86-29: Nonmonetary Transactions: Magnitude of Boot and the Exceptions to the Use of Fair Value* (EITF 86-29) and *FASB Emerging Issues Task Force Issue No. 93-11: Accounting for Barter Transactions Involving Barter Credits* (EITF 93-11) consistent with the general rule discussed in paragraph 27 of this statement. This statement also adopts with modification *FASB Emerging Issues Task Force Issue No. 99-17, Accounting for Advertising Barter Transactions*.

33. This statement nullifies *INT 99-21: EITF No. 98-7, Accounting for Exchanges of Similar Equity Method Investments*.

34. This statement continues the rejection of paragraph 16 of *Accounting Principles Board Opinion No. 6, Status of Accounting Research Bulletins* and *Emerging Issues Task Force No. 96-4, Accounting for Reorganizations Involving a Non-Pro Rata Split-off of Certain Nonmonetary Assets to Owners*.

35. This statement adopts with modification *ASU 2019-08, Compensation—Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606): Codification Improvements—Share-Based Consideration Payable to a Customer.*

Effective Date and Transition

36. The provisions of this statement shall be effective for nonmonetary asset exchanges occurring in fiscal periods beginning after January 1, 2007. Earlier application is permitted for nonmonetary asset exchanges occurring in fiscal periods beginning after the date this statement is issued. The provisions of this statement shall be applied prospectively. The guidance in paragraph 21 related to long-lived assets to be disposed of other than by sale was previously included within *SSAP No. 90—Impairment or Disposal of Real Estate Investments*. In 2012, the guidance from SSAP No. 95 was incorporated within SSAP No.

90, with those paragraphs in SSAP No. 95 being nullified. The original guidance included in this statement, as well as the original guidance adopted in SSAP No. 90 for long-lived assets to be disposed of other than by sale, are retained for historical purposes in Issue Paper No. 127.

37. This statement adopts the consensus positions of *EITF 01-1: 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 certain modifications to incorporate guidance in EITF 96-18 regarding the measurement date. EITF 96-18 was previously rejected by the working group in *INT 99-13: EITF 96-18: Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services* in the context of *SSAP No. 13—Stock Options and Stock Purchase Plans*; however, the measurement guidance included in Issue 1 of EITF 96-18 is adopted in this statement. The reference in paragraph 4 to *INT 03-16: Contribution of Stock*, was deleted as guidance was incorporated into SSAP No. 25 and SSAP No. 68. The guidance in paragraph 25 of this statement was originally contained within *INT 00-29: EITF 99-17: Accounting for Advertising Barter Transactions* and was effective June 12, 2000. The guidance in paragraphs 21-22 was originally contained within *INT 02-19: EITF 01-1: Accounting for a Convertible Instrument Granted or Issued to a Nonemployee for Goods or Services or a Combination of Goods or Services and Cash* and was effective December 8, 2002.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 127—Exchanges of Nonmonetary Assets, A Replacement of SSAP No. 28—Nonmonetary Transactions*

Statement of Statutory Accounting Principles No. 97

Investments in Subsidiary, Controlled and Affiliated Entities

STATUS

Type of Issue	Common Area
Issued	December 2, 2007
Effective Date	December 31, 2007
Affects	Supersedes SSAP No. 88; Nullifies and incorporates INT 01-07, INT 03-03, INT 04-10 and INT 08-03
Affected by	No other pronouncements
Interpreted by	INT 00-24, INT 06-07
Relevant Appendix A Guidance	A-820

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for investments in subsidiaries, controlled and affiliated entities, hereinafter referred to as SCA entities.

2. This statement supersedes the conclusions reached in *SSAP No. 88—Investments in Subsidiary, Controlled, and Affiliated Entities*.

SUMMARY CONCLUSION

Definitions

3. Parent and subsidiary are defined as follows:

   a. Parent—An entity that directly or indirectly owns and controls the reporting entity;

   b. Subsidiary—An entity that is, directly or indirectly, owned and controlled by the reporting entity.

4. An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies as defined in *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*. Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity method for all such investments.

5. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by common management, or (d) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity[1].

6. Control as defined in paragraph 5 shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13% and therefore each member of the affiliated group

[1] Investments in an exchange traded fund (ETF), a mutual fund (as defined by the SEC) or a foreign open-end investment fund governed and authorized in accordance with regulation established by the applicable foreign jurisdiction does not reflect ownership in an underlying entity, regardless of the ownership percentage the reporting entity (or the holding company group) has of the ETF, mutual fund or foreign open-end investment fund unless ownership of the fund actually results in "control" with the power to direct or cause the direction of management of an underlying company. ETFs, mutual funds and foreign open-end investment funds are comprised of portfolios of securities subject to the regulatory requirements of the federal securities laws or the applicable foreign jurisdictions laws. ETFs, mutual funds and foreign open-end investment funds held by a reporting entity shall be reported as common stock, unless the fund qualifies for bond or preferred stock treatment per the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. Reporting entities are not required to verify that SCAs (subject to SSAP No. 97) are represented in the portfolio of securities held in ETFs, mutual funds or foreign open-end investment funds or to adjust the value of SCAs as a result of investments in ETFs, mutual funds or foreign open-end investment funds.

shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment based on the criteria in *FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18.* The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting securities of an investee. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. An investment in an SCA entity may fall below the level of ownership described in paragraph 5, in which case, the reporting entity would discontinue the use of the equity method, as prescribed in paragraph 13.g. Additionally, through an increase in the level of ownership, a reporting entity may become qualified to use the equity method of accounting (paragraph 8.b.), in which case, the reporting entity shall add the cost of acquiring additional interest to the current basis of the previously held interest and shall apply the equity method prospectively, as of the date the investment becomes qualified for equity method accounting. Examples of situations where the presumption of control may be in doubt include the following:

a. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.

b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.

c. An entity where the insurer has given up participating rights[2] as a shareholder to the investee.

7. Investments in SCA entities 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.

Applying the Market Valuation, Audited Statutory Equity and Audited GAAP Equity Methods

8. The admitted investments in SCA entities shall be valued using either the market valuation approach (as described in paragraph 8.a.), or one of the equity methods (as described in paragraph 8.b.) adjusted as appropriate in accordance with the guidance in *SSAP No. 25—Affiliates and Other Related Parties*, paragraph 18.d.

a. In order to use the market valuation approach for SCA entities, the following requirements apply:

i. The subsidiary must be traded on one of the following major exchanges: (1) the New York Stock Exchange, (2) the NASDAQ, or (3) the Japan Exchange Group;

ii. The reporting entity must submit subsidiary information to the NAIC SCA analysts for calculation of the subsidiary's market value. Such calculation could result in further discounts in market value above the established base discounts based on ownership percentages detailed below;

iii. Ownership percentages for determining the discount rate shall be measured at the holding company level;

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[2] The term "participating rights" refers to the type of rights that allows an investor to effectively participate in significant decisions related to an investee's ordinary course of business and is distinguished from the more limited type of rights referred to as "protective rights". Refer to the sections entitled: "Protective Rights" and "Substantive Participating Rights" in *EITF 96-16, Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights*. The term "participating rights" shall be used consistent with the discussion of substantive participating rights in this EITF.

iv. If an investment in a SCA results in an ownership percentage between 10% and 50%, a base discount percentage between 0% and 20% on a sliding scale basis is required;

v. If an investment in a SCA results in an ownership percentage greater than 50% up to and including 80%, a base discount percentage between 20% and 30% on a sliding scale basis is required;

vi. If an investment in a SCA results in an ownership percentage greater than 80% up to and including 85%, a minimum base discount percentage of 30% is required.

vii. Further, the SCA must have at least two million shares outstanding, with a total market value of at least $50 million in the public's control; and

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

b. If a SCA investment does not meet the requirements for the market valuation approach in paragraph 8.a. or, if the requirements are met, but a reporting entity elects not to use that approach, the reporting entity's proportionate share of its investments in SCAs shall be recorded as follows:

i. Investments in U.S. insurance SCA entities shall be recorded based on either 1) the underlying audited statutory equity of the respective entity's financial statements, adjusted for any unamortized goodwill as provided for in *SSAP No. 68—Business Combinations and Goodwill*[3] or 2) the underlying audited statutory equity of the respective entity's financial statements, adjusted for any unamortized goodwill, modified to remove the impact of any permitted or prescribed accounting practices that depart from the NAIC *Accounting Practices and Procedures Manual*. Reporting entities shall record investments in U.S. insurance SCA entities on at least a quarterly basis, and shall base the investment value on the most recent quarterly information available from the SCA. Entities may recognize their investment in U.S. insurance SCA entities based on the unaudited statutory equity in the SCAs year-end annual statement if the annual SCA audited financial statements are not complete as of the filing deadline. The recorded statutory equity shall be adjusted for audit adjustments, if any, as soon as the annual audited financial statements have been completed. Annual consolidated or combined audits are allowed if completed in accordance with the Model Regulation Requiring Annual Audited Financial Reports as adopted by the SCA's domiciliary state;

ii. Investments in both U.S. and foreign noninsurance SCA entities that are engaged in the following transactions or activities:

(a) Collection of balances as described in *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*

[3] If the insurance SCA employs accounting practices that depart from the NAIC accounting practices and procedures, and the reporting insurance entity has not adjusted the valuation of the insurance SCA to be consistent with the NAIC accounting practices and procedures, (i.e., retains the effect of the permitted or prescribed practice in its valuation), disclosure about those accounting practices that affect the insurance SCA's net income and surplus shall be made pursuant to paragraph 37. If the reporting entity has adjusted the investment in the insurance SCA with the resulting valuation being consistent with the accounting principles of the AP&P Manual, the disclosures in paragraph 37 are not required.

(b) Sale/lease or rental of EDP Equipment and Software as described in *SSAP No. 16~~R~~—Electronic Data Processing Equipment and Software*

(c) Sale/lease or rental of furniture, fixtures, equipment or leasehold improvements as described in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements*

(d) Loans to employees, agents, brokers, representatives of the reporting entity or SCA as described in *SSAP No. 20—Nonadmitted Assets*

(e) Sale/lease or rental of automobiles, airplanes and other vehicles as described in *SSAP No. 20—Nonadmitted Assets*

(f) Providing insurance services on behalf of the reporting entity including but not limited to accounting, actuarial, auditing, data processing, underwriting, collection of premiums, payment of claims and benefits, policyowner services

(g) Acting as an insurance or administrative agent or an agent for a government instrumentality performing an insurance function (e.g. processing of state workers compensations plans, managing assigned risk plans, Medicaid processing etc).

(h) Purchase or securitization of acquisition costs

and if 20% or more of the SCA's revenue is generated from the reporting entity and its affiliates, then the underlying equity of the respective entity's audited U.S. Generally Accepted Accounting Principles (GAAP) financial statements shall be adjusted to a limited statutory basis of accounting in accordance with paragraph 9. For purposes of this section, revenue means GAAP revenue reported in the audited U.S. GAAP financial statements excluding realized and unrealized capital gains/losses. Foreign SCA entities are defined as those entities incorporated or otherwise legally formed under the laws of a foreign country. Paragraphs 22-27 provide guidance for investments in holding companies;

iii. Investments in both U.S. and foreign noninsurance SCA entities that do not qualify under paragraph 8.b.ii., shall be recorded based on the audited U.S. GAAP equity of the investee. Foreign SCA entities are defined as those entities incorporated or otherwise legally formed under the laws of a foreign country. Additional guidance on investments in downstream holding companies is included in paragraphs 22-27. Additional guidance on the use of audited foreign GAAP basis financial statements for the U.S. GAAP equity valuation amount is included in paragraph 23.b.

iv. Investments in foreign insurance SCA entities shall be recorded based on the underlying U.S. GAAP equity from the audited U.S. GAAP basis financial statements, adjusted to a limited statutory basis of accounting in accordance with paragraph 9, if available. If the audited U.S. GAAP basis financial statements are not available, the investment can be recorded on the audited foreign statutory basis financial statements of the respective entity adjusted to a limited statutory basis of accounting in accordance with paragraph 9 and adjusted for reserves of the foreign insurance SCA with respect to the business it assumes directly and indirectly from a U.S. insurer using the statutory accounting principles promulgated by the NAIC in the *Accounting Practices and Procedures Manual*. The audited foreign statutory basis financial statements must include an audited footnote that reconciles net income and equity on the foreign statutory basis of accounting to the U.S. GAAP basis. Foreign insurance SCA entities are defined as alien insurers formed according to the legal requirements of a foreign country.

c. The following provides guidance regarding the audits for entities covered under paragraph 8.b.:

i. The investment in the SCA shall be nonadmitted if the audited financial statements include substantial doubt about the entity's ability to continue as a going concern. Additionally, the investment shall be nonadmitted on the basis/contents of the audit opinion as detailed in paragraph 21.

ii. The recorded GAAP equity shall be adjusted for any audit adjustments resulting from either the annual audited GAAP financial statements of the respective entity or, if the entity is a member of a consolidated or combined group of insurers, the annual audited GAAP financial statements of the consolidated or combined group of companies, as soon as determined. GAAP is defined as those pronouncements included in the FASB codification.

iii. Annual consolidated or combined audits are allowed for the valuation of U.S. insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA's domiciliary state.

iv. Consolidated or combined financial statements are allowed for the valuation of downstream SCA entities, including downstream SCA entities, that directly or indirectly own U.S. insurance entities, provided that the statutory financial statements of such U.S. insurance entities are audited. The audited financial statements of the downstream SCA entities shall include, as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities, non-SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet of the downstream SCA entities shall then be adjusted for GAAP to SAP differences of the insurance entities and paragraph 8.b.ii. and 8.b.iv. entities owned directly and indirectly by the downstream SCA entities.

v. Investments in foreign SCA entities shall follow the guidance in paragraphs 8.b.ii., 8.b.iii. and 8.b.iv. based upon the nature of the SCA as described in the respective paragraphs. To fulfill the requirement for audited U.S. GAAP basis financial statements, the value of foreign SCA investments may be based on the GAAP equity from audited financial statements prepared on a foreign GAAP basis. The audited foreign GAAP basis financial statements must include an audited footnote that reconciles net income and equity on the foreign GAAP basis of accounting to the U.S. GAAP basis. The statutory carrying value of foreign insurance SCA entities (i.e., paragraph 8.b.iv. entities) and foreign noninsurance paragraph 8.b.ii. SCA entities shall include the additional adjustments as described in paragraph 9.

9. The limited statutory basis of accounting for investments in noninsurance SCA entities, subject to paragraph 8.b.ii. and foreign insurance SCA entities, subject to paragraph 8.b.iv., shall be adjusted for the following:

a. Nonadmit assets pursuant to the following statutory accounting principles as promulgated by the NAIC in the *Accounting Practices and Procedures Manual*;

i. *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*

ii. *SSAP No. 16~~R~~—Electronic Data Processing Equipment and Software*

iii. *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements*

iv. *SSAP No. 20—Nonadmitted Assets*

v. *SSAP No. 21~~R~~—Other Admitted Assets* (e.g., collateral loans secured by assets that do not qualify as investments are nonadmitted under SAP)

vi. *SSAP No. 29—Prepaid Expenses*

vii. *SSAP No. 105~~R~~—Working Capital Finance Investments*

b. Expense costs that are capitalized in accordance with GAAP but are expensed pursuant to statutory accounting as promulgated by the NAIC in the *Accounting Practices and Procedures Manual* (e.g., deferred policy acquisition costs, preoperating, development and research costs, etc.);

c. Adjust depreciation for certain assets in accordance with the following statutory accounting principles:

i. *SSAP No. 16~~R~~—Electronic Data Processing Equipment and Software*

ii. *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements*

iii. *SSAP No. 68—Business Combinations and Goodwill*

d. Nonadmit the amount of goodwill of the SCA in excess of 10% of the audited U.S. GAAP equity of the SCA's last audited financial statements.

e. Nonadmit amount of the net deferred tax assets (DTAs) of the SCA in excess of 10% of the audited U.S. GAAP equity of the SCA's last audited financial statements.

f. Nonadmit any surplus notes held by the SCA issued by the reporting entity.

g. Adjust the U.S. GAAP annuity account value reserves of a foreign insurance SCA, with respect to the business it wrote directly, using the commissioners' annuity reserve valuation method (CARVM) as defined in paragraphs 14 and 15 of Appendix A-820 (including the reserving provisions in the various Actuarial Guidelines which support CARVM). The valuation interest rate and mortality tables to be used in applying CARVM should be that prescribed by the foreign insurance SCA's country of domicile. If the Foreign SCA's country of domicile does not prescribe the necessary tables and/or rates, no reserve adjustment shall be made.

Note that the outcome of these adjustments can result in a negative equity valuation of the investment for all paragraph 8.b.ii. entities. For a paragraph 8.b.iv. entity, the application of these adjustments will stop at zero, and will not result in negative equity valuation unless the paragraph 8.b.iv. entity provides services to the reporting entity or its affiliates or holds assets on behalf of the reporting entity. If such services, including reinsurance transactions, are occurring, the adjustments required in this paragraph can result in a negative equity valuation. (See additional equity method application guidance in paragraph 13.e. regarding guarantees and financial support.)

10. For investments in entities recorded on an equity method (paragraph 8.b.i. through 8.b.iv.), the amount to be recorded at acquisition shall be defined as the initial investment in an investee at cost as defined in SSAP No. 68, paragraph 3, adjusted to exclude any investments in an investee's preferred stock

and/or surplus notes[4]. This guidance shall be followed for initial investments as well as subsequent investments in the investee.

11. For investments in entities recorded on an equity method (paragraph 8.b.i. through 8.b.iv.) after the date of acquisition, the investment amount shall be 1) adjusted for the amortization of statutory goodwill as defined in SSAP No. 68, and 2) adjusted, with a corresponding unrealized gain or loss, for the reporting entity's share of undistributed earnings and losses of the investee (net of dividends declared[5]). (This results in a reduction of the investment amount when dividends declared are in excess of the undistributed accumulated earnings attributable to the investee.) The following additional adjustment, based on the equity method applied for the investment, shall also be made:

a. For investments in scope of paragraph 8.b.i. (based on audited statutory equity) the investment amount shall be adjusted for the reporting entity's share of the change in special surplus funds, other than special surplus funds and unassigned funds (surplus), as defined in *SSAP No. 72—Surplus and Quasi-Reorganizations*. Additionally, the investment amount shall be adjusted, with a corresponding unrealized gain or loss, for the reporting entity's share of other changes in the investee's surplus (e.g., the change in the investee's nonadmitted assets);

b. For investments in scope of paragraphs 8.b.ii., 8.b.iii. and 8.b.iv. (underlying audited GAAP equity), the investment amount shall be adjusted for the reporting entity's share of adjustments recorded directly to the investee's stockholder's equity under GAAP, with a corresponding entry to unrealized gain or loss. For investments in scope of paragraphs 8.b.ii. and 8.b.iv. (underlying audited GAAP with limited statutory adjustments), the investment amount shall also be adjusted in accordance with paragraph 9.

12. If the reporting entity uses the market valuation approach outlined in paragraph 8.a., changes in that valuation after initial acquisition shall be included in unrealized gains and losses

13. On at least a quarterly basis, the procedures set forth below shall be followed by a reporting entity in applying an equity method of accounting (as described in paragraphs 8.b.i. through 8.b.iv.), as applicable, to investments in SCA entities:

a. A difference between the cost of an investment and the underlying equity in the statutory or GAAP book value, as applicable, of the acquired company at the date of acquisition shall be accounted for in accordance with SSAP No. 68 however, positive goodwill for noninsurance SCA entities subject to paragraph 8.b.ii. and foreign insurance SCA entities subject to paragraph 8.b.iv. shall be subject to the admissibility criteria in paragraph 9.d. rather than the admissibility criteria of paragraph 7 of SSAP No. 68.

b. A transaction of an investee of a capital nature that affects the reporting entity's share of stockholders' equity of the investee shall be reflected as an unrealized gain or loss (e.g., where the investee issues additional stock or a new class of stock that impacts the reporting entity's equity ownership in the investee, the reporting entity's recorded investment shall be adjusted to reflect the transaction);

c. Realized gains or losses on the sale of an investment in a SCA entity shall be recorded in an amount equal to the difference at the time of sale between the selling price and carrying amount of the investment plus any previously recorded unrealized gain or loss;

[4] The guidance in paragraphs 28-32 shall be applied for the separate reporting of preferred stock and surplus notes.

[5] Dividends are recognized in investment income when declared.

d. If financial statements of an investee are not sufficiently timely for the reporting entity to apply an equity method to the investee's current results of operations, the reporting entity shall record its share of the earnings or losses of an investee from the most recent available financial statements. A lag in reporting shall be consistent from period to period. This paragraph does not apply to a SCA valued under paragraph 8.b.i.;

e. For entities subject to paragraphs 8.b.i., 8.b.ii., 8.b.iii. and 8.b.iv., a reporting entity's share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by an equity method plus advances made by the investor. The reporting entity shall discontinue applying an equity method when the investment (including advances) is reduced to zero[6] and shall not provide for additional losses, while still continuing to track the amount of unreported equity method losses, until any future equity method income can be reported. If the reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee, the provisions of *SSAP No. 5~~R~~—Liabilities, Contingencies and Impairments of Assets* shall be followed. As the entire equity method loss (subject to the financial guarantee/commitment) shall be recognized under SSAP No. 5~~R~~, it does not also need to be recognized under SSAP No. 97. If the investee subsequently reports net income, the reporting entity shall resume applying an equity method only after its share of that net income equals the share of net losses not recognized during the period that an equity method was suspended;

f. When an investee has outstanding cumulative preferred stock, the reporting entity shall compute its share of earnings (losses) after deducting the investee's preferred dividends, whether or not such dividends are declared;

g. An investment in a SCA entity may fall below the level of ownership described in paragraph 5 from the sale of a portion of an investment by the reporting entity, the sale of additional interests by an investee, or other transactions. The reporting entity shall discontinue accruing its share of the earnings or losses of the investee for an investment that no longer qualifies for an equity method. The earnings or losses that relate to the investment interests retained by the reporting entity and that were previously accrued shall remain as a part of the carrying amount of the investment. The investment account shall not be adjusted retroactively under the conditions described in this subparagraph. However, dividends received by the investor in subsequent periods which exceed the reporting entity's share of earnings for such periods shall be applied as a reduction of the carrying amount of the investment.

14. Once the reporting entity elects to use a valuation approach for a particular subsidiary, the reporting entity may not change the valuation method to another method without the approval of the domiciliary commissioner. For instance, if an entity selects the market valuation method, it may not change to an equity method or vice versa without approval from the domiciliary commissioner. Further, in order for an entity to transfer from a paragraph 8.a. or 8.b.ii. valuation to a paragraph 8.b.iii. valuation, the SCA shall not exceed the 20% threshold (as defined in paragraph 8.b.ii.) for three consecutive years prior to making the change. When an investment qualifies for use of another method of accounting, the reporting entity shall adopt the new method of accounting and the investment shall be adjusted to reflect the reporting entity's

[6] Although the SCA is reported at zero in the investment schedule, a guarantee liability (either contingent or noncontingent) may be required to be reported under SSAP No. 5~~R~~. Additionally, refer to the guidance related to discontinuance of an equity method in paragraphs 15-17 and *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee* and *EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses*. As detailed in INT 00-24, a reporting entity's share of losses in an SCA shall be applied to other investments held in the SCA once the SCA (common stock) investment has been reduced to zero.

equity interest in the SCA entity under the new method. A corresponding amount shall be recorded as an unrealized gain or loss.

15. If an additional investment, in whole or in part, represents, in substance, the funding of prior losses, the entity should recognize previously suspended losses only up to the amount of the additional investment determined to represent the funding of prior losses. Whether the investment represents the funding of prior losses depends on the facts and circumstances.

16. Judgment is required in determining whether prior losses are being funded and that all available information should be considered in performing the related analysis. The following are certain factors to consider in that regard. However, no one factor should be considered presumptive or determinative.

a. Whether the additional investment is acquired from a third party or directly from the investee. When the additional investment is purchased from a third party and the investee does not obtain additional funds either from the investor or the third party, it is unlikely that, in the absence of other factors, prior losses are being funded.

b. The fair value of the consideration received in relation to the value of the consideration paid for the additional investment. For example, if the fair value of the consideration received is less than the fair value of the consideration paid, it may indicate that prior losses are being funded to the extent that there is disparity in the value of the exchange.

c. Whether the additional investment results in an increase in ownership percentage of the investee. In instances in which the investment is made directly with the investee, the investor should consider the form of the investment and whether other investors are making simultaneous investments proportionate to their interests. Investments made without a corresponding increase in ownership or other interests, or a pro rata equity investment made by all existing investors, may indicate that prior losses are being funded.

d. The seniority of the additional investment relative to existing equity of the investee. An investment in an instrument that is subordinate to other equity of the investee may indicate that prior losses are being funded.

17. Upon making the additional investment, the investor should evaluate whether it has become otherwise committed to provide financial support to the investee.

18. A reporting entity that owns an interest in itself via direct ownership of shares of an upstream intermediate or ultimate parent shall reduce the value of such shares for the reciprocal ownership. If the shares of the parent are owned indirectly by a reporting entity, via a downstream SCA entity, the directly held entity, which owns the parent's shares, shall have its value reduced for the reciprocal ownership.

19. Any parent reporting entity that owns an interest in itself via either direct or indirect ownership of a down-stream affiliate, which in turn owns shares of the parent reporting entity, shall eliminate its interest in these shares from the valuation of such affiliate.

Investment in Parent-Issued Surplus Notes

20. Any parent reporting entity that has issued a surplus note, which has been acquired by an SCA (held directly or indirectly) shall adjust the investment in the SCA to eliminate the issued surplus note to prevent double counting of the surplus note at the parent reporting entity. Without adjustment, the issued surplus note would be reported both as an increase in surplus by the parent reporting entity, as well as an admitted asset of the parent through the "investment in an SCA." The surplus note shall also be eliminated for instances in which the SCA acquires any portion of outstanding surplus notes issued by the parent through any means (e.g., directly acquired from the parent, acquired through a third-party broker, or via the market).

Qualified Versus Unqualified Opinions

21. Various opinions can be issued in which an entity can record certain investments under the GAAP Equity method of accounting. The reporting entity shall record investments that require audited GAAP equity in the manner described below when the audit opinion on the GAAP financial statements contains the following language:

a. The investment shall be nonadmitted if the audit opinion contains a disclaimer of opinion for the most recent statement of financial position presented in the financial statements.

b. The investment shall be nonadmitted if the audit opinion contains a qualified opinion due to a scope limitation that impacts the most recent statement of financial position presented in the financial statements and the impact of the scope limitation cannot be quantified. However, if the impact of the scope limitation is quantified in the audited financial statements or the audit opinion, the investment shall be admitted and the reporting entity's valuation of the investment shall be determined based on the GAAP equity of the investee, adjusted to exclude the impact of the quantified scope limitation.

c. The investment shall be nonadmitted if the audit opinion contains a qualified opinion due to a departure from GAAP that impacts the most recent statement of financial position presented in the financial statements and the impact of such departure is not quantified in either the auditor's report or the footnotes to the financial statements (see quantification exception related to the valuation of a U.S. insurance entity on the basis of U.S. statutory accounting principles discussed below). However, if the impact of the departure from GAAP is quantified in the audited financial statements or the audit opinion, the investment shall be admitted and the reporting entity's valuation of the investment shall be determined based on the GAAP equity of the investee, adjusted to exclude the impact of the quantified departure from GAAP. EXCEPTION: There is no need to quantify the impact of a departure from GAAP in either the auditor's report or the footnotes to the financial statements if a qualified audit opinion is issued due to a departure from GAAP and the departure is related to the valuation of an U.S. insurance entity on the basis of U.S. statutory accounting principles. In such cases, the investment shall be admitted without quantifying the departure.

d. The investment shall be nonadmitted if the audit opinion contains an adverse opinion due to a departure from GAAP that impacts the most recent statement of financial position presented in the financial statements and the impact of such departure is not quantified in either the auditor's report or the footnotes to the financial statements (see quantification exception related to the valuation of a U.S. insurance entity on the basis of U.S. statutory accounting principles discussed below). However, if the impact of the departure from GAAP is quantified in the audited financial statements or the audit opinion, the investment shall be admitted and the reporting entity's valuation of the investment shall be determined based on the GAAP equity of the investee, adjusted to exclude the impact of the quantified departure from GAAP. EXCEPTION: There is no need to quantify the impact of a departure from GAAP in either the auditor's report or the footnotes to the financial statements if an adverse audit opinion is issued due to a departure from GAAP and the departure is related to the valuation of an U.S. insurance entity on the basis of U.S. statutory accounting principles. In such cases, the investment shall be admitted without quantifying the departure.

e. The investment shall be nonadmitted if the audit report or accompanying financial statements/notes contains explanatory language indicating there is an unalleviated substantial doubt about the investee's ability to continue as a going concern.

Valuation of Investments in Downstream Holding Companies

22. SSAP No. 48 requires the financial statements of joint ventures, partnerships, and/or limited liability companies in which the downstream noninsurance holding company has a minor ownership interest or otherwise lacks control, i.e., ownership interest is less than 10% (hereinafter referred to as "non-SCA SSAP No. 48 entities"), to be valued using U.S. GAAP basis financial statements. Valuation of a downstream holding company, including its investments in SCA entities, depends upon the nature of the SCA entities and non-SCA SSAP No. 48 entities it holds in accordance with paragraph 8 of this statement. All liabilities, commitments, contingencies, guarantees or obligations of the downstream noninsurance holding company, which are required to be recorded under applicable statutory accounting guidance, shall be reflected in the parent insurance reporting entity's determination of the carrying value of the investment in the downstream noninsurance holding company, if not already recorded in the financial statements of the downstream noninsurance holding company. If an SCA investment of the downstream holding company does not meet the provisions of paragraph 8.a. or if it elects not to use the guidance in paragraph 8.a., and instead uses the guidance in paragraph 8.b., the downstream holding company would be valued as the sum of the following (if applicable):

a. Investments by a downstream holding company in U.S. insurance SCA entities are recorded based upon the guidance in paragraph 8.b.i.;

b. Investments by a downstream holding company in noninsurance SCA entities that are engaged in transactions or activities described in paragraph 8.b.ii., are recorded based upon the guidance in paragraph 8.b.ii.;

c. Investments by a downstream holding company in noninsurance SCA entities that do not qualify under paragraph 22.b. shall be recorded based upon the guidance in paragraph 8.b.iii.;

d. Investments by a downstream holding company in foreign insurance SCA entities shall be recorded based upon the guidance in paragraph 8.b.iv.; and

e. Any other assets and/or liabilities of the downstream holding company (not addressed in paragraphs 22.a. through 22.d.) shall be valued in accordance with the applicable SSAP.

For purposes of applying paragraphs 22-27 of this statement, a downstream holding company shall be considered to be the parent reporting entity's investment in a SCA entity. See paragraphs 26 and 27 for a limited exception to the audited financial statements requirement for downstream noninsurance holding companies which meet specified conditions.

Admissibility Requirements of Investments in Downstream Holding Companies

23. To meet the admissibility requirements of this statement, unless the limited exception to the audited financial statements requirement discussed in paragraphs 26 and 27 applies, an annual audit of the financial statements of SCA entities, including the downstream holding company valued under paragraphs 8.b.i through 8.b.iv. must be obtained. The requirement for audited financial statements may be met by utilizing any one of the following methods:

a. Audited US GAAP financial statements of the downstream SCA holding company. (Consolidated or combined financial statements are allowed encompassing one or more downstream holding companies, including such holding companies that directly own U.S. insurance entities, provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA's domiciliary state.) The audited financial statements of the downstream holding company shall include as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities and non-SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet schedule shall separately present those entities owned directly by the downstream holding company. The consolidating or combining balance sheet shall then be adjusted for GAAP to SAP differences for paragraph 8.b.i., 8.b.ii. and 8.b.iv. entities owned directly or indirectly by the downstream holding company. The adjusted amount would then be the reported value of the investment in the downstream holding company at the higher-level reporting entity; or

b. Audited foreign GAAP-basis financial statements of the downstream SCA holding company. (Consolidated or combined financial statements are allowed encompassing one or more downstream holding companies, including such holding companies that directly own U.S. insurance entities, provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA's domiciliary state.) The audited foreign GAAP basis financial statements shall include an audited footnote disclosure within the financial statements that reconciles each consolidated entity's net income and equity on a foreign basis of accounting to a U.S. GAAP basis. The audited financial statements of the downstream holding company shall include as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities non-SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet schedule shall separately present those entities owned directly by the downstream holding company. The consolidating or combining balance sheet shall then be adjusted for GAAP to SAP differences of the insurance entities and paragraph 8.b.ii. and paragraph 8.b.iv. entities owned directly or indirectly by the downstream holding company. The adjusted amount would then be the reported value of the investment in the downstream holding company at the higher-level reporting entity; or

c. Individual audits of the downstream holding company and the downstream holding company's investments in individual SCA entities.

24. If the downstream noninsurance holding company does not meet the requirements of paragraph 26, audited GAAP financial statements, as described in paragraph 23, are required ~~for the downstream noninsurance holding company and its SCA and non-SCA investments~~ in order for the investment in the downstream noninsurance holding company to be classified as an admitted asset.

25. A purchased downstream holding company is valued in accordance with the provisions of paragraphs 22-25 and the provisions of SSAP No. 68.

Limited Exceptions to the Audit Requirements for Downstream Noninsurance Holding Companies

26. This statement requires that investments in SCA entities be recorded using one of the valuation methods described in paragraph 8 in order to be admitted assets. Each of the paragraph 8.b. valuation methods require the financial statements of SCA entities, including downstream noninsurance holding companies, to be audited in order for the investments in SCA entities to be admitted assets. Likewise, SSAP No. 48 requires the financial statements of joint ventures, partnerships, and/or limited liability companies in which the downstream noninsurance holding company has a minor ownership interest or otherwise lacks control, i.e., ownership interest is less than 10% to be audited (U.S. GAAP) in order to be admitted assets. There is a limited exception to the requirement to have audited financial statements of a downstream noninsurance holding company, provided that the entities owned by the downstream noninsurance holding company (paragraph 8.b.iii. entity) have audited financial statements as described in paragraphs 26 and 27.

27. The process of admitting audited investments in entities owned by an unaudited downstream noninsurance holding company SCA entity will be known as a "look through." In order to admit the investments in audited SCAs or the audited non-SCA SSAP No. 48 entities owned by an unaudited downstream noninsurance holding company, a reporting entity may apply the look through approach, provided all of the following conditions are met:

a. The downstream noninsurance holding company is an 8.b.iii entity, and

b. The downstream noninsurance holding company does not own any other assets which are material to the downstream holding company other than the audited SCA entities and/or audited non-SCA SSAP No. 48 entities, and

c. The downstream noninsurance holding company is not subject to liabilities, commitments, contingencies, guarantees or obligations which are material to the downstream noninsurance holding company.

If an investment in a downstream noninsurance holding company meets the requirements set forth above, the reporting entity can admit the individual audited SCA entities and/or audited non-SCA SSAP No. 48 entities; however, unaudited immaterial assets of the downstream noninsurance holding company are to be carried at the lesser of the paragraph 8 valuation or nonadmitted (e.g. some equity method investments are required to be carried at a negative value due to either statutory adjustments or to parental obligations to keep funding the subsidiary). If a holding company structure has more than one downstream non-insurance holding company, each downstream non-insurance holding company may be looked through, provided each downstream non-insurance holding company meets all of the conditions in paragraph 27.

Investment in Preferred Stock or Surplus Notes of a Subsidiary, Controlled and Affiliated Entity

28. Investments in common stock, preferred stock and surplus notes are reported separately. Care should be taken to avoid double counting of the separate investments. When the SCA investee has issued multiple equity components such as common stock, preferred stock and/or surplus note(s) the total reported equity of the SCA investee must be separated into the respective components in order to determine the equity attributable to each class.

29. In order to establish the equity value of the common stock investment in an SCA, the reporting entity reduces the total equity of the SCA by the SCA's (issuer's) value of the preferred stock and/or surplus notes on the issuer's balance sheet (not the reporting entity's book/adjusted carrying value for the SCA's preferred stock and/or surplus notes held).

30. Investments in the preferred stock of an SCA shall be accounted for and reported in accordance with the provisions of *SSAP No. 32~~R~~—Preferred Stock*.

31. Investments in the surplus notes of an SCA shall be accounted for and reported in accordance with the provisions of *SSAP No. 41~~R~~—Surplus Notes*.

32. The following example is provided to illustrate the accounting and reporting. The reporting entity holds 100% of the preferred stock. The SCA issued the preferred stock for $50,000. The investment in the SCA, measured in accordance with this statement is $250,000 including the preferred stock of the SCA. The investment in the SCA is $200,000 ($250,000-50,000) and the preferred stock is measured and reported in accordance with SSAP No. 32~~R~~.

Impairment

33. For any decline in the fair value of an investment in a SCA entity that is other than temporary(INT 06-07), the investment shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. The write down shall first be considered as an

adjustment to any portion of the investment that is nonadmitted (e.g., goodwill). The new cost basis shall not be changed for subsequent recoveries in fair value. Future declines in fair value, which are determined to be other than temporary shall be recorded as realized losses. An impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to recover the carrying amount of the investment or there is evidence indicating inability of the investee to sustain earnings, which would justify the carrying amount of the investment. A fair value of an investment that is below the carrying amount based on the statutory equity method or the existence of investee operating losses may indicate a loss in value, however, they are not necessarily indicative of a loss in value that is other than temporary.

Consolidation

34. Majority-owned subsidiaries shall not be consolidated for individual entity statutory reporting. This does not exempt certain reporting entities that are members of an affiliated group from the requirement to issue consolidated or combined annual statements as supplemental information in accordance with NAIC guidelines.

Disclosures

35. All SCA investments within the scope of this statement (except paragraph 8.b.i. entities) shall include disclosure of the SCA balance sheet value (admitted and nonadmitted) as well as information received from the NAIC in response to the SCA filing (e.g., date and type of filing, NAIC valuation amount, whether resubmission of filing is required). This disclosure shall include an aggregate total of all SCAs (except paragraph 8.b.i. entities) with detail of the aggregate gross value under this statement with the admitted and nonadmitted amounts reflected on the balance sheet. (As noted in paragraph 4, joint ventures, partnerships and limited liability companies are accounted for under the guidance in SSAP No. 48. As such, those entities are not subject to the disclosures in this statement, unless specifically directed by SSAP No. 48.)

a. For all periods presented, a reporting entity whose shares of losses in an SCA exceeds its investment in the SCA shall disclose its share of losses. (This is required regardless of a guarantee or commitment of future financial support to the SCA.) This disclosure shall include the following:

i. The reporting entity's accumulated share of the SCA losses not recognized during the period that the equity method was suspended;

ii. The reporting entity's share of the SCA's equity, including negative equity;

iii. Whether a guaranteed obligation or commitment for financial support exists; and

iv. The amount of the recognized guarantee under SSAP No. 5~~R~~.

This disclosure shall apply beginning in the period the SCA's equity initially falls below zero and shall continue to be disclosed as long as the SCA investment is in a deficit position. Additionally, the reporting entity shall detail in a narrative disclosure whether losses in the SCA have impacted other investments as required by *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee* and *EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses.*

36. The significance of an investment to the reporting entity's financial position and results of operations shall be considered in evaluating the extent of disclosures of the financial position and results of operations of an investee. The following disclosures shall be made for all investments in SCA entities that exceed 10% of the total admitted assets of the reporting entity:

a. Financial statements of a reporting entity shall disclose (i) the name of each SCA entity and percentage of ownership of common stock, (ii) the accounting policies of the reporting entity with respect to investments in SCA entities, and (iii) the difference, if any, between the amount at which the investment is carried and the amount of underlying equity in net assets (i.e., goodwill, other nonadmitted assets, fair value or discounted fair value adjustments, adjustments pursuant to SSAP No. 25, paragraph ~~19~~20.d.) and the accounting treatment of the difference;

b. For those SCA entities for which a quoted market price is available, the aggregate value of each SCA investment based on the quoted price and the difference, if any, between the amount at which the investment is carried and the quoted price shall be disclosed;

c. Summarized information as to assets, liabilities and results of operations shall be presented for SCA entities, either individually or in groups;

d. Conversion of outstanding convertible securities, exercise of outstanding options and warrants and other contingent issuances of an investee may have a significant effect on an investor's share of reported earnings or losses. Accordingly, material effects of possible conversions, exercises or contingent issuances shall be disclosed in notes to the financial statements of the reporting entity; and

e. For those SCA entities in which the reporting entity elected, or was required, to change its valuation method as described in paragraph 14, a description of the reason for the change and the amount of adjustment recorded as unrealized gains or losses shall be disclosed. The entity shall also disclose whether commissioner approval was obtained in accordance with paragraph 14.

37. A reporting entity that reports an investment in an insurance SCA (per paragraph 8.b.i.) for which the audited statutory equity reflects a departure from the NAIC statutory accounting practices and procedures (e.g., permitted or prescribed practices) shall disclose the following:

a. A description of the accounting practice, with a statement that the practice differs from the NAIC statutory accounting practices and procedures.

b. The monetary effect on net income and surplus reflected by the insurance SCA as a result of using an accounting practice that differed from NAIC statutory accounting practices and procedures.

c. Whether the RBC of the insurance SCA would have triggered a regulatory event had it not used a prescribed or permitted practice.

d. The reported entity's investment in the insurance SCA per the audited statutory equity, and the investment in the insurance SCA the reporting entity would have reported if the insurance SCA had completed statutory financial statements in accordance with the NAIC statutory accounting practices and procedures.

38. A reporting entity that calculates its investment in a foreign insurance subsidiary by adjusting annuity GAAP account value reserves using CARVM and the related Actuarial Guidelines shall disclose the interest rates and mortality assumptions used in the calculation as prescribed by the insurance department of the foreign country.

39. Any commitment or contingent commitment to a SCA entity shall be disclosed (e.g., guarantees or commitments to provide additional capital contributions).

40. A reporting entity that recognizes an impairment loss shall disclose the following in the financial statements that include the period of the impairment write down:

a. A description of the impaired assets and the facts and circumstances leading to the impairment; and

b. The amount of the impairment and how fair value was determined.

41. If a reporting entity holds an investment in a downstream noninsurance holding company, the reporting entity may look-through the downstream noninsurance holding company to the value of (i) SCA entities having audited financial statements and/or (ii) joint ventures, partnerships, and/or limited liability companies having audited financial statements in which the downstream noninsurance holding company has a minor ownership interest or otherwise lacks control, i.e., ownership interest is less than 10% in lieu of obtaining an audit of the financial statements of the downstream noninsurance holding company (provided the limited exception to the audited financial statements requirement contained in paragraphs 26-27 applies).

42. If a reporting entity utilizes the look-through approach for the valuation of the downstream noninsurance holding company instead of obtaining audited financial statements of the downstream noninsurance holding company, the financial statements of the reporting entity shall include the following disclosures:

a. The name of the downstream noninsurance holding company;

b. The carrying value of the investment in the downstream non insurance holding company;

c. The fact that the financial statements of the downstream noninsurance company are not audited;

d. The fact that the reporting entity has limited the value of its investment in the downstream noninsurance holding company to the value contained in the audited financial statements, including adjustments required by this statement, of SCA entities and/or non-SCA SSAP No. 48 entities owned by the downstream noninsurance holding company and valued in accordance with paragraphs 22-25;

e. The fact that all liabilities, commitments, contingencies, guarantees or obligations of the downstream noninsurance holding company, which are required to be recorded as liabilities, commitments, contingencies, guarantees or obligations under applicable accounting guidance, are reflected in the reporting entity's determination of the carrying value of the investment in the downstream noninsurance holding company, if not already recorded in the financial statements of the downstream noninsurance holding company.

43. Investments reported using an equity method from paragraph 8.b.ii. through 8.b.iv. may have fiscal year ends, not calendar year ends. To recognize a change to the reporting year-end of an equity method investee, including changes in, or the elimination of, previously existing differences (lag period) due to the reporting entity's ability to obtain financial results from a reporting period that is more consistent with, or the same as, that of the reporting entity, the guidance included in *FASB Emerging Issues Task Force 06-9: Reporting a Change in (or the elimination of) a Previously Existing Difference between the fiscal Year-End of a Parent Company and That of a Consolidated Entity or between the Reporting Period of an Investor and That of an Equity Method Investee* that defines such reporting period changes as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors* shall be followed. For instances in which this change in accounting principle occurs, disclosure requirements of SSAP No. 3 shall be followed.

44. Refer to the Preamble for further discussion regarding disclosure requirements. The disclosures in paragraph 36.d. shall be included in the annual audited statutory financial reports only.

Relevant Literature

45. This statement adopts the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*.

46. This statement adopts *ASU 2016-07, Investments—Equity and Joint Ventures*, modified to reflect statutory terms, including the definition of control and statutory reporting concepts. This statement adopts *FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18* as guidance to be considered in determining the existence of control.

47. This statement adopts with modification EITF 06-9 to include:

a. Adopt the guidance that defines such reporting period changes as a change in accounting principle in accordance with SSAP No. 3, modified to apply only to equity method investments. For instances in which this change in accounting principle occurs, disclosure requirements of SSAP No. 3 shall be followed.

b. The consolidation guidance in EITF 06-9 is rejected.

c. Changes affecting companies reporting investments in SCA entities using the equity method: Investments in paragraph 8.b.i. entities are required to be calendar year-end. Investments in paragraphs 8.b.ii. through 8.b.iv. entities may have other fiscal year ends, thus this issue could apply to equity method investments under paragraphs 8.b.ii. through 8.b.iv. or under equity method valued investments that fall within the scope of SSAP No. 48.

48. This statement rejects *ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323 and Topic 815, ASU 2019-06, Intangibles—Goodwill and Other Business Combinations, and Non-for-Profit Entities, ASU 2011-10, Derecognition of in Substance Real Estate, APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock, AICPA Accounting Interpretations APB 18, The Equity Method of Accounting for Investments in Common Stock:* Accounting Interpretations of *APB Opinion No. 18, FASB Technical Bulletin No. 79-19, Investor's Accounting for Unrealized Losses on Marketable Securities Owned by an Equity Method Investee, FASB Emerging Issues Task Force No. 87-21, Change of Accounting Basis in Master Limited Partnership Transactions, FASB Emerging Issues Task Force No. 96-16, Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights*, *FASB Emerging Issues Task Force No. 98-2: Accounting by a Subsidiary or Joint Venture for an Investment in the stock of Its Parent Company or Joint Venture Partner* and *FASB Staff Position No. APB 18-1*, *Accounting by an Investor for Its Proportionate Share of Accumulated Other Comprehensive Income of an Investee Accounted for under the Equity Method in Accordance with APB Opinion No. 18 upon a Loss of Significant Influence.*

Effective Date and Transition

49. This statement is effective for reporting periods ending on and after December 31, 2007. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. Detail of 2011 amendments that relocated guidance from this statement to SSAP No. 32~~R~~ and SSAP No. 68 is provided in those statements respectively. Guidance reflected in paragraph 21, incorporated from *INT 03-03: Admissibility of Investments Recorded Based on the Audited GAAP Equity of the Investee when a Qualified Opinion is*

Provided was originally effective December 7, 2003. Guidance reflected in paragraphs 15-17 incorporated from *INT 04-10: Accounting for Subsequent Investments in an Investee after Suspension of Equity Method Loss Recognition* was originally effective December 5, 2004. Guidance in paragraph 43 was previously included within *INT 08-03: EITF 06-9: Reporting a Change in (or the elimination of) a Previously Existing Difference between the fiscal Year-End of a Parent Company and That of a Consolidated Entity or between the Reporting Period of an Investor and That of an Equity Method Investee* and was effective for periods beginning May 31, 2008.

REFERENCES

Other

- *Purposes and Procedures Manual of the NAIC Investment Analysis Office*

Relevant Issue Papers

- *Issue Paper No. 118—Investments in Subsidiary, Controlled and Affiliated Entities, A Replacement of SSAP No. 46*

EXHIBIT A – SCA REPORTING PROCESS

50. SCA entities, except for domestic SCA insurance company investments accounted for under paragraph 8.b.i of this statement, in which the reporting entity has an equity interest (common or preferred stock), are required to be filed with the NAIC. Nonadmitted assets are not required to be filed in a Sub 2 as long as they were nonadmitted, or had a zero value, for the full reporting period (all interim and annual reporting). Immaterial asset SCAs do not have an automatic exclusion from filing, as immateriality of an SCA will be ascertained by the state of domicile of the insurance reporting entity, but companies are allowed to request an exemption from the domiciliary state to not file an SCA on the basis that it is immaterial. The filing process does not include investments within the scope of SSAP No. 48.

51. Except for domestic SCA insurance company investments accounted for under paragraph 8.b.i., all SCA investments within the scope of this statement, purchased during any one calendar year, shall be reported to the NAIC on a Sub 1 form within 90 days of the acquisition or formation of the investment; this includes nonadmitted, zero-valued and immaterial SCAs. The NAIC will process that filing in the same year but will not at that time approve or disapprove a value for the SCA investment. By August 31 of each year, the insurance company shall submit a Sub 2 filing for the previously purchased SCA investment reported on a Sub 1 form and later that year, the NAIC will approve a value for the transaction. For SCAs that routinely receive their audit reports after the August 31 deadline, a filing deadline of one month after the audit date shall be applied. Filers must provide previous years' audit reports to verify an audit report dated after August 31 in order to not be charged a late fee for a Sub 2 filing that is filed after the August 31 deadline. The value approved by the NAIC at the conclusion of the Sub 2 form filing is reported by the insurance company on its financial statement blank. If the insurance company has reported a value for the SCA investment on its financial statement blank that differs from the value approved by the NAIC, the insurer is required to adjust the reported value in its next quarterly financial statement blank unless otherwise directed by the insurer's state of domicile.

52. Insurance companies shall use one of the valuation methods described in paragraph 8 to calculate the value of their investments in insurance and non-insurance SCA companies. An insurance company shall calculate the value of its investments in foreign insurance and all non-insurance company SCA entities and report the value to the NAIC no later than August 31, or one month after the audit report date for SCAs that routinely receive their audits after August 31 for existing SCA investments, and within 90 days of the acquisition or formation of a new SCA investment.

Initial Reporting of SCA Investments

53. Reporting the acquisition or formation of a new investment is accomplished by submitting a completed Sub 1 form for each investment disclosing, (i) the valuation reported or to be reported by the insurance company on its latest or next quarterly financial statement blank, (ii) which method of those described in paragraph 8 was used to arrive at the valuation, (iii) the factual context of the transaction, and (iv) economic and business motivations for the transaction. The submission will be processed by the NAIC only if the NAIC determines it has been provided with all material information with respect to all SCA companies of the reporting insurance company that require valuation.

54. The purpose of a Sub 1 filing is to gather basic information about the SCA. If the NAIC determines that the reported transaction meets the tests specified, it will complete the filing in the VISION database. If the NAIC determines that the transaction does not meet the tests specified, it will not complete the filing in the VISION database and instead shall notify the reporting insurance company and the state of domicile in writing of its determination.

Subsequent Reporting of SCA Investments

55. By August 31 or one month after the audit report date of each year and subsequent to the reporting of an SCA investment on the Sub 1 form, the insurance company shall submit a Sub 2 form filing, with all supporting documentation for foreign SCAs provided in English, for the same SCA investment.

Additionally, by August 31 or one month after the audit report date of each year, any insurance company that has made a Sub 2 form filing in a previous year must update the information by filing an updated Sub 2 form filing.

56. Each year the NAIC shall compile a list of all SCA investments (excluding insurance company SCAs (paragraph 8.b.i.) nonadmitted and zero-value SCAs) reported as Sub 1 form filings for which a Sub 2 form filing has not yet been received. For these transactions, the NAIC will notify the responsible reporting insurance company and its state of domicile that it has not received a Sub 2 filing for the SCA investment.

57. The purpose of the Sub 2 filing is to determine whether the value calculated by the reporting insurance company for the SCA investment is appropriate and to approve that or some other value for reporting on the insurer's financial statement blank.

58. An insurance company that concludes an SCA transaction at year-end may be unable to file a Sub 1 form prior to the time it would be required to file a Sub 2 form. Where this is the case, the NAIC is authorized to accept and review a Sub 1 filing from such an insurance company and to accept and review the Sub 2 filing after the Sub 1 filing review has been completed.

59. No filing of an investment in a domestic SCA insurance company valued under paragraph 8.b.i. shall be required to be made with the NAIC.

Consistency in Application of Chosen Valuation Method

60. The valuation method used for a specific SCA company shall be determined by the guidance in paragraph 8. If a reporting insurance company previously selected the Market Valuation Method and wished to change to an Equity Method (or vice versa), they may only do so with the approval of the domiciliary commissioner. Once the approval of the domiciliary commissioner has been obtained, the reporting insurance company shall provide the NAIC with evidence of that approval as part of the Sub 1 or Sub 2 filing.

61. For reporting insurance companies that use the Market Valuation Method, the reporting insurance company shall obtain the discount rate to be applied from the NAIC. The discounts identified in Exhibit E are minimum discounts. The NAIC calculation may result in discounts in market value higher than those shown in Exhibit E.

Assessment and Review of Sub 1 Form

62. Upon receipt of the reporting insurance company's Sub 1 filing, the NAIC shall conduct an assessment in the following manner:

a. If the NAIC is aware of any broad regulatory concerns or issues affecting the reporting insurance company or the reported SCA investment, it shall determine whether such concerns or issues are relevant to valuation of the SCA investment. If so, the NAIC shall take such action as seems appropriate under the circumstances.

b. The NAIC shall ensure that the value reported by the insurance company on a Sub 1 form has been arrived at by application of one of the permitted valuation methods described in paragraph 8. If a reporting insurance company submits a Sub 1 form filing that reports a value calculated under an inappropriate method, the NAIC shall contact the insurer to resolve the discrepancy or it shall recalculate the value of the SCA investment under the most appropriate valuation method and notify the reporting insurance company of such action.

c. The NAIC shall review the factual, business and economic context of the transaction to determine whether, (i) the SCA investment appears to be an arms-length business arrangement with a reasonable economic value to the reporting insurance company, (ii) the valuation method chosen is reasonable in view of the factual, business and economic context of the transaction, (iii) the transaction is reasonable in the context of all the known facts surrounding the insurance company and its operations, and (iv) the value reported appropriately reflects economic value to the insurance company. The NAIC may consider other factors that appear relevant from the context of the transaction including:

i. The specific tax, accounting or other regulatory treatment sought.

ii. Whether the transaction effects a legally effective, binding and permanent transfer of the risks and rewards of ownership.

iii. The effect of the SCA valuation on the solvency of the insurer.

iv. The degree of affiliation between the insurer and the party from whom such company was acquired, the form of the consideration (cash, property or the exchange of stock), evidence of ability to recover cost and whether the acquisition price represented the result of arms-length dealing between economic equals.

v. The right to dividends or other payments from the SCA and any limitations thereto.

vi. The nature, extent and demonstrable financial value of the business operations of the SCA.

vii. The value of the assets owned by the SCA.

If the NAIC determines that the transaction does not seem to present economic value to the insurance company, or that the transaction tends to obscure issues that might be relevant to an NAIC member or that the information provided is insufficient or unreliable as a basis upon which to make a determination, then the NAIC shall notify the reporting insurance company and the NAIC member of the reporting insurance company's state of domicile and request guidance.

d. The NAIC shall review whether the reporting insurance company has correctly applied the correct valuation guidance under paragraph 8 and made adjustments, if applicable, under paragraph 9.

63. If the SCA investment reported on the Sub 1 form filing is deemed to meet the assessment and reviews described in paragraph 62, the NAIC shall complete the filing in the VISION database. A completed filing will be a Sub 1 filing where the reported SCA investment meets the tests described above. The completed filing will be revised to a value if and when the filer submits a Sub 2 form on the same transaction and the NAIC approves a final value based on the information provided. (Assignment of completion to an SCA investment does not mean, and shall not be interpreted to mean, that the NAIC is expressing an opinion as to the value claimed by the reporting insurance company for the reported SCA investment. The completion implies only that, based on the information provided, the NAIC has determined that the SCA investment meets the tests described in paragraph 62.)

Assessment and Review of Sub 2 Form

64. By August 31 or one month after the audit report date of each year, the NAIC shall initiate a review of all SCA investments for which new Sub 2 form filings have been received as well as an annual update review of Sub 2 SCA investments already logged in the VISION database. The NAIC review shall encompass a review of the most recent annual statutory reporting by the parent insurance company's

Schedule Y (to ascertain the identity of the members of the holding company system and to ensure that information for all SCA companies has been submitted), a review of the parent's financial statement blank to review the last reported value for the SCA investments and a review of the VISION database to determine whether SCA debt and SCA preferred securities have been assigned NAIC designations. As part of its analysis, the NAIC shall review the portion of the bond investments carried by the parent or a subsidiary insurer with a **Z** notation. If the NAIC determines that the portion of the **Z** bonds shown on the documentation is significant, the NAIC shall not process the Sub 2 filing until the insurance company reports the bonds to permit removal of the **Z** notation. Beginning with year-end 2019, two new suffixes will apply: **YE** and **IF**. YE means that the security is a properly filed annual update that the SVO has determined will not be assigned an NAIC designation by the close of the year-end reporting cycle. The symbol YE is assigned by the SVO pursuant to the carryover administrative procedure described in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. When the SVO assigns the symbol YE it also assigns the NAIC designation in effect for the previous reporting year. IF means that the security is an initial filing that has been properly filed with the SVO but which the SVO has determined will not be assigned an NAIC designation by the close of the year-end reporting cycle. The symbol IF is assigned by the SVO and communicates that the insurer should self-designate the security for year-end and identify it with the symbol IF. IF, therefore, also communicates to the regulator that the NAIC designation reported by the insurance company was not derived by or obtained from the SVO, but has been determined analytically by a reporting insurance company.

65. Upon completion of the procedures described above, the NAIC will determine whether the value reported by the insurance company on the current SCA filing was calculated in accordance with the instructions for the valuation method chosen and verify that the filed value reflects the adjustments required by paragraph 9.

66. Upon approval of a value (including making necessary adjustments), the NAIC will complete the Sub 2 filing with the approved value in the status field of the VISION database.

67. The NAIC shall report its determination to the insurance company. If a significant discrepancy exists between the value claimed by the reporting insurance company and the value approved by the NAIC, the NAIC shall communicate the discrepancy with the company. If the NAIC cannot come to a conclusion based on the support provided, the filing can be rejected in VISION, and written notification will be provided to the reporting insurance company and the company's state of domicile of this action. This correspondence will be sent to the domiciliary state. Filers are able to download their review information from the NAIC filing system.

Additional Reporting Instructions

68. A reporting entity that has direct ownership of shares of an upstream intermediate or ultimate parent owns an interest in itself and is required to reduce the value of those shares from the value of the reporting entity. This is referred to as elimination of reciprocal ownership.

69. If the shares of the parent are owned indirectly by a reporting entity, for example, because the reporting entity owns a downstream SCA entity that directly owns shares in the parent, the entity that owns the parent's shares must reduce its value by the value of the shares in the parent. This is referred to as elimination of the reciprocal ownership.

70. Any parent reporting entity that owns an interest in itself via either direct or indirect ownership of a down-stream affiliate, which in turn owns shares of the parent reporting entity, shall eliminate its proportionate interest in these shares from the valuation of such affiliate.

71. Pursuant to paragraph 22, in lieu of separate GAAP audits of SCA entities of the downstream holding company, the insurer can choose to have a GAAP audit performed at the holding company level with a consolidating balance sheet showing GAAP equity of all the SCA entities. The consolidating balance

sheet shall then be adjusted for GAAP to SAP differences of the insurance entities as described in this statement. This adjusted amount would then be the reported value of the investment in downstream holding company at the higher-level insurance company.

72. Investments in the surplus notes of an SCA shall be accounted for in accordance with the provisions of SSAP No. 41~~R~~. If the reporting entity also holds an investment in preferred stock or surplus notes, refer to paragraphs 28-32 of this statement.

EXHIBIT B – ILLUSTRATIONS

Accounting for SCAs

This illustration is intended to provide an example of the application of paragraphs 8.b.ii. and 8.b.iii. of this statement. Where an SCA meets the criteria of paragraph 8.b.ii., the illustration further demonstrates the necessary adjustments described in paragraph 9. While not all inclusive, the illustration is representative of the process and adjustments necessary to comply with this statement. That is, the reporting entity must, first, determine which sub-section of paragraph 8 applies with respect to each SCA. Secondly, where the reporting entity has determined that an SCA meets the criteria of paragraph 8.b.ii. or 8.b.iv., then the carrying amount is adjusted in accordance with the sub-section, which includes adjustments contained in the provisions of paragraph 9.

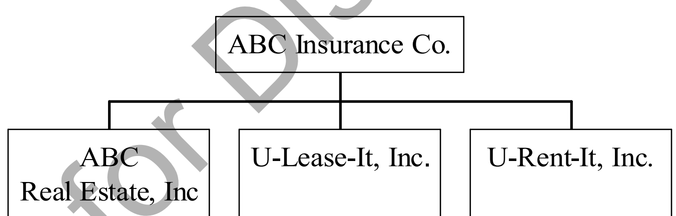
The ABC Insurance Company owns 100% of three subsidiaries:

1. ABC Real Estate, Inc. – owns and manages real estate properties and has no inter-company transactions

2. U-Lease-It, Inc. – leases furniture and equipment to local businesses including the insurance company. Lease fees received from ABC were $10 million each in 20x2 and 20x1.

3. U-Rent-It, Inc. – leases EDP equipment to local businesses including the insurance company. Lease fees received from ABC were $2 million each in 20x2 and 20x1.

ABC Insurance Company



Determination and application of adjustments to audited GAAP equity methods (paragraph 8.b. of this statement)

ABC Real Estate, Inc. – the company is not engaged in any activities described in paragraph 8.b.ii. No adjustments are made, and ABC Insurance Company records its investment based upon audited GAAP equity in accordance with 8b.iii.

U-Lease-It, Inc. – the company is engaged in activities described in paragraph 8.b.ii., leasing furniture and equipment. The fees paid by ABC and reflected in income of U-Lease-It, Inc. exceed 20% of GAAP revenue calculated as follows:

U-Lease-It, Inc.	(Millions)	
	20x1	**20x2**
GAAP revenue	46.5	46.4
Less:		
Realized capital gains/(losses)	6	(.2)
Adjusted GAAP revenue	45.9	46.6
Lease fees from ABC	10.0	10.0
Fees/adjusted GAAP revenue	21.8%	21.5%

U-Rent-It, Inc. – the company is engaged in activities described in paragraph 8.b.ii., leasing EDP equipment. The fees paid by ABC and reflected in income of U-Rent-It, Inc. do not exceed 20% of GAAP revenue. No adjustments are made, and ABC Insurance Company records its investment based upon audited GAAP equity in accordance with 8b.iii. The calculation test is as follows:

U-Rent-It, Inc.	(Millions)	
	20x2	**20x1**
GAAP revenue	32.6	30.5
Lease fees from ABC	2.0	2.0
Fees/GAAP revenue	6.1%	6.6%

Adjustments to audited GAAP equity for U-Lease-It, Inc.

	(Millions)	
	20x2	**20x1**
Audited GAAP equity	129	130
Nonadmit furniture & equipment	(250)	(260)
Nonadmit excess goodwill *	(2)	(2)
Adjusted GAAP equity	(123)	(132)

*Goodwill adjustment - 20x2=$15- (10% x $130[20x1GAAP equity] and 20x1=$15-(10% x $129.9 [20x0 GAAP equity])

Note: No DTA adjustment since the amount is less than 10% of GAAP equity

Schedule D, Affiliated Common Stocks for ABC Insurance Company

	(Millions)	
	20x2	**20x1**
ABC Real Estate Inc.	223	219
U-Lease-It, Inc.	(123)	(132)
U-Rent-It, Inc.	30	27
Total	130	114

Note: The change in carrying value between years of $16 million is reported as an unrealized gain in 20x2.

Illustrated Balance Sheets

ABC Insurance Company

	20x2	20x1		20x2	20x1
Net Admitted Assets			Liabilities		
Bonds	11,210	11,150	Policy reserves	12,516	12,394
Common stock (unaffiliated)	325	315	Contract claims	30	29
Common Stock (affiliated)	130	114			
Real estate	120	125	Expenses due and accrued	14	13
Mortgage loans	1,685	1,640	Misc. liabilities	250	245
Cash	10	7	Total liabilities	12,810	12,681
Sub-total	13,480	13,351	Common stock	100	100
Other assets	20	14	Unassigned funds	590	584
Total	13,500	13,365	Total equity	690	684
			Total	13,500	13,365

ABC Real Estate, Inc.

	20x2	20x1		20x2	20x1
Assets			Liabilities		
Cash	10	7	Notes payable	260	220
Bonds (available for sale)	110	103	Misc. liabilities	17	11
Real estate investments	330	280	Total liabilities	277	231
Other assets	50	60			
Total	500	450	Common stock	15	15
			Retained earnings	208	204
			Total equity	223	219
			Total	500	450

U-Lease-It, Inc.

	20x2	20x1		20x2	20x1
Assets			Liabilities		
Cash	5	7	Accounts payable	15	12
Bonds (available for sale)	20	18	Notes payable	183	190
Furniture & equipment	250	260	Total liabilities	198	202
Investments in subs (15.0 mil. Goodwill)	45	42	Common stock	15	15
Federal tax recoverable (DTA)	7	5	Retained earnings	114	115
Total	327	332	Total equity	129	130
			Total	327	332

Summary of Operations

	20x2	20x1
Revenues:		
Interest income	8.1	9.0
Realized capital gains/(losses)	0.6	(0.2)
Investment in sub	3.0	2.6
Lease fees	34.8	35.0
Total	46.5	46.4
Expenses:		
General Administration	6.4	6.2
Depreciation	42.4	41.0
Total	48.8	47.2
Net income before taxes	(2.3)	(0.8)
Federal income tax benefit	0.8	0.3
Net income	(1.5)	(0.5)
Unrealized capital gains/losses	0.4	0.6

U-Rent-It, Inc.

	20x2	20x1		20x2	20x1
Assets			Liabilities		
Cash	6	6	Accounts payable	3	4
Bonds (available for sale)	5	4	Notes payable	202	199
EDP equipment	220	216	Total liabilities	205	203
Other assets	4	4			
Total	235	230	Common stock	10	10
			Retained earnings	20	17
			Total equity	30	27
			Total	235	230

Summary of Operations

	20x2	20x1
Revenues:		
Interest income	0.5	0.4
Lease fees	32.1	30.1
Total	32.6	30.5
Expenses:		
General Administration	3.0	3.0
Depreciation	25.7	24.5
Total	28.7	27.5
Net income before taxes	3.9	3.0
Federal income tax	(1.3)	(1.0)
Net income	2.6	2.0
Unrealized capital gains/losses	0.4	0.6

EXHIBIT C – IMPLEMENTATION QUESTIONS AND ANSWERS

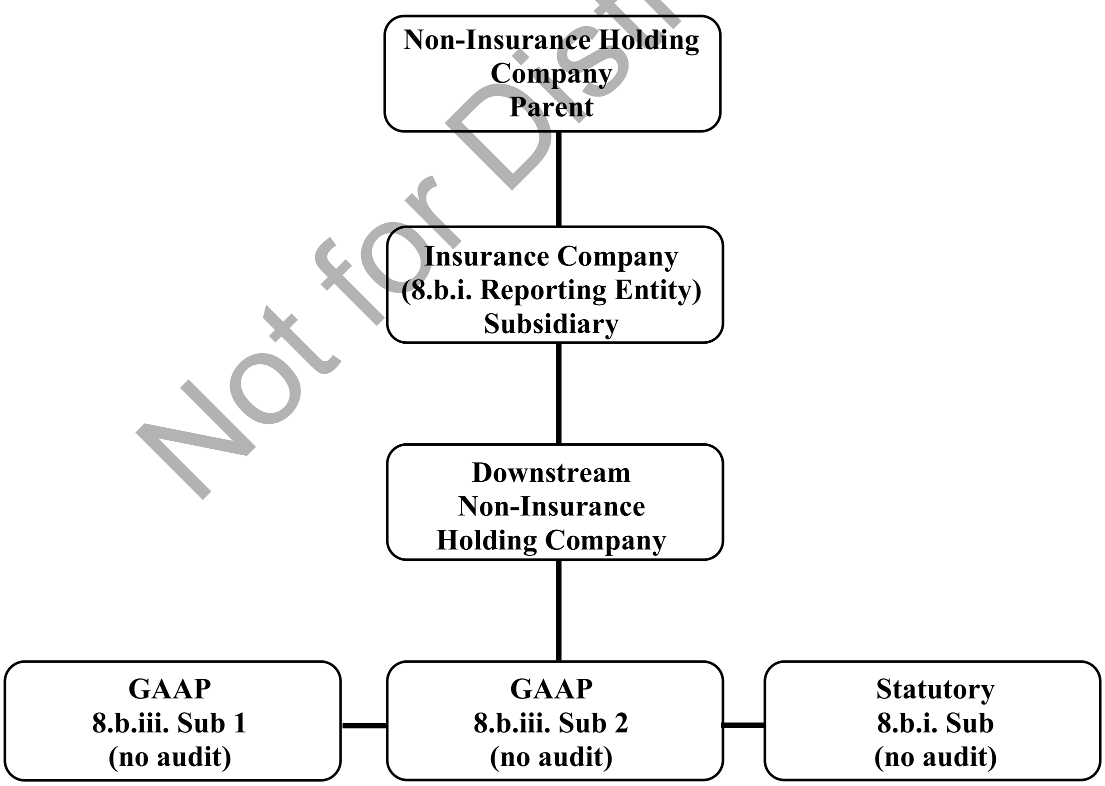
1. **Q – Is the list of activities listed in paragraph 8.b.ii.(f) of SSAP No. 97 meant to be all-inclusive? The guidance is as follows:**

> 8.b.ii.(f) Providing insurance services on behalf of the reporting entity including but not limited to accounting, actuarial, auditing, data processing, underwriting, collection of premiums, payment of claims and benefits, policyowner services

1.1 **A –** No, the Working Group did not intend for this list to be all-inclusive, but rather to be used as examples of the types of functions that can be performed by non-insurance companies. The purpose of the list is to set forth examples of activities that are often performed by an insurer directly that can result in less conservative values if performed by an entity that is not required to utilize statutory accounting as defined within the NAIC *Accounting Practices and Procedures Manual*. Therefore, the reporting entity, the auditor, and the regulator should consider whether the purpose of having the subsidiary is to avoid statutory accounting principles as discussed in *SSAP No. 25—Affiliates and Other Related Parties*, paragraph 18.d., and adjust the value of the SCA as appropriate. SSAP No. 25, paragraph ~~19~~20.d. reads as follows:

> Transactions which are designed to avoid statutory accounting practices shall be reported as if the reporting entity continued to own the assets or to be obligated for a liability directly instead of through a subsidiary.

2. **Q – As illustrated below, would an audit of the upstream holding company with consolidating balance sheets of the insurance company meet the requirements for auditing the subsidiaries under SSAP No. 97?**



2.1 **A –** No, SSAP No. 97 is specific in that it only allows audited GAAP financial statements of the downstream holding company level (See paragraph 23).

2.2 So, in the example provided above, the reporting entity cannot use an audit of the upstream holding company as the basis for complying with the audit requirements of SSAP No. 97. The primary purpose of the audit is to provide assurance that the valuation of the entity being considered is not materially misstated. Although assurance of this type would be provided for within an unqualified opinion of an upstream holding company, it would only be provided for in the context of the entity being audited. Since the materiality level for an upstream holding company is likely to be set at a higher level, the potential for material misstatement for the reporting entity's subsidiary(ies) could still exist within that unqualified opinion. It should also be noted, however, that individual state insurance holding company laws would still require an audit of the ultimate controlling entity.

3. **Q – Are consolidated, consolidating or combined audited financial statements allowed to meet the requirements for SSAP No. 97? Definitions of these types of audited financial statements are presented below:**

- Consolidated Audited Financial Statements (*ARB 51: Consolidated Financial Statements*, paragraph 1)

1. The purpose of consolidated statements is to present, primarily for the benefit of the shareholders and creditors of the parent company, the results of operations and the financial position of a parent company and its subsidiaries essentially as if the group were a single company with one or more branches or divisions. There is a presumption that consolidated statements are more meaningful than separate statements and that they are usually necessary for a fair presentation when one of the companies in the group directly or indirectly has a controlling financial interest in the other companies.

- Consolidating Audited Financial Statements (*ARB 51: Consolidated Financial Statements*, paragraph 24)

24. In some cases, parent-company statements may be needed, in addition to consolidated statements, to indicate adequately the position of bondholders and other creditors or preferred stockholders of the parent. Consolidating statements, in which one column is used for the parent company and other columns for particular subsidiaries or groups of subsidiaries, often are an effective means of presenting the pertinent information.

- Combined Audited Financial Statements (*ARB 51: Consolidated Financial Statements*, paragraphs 22 and 23)

23. To justify the preparation of consolidated statements, the controlling financial interest should rest directly or indirectly in one of the companies included in the consolidation. There are circumstances, however, where combined financial statements (as distinguished from consolidated statements) of commonly controlled companies are likely to be more meaningful than their separate statements. For example, combined financial statements would be useful where one individual owns a controlling interest in several corporations which are related in their operations. Combined statements would also be used to present the financial position and the results of operations of a group of unconsolidated subsidiaries. They might also be used to combine the financial statements of companies under common management.

24. Where combined statements are prepared for a group of related companies, such as a group of unconsolidated subsidiaries or a group of commonly controlled companies, intercompany transactions and profits or losses should be eliminated, and if there are problems in connection with such matters as minority interests, foreign operations, different fiscal periods, or income taxes, they should be treated in the same manner as in consolidated statements.

3.1 **A –** In this example, only consolidating and combined financial statements are allowed under SSAP No. 97. Combined audited financial statements are used to present the financial position and results of operations of a group of unconsolidated commonly controlled enterprises. Although U.S. Generally Accepted Auditing Standards requirements for combined statements are similar to those required for consolidated financial statements, combined statements are allowed for purposes of meeting the requirements of this statement. (Consolidated or combined financial statements are allowed encompassing one or more downstream SCA entities, including downstream SCA entities that directly or indirectly own U.S. insurance entities provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA's domiciliary state.)

4. **Q – Does a balance sheet audit meet the admissibility test within SSAP No. 97, or would a full audit be required?**

4.1 **A –** The Working Group intended for a full financial statement audit to be performed, rather than a limited reporting engagement, in accordance with AU Section 508, paragraph 33 which states:

> ***Limited reporting engagements.*** The auditor may be asked to report on one basic financial statement and not on the others. For example, he or she may be asked to report on the balance sheet and not on the statements of income, retained earnings or cash flows. These engagements do not involve scope limitations if the auditor's access to information underlying the basic financial statements is not limited and if the auditor applies all the procedures he considers necessary in the circumstances; rather, such engagements involve limited reporting objectives. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

4.2 In addition, within SSAP No. 97, paragraph 8.c.ii. (line 1), there is a reference to the "annual GAAP audit," which indicates a full audit. A limited engagement audit was not the intent when SSAP No. 97 or its predecessors, were developed.

4.3 Therefore, SSAP No. 97 requires the presentation of the balance sheet, income statement, statement of surplus and cash flows of each admitted entity to be presented, along with the corresponding notes to the financial statements (which can be accomplished as a whole).

5. **Q – Does the audit opinion provided on the subsidiaries financial statements have to be clean or unqualified in order for the SCA investment to be admitted?**

5.1 **A –** Paragraph 21 addresses various opinions that can be issued in which an entity can record certain investments under the GAAP Equity method of accounting. In certain cases, such as when the audit opinion is a disclaimer of opinion or there is indication that there is substantial doubt about the entity's ability to continue as a going concern, the guidance states the investment shall be nonadmitted. In instances where there is an unalleviated substantial doubt about the entity's ability to continue as a going concern listed in any part of the audit report or accompanying financial statements/notes, the investment shall be nonadmitted. In addition, if there is a qualified opinion due to a departure from GAAP (or an adverse opinion) or due to a scope limitation, the investment shall be nonadmitted unless the impact of the departure is quantified within the audit opinion (see quantification exception related to the valuation of a U.S. insurance entity on the basis of U.S. statutory accounting principles discussed below). In cases where the departure is quantified, the reporting entity would admit the amount after adjusting for the quantified departure from GAAP. An audit report that contains a qualified or adverse opinion for any other reason than for what is stated within paragraph 21 would result in the nonadmissibility of the investment within that subsidiary. There is no need to quantify the impact of a departure from GAAP in either the auditor's report or the footnotes to the financial statements if a qualified audit opinion is issued due to a departure from GAAP and the departure is related to the valuation of an U.S. insurance entity on the basis of U.S. statutory accounting principles. In such cases, the investment shall be admitted without quantifying the departure.

6. **Q – Do GAAP audits for non-insurance entities need to be completed before the annual statement or audited financial statements are filed? They are required to be completed annually, but should there be clarification on when the audits are due?**

6.1 **A –** Paragraph 13.d. of SSAP No. 97 allows for a lag time if the audits of the investees are not completed as of the reporting date, as long as the lag is on a consistent annual basis and the SCA is not valued under paragraph 8.b.i. The following is an excerpt from paragraph 13.d. (bolded for emphasis). The SCA entity is still required to be audited annually.

> 13.d. If financial statements of an investee are not sufficiently timely for the reporting entity to apply an equity method to the investee's current results of operations, the reporting entity shall record its share of the earnings or losses of an investee from the **most recent available financial statements. A lag in reporting shall be consistent from period to period**. This paragraph does not apply to a SCA valued under paragraph 8.b.i.

7. **Q – Is it possible for an SCA investment valued using an equity method to be reported as a negative value?**

7.1 **A –** Yes, the equity method noninsurance SCA could have a negative equity. For example, SSAP No. 97, paragraph 8.b.ii., relating to noninsurance SCA entities may require some assets to be reported as a negative value (nonadmitted) in paragraph 9. In this example, a paragraph 8.b.ii. SCA subsidiary that is only holding furniture, which is nonadmitted, would be reflected with negative equity to the extent the value of the nonadmitted asset(s) exceed(s) reported equity. It should be noted that although SSAP No. 97, paragraph 13.e., discusses some situations in which the equity method should be discontinued, this does not apply to SCA entities, which meet the requirements of paragraph 8.b.ii. In addition, SSAP No. 97, paragraph 13.e., lists some situations where the equity method for paragraph 8.b.ii. and paragraph 8.b.iv. entities would result in a valuation that is less than zero.

8. **Q – Paragraph 13.e. of SSAP No. 97 lists some situations where the equity method should be discontinued. If the equity method is discontinued, does the reporting entity cease tracking equity losses?**

8.1 **A –** No, the reporting entity does not cease tracking losses related to the investment in the SCA if an equity method is discontinued. If the equity method is discontinued, follow the guidance in paragraphs 15-17 and *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee and EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses*.

8.2 INT 00-24 lists situations that might require the reporting entity to write down other investments in the SCA subsidiary, such as loans, because of continuing losses in the SCA investment. Paragraphs 15-17 provides guidance to assist in determining whether prior losses are being funded if the reporting entity purchases additional stock, etc. after suspending the equity method. Paragraphs 15-17 in INT 00-24 note that even if the equity method is not being applied, the investment should be tracked to determine if additional losses have to be applied to other items and to determine if the investment in the SCA has a future recovery.

9. **Q – SSAP No. 97, paragraphs 28-32, provides guidance on segregating the equity from common stock from the equity in the form of preferred stock and surplus notes. This guidance is required for reporting reasons and to prevent double counting of these items in the SCA equity. This section indicates that preferred stock is deducted from the total equity. The guidance notes that reporting entities report their investments in preferred stock in accordance with *SSAP No. 32~~R~~—Preferred Stock*, which requires reporting at book value, fair value, or the lower of book value or fair value. When deducting the preferred stock from the equity of the SCA, which measure of preferred stock is to be utilized; the investor's reporting valuation or the Issuer's value in the equity section of their balance sheet?**

9.1 **A –** In order to establish the equity value of the common stock investment in an SCA, the reporting entity reduces the total equity of the SCA by the SCA's (Issuer's) value of the preferred stock on the issuer's balance sheet (not the reporting entity's Book/Adjusted Carrying Value for the SCA's preferred stock held). Continuing from the example in paragraph 32, if the reporting entity's Book/Adjusted Carrying Value for the SCA preferred stock is currently $40,000, the SCA's issuing value of the preferred stock ($50,000) would still be used to calculate the total equity of the SCA ($250,000 - $50,000 = $200,000). It should be noted this calculation does not affect the preferred stock valuation of $40,000 on the books of the investor.

10. **Q – If a parent reporting entity owns another insurance company that has obtained a permitted practice, or exemption or waiver from its state of domicile from the annual statutory audit requirement, would the parent be automatically allowed to admit the investment in the unaudited subsidiary?**

10.1 **A –** No, the parent would need to obtain a permitted practice allowing the parent reporting entity to admit the non-audited insurance company due to the admissibility requirements of SSAP No. 97.

EXHIBIT D – DETERMINING THE VALUATION METHOD UNDER SSAP NO. 97

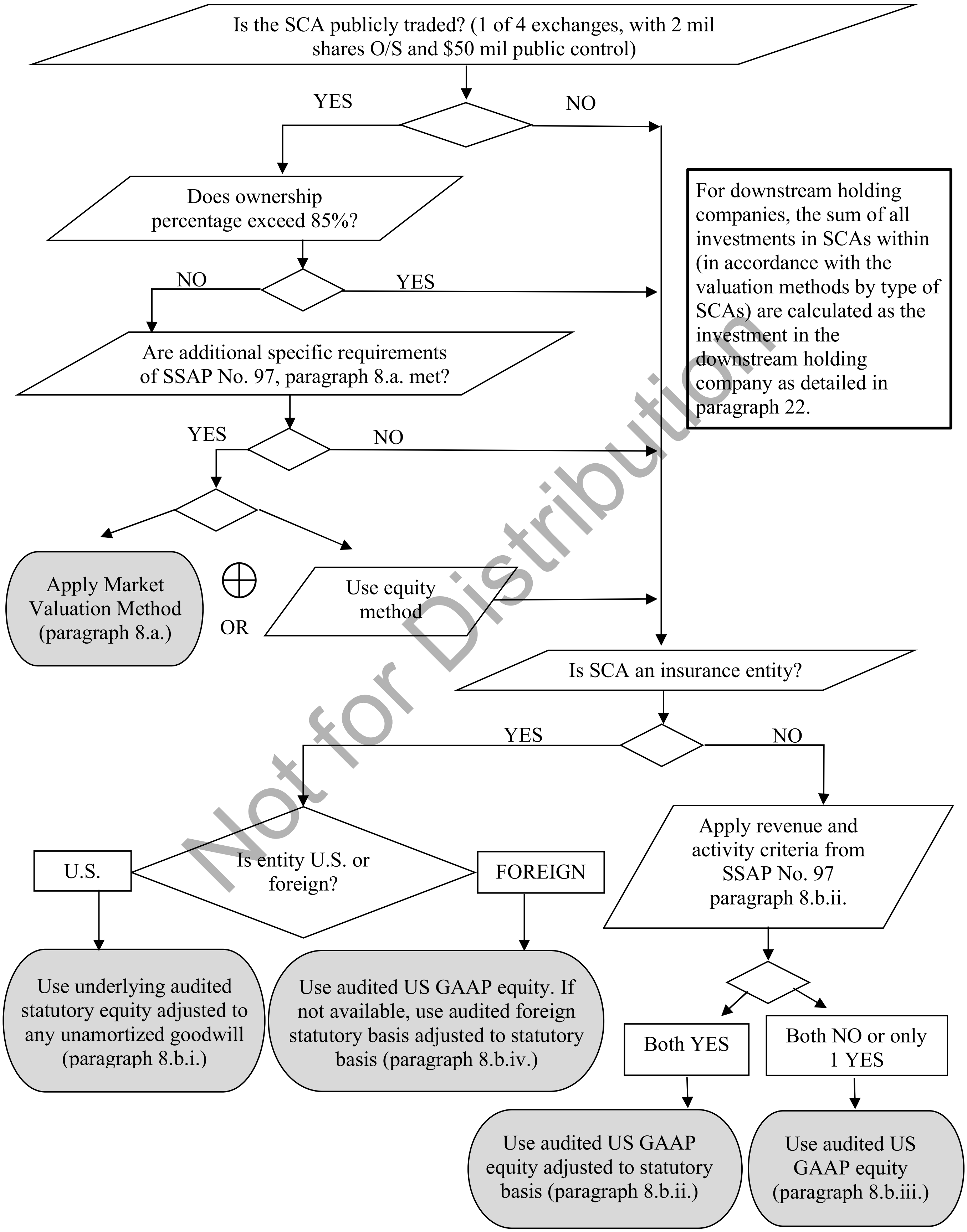


EXHIBIT E – SLIDING SCALE DISCOUNTING OF SCA ENTITIES USING THE MARKET VALUATION APPROACH

This chart illustrates the sliding scale discounting by ownership percentage that is described in paragraphs 8.a.iv., 8.a.v. and 8.a.vi. of this statement for investments in subsidiary controlled or affiliated entities which are carried using the market valuation approach.

Ownership Percentage	Discount Percentage	Ownership Percentage	Discount Percentage
10%	0.00%	48%	19.00%
11%	0.50%	49%	19.50%
12%	1.00%	50%	20.00%
13%	1.50%	51%	20.33%
14%	2.00%	52%	20.67%
15%	2.50%	53%	21.00%
16%	3.00%	54%	21.33%
17%	3.50%	55%	21.67%
18%	4.00%	56%	22.00%
19%	4.50%	57%	22.33%
20%	5.00%	58%	22.67%
21%	5.50%	59%	23.00%
22%	6.00%	60%	23.33%
23%	6.50%	61%	23.67%
24%	7.00%	62%	24.00%
25%	7.50%	63%	24.33%
26%	8.00%	64%	24.67%
27%	8.50%	65%	25.00%
28%	9.00%	66%	25.33%
29%	9.50%	67%	25.67%
30%	10.00%	68%	26.00%
31%	10.50%	69%	26.33%
32%	11.00%	70%	26.67%
33%	11.50%	71%	27.00%
34%	12.00%	72%	27.33%
35%	12.50%	73%	27.67%
36%	13.00%	74%	28.00%
37%	13.50%	75%	28.33%
38%	14.00%	76%	28.67%
39%	14.50%	77%	29.00%
40%	15.00%	78%	29.33%
41%	15.50%	79%	29.67%
42%	16.00%	80%	30.00%
43%	16.50%	81%	30.00%
44%	17.00%	82%	30.00%
45%	17.50%	83%	30.00%
46%	18.00%	84%	30.00%
47%	18.50%	85%	30.00%

EXHIBIT F – ILLUSTRATION OF THE APPLICATION OF INT 00-24

XYZ Investment in ABC Company

1. ABC Company is a life insurance company, formed January 2, 20X1, to sell health insurance in the state of New York. On January 2, 20X1, XYZ Insurance Company invested $500,000 in ABC, and purchased 100,000 shares of common stock at par, and 40,000 shares of preferred stock at par. ABC Preferred stock is non-voting, 5% cumulative.

2. XYZ determined it has obtained a controlling interest in ABC as XYZ owns 50% of the voting interests of ABC. XYZ accounted for its investment in ABC Insurance Company under the statutory equity method of accounting. The following table is selected information from the financial statements of ABC Insurance Company.

			20X1 – 20X4		
	1/2/20X1	12/31/20X1	12/31/20X2	12/31/20X3	12/31/20X4
Capital and Surplus:					
Common stock, $1 par, 200,000 shares issued and outstanding	$200,000	$200,000	$200,000	$200,000	$200,000
Preferred stock, $10 par, 100,000 shares issued and outstanding	$1,000,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Surplus Notes			$500,000	$500,000	$500,000
Unassigned Funds (Surplus)		$130,000	($180,000)	($630,000)	($1,430,000)
Total Capital and Surplus	$1,200,000	$1,330,000	$1,520,000	$1,070,000	$270,000

			20X5 – 20X9		
	12/31/20X5	12/31/20X6	12/31/20X7	12/31/20X8	12/31/20X9
Capital and Surplus:					
Common stock, $1 par, 200,000 shares issued and outstanding	$200,000	$200,000	$200,000	$200,000	$200,000
Preferred stock, $10 par, 100,000 shares issued and outstanding	$1,000,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Surplus Notes	$500,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Unassigned Funds (Surplus)	($1,980,000)	($1,830,000)	($1,280,000)	($430,000)	$820,000
Total Capital and Surplus	($280,000)	$370,000	$920,000	$1,770,000	$3,020,000

3. At 1/2/20X1, XYZ recorded the following entry to record its investment in ABC:

Investment in ABC Common stock	$100,000	
Investment in ABC Preferred stock	$400,000	
Cash		$500,000

To record initial investment in ABC Insurance Company

4. During the year ended 12/31/20X1, ABC had statutory net income before dividends of $200,000. At 12/31/20X1, ABC declared and paid a 5% preferred dividend, and a common stock dividend of $.10 per share. XYZ recorded the following entries:

Cash	$20,000	
Dividend Income		$20,000

To record preferred dividend income from ABC Insurance Company for 20X1.

Investment in ABC Common stock	$75,000	
Unrealized Gain/Loss		$75,000

To record 20X1 unrealized gain on investment in ABC Common. (($200,000 - $50,000) * 50%)

Cash	$10,000	
Unrealized Gain/Loss	$10,000	
Dividend Income		$10,000
Investment in ABC Common stock		$10,000

To record 20X1 dividend on ABC Common. (100,000 shares * $.10)

5. During the year ended 12/31/20X2, ABC issued an 8% surplus note of $500,000. XYZ purchased 100% of the surplus note. During that same year, ABC incurred a statutory net loss before dividends of $250,000. At 12/31/20X2, ABC declared and paid a 5% preferred dividend, and a common stock dividend of $.05 per share. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Investment in ABC Surplus Notes	$500,000	
Cash		$500,000

To record investment in ABC Insurance Company surplus notes.

Cash	$20,000	
Dividend Income		$20,000

To record preferred dividend income from ABC Insurance Company for 20X2.

Unrealized Gain/Loss	$150,000	
Investment in ABC Common stock		$150,000

To record 20X2 unrealized loss on investment in ABC Common. (($-250,000 - $50,000) * 50%)

Cash	$5,000	
Unrealized Gain/Loss	$5,000	
Dividend Income		$5,000
Investment in ABC Common stock		$5,000

To record 20X2 dividend on ABC Common. (100,000 shares * $.05)

6. During the year ended 12/31/20X3, ABC Insurance Company incurred a statutory net loss before dividends of $400,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Dividends Receivable	$20,000	
Dividend Income		$20,000

To record preferred dividend income from ABC Insurance Company for 20X3.

Unrealized Gain/Loss	$182,000	
Investment in ABC Preferred stock		$172,000
Investment in ABC Common stock		$10,000

To record 20X3 unrealized loss on investment in ABC Common and Preferred.

Total net loss and preferred stock dividend ($450,000).

Common stock component reduces the Investment in ABC Common stock component to $0. (20,000 * 50%)

Total net loss and preferred dividend (-$400,000 - $50,000)	$450,000
Less amount used to reduce common stock investment to $0	20,000
Amount remaining to be allocated to investment in preferred	430,000
XYZ ownership % of preferred	40%
XYZ reduction in investment in preferred	$172,000

7. During the year ended 12/31/20X4, ABC Insurance Company incurred a statutory net loss before dividends of $750,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Dividends Receivable	$20,000	
Dividend Income		$20,000

To record preferred dividend income from ABC Insurance Company for 20X4.

Unrealized Gain/Loss	$458,000	
Investment in ABC Preferred stock		$228,000
Investment in ABC Surplus note		$230,000

To record 20X4 unrealized loss on investment in ABC Preferred and Surplus Notes.

Total net loss and preferred stock dividend ($800,000).

Common stock component reduces the Investment in ABC Preferred stock component to $0. (570,000 * 40%)

Preferred stock component calculated as:

Total net loss and preferred dividend (-$750,000 - $50,000)	$800,000
Less amount used to reduce preferred stock investment to $0	570,000
Amount remaining to be allocated to investment in surplus note	230,000
XYZ ownership % of surplus note	100%
XYZ reduction in investment in ABC Surplus Notes	$230,000

8. During the year ended 12/31/20X5, ABC Insurance Company incurred a statutory net loss before dividends of $500,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Dividends Receivable	$20,000	
Dividend Income		$20,000

To record preferred dividend income from ABC Insurance Company for 20X5.

Unrealized Gain/Loss	$270,000	
Investment in ABC Surplus note		$270,000

To record 20X5 unrealized loss on investment in ABC Surplus Notes.

Total ABC net loss and preferred stock dividend (-$500,000 - $50,000).

Surplus Note component calculated as:

Total net loss and preferred dividend (-$500,000 - $50,000)	$550,000
XYZ ownership % of ABC Surplus Note	100%
	$550,000
Amount of unrealized loss recognized in 20X5	$270,000
Amount of unrealized loss suspended	$280,000

9. Since XYZ had not guaranteed any liabilities of ABC, the reduction they would recognize is limited to their remaining investment in ABC Surplus Notes. Therefore, they would only recognize a 20X5 unrealized loss on their investment in ABC of $270,000.

10. During the year ended 12/31/20X6, ABC Insurance Company realigned their marketing efforts and modified the products they were selling. ABC also issued an additional 8% surplus note of $500,000. This surplus note was purchased by an unaffiliated third party. During the year ended 12/31/X6, ABC Insurance

Company had statutory net income before dividends of $200,000. ABC Insurance Company did not declare any dividends on common stock but declared and paid current and dividends in arrears on preferred. XYZ recorded the following entries:

Cash	$80,000	
Dividends Receivable		$60,000
Dividend Income		$20,000

To record preferred dividend income from ABC Insurance Company for 20X6, and receipt of preferred dividends receivable for 20X3, 20X4 and 20X5.

11. XYZ did not record any change in their investment in ABC Surplus Notes, ABC Preferred or ABC Common, since ABCs' net income after preferred dividends did not exceed the losses accumulated during the period that XYZ suspended recording unrealized losses.

12. The following amounts were tracked:

Total ABC net income and preferred stock dividend ($200,000 - $50,000).	
Surplus Note component calculated as:	
Total net income and preferred dividend ($200,000 - $50,000)	$150,000
XYZ ownership % of ABC Surplus Note	50%
	$75,000
Amount of unrealized loss suspended in 20X5	$280,000
Remaining amount of unrealized loss suspended	$205,000

13. During the year ended 12/31/20X7, ABC Insurance Company had statutory net income before dividends of $600,000. At 12/31/20X7, ABC declared and paid a 5% preferred dividend. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Cash	$20,000	
Dividend Income		$20,000

To record preferred dividend income from ABC Insurance Company for 20X7.

Investment in ABC Surplus Notes	$70,000	
Unrealized Gain/Loss		$70,000

To record 20X7 unrealized gain on investment in ABC Surplus Notes.

Total ABC net income and preferred stock dividend ($600,000 - $50,000).

Surplus Note component calculated as:

Total net income and preferred dividend ($600,000 - $50,000)	$550,000
XYZ ownership % of ABC Surplus Note	50%
	$275,000
Remaining amount of unrealized loss suspended in 20X5	$205,000
20X7 amount of unrealized gain on investment in ABC Surplus Note	$ 70,000

14. During the year ended 12/31/20X8, ABC Insurance Company had statutory net income before dividends of $900,000. At 12/31/20X8, ABC declared and paid a 5% preferred dividend. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Cash	$20,000	
Dividend Income		$20,000

To record preferred dividend income from ABC Insurance Company for 20X8.

Total ABC net income and preferred stock dividend ($900,000 - $50,000).

Surplus Note component calculated as:

Total net income and preferred dividend ($900,000 - $50,000)		$850,000
XYZ ownership % of ABC Surplus Note		50%
20X8 amount of unrealized gain on investment in ABC Surplus Note		$425,000
Investment in ABC Surplus Notes	$425,000	
Unrealized Gain/Loss		$ 425,000

To record 20X8 unrealized gain on investment in ABC Surplus Notes.

15. During the year ended 12/31/20X9, ABC Insurance Company had statutory net income, before interest on surplus notes and dividends, of $1,400,000. The commissioner approved one year's interest payment on the surplus notes. At 12/31/20X9, ABC declared and paid a 5% preferred dividend, and a $.10 dividend per share on Common stock. XYZ recorded the following entries:

Cash	$ 20,000	
Dividend Income		$ 20,000

To record preferred dividend income from ABC Insurance Company for 20X9.

Cash	$ 40,000	
Interest Income		$ 40,000

To record surplus notes interest income from ABC Insurance Company for 20X9. ($500,000 * 8%)

Investment in ABC Surplus Notes	$ 5,000	
Investment in ABC Preferred Stock	$ 400,000	
Investment in ABC Common Stock	$ 130,000	
Unrealized Gain/Loss		$ 535,000

To record 20X9 unrealized gain on investment in ABC Common, Preferred and Surplus Notes. Components computed as follows:

Total Net Income net of preferred stock dividend and interest on surplus notes ($1,400,000 - $50,000 - $80,000)	$ 1,270,000
Less amount needed to restore investment in surplus notes	($ 10,000)
Amount available for preferred stock and common stock investment restoration	$ 1,260,000
Amount needed to restore preferred stock component	($ 1,000,000)
Amount available to restore common stock component	$ 260,000
Surplus Notes Component ($10,000 * 50%)	$ 5,000
Preferred Stock Component ($1,000,000 * 40%)	$ 400,000
Common Stock Component ($260,000 * 50%)	$ 130,000

Cash	$ 10,000	
Unrealized Gain/Loss	$ 10,000	
Dividend Income		$ 10,000
Investment in ABC Common Stock		$ 10,000

To record 20X9 dividend on ABC Common. (100,000 shares * $.10)

Statement of Statutory Accounting Principles No. 100

Fair Value

STATUS

Type of Issue	Common Area
Issued	December 5, 2009; Substantively revised November 6, 2017
Effective Date	December 31, 2010; Substantive revisions detailed in Issue Paper No. 157 effective January 1, 2018
Affects	Nullifies INT 09-04
Affected by	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

SCOPE OF STATEMENT

1. This statement defines fair value, establishes a framework for measuring fair value and establishes disclosure requirements about fair value.

SUMMARY CONCLUSION

2. This standard applies under other accounting pronouncements that require or permit fair value measurements, but this standard does not require any new fair value amendments. However, the application of this standard may change current practice. This standard does not eliminate the practicability exceptions to fair value measurements in accounting pronouncements within the scope of this standard.

3. This standard applies under other statutory accounting pronouncements that require or permit fair value measurements, except as follows:

a. This standard does not eliminate the practicality exceptions to fair value measurements in accounting pronouncements within the scope of this standard.

b. This standard does not apply under *SSAP No. 22~~R~~—Leases* and other accounting pronouncements that address fair value measurements for purposes of lease classification to measurement under SSAP No. 22~~R~~. This scope exception does not apply to assets acquired or liabilities assumed in a business combination that are required to be measured at fair value under *SSAP No. 68—Business Combinations and Goodwill*, regardless of whether those assets and liabilities are related to leases. This standard does not apply to share-based payment transactions captured within *SSAP No. 104~~R~~—Share-Based Payments*.

Definition of Fair Value

4. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Components of the Fair Value Definition

5. Asset/Liability – A fair value measurement is for a particular asset or liability. Therefore, the measurement should consider attributes specific to the asset or liability, for example, the condition and/or location of the asset or liability and restrictions, if any, on the sale or use of the asset at the measurement date. The asset or liability might be a standalone asset or liability (for example, a financial instrument or an operating asset) or a group of assets and/or liabilities (for example, an asset group, a reporting unit, or a business).

6. Price – A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale). The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. Therefore, the objective of a fair value measurement is to determine the price that would be received to sell the asset or paid to transfer the liability at the measurement date (an exit price).

7. Principal (or Most Advantageous) Market – A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The principal market is the market in which the reporting entity would sell the asset or transfer the liability with the greatest volume and level of activity for the asset or liability. The most advantageous market is the market in which the reporting entity would sell the asset or transfer the liability with the price that maximizes the amount that would be received for the asset or minimizes the amount that would be paid to transfer the liability, considering transaction costs in the respective market(s). In either case, the principal (or most advantageous) market (and thus, market participants) should be considered from the perspective of the reporting entity, thereby allowing for differences between and among entities with different activities. If there is a principal market for the asset or liability, the fair value measurement shall represent the price in that market (whether that price is directly observable or otherwise determined using a valuation technique), even if the price in a different market is potentially more advantageous at the measurement date.

8. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. Transaction costs represent the incremental direct costs to sell the asset or transfer the liability in the principal (or most advantageous) market for the asset or liability. Transaction costs are not an attribute of the asset or liability; rather, they are specific to the transaction and will differ depending on how the reporting entity transacts. However, transaction costs do not include the costs that would be incurred to transport the asset or liability to (or from) its principal (or most advantageous) market. If location is an attribute of the asset or liability (as might be the case for a commodity), the price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall be adjusted for the costs, if any, that would be incurred to transport the asset or liability to (or from) its principal (or most advantageous) market.

9. Market Participants – Market participants are buyers and sellers in the principal (or most advantageous) market for the asset or liability that are:

a. Independent of the reporting entity; that is, they are not related parties;

b. Knowledgeable, having a reasonable understanding about the asset or liability and the transaction based on all available information, including information that might be obtained through due diligence efforts that are usual and customary;

c. Able to transact for the asset or liability; and

d. Willing to transact for the asset or liability; that is, they are motivated but not forced or otherwise compelled to do so.

10. The fair value of the asset or liability shall be determined based on the assumptions that market participants would use in pricing the asset or liability. In developing those assumptions, the reporting entity need not identify specific market participants. Rather, the reporting entity should identify characteristics that distinguish market participants generally, considering factors specific to (a) the asset or liability, (b) the principal (or most advantageous) market for the asset or liability, and (c) market participants with whom the reporting entity would transact in that market.

11. Application to Assets – A fair value measurement assumes the highest and best use of the asset by market participants, considering the use of the asset that is physically possible, legally permissible, and financially feasible at the measurement date. In broad terms, highest and best use refers to the use of an asset by market participants that would maximize the value of the asset or the group of assets within which the asset would be used. Highest and best use is determined based on the use of the asset by market participants, even if the intended use of the asset by the reporting entity is different.

12. The highest and best use of the asset establishes the valuation premise used to measure the fair value of the asset. Specifically:

a. In-use – The highest and best use of the asset is in-use if the asset would provide maximum value to market participants principally through its use in combination with other assets as a group (as installed or otherwise configured for use). For example, that might be the case for certain nonfinancial assets. If the highest and best use of the asset is in-use, the fair value of the asset shall be measured using an in-use valuation premise. When using an in-use valuation premise, the fair value of the asset is determined based on the price that would be received in a current transaction to sell the asset assuming that the asset would be used with other assets as a group and that those assets would be available to market participants. Generally, assumptions about the highest and best use of the asset should be consistent for all of the assets of the group within which it would be used.

b. In-exchange – The highest and best use of the asset is in-exchange if the asset would provide maximum value to market participants principally on a standalone basis. For example, that might be the case for a financial asset. If the highest and best use of the asset is in-exchange, the fair value of the asset shall be measured using an in-exchange valuation premise. When using an in-exchange valuation premise, the fair value of the asset is determined based on the price that would be received in a current transaction to sell the asset standalone.

13. Because the highest and best use of the asset is determined based on its use by market participants, the fair value measurement considers the assumptions that market participants would use in pricing the asset, whether using an in-use or an in-exchange valuation premise.

14. Application to Liabilities – Consideration of non-performance risk (own credit-risk) should not be reflected in the fair value calculation for liabilities (including derivative liabilities) at subsequent measurement. At initial recognition, it is perceived that the consideration of own-credit risk may be inherent in the contractual negotiations resulting in the liability. The consideration of non-performance risk for subsequent measurement is inconsistent with the conservatism and recognition concepts as well as the assessment of financial solvency for insurers, as a decrease in credit standing would effectively decrease reported liabilities and thus seemingly increase the appearance of solvency. Furthermore, liabilities reported or disclosed at "fair value" shall not reflect any third-party credit guarantee of debt.

Equity Securities Subject to Contractual Sale Restrictions

15. An equity security that an entity cannot sell on the measurement date because of a contractual sale restriction shall be measured at fair value on the basis of the price in the principal (or most advantageous) market[1]. A contractual sale restriction does not change the market in which that equity security would be sold. A discount applied to the price of an equity security because of a contractual sale restriction is not a characteristic of the equity security. A contractual sale restriction is a characteristic of the reporting entity holding the equity security rather than a characteristic of the asset and, therefore, is not considered in measuring the fair value of an equity security. A contractual sale restriction prohibiting the sale of an equity security is a characteristic of the reporting entity holding the equity security and shall not be separately recognized as its own unit of account.

16. The effect on a fair value measurement arising from a restriction on the sale or use of an asset by a reporting entity will differ depending on whether the restriction would be taken into account by market participants when pricing the asset. When the restriction is a characteristic of the asset, the restriction should be considered in measuring the fair value of the asset. For example, an equity security issued through a private placement is not registered and is legally restricted from being sold on a national securities exchange or an over-the-counter market until the shares are registered or the conditions necessary for an exemption from registration have been satisfied. A market participant would sell the private placement equity securities in a different market than the market used for registered equity securities on the measurement date. Because that restriction would be a characteristic of the equity security, a market participant would consider the inability to resell the security on a national securities exchange or an over-the-counter market when pricing the equity security; therefore, the reporting entity that holds the Class A shares acquired through a private placement transaction would consider that restriction a characteristic of the asset, and the reporting entity should measure the fair value of the equity security on the basis of the market price of the similar unrestricted equity security adjusted to reflect the effect of the restriction[1].

[1] Refer to *SSAP No. 4—Assets and Nonadmitted Assets* for admissibility guidance for restricted equity securities.

Fair Value at Initial Recognition

17. When an asset is acquired or a liability is assumed in an exchange transaction for that asset or liability, the transaction price represents the price paid to acquire the asset or received to assume the liability (an entry price). In contrast, the fair value of the asset or liability represents the price that would be received to sell the asset or paid to transfer the liability (an exit price). Conceptually, entry prices and exit prices are different. Entities do not necessarily sell assets at the prices paid to acquire them. Similarly, entities do not necessarily transfer liabilities at the prices received to assume them.

18. In many cases, the transaction price will equal the exit price and, therefore, represent the fair value of the asset or liability at initial recognition. In determining whether a transaction price represents the fair value of the asset or liability at initial recognition, the reporting entity shall consider factors specific to the transaction and the asset or liability. For example, a transaction price might not represent the fair value of an asset or liability at initial recognition if:

a. The transaction is between related parties.

b. The transaction occurs under duress or the seller is forced to accept the price in the transaction. For example, that might be the case if the seller is experiencing financial difficulty.

c. The market in which the transaction occurs is different from the market in which the reporting entity would sell the asset or transfer the liability, that is, the principal or most advantageous market. For example, those markets might be different if the reporting entity is a securities dealer that transacts in different markets, depending on whether the counterparty is a retail customer (retail market) or another securities dealer (inter-dealer market).

d. For liabilities, differences may exist as non-performance risk (own credit risk) is not reflected in the fair value (i.e., exit price) determination of all liabilities (including derivatives).

Valuation Techniques

19. Valuation techniques consistent with the market approach, income approach, and/or cost approach shall be used to measure fair value. Key aspects of those approaches are summarized below:

a. Market approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities (including a business). For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparables. Multiples might lie in ranges with a different multiple for each comparable. The selection of where within the range the appropriate multiple falls requires judgment, considering factors specific to the measurement (qualitative and quantitative). Valuation techniques consistent with the market approach include matrix pricing. Matrix pricing is a mathematical technique used principally to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities.

b. Income approach. The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present amount (discounted). The measurement is based on the value indicated by current market expectations about those future amounts. Those valuation techniques include present value techniques; option-pricing models, such as the Black-Scholes-Merton formula (a closed-form model) and a binomial model (a lattice model), which incorporate present value techniques; and the multiperiod excess earnings method, which is used to measure the fair value of certain intangible assets.

c. Cost approach. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (often referred to as current replacement cost). From the perspective of a market participant (seller), the price that would be received for the asset is determined based on the cost to a market participant (buyer) to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence. Obsolescence encompasses physical deterioration, functional (technological) obsolescence, and economic (external) obsolescence and is broader than depreciation for financial reporting purposes (an allocation of historical cost) or tax purposes (based on specified service lives).

20. Valuation techniques that are appropriate in the circumstances and for which sufficient data are available shall be used to measure fair value. In some cases, a single valuation technique will be appropriate (for example, when valuing an asset or liability using quoted prices in an active market for identical assets or liabilities). In other cases, multiple valuation techniques will be appropriate (for example, as might be the case when valuing a reporting unit). If multiple valuation techniques are used to measure fair value, the results (respective indications of fair value) shall be evaluated and weighted, as appropriate, considering the reasonableness of the range indicated by those results. A fair value measurement is the point within that range that is most representative of fair value in the circumstances.

21. Valuation techniques used to measure fair value shall be consistently applied. However, a change in a valuation technique or its application (for example, a change in its weighting when multiple valuation techniques are used) is appropriate if the change results in a measurement that is equally or more representative of fair value in the circumstances. That might be the case if, for example, new markets develop, new information becomes available, information previously used is no longer available, or valuation techniques improve. Revisions resulting from a change in the valuation technique or its application shall be accounted for as a change in accounting estimate pursuant to *SSAP No. 3—Accounting Changes and Corrections of Errors*. The disclosure provisions of SSAP No. 3 for a change in accounting estimate are not required for revisions resulting from a change in a valuation technique or its application.

Inputs to Valuation Techniques

22. In this standard, inputs refer broadly to the assumptions that market participants would use in pricing the asset or liability, including assumptions about risk, for example, the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model) and/or the risk inherent in the inputs to the valuation technique. Inputs may be observable or unobservable:

a. Observable inputs are inputs that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the reporting entity.

b. Unobservable inputs are inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

Valuation techniques used to measure fair value shall maximize the use of observable inputs and minimize the use of unobservable inputs.

Fair Value Hierarchy

23. To increase consistency and comparability in fair value measurements and related disclosures, the fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). 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.

24. The availability of inputs relevant to the asset or liability and the relative reliability of the inputs might affect the selection of appropriate valuation techniques. However, the fair value hierarchy prioritizes the inputs to valuation techniques, not the valuation techniques. For example, a fair value measurement using a present value technique might fall within Level 2 or Level 3, depending on the inputs that are significant to the measurement in its entirety and the level in the fair value hierarchy within which those inputs fall.

Level 1 Inputs

25. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available, except as discussed in paragraphs 26 and 27.

26. If the reporting entity holds a large number of similar assets or liabilities (for example, debt securities) that are required to be measured at fair value, a quoted price in an active market might be available but not readily accessible for each of those assets or liabilities individually. In that case, fair value may be measured using an alternative pricing method that does not rely exclusively on quoted prices (for example, matrix pricing) as a practical expedient. However, the use of an alternative pricing method renders the fair value measurement a lower level measurement.

27. In some situations, a quoted price in an active market might not represent fair value at the measurement date. That might be the case if, for example, significant events (principal-to-principal transactions, brokered trades, or announcements) occur after the close of a market but before the measurement date. The reporting entity should establish and consistently apply a policy for identifying those events that might affect fair value measurements. However, if the quoted price is adjusted for new information, the adjustment renders the fair value measurement a lower level measurement.

28. If the reporting entity holds a position in a single financial instrument (including a block) and the instrument is traded in an active market, the fair value of the position shall be measured within Level 1 as the product of the quoted price for the individual instrument times the quantity held. The quoted price shall not be adjusted because of the size of the position relative to trading volume (blockage factor). The use of a blockage factor is prohibited, even if a market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

Level 2 Inputs

29. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term,

a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

a. Quoted prices for similar assets or liabilities in active markets

b. Quoted prices for identical or similar assets or liabilities in markets that are not active, that is, markets in which there are few transactions for the asset or liability, the prices are not current, or price quotations vary substantially either over time or among market makers (for example, some brokered markets), or in which little information is released publicly (for example, a principal-to-principal market)

c. Inputs other than quoted prices that are observable for the asset or liability (for example, interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates)

d. Inputs that are derived principally from or corroborated by observable market data by correlation or other means (market-corroborated inputs).

30. Adjustments to Level 2 inputs will vary depending on factors specific to the asset or liability. Those factors include the condition and/or location of the asset or liability, the extent to which the inputs relate to items that are comparable to the asset or liability, and the volume and level of activity in the markets within which the inputs are observed. An adjustment that is significant to the fair value measurement in its entirety might render the measurement a Level 3 measurement, depending on the level in the fair value hierarchy within which the inputs used to determine the adjustment fall.

31. The reporting entity should evaluate the following factors to determine whether there has been a significant decrease in the volume and level of activity for the asset or liability when compared with normal market activity for the asset or liability (or similar assets or liabilities). The factors include, but are not limited to:

a. There are few recent transactions.

b. Price quotations are not based on current information.

c. Price quotations vary substantially either over time or among market makers (for example, some brokered markets).

d. Indexes that previously were highly correlated with the fair values of the asset or liability are demonstrably uncorrelated with recent indications of fair value for that asset or liability.

e. There is a significant increase in implied liquidity risk premiums, yields, or performance indicators (such as delinquency rates or loss severities) for observed transactions or quoted prices when compared with the reporting entity's estimate of expected cash flows, considering all available market data about credit and other nonperformance risk for the asset or liability.

f. There is a wide bid-ask spread or significant increase in the bid-ask spread.

g. There is a significant decline or absence of a market for new issuances (that is, a primary market) for the asset or liability or similar assets or liabilities.

h. Little information is released publicly (for example, a principal-to-principal market).

The reporting entity shall evaluate the significance and relevance of the factors to determine whether, based on the weight of the evidence, there has been a significant decrease in the volume and level of activity for the asset or liability.

32. If the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities), transactions or quoted prices may not be determinative of fair value (for example, there may be increased instances of transactions that are not orderly). Further analysis of the transactions or quoted prices is needed, and a significant adjustment to the transactions or quoted prices may be necessary to estimate fair value in accordance with this standard. Significant adjustments also may be necessary in other circumstances (for example, when a price for a similar asset requires significant adjustment to make it more comparable to the asset being measured or when the price is stale).

33. This standard does not prescribe a methodology for making significant adjustments to transactions or quoted prices when estimating fair value. Paragraphs 19-21 discuss the use of valuation techniques in estimating fair value. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate (for example, the use of a market approach and a present value technique). When weighting indications of fair value resulting from the use of multiple valuation techniques, the reporting entity shall consider the reasonableness of the range of fair value estimates. The objective is to determine the point within that range that is most representative of fair value under current market conditions. A wide range of fair value estimates may be an indication that further analysis is needed.

34. Even in circumstances where there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. Determining the price at which willing market participants would transact at the measurement date under current market conditions if there has been a significant decrease in the volume and level of activity for the asset or liability depends on the facts and circumstances and requires the use of significant judgment. However, the reporting entity's intention to hold the asset or liability is not relevant in estimating fair value. Fair value is a market-based measurement, not an entity-specific measurement.

35. Even if there has been a significant decrease in the volume and level of activity for the asset or liability, it is not appropriate to conclude that all transactions are not orderly (that is, distressed or forced). Circumstances that may indicate that a transaction is not orderly include, but are not limited to:

a. There was not adequate exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities under current market conditions.

b. There was a usual and customary marketing period, but the seller marketed the asset or liability to a single market participant.

c. The seller is in or near bankruptcy or receivership (that is, distressed), or the seller was required to sell to meet regulatory or legal requirements (that is, forced).

d. The transaction price is an outlier when compared with other recent transactions for the same or similar asset or liability.

The reporting entity shall evaluate the circumstances to determine whether the transaction is orderly based on the weight of the evidence.

36. The determination of whether a transaction is orderly (or not orderly) is more difficult if there has been a significant decrease in the volume and level of activity for the asset or liability. Accordingly, the reporting entity shall consider the following guidance:

a. If the weight of the evidence indicates the transaction is not orderly, the reporting entity shall place little, if any, weight (compared with other indications of fair value) on that transaction price when estimating fair value or market risk premiums.

b. If the weight of the evidence indicates the transaction is orderly, the reporting entity shall consider that transaction price when estimating fair value or market risk premiums. The amount of weight placed on that transaction price when compared with other indications of fair value will depend on the facts and circumstances such as the volume of the transaction, the comparability of the transaction to the asset or liability being measured at fair value, and the proximity of the transaction to the measurement date.

c. If the reporting entity does not have sufficient information to conclude that the transaction is orderly or that the transaction is not orderly, it shall consider that transaction price when estimating fair value or market risk premiums. However, that transaction price may not be determinative of fair value (that is, that transaction price may not be the sole or primary basis for estimating fair value or market risk premiums). The reporting entity shall place less weight on transactions on which the reporting entity does not have sufficient information to conclude whether the transaction is orderly when compared with other transactions that are known to be orderly.

In its determinations, the reporting entity need not undertake all possible efforts, but shall not ignore information that is available without undue cost and effort. The reporting entity would be expected to have sufficient information to conclude whether a transaction is orderly when it is party to the transaction.

37. Regardless of the valuation technique(s) used, the reporting entity shall include appropriate risk adjustments. Risk-averse market participants generally seek compensation for bearing the uncertainty inherent in the cash flows of an asset or liability (risk premium). A fair value measurement should include a risk premium reflecting the amount market participants would demand because of the risk (uncertainty) in the cash flows. Otherwise, the measurement would not faithfully represent fair value. In some cases, determining the appropriate risk premium might be difficult. However, the degree of difficulty alone is not a sufficient basis on which to exclude a risk adjustment. Risk premiums should be reflective of an orderly transaction (that is, not a forced or distressed sale) between market participants at the measurement date under current market conditions.

38. When estimating fair value, this standard does not preclude the use of quoted prices provided by third parties, such as pricing services or brokers, when the reporting entity has determined that the quoted prices provided by those parties are determined in accordance with this standard. However, when there has been a significant decrease in the Volume or level of activity for the asset or liability, the reporting entity should evaluate whether those quoted prices are based on current information that reflects orderly transactions or a valuation technique that reflects market participant assumptions (including assumptions about risks). In weighting a quoted price as an input to a fair value measurement, the reporting entity should place less weight (when compared with other indications of fair value that are based on transactions) on quotes that do not reflect the result of transactions. Furthermore, the nature of the quote (for example, whether the quote is an indicative price or a binding offer) should be considered when weighting the available evidence, with more weight given to quotes based on binding offers.

Level 3 Inputs

39. Level 3 inputs are unobservable inputs for the asset or liability. Unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for

situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, that is, an exit price from the perspective of a market participant that holds the asset or owes the liability. Therefore, unobservable inputs shall reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). Unobservable inputs shall be developed based on the best information available in the circumstances, which might include the reporting entity's own data. In developing unobservable inputs, the reporting entity need not undertake all possible efforts to obtain information about market participant assumptions. However, the reporting entity shall not ignore information about market participant assumptions that is reasonably available without undue cost and effort. Therefore, the reporting entity's own data used to develop unobservable inputs shall be adjusted if information is reasonably available without undue cost and effort that indicates that market participants would use different assumptions.

Inputs Based on Bid and Ask Prices

40. If an input used to measure fair value is based on bid and ask prices (for example, in a dealer market), the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value, regardless of where in the fair value hierarchy the input falls (Level 1, 2, or 3). This standard does not preclude the use of mid-market pricing or other pricing conventions as a practical expedient for fair value measurements within a bid-ask spread.

Utilizing Net Asset Value Per Share as a Practical Expedient to Fair Value

41. A reporting entity may utilize net asset value per share (NAV)[2] as a practical expedient to fair value in either of the following situations, unless, as prescribed in paragraph 46, it is probable that the reporting entity will sell the investment for an amount different from the net asset value per share (or its equivalent):

a. When a SSAP specifically identifies NAV as a permitted practical expedient.

b. When the conditions specified in paragraph 42 are met.

42. Pursuant to paragraph 41, a reporting entity is permitted to utilize NAV as a practical expedient to fair value when the investment meets both of the following criteria:

a. The investment does not have a readily determinable fair value as defined in paragraph 43.

b. The investment is in an investment company or is an investment in a real estate fund for which it is industry practice to measure investment assets at fair value on a recurring basis and to issue financial statements consistent with the measurement principles of an investment company.

43. An equity security has a readily determinable fair value if it meets any of the following conditions:

a. The fair value of an equity security is readily determinable if sales prices or bid-and-asked quotations are currently available on a securities exchange registered with the U.S. Securities and Exchange Commission (SEC) or in the over-the-counter market, provided that those prices or quotations for the over-the-counter market are publicly reported by

[2] Net asset value per share is the amount of net assets attributable to each share of capital stock (other than senior equity securities, that is, preferred stock) outstanding at the close of the period. It excludes the effects of assuming conversion of outstanding convertible securities, whether or not their conversion would have a diluting effect. *(This footnote reflects the definition of Net Asset Value Per Share from the FASB Codification Master Glossary.)*

the National Association of Securities Dealers Automated Quotations systems or by OTC Markets Group Inc. Restricted stock meets that definition if the restriction terminates within one year[3].

b. The fair value of an equity security traded only in a foreign market is readily determinable if that foreign market is of a breadth and scope comparable to one of the U.S. markets identified in paragraph 43.a.

c. The fair value of an equity security that is an investment in a mutual fund or in a structure similar to a mutual fund (that is, a limited partnership or a venture capital entity) is readily determinable if the fair value per share (unit) is determined and published and is the basis for current transactions.

44. An entity is considered an investment company if it qualifies under the following assessments:

a. An entity regulated under the Investment Company Act of 1940.

b. An entity that is not regulated under the Investment Company Act of 1940, but that possesses all of the following fundamental characteristics:

i. The entity, 1) obtains funds from one or more investors and provides the investors with investment management services, and 2) commits to its investors that its business purpose and only substantive activities are investing the funds solely for returns from capital appreciation, investment income, or both.

ii. The entity or its affiliates do not obtain or have the objective of obtaining returns or benefits from an investee or its affiliates that are not normally attributable to ownership interests or that are other than capital appreciation or investment income.

c. The following characteristics are not required, but are typically found in an investment company. If the entity does not possess one or more of these typical characteristics, the reporting entity shall conduct further assessments to determine whether the entity's activities are consistent with those of an investment company:

i. The entity has more than one investment.

ii. The entity has more than one investor.

iii. The entity has investors that are not related parties of the parent or the investment manager.

iv. The entity has ownership interests in the form of equity or partnership interests.

v. The entity manages substantially all of its investments on a fair value basis.

45. If a reporting entity is permitted under paragraph 41 to utilize NAV as a practical expedient, the reporting entity shall identify whether the holdings of the investment company, in determining NAV, are measured at fair value as of the reporting entity's measurement date. If the NAV of the investment obtained from the entity is not as of the reporting entity's measurement date, or is not based on a fair value measurement of the underlying investments, the reporting entity shall consider whether an adjustment to the most recent NAV is necessary. The objective of any adjustment is to estimate a net asset

[3] If an investment would otherwise have a readily determinable fair value, except that the investment has a restriction expiring in more than one year, the reporting entity is not permitted to use NAV for that investment.

value per share for the investment that is calculated on the basis of underlying investments held at fair value.

46. A reporting entity shall decide on an investment-by-investment basis whether to apply the practical expedient in paragraph 41 and shall apply that practical expedient consistently to the fair value measurement of the reporting entity's entire position in a particular investment, unless it is probable at the measurement date that the reporting entity will sell a portion of an investment at an amount different from NAV. In those situations, the reporting entity shall account for the portion of the investment that is being sold at fair value, as defined in paragraph 4, without use of the NAV practical expedient.

47. A reporting entity is not permitted to estimate the fair value of an investment (or a portion of the investment) using the NAV of the investment (or its equivalent) as a practical expedient if, as of the reporting entity's measurement date, it is probable that the reporting entity will sell the investment for an amount different from the net asset value per share (or its equivalent). A sale is considered probable only if all of the following criteria have been met as of the reporting entity's measurement date:

a. Management having the authority to approve the action commits to a plan to sell the investment.

b. An active program to locate a buyer and other actions required to complete the plan to sell the investment have been initiated.

c. The investment is available for immediate sale subject only to terms that are usual and customary for sales of such investments (for example, a requirement to obtain approval of the sale from the investee or a buyer's due diligence procedures).

d. Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

48. An investment reported at NAV as a practical expedient pursuant to paragraph 41, shall not be categorized within the fair value hierarchy. Although the investment is not categorized within the fair value hierarchy, a reporting entity shall separately identify NAV (or its equivalent) as required under paragraphs 50.a. and 50.b. to permit reconciliations.

Disclosures

49. 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. To meet these objectives, the reporting entity shall disclose the information in paragraphs 50 through 59.

50. For each class of assets and liabilities measured and reported[4] 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.

[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-then-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. 26~~R~~ this security is considered to still be reported at amortized cost.

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 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.

d. 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).

iii. The amounts of any transfers into or out of Level 3 and the reasons for those transfers. Transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3.

e. A reporting entity shall 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.

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

a. The disclosures required by paragraphs 50.a. and 50.b. on a gross basis.

b. The reconciliation disclosures required by paragraph 50.c., 50.d. and 50.e. on either a gross or net basis.

52. The quantitative disclosures required in paragraphs 50-51 of this standard shall be presented using a tabular format.

53. 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.

54. For investments measured using the NAV practical expedient pursuant to paragraph 41, 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. A reporting entity shall disclose 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 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 when the restriction from redemption might lapse if the investee has communicated that timing to the reporting entity or announced the timing publicly. If 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 47 but the individual investments to be sold have not been identified (for example, if a reporting entity decides to sell 20% 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 41, the reporting entity shall disclose its plans to sell and any remaining actions required to complete the sale(s).

55. 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

56. 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 57. 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 50.

57. The disclosures about fair value prescribed in paragraph 56 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. 92—Postretirement Benefits Other Than Pensions*, *SSAP No. 102—Pensions* and *SSAP No. 104~~R~~—Share-Based Payments*.

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

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

d. Lease contracts as defined in *SSAP No. 22~~R~~—Leases.*

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.

58. 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.

59. 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

60. For equity securities that are subject to contractual sales, disclose the fair value of equity securities subject to contractual sale restrictions.

61. 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. 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.

b. 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.

c. This standard includes revisions to reference statutory standards or terms instead of GAAP standards or terms.

d. 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.

62. 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). These revisions are not adopted, as the underlying GAAP guidance within ASU 2009-05 has not been considered for statutory accounting. When ASU 2009-05 is 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 April 2019 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.

63. 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.

64. Paragraphs 56-59 of this statement 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 57 of this statement. 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.

65. This standard adopts *ASU 2022-03, Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions*, with modification to be consistent with statutory language in the respective statutory accounting statements.

66. This standard rejects *ASU 2019-05, Financial Instruments—Credit Losses: Targeted Transition Relief, ASU 2018-03, Recognition and Measurement of Financial Assets and Financial Liabilities, ASU 2013-03, Financial Instruments – Clarifying the Scope and Applicability of a Particular Disclosure to Nonpublic Entities* (ASU 2013-03), *ASU 2016-01, Financial Instruments – Overall* (ASU 2016-01), *FSP FAS 157-2: Effective Date of FASB Statement No. 157* (FSP FAS 157-2) and *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).

Effective Date and Transition

67. This standard shall be effective for December 31, 2010, annual financial statements, with interim and annual financial statement reporting thereafter. Early adoption is permitted for December 31, 2009, annual financial statements, with interim and annual reporting thereafter. Nonsubstantive disclosure revisions adopted in August and November 2010 to paragraphs 50-51 and the corresponding disclosure illustrations are initially effective for year-end 2010 financial statements, with interim and annual reporting thereafter. Nonsubstantive revisions adopted March 2011 to paragraphs 50.a., 50.d.ii., 53 and 56 of this statement are effective January 1, 2012, with interim and annual reporting thereafter as required in this statement. (Paragraph 53 is satisfied by the annual statement investment schedules and is not required quarterly.) Revisions to adopt ASU 2009-12 and ASU 2015-07, and provide guidance for allowing net asset value per share as a practical expedient to fair value when certain conditions are met as detailed in Issue Paper No. 157, is effective January 1, 2018, with early adoption permitted.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 138—Fair Value Measurements*
- *Issue Paper No. 157—Use of Net Asset Value*

Statement of Statutory Accounting Principles No. 101

Income Taxes

STATUS

Type of Issue	Common Area
Issued..	August 31, 2011
Effective Date...	January 1, 2012
Affects	Supersedes SSAP No. 10 and SSAP No. 10R; Nullifies INT 00-21, INT 00-22, INT 01-19 and INT 01-20
Affected by	No other pronouncements
Interpreted by	INT 01-18; INT 06-12; INT 18-03; INT 22-02; INT 23-03
Relevant Appendix A Guidance	None

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for current and deferred federal and foreign income taxes and current state income taxes. This statement supersedes conclusions reached in *SSAP No. 10—Income Taxes* and *SSAP No. 10R—Income Taxes, A Temporary Replacement of SSAP No. 10*.

SUMMARY CONCLUSION

2. For purposes of accounting for federal and foreign income taxes, reporting entities shall adopt *FASB Statement No. 109, Accounting for Income Taxes* (FAS 109) with modifications for state income taxes[INT 18-03], the realization criteria for deferred tax assets, and the recording of the impact of changes in deferred tax balances. One objective of accounting for income taxes is to recognize the estimated amount of taxes payable or refundable for the current year as a tax liability or asset. A second objective is to recognize deferred tax liabilities and assets for the future tax consequences of events that have been recognized in a reporting entity's statutory financial statements or tax returns. However, the second objective is realistically constrained because (a) the tax payment or refund that results from a particular tax return is a joint result of all the items included in that return, (b) taxes that will be paid or refunded in future years are the joint result of events of the current or prior years and events of future years, and (c) information available about the future is limited. As a result, financial statements will recognize current and deferred income tax assets and liabilities in accordance with the provisions of this statement based upon estimates and approximations. For purposes of this statement, only adjusted gross deferred tax assets that are more likely than not (a likelihood of more than 50%) to be realized shall be considered in determining admitted adjusted gross deferred tax assets.

Current Income Taxes

3. "Income taxes incurred" shall include current income taxes, the amount of federal and foreign income taxes paid (recovered) or payable (recoverable) for the current year. Current income taxes are defined as:

a. Current year estimates (including quarterly estimates) of federal and foreign income taxes payable or refundable, based on tax returns for the current and prior years, except as addressed in paragraph 3.b., and tax loss contingencies (including related interest and penalties) for current and all prior years, computed in accordance with *SSAP No. 5~~R~~—Liabilities, Contingencies and Impairments of Assets* with the following modifications:

   i. The term "probable" as used in SSAP No. 5~~R~~ shall be replaced by the term "more likely than not (a likelihood of more than 50%)" for federal and foreign income tax loss contingencies only.

   ii. For purposes of the determination of a federal and foreign income tax loss contingency, it shall be presumed that the reporting entity will be examined by the relevant taxing authority that has full knowledge of all relevant information.

   iii. If the estimated tax loss contingency is greater than 50% of the tax benefit originally recognized, the tax loss contingency recorded shall be equal to 100% of the original tax benefit recognized.

b. Amounts incurred or received during the current year relating to prior periods, to the extent not previously provided, as such amounts are deemed to be changes in accounting estimates as defined in *SSAP No. 3—Accounting Changes and Corrections of Errors*.

c. In determining when tax loss contingencies associated with temporary differences should be included in current income taxes under paragraph 3.a., and therefore included in deferred taxes under paragraph 7, a reporting entity is not required to "gross-up" its current and deferred taxes until such time as an event has occurred that would cause a re-evaluation of the contingency and its probability of assessment, e.g., the IRS has identified the item as one which may be adjusted upon audit. Such an event could be the reporting entity's (or its affiliate or parent in a consolidated income tax return) receipt of a Form 5701, Proposed Audit Adjustment, or could occur earlier upon receipt of an Information Document

Request. At such time, the company must reassess the probability of an adjustment, reasonably re-estimate the amount of tax contingency as determined in accordance with paragraph 3.a., make any necessary adjustment to deferred taxes, and re-determine the admissibility of any adjusted gross deferred tax asset as provided in paragraph 11.

4. State taxes (including premium, income and franchise taxes) shall be computed in accordance with SSAP No. 5~~R~~ and shall be limited to (a) taxes due as a result of the current year's taxable basis calculated in accordance with state laws and regulations and (b) amounts incurred or received during the current year relating to prior periods, to the extent not previously provided as such amounts are deemed to be changes in accounting estimates. Property and casualty insurance companies shall report state taxes as other underwriting expenses under the caption "Taxes, licenses, and fees." Life and accident and health insurance companies shall report such amounts as general expenses under the caption "Insurance taxes, licenses, and fees, excluding federal income taxes." Other health entities shall report such amounts as general administration expenses under the caption "Taxes, licenses, and fees." State tax recoverables that are reasonably expected to be recovered in a subsequent accounting period are admitted assets. State taxes are reasonably expected to be recovered if the refund is attributable to overpayment of estimated tax payments, errors, carrybacks, or items for which the reporting entity has authority to recover under a state regulation or statute.

Deferred Income Taxes

5. Because tax laws and statutory accounting principles differ in their recognition and measurement of assets, liabilities, equity, revenues, expenses, gains, and losses, differences arise between:

a. The amount of taxable income and pretax statutory financial income for a year, and

b. The tax bases of assets or liabilities and their reported amounts in statutory financial statements.

6. A reporting entity's balance sheet shall include deferred income tax assets (DTAs) and liabilities (DTLs) related to the estimated future tax consequences of temporary differences and carryforwards, generated by statutory accounting, as defined in paragraph 11 of FAS 109.

7. A reporting entity's deferred tax assets and liabilities are computed as follows:

a. Temporary differences are identified and measured using a "balance sheet" approach whereby statutory and tax basis balance sheets are compared;

b. Temporary differences include unrealized gains and losses and nonadmitted assets but do not include asset valuation reserve (AVR), interest maintenance reserve (IMR), Schedule F penalties and, in the case of a mortgage guaranty insurer, amounts attributable to its statutory contingency reserve to the extent that "tax and loss" bonds have been purchased;

c. Total DTAs and DTLs are computed using enacted tax rates;

d. A DTL is not recognized for amounts described in paragraph 31 of FAS 109; and

e. Gross DTAs are reduced by a statutory valuation allowance adjustment if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50%) that some portion or all of the gross DTAs will not be realized. The statutory valuation allowance adjustment[1], determined in a manner consistent with paragraphs 20-25 of FAS 109[2], shall reduce the gross DTAs to the amount that is more likely than not to be realized (the adjusted gross deferred tax assets).

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)[3]. Admitted adjusted gross DTAs and DTLs shall be offset and presented as a single amount on the statement of financial position.

Admissibility of Income Tax Assets

9. Current income tax recoverables shall include all current income taxes, including interest, reasonably expected to be recovered in a subsequent accounting period, whether or not a return or claim has been filed with the taxing authorities. Current income tax recoverables are reasonably expected to be recovered if the refund is attributable to overpayment of estimated tax payments, errors, carrybacks, as defined in paragraph 289 of FAS 109, or items for which the reporting entity has substantial authority, as that term is defined in Federal Income Tax Regulations.[INT 06-12]

10. Current income tax recoverables meet the definition of assets as specified in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement.

11. The net admitted DTA shall not exceed the excess of the adjusted gross DTA, as determined under paragraph 7.e., over gross DTL. Adjusted gross DTAs shall be admitted based upon the three-component admission calculation at an amount equal to the sum of paragraphs 11.a., 11.b., and 11.c.:

[1] The statutory valuation allowance adjustment is utilized strictly to calculate the "adjusted gross DTA". (Admittance criteria in paragraph 11 are applied to the "adjusted gross DTA".) In determining the amount of adjusted gross DTA, the reporting entity shall consider reversal patterns of temporary differences to the extent necessary to support establishing or not establishing a valuation allowance adjustment, determined in accordance with paragraphs 228 and 229 of FAS 109. For purposes of this accounting statement, consideration of reversal patterns does not require scheduling beyond that necessary to support establishing or not establishing a valuation allowance adjustment. The application of the statutory valuation allowance adjustment in this statement shall not result in a statutory valuation allowance reserve within the statutory financial statements, but rather should result in a reduction of the gross DTA.

[2] For purposes of determining the amount of adjusted gross DTA and the amount admitted under paragraph 11, the admission calculation shall be made on a separate company, reporting entity basis. A reporting entity that files a consolidated federal income tax return with its parent should look to the amount of taxes it paid (or were allocated to it) as a separate legal entity in determining the admitted DTA under paragraph 11.a. Furthermore, the DTA under this paragraph may not exceed the amount that the reporting entity could reasonably expect to have refunded by its parent. The taxes paid by the reporting entity represent the maximum DTA that may be admitted under paragraph 11.a., although the amount could be reduced pursuant to the group's tax allocation agreement. The amount of admitted adjusted gross DTA under paragraph 11.b.i. is limited to the amount that the reporting entity expects to realize within the applicable realization period, on a separate company basis. The reporting entity must estimate its separate company taxable income and the tax benefit that it expects to receive from reversing deductible temporary differences in the form of lower tax payments to its parent. A reporting entity that projects a tax loss in the applicable realization period cannot admit a DTA related to the loss under paragraph 11.b., even if the loss could offset taxable income of other members in the consolidated group and the reporting entity could expect to be paid for the tax benefit pursuant to its tax allocation agreement.

[3] 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.

a. Federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse during a timeframe corresponding with IRS tax loss carryback provisions[4], not to exceed three years, including any amounts established in accordance with the provision of SSAP No. 5~~R~~ as described in paragraph 3.a. of this statement related to those periods.

b. If the reporting entity is subject to risk-based capital requirements or is required to file a Risk-Based Capital Report with the domiciliary state, the reporting entity shall use the *Realization Threshold Limitation Table – RBC Reporting Entities* (RBC Reporting Entity Table) in this component of the admission calculation. The RBC Reporting Entity Table's threshold limitations are contingent upon the ExDTA ACL RBC Ratio[5].

If the reporting entity is either a mortgage guaranty insurer or financial guaranty insurer that is not subject to risk-based capital requirements and is not required to file a Risk-Based Capital Report with the domiciliary state and the reporting entity meets the minimum capital and reserve requirements for the state of domicile, then the reporting entity shall use the *Realization Threshold Limitation Table – Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entities* (Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table) in this component of the admission calculation. The Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table's threshold limitations are contingent upon the following ratio: the numerator is equal to the sum of 1) surplus to policyholders, 2) less the amount of the admitted DTA in paragraph 11.a. (ExDTA Surplus) plus, 3) contingency reserves. The denominator is equal to the required amount of minimum aggregate capital required to be maintained under the applicable NAIC model law or state variation thereof based on the risk characteristics and the amount of insurance in force (Required Aggregate Risk Capital)[6].

If the reporting entity (1) is not subject to risk-based capital requirements, (2) is not required to file a Risk-Based Capital Report with the domiciliary state, (3) is not a mortgage guaranty or financial guaranty insurer, and (4) meets the minimum capital and reserve requirements, then the reporting entity shall use the *Realization Threshold Limitation Table – Other Non-RBC Reporting Entities* (Other Non-RBC Reporting Entity Table). The Other Non-RBC Reporting Entity Table's threshold limitations are contingent upon the ratio of adjusted gross DTA (Adjusted gross DTA less the amount of DTA admitted in paragraph 11.a.) to adjusted capital and surplus[7].

4 For example, under the Federal Internal Revenue Code, ordinary losses can be carried back two years for entities taxed as nonlife insurance companies, while capital losses for entities taxed both as nonlife and life insurance companies can be carried back three years. For losses arising in tax years after 2017, entities taxed as life insurance companies are not permitted to carryback ordinary losses.

5 The December 31 Risk-Based Capital ratio is calculated based on the Authorized Control Level RBC for the current reporting period, which is in the process of being filed with the state of domicile, and computed without net deferred tax assets (ExDTA ACL RBC). The interim period (March 31, June 30, and September 30) ExDTA ACL RBC ratio numerator shall use the Total Adjusted Capital (TAC) with current quarter surplus ExDTA and current quarter TAC adjustments. The interim period denominator shall use the Authorized Control Level RBC as filed for the most recent calendar year.

6 If the reporting entity is a mortgage guaranty insurer, this ratio is based on the requirements of Section 12 of the NAIC Mortgage Guaranty Insurance Model Law and state laws that, based on the risk characteristics and amount of insurance in force, require aggregate capital to be maintained in a risk-to-capital ratio of not less than 25 to 1. If the reporting entity is a financial guaranty insurer, this ratio is based on the requirements of Section 4C of the NAIC Financial Guaranty Insurance Model Guideline 1626 and state laws that require aggregate capital to be maintained based on the risk characteristics and amount of insurance in force.

7 Consistent with the requirements of paragraph 11.b.ii., adjusted statutory capital and surplus used in this calculation component is based on statutory capital and surplus for the current reporting period excluding any net DTA, EDP equipment and operating system software and any net positive goodwill.

Realization Threshold Limitation Table – RBC Reporting Entities

ExDTA ACL RBC (%)	11.b.i.	11.b.ii.
Greater than 300%	3 years	15%
200 – 300%	1 year	10%
Less than 200%	0 years	0%

Realization Threshold Limitation Table – Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entities

(See paragraph 11.b.) Ex DTA Surplus plus Contingency Reserves/Required Aggregate Risk Capital (%)	11.b.i.	11.b.ii.
Greater than 115%	3 years	15%
100% to 115%	1 year	10%
Less than 100%	0 years	0%

Realization Threshold Limitation Table – Other Non-RBC Reporting Entities

Adjusted Gross DTA / Adjusted Capital & Surplus (%)	11.b.i.	11.b.ii.
Less than 50%	3 years	15%
50% to 75%	1 year	10%
Greater than 75%	0 years	0%

The reporting entity shall admit:

i. The amount of adjusted gross DTAs, after the application of paragraph 11.a.[8], expected to be realized within the applicable period (refer to the 11.b.i. column of the applicable Realization Threshold Limitation Table above; the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table, or the Other Non-RBC Reporting Entity Table) following the balance sheet date limited to the amount determined in paragraph 11.b.ii.

ii. An amount that is no greater than the applicable percentage (refer to the 11.b.ii. column of the applicable Realization Threshold Limitation Table above: the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table, or the Other Non-RBC Reporting Entity Table) of statutory capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for the current reporting period's statement filed with the domiciliary state commissioner adjusted to exclude any net DTAs, EDP equipment and operating system software and any net positive goodwill.(INT 01-18) For financial guaranty or mortgage guaranty non-RBC reporting entities, the amount of statutory capital and surplus utilized for this part of the calculation does not include contingency reserves.

[8] Under the Federal Internal Revenue Code, entities taxed as life insurance companies are not permitted to carryback ordinary losses arising in tax years after 2017. As such, admittance of ordinary DTAs for such entities will be limited to paragraph 11.b. and paragraph 11.c. for reporting periods ending with and subsequent to December 31, 2017.

c. The amount of adjusted gross DTAs, after application of paragraphs 11.a. and 11.b. that can be offset against existing gross DTLs. The reporting entity shall consider the character (i.e., ordinary versus capital) of the DTAs and DTLs such that offsetting would be permitted in the tax return under existing enacted federal income tax laws and regulations. Additionally, for purposes of this component, the reporting entity shall consider the reversal patterns of temporary differences; however, this consideration does not require scheduling beyond that required in paragraph 7.e.

12. In computing a reporting entity's admitted adjusted gross DTA pursuant to paragraph 11;

a. For purposes of paragraph 11.a., existing temporary differences that reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years, shall be determined in accordance with paragraphs 228 and 229 of FAS 109;

b. In determining the amount of federal income taxes that can be recovered through loss carrybacks, the amount and character (i.e., ordinary versus capital) of the loss carrybacks and the impact, if any, of the Alternative Minimum Tax shall be determined in accordance with the provisions of the Internal Revenue Code, and regulations thereunder;

c. The amount of carryback potential that may be considered in calculating the admitted adjusted gross DTAs of a reporting entity in paragraph 11.a. that files a consolidated income tax return with one or more affiliates, may not exceed the amount that the reporting entity could reasonably expect to have refunded by its parent; and

d. The phrases "reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years," "realized within one year of the balance sheet date" and "realized within three years of the balance sheet date" are intended to accommodate interim reporting dates and reporting entities that file on an other than calendar year basis for federal income tax purposes.

Realization of Tax Benefits and Tax Planning Strategies

13. Future realization of the tax benefit of an existing deductible temporary difference or carryforward ultimately depends on the existence of sufficient taxable income of the appropriate character (for example, ordinary income or capital gain) within the carryback, carryforward period available under the tax law. The following four possible sources of taxable income may be available under the tax law to realize a tax benefit for deductible temporary differences and carryforwards:

a. Future reversals of existing taxable temporary differences.

b. Future taxable income exclusive of reversing temporary differences and carryforwards.

c. Taxable income in prior carryback year(s) if carryback is permitted under the tax law.

d. Tax-planning strategies in paragraph 14 that would, if necessary, be implemented to, for example:

i. Accelerate taxable amounts to utilize expiring carryforwards;

ii. Change the character of taxable or deductible amounts from ordinary income or loss to capital gain or loss; and

iii. Switch from tax-exempt to taxable investments.

Evidence available about each of those possible sources of taxable income will vary for different tax jurisdictions and, and possibly, from year to year. To the extent evidence about one or more sources of taxable income is sufficient to support a conclusion that the reporting entity will realize the full or a partial amount of its adjusted gross deferred tax assets, other sources need not be considered. Consideration of each source is required, however, to determine the amount of the statutory valuation allowance adjustment that is recognized for gross deferred tax assets under paragraph 7.e.

14. In some circumstances, there are tax-planning strategies (including elections for tax purposes) that (a) are prudent and feasible, (b) a reporting entity ordinarily might not take, but would take to prevent an operating loss or tax credit carryforward from expiring unused, and (c) would result in realization of deferred tax assets. A reporting entity shall consider tax-planning strategies in determining the amount of the statutory valuation allowance adjustment necessary under paragraph 7.e. Consideration of tax planning strategies for the realization of deferred tax assets when determining admission under paragraph 11 is not required; however, such strategies shall not conflict with the tax planning strategies used when computing the statutory valuation allowance. Any significant potential expenses to implement a tax-planning strategy or any significant losses that would be recognized if that strategy were implemented (net of any recognizable tax benefits associated with those expenses or losses) shall reduce the amount of admission under paragraph 11.

15. When a prudent and feasible tax-planning strategy is contemplated, and management determines this strategy would more likely than not enable the reporting entity to realize the full or a partial amount of its adjusted gross deferred tax assets, paragraph 3 of this statement related to tax loss contingencies shall be applied in determining admissibility of deferred tax assets under paragraph 11 of this statement.

Intercompany Income Tax Transactions

16. In the case of a reporting entity that files a consolidated income tax return with one or more affiliates, income tax transactions (including payment of tax contingencies to its parent) between the affiliated parties shall be recognized if:

a. Such transactions are economic transactions as defined in *SSAP No. 25—Affiliates and Other Related Parties*;

b. Are pursuant to a written income tax allocation agreement; and

c. Income taxes incurred are accounted for in a manner consistent with the principles of FAS 109, as modified by this statement.

17. Amounts owed to a reporting entity pursuant to a recognized transaction shall be treated as a loan or advance, and nonadmitted, pursuant to SSAP No. 25, to the extent that the recoverable is not settled within 90 days of the filing of a consolidated income tax return, or where a refund is due the reporting entity's parent, within 90 days of the receipt of such refund.

Intraperiod Tax Allocation

18. In accordance with paragraph 35 of FAS 109, a reporting entity's unrealized gains and losses shall be recorded net of any allocated DTA or DTL. The amount allocated shall be computed in a manner consistent with paragraph 38 of FAS 109.

19. Income taxes incurred shall be allocated to net income and realized capital gains or losses in a manner consistent with paragraph 38 of FAS 109. Furthermore, income taxes incurred or received during the current year attributable to prior years shall be allocated, to the extent not previously provided, to net income in accordance with SSAP No. 3 unless attributable, in whole or in part, to realized capital gains or losses, in which case, such amounts shall be apportioned between net income and realized capital gains and losses, as appropriate.

Interim Periods

20. Income taxes incurred in interim periods shall be computed using an estimated annual effective current tax rate for the annual period in accordance with the methodology described in paragraphs 19 and 20 of *Accounting Principles Board Opinion No. 28, Interim Financial* Reporting. Estimates of the annual effective tax rate at the end of interim periods are, of necessity, based on estimates and are subject to subsequent refinement or revision. If a reliable estimate cannot be made, the actual effective tax rate for the year-to-date may be the best estimate of the annual effective tax rate. If a reporting entity is unable to estimate a part of its "ordinary" income (or loss) or the related tax (or benefit) but is otherwise able to make a reliable estimate, the tax (or benefit) applicable to the item that cannot be estimated shall be reported in the interim period in which the item is reported.

Disclosures

21. Statutory financial statement disclosures shall be made in a manner consistent with the provisions of paragraphs 43-45 and 48 of FAS 109. However, required disclosures with regard to a reporting entity's GAAP valuation allowance shall be replaced with disclosures relating to the statutory valuation allowance adjustment and the nonadmittance of some portion or all of a reporting entity's DTAs. The financial statements shall include the disclosures required by paragraph 47 of FAS 109 for non-public companies. Paragraphs 22-28 describe the disclosure requirements as modified for the difference between the requirements of FAS 109 and those prescribed by this statement.

22. The components of the net DTA or DTL recognized in a reporting entity's financial statements shall be disclosed as follows:

a. The total of all DTAs (gross, adjusted gross, admitted and nonadmitted) by tax character;

b. The total of all DTLs by tax character;

c. The total DTAs nonadmitted as the result of the application of paragraph 11;

d. The net change during the year in the total DTAs nonadmitted;

e. The amount of each result or component of the calculation, by tax character of paragraphs 11.a., 11.b.i., 11.b.ii., and 11.c., and the ExDTA ACL RBC Ratio, the ExDTA Surplus plus Contingency Reserves/Required Aggregate Risk Capital Ratio, or the Adjusted Gross DTA/Adjusted Capital and Surplus Ratio used in the applicable *Realization Threshold Limitation Table* (the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table, or the Other Non-RBC Reporting Entity Table) in paragraph 11.b., as applicable; and

f. The impact of tax-planning strategies on the determination of adjusted gross DTAs and the determination of net admitted DTAs, by percentage and by tax character, and whether the tax-planning strategies include the use of reinsurance-related tax planning strategies.

23. To the extent that DTLs are not recognized for amounts described in paragraph 31 of FAS 109, the following shall be disclosed:

a. A description of the types of temporary differences for which a DTL has not been recognized and the types of events that would cause those temporary differences to become taxable;

~~b. The cumulative amount of each type of temporary difference;~~

~~c.~~b. The amount of the unrecognized DTL for temporary differences related to investments in foreign subsidiaries and foreign corporate joint ventures that are essentially permanent in duration if determination of that liability is practicable or a statement that determination is not practicable; and

~~d.~~c. The amount of the DTL for temporary differences other than those in paragraph 23.b~~c~~. that is not recognized in accordance with the provisions of paragraphs 31 of FAS 109.

24. The significant components of income taxes incurred (i.e., current income tax expense) and the changes in DTAs and DTLs shall be disclosed. Those components would include, for example:

a. Current tax expense or benefit;

b. The change in DTAs and DTLs (exclusive of the effects of other components listed below);

c. Investment tax credits;

d. The benefits of operating loss carryforwards;

e. Adjustments of a DTA or DTL for enacted changes in tax laws or rates or a change in the tax status of the reporting entity; and

f. Adjustments to gross deferred tax assets because of a change in circumstances that causes a change in judgment about the realizability of the related deferred tax asset, and the reason for the adjustment and change in judgment.

25. Additionally, to the extent that the sum of a reporting entity's income taxes incurred and the change in its DTAs and DTLs is different from the result obtained by applying the federal statutory rate to its pretax net income, a reporting entity shall disclose the nature of the significant reconciling items.

26. A reporting entity shall also disclose the following:

a. The amounts, origination dates and expiration dates of operating loss and tax credit carryforwards available for tax purposes;

b. The amount of federal income taxes incurred in the current year and each preceding year, which are available for recoupment in the event of future net losses; and

c. The aggregate amount of deposits admitted under Section 6603 of the Internal Revenue Service Code.

27. For any federal or foreign income tax loss contingencies as determined in accordance with paragraph 3.a. for which it is reasonably possible that the total liability will significantly increase within 12 months of the reporting date, the reporting entity shall disclose an estimate of the range of the reasonably possible increase or a statement that an estimate of the range cannot be made.

28. If a reporting entity's federal income tax return is consolidated with those of any other entity or entities, the following shall be disclosed:

a. A list of names of the entities with whom the reporting entity's federal income tax return is consolidated for the current year; and

b. The substance of the written agreement, approved by the reporting entity's Board of Directors, which sets forth the manner in which the total combined federal income tax for all entities is allocated to each entity which is a party to the consolidation. (If no written agreement has been executed, explain why such an agreement has not been executed.) Additionally, the disclosure shall include the manner in which the entity has an enforceable right to recoup federal income taxes in the event of future net losses which it may incur or to recoup its net losses carried forward as an offset to future net income subject to federal income taxes.

29. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

30. This statement adopts the provisions of FAS 109 except as modified in paragraph 2 of this statement which results in paragraphs 29-30, 36-37, 39, 41-42, 46, and 49-59 of FAS 109 being rejected, inasmuch as they are not applicable to reporting entities subject to this statement or are inconsistent with other statutory accounting principles. Paragraph 47 of FAS 109 is adopted with modification to provide for the disclosures required for non-public reporting entities. This statement rejects *ASU 2016-16, Intra-Entity Transfers of Assets Other than Inventory*.

31. This statement rejects *ASU 2013-11, Income Taxes: Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists, ASU 2015-17 Balance Sheet Classification of Deferred Taxes*, *FASB Interpretation No. 18, Accounting for Income Taxes in Interim Periods…an interpretation of APB Opinion No. 28* and *FIN 48: Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109*.

32. The following lists FASB Staff Positions that are adopted or rejected by this statement:

a. *FASB Staff Position FAS 109-1, Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004* is adopted in its entirety.

b. FASB *Staff Position FAS 109-2, Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004* is rejected in its entirety.

c. *FASB Staff Position FIN 48-2, Effective Date of FIN 48 for Certain Nonpublic Enterprises* is rejected in its entirety.

d. *FASB Staff Position FIN 48-3, Effective Date of FIN 48 for Certain Nonpublic Enterprises* is rejected in its entirety.

33. The following lists Accounting Principles Board Opinions that are adopted or rejected by this statement:

a. *Accounting Principles Board Opinion No. 2, Accounting for the "Investment Credit,"* paragraphs 9-15 are adopted with modification to utilize the cost reduction method only and rejects all other paragraphs;

b. *Accounting Principles Board Opinion No. 4 (Amending No. 2), Accounting for the "Investment Credit,"* is rejected in its entirety;

c. *Accounting Principles Board Opinion No. 10, Omnibus Opinion—1966,* paragraph 6 is adopted;

d. *Accounting Principles Board Opinion No. 23, Accounting for Income Taxes—Special Areas,* paragraphs 1-3, 5-9, 12-13, and 15-18 are adopted, and paragraphs 19-25, and 31-33 are rejected;

e. *Accounting Principles Board Opinion No. 28, Interim Financial Reporting,* paragraphs 19 and 20 are adopted and all other paragraphs rejected.

34. The following lists FASB Technical Bulletins that are adopted or rejected by this statement:

a. *FASB Technical Bulletin No. 79-9, Accounting in Interim Periods for Changes in* Income *Tax Rates* is rejected in its entirety;

b. FASB *Technical Bulletin No. 82-1, Disclosure of the Sale or Purchase of Tax Benefits through Tax Leases* is adopted in its entirety.

35. The following lists FASB Emerging Issues Task Force Issues that are adopted or rejected by this statement:

a. FASB *Emerging Issues Task Force No. 91-8, Application of FASB Statement No. 96 to a State Tax Based on the Greater of a Franchise Tax or an Income Tax,* is rejected in its entirety;

b. *FASB Emerging Issues Task Force No. 92-8, Accounting for the Income Tax Effects* under *FASB Statement No. 109 of a Change in Functional Currency When an Economy Ceases to Be Considered Highly Inflationary*, is adopted in its entirety;

c. FASB *Emerging Issues Task Force No. 93-13, Effect of a Retroactive Change in Enacted Tax Rates That Is Included in Income from Continuing Operations*, is rejected in its entirety;

d. *FASB Emerging Issues Task Force No. 93-16, Application of FASB Statement No. 109 to* Basis *Differences within Foreign Subsidiaries That Meet the Indefinite Reversal Criterion of APB Opinion No. 23*, is rejected in its entirety;

e. FASB *Emerging Issues Task Force No. 93-17, Recognition of Deferred Tax Assets for a Parent Company's Excess Tax Basis in the Stock of a Subsidiary That Is Accounted for as a Discontinued Operation*, is adopted in its entirety;

f. *FASB Emerging Issues Task Force No. 94-10, Accounting by a Company for the* Income *Tax Effects of Transactions among or with Its Shareholders under FASB Statement No. 109*, is rejected in its entirety;

g. FASB *Emerging Issues Task Force No. 95-9, Accounting for Tax Effects of Dividends in France in Accordance with FASB Statement No. 109*, is rejected in its entirety;

h. FASB *Emerging Issues Task Force No. 95-10, Accounting for Tax Credits Related to Dividend Payments in Accordance with FASB Statement No. 109*, is rejected in its entirety;

i. *FASB Emerging Issues Task Force No. 95-20, Measurement in the Consolidated Financial Statements of a Parent of the Tax Effects Related to the Operations of a* Foreign *Subsidiary That Receives Tax Credits Related to Dividend Payments*, is rejected in its entirety.

36. This statement rejects AICPA Accounting Interpretations, Accounting for the Investment Credit: Accounting Interpretations of APB Opinion No. 4 in its entirety.

37. This statement rejects *ASU 2023-09, Improvements to Income Tax Disclosures*. The disclosure detailed in paragraph 23.b. was deleted from statutory accounting guidance as the Tax Cuts and Jobs Act made this disclosure effectively irrelevant.

Effective Date and Transition

~~37.~~38. This statement shall be effective for years beginning January 1, 2012. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. Revisions adopted in August 2019 to Exhibit A – Implementation Questions and Answers which update the exhibit in response to changes from the federal Tax Cuts and Jobs Act and to clarify deferred tax asset and deferred tax liability offsetting under paragraph 11.c., are effective for financial accounting years ending December 31, 2019. Any change in income tax balances resulting from the August 2019 revisions are accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 83—Accounting for Income Taxes*

EXHIBIT A – IMPLEMENTATION QUESTIONS AND ANSWERS

The National Association of Insurance Commissioners issued *SSAP No. 101—Income Taxes*, with a corresponding implementation question and answer exhibit, with an effective date of January 1, 2012. Further nonsubstantive revisions were developed to update the Q&A for the revised corporate federal income tax rate and certain other federal tax law changes primarily under the Tax Cuts and Jobs Act enacted in December 2017 and to clarify deferred tax asset and deferred tax liability offsetting under SSAP No. 101, paragraph 11.c. These revisions to the implementation guidance are effective for financial accounting years ending December 31, 2019. Any change in income tax balances resulting from the August 2019 revisions are accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

Index to Questions:

Question No.	Question	SSAP No. 101 Paragraph Reference	Page Number
12	How do you present deferred taxes in the annual statement?	8, 18 and 21-28	52
13	How are tax-planning strategies to be considered in determining adjusted gross DTAs and admitted adjusted gross DTAs?	11.a., 11.b.i., 14 and 15	~~61~~60

1. Q – What are the primary differences between the accounting for income taxes pursuant to FAS 109 and SSAP No. 101? [No specific paragraph reference]

1.1 A – SSAP No. 101 establishes statutory accounting principles for current and deferred federal and foreign income taxes and current state income taxes. In general, SSAP No. 101 adopts the concepts of FAS 109, with modifications. The primary differences and modifications are summarized below:

1.2 State Income Tax

- FAS 109 – State income taxes should be included as "income taxes incurred." Deferred state income taxes are recognized.

- SSAP No. 101 – State income taxes should be included as "Taxes, Licenses, and Fees" by property and casualty insurers and as "Insurance taxes, licenses, and fees, excluding federal income taxes" by life and accident and health insurers. No deferred state income taxes are recognized.

1.3 Valuation Allowance

- FAS 109 – Gross deferred tax assets (DTAs) are reduced by a valuation allowance if it is more likely than not that some portion or all of the DTAs will not be realized. The valuation allowance should be sufficient to reduce the DTA to the amount that is more likely than not to be realized.

- SSAP No. 101 – Gross DTAs are reduced by a statutory valuation allowance adjustment that is determined on a separate company, reporting entity basis. Pursuant to paragraphs 2 and 7.e. of SSAP No. 101, gross DTAs are adjusted to an amount that is more likely than not to be realized (a likelihood of more than 50%). Only adjusted gross DTAs shall be considered in determining admitted adjusted gross DTAs. See Question 2 for further discussion of the statutory valuation allowance adjustment. See Question 4 for a further discussion of the admissibility test. See Question 12 for further discussion of presentation and disclosure of the statutory valuation allowance adjustment.

1.4 Unique Statutory Accounting Items

- FAS 109 – In general, the effects of all temporary differences must be reflected with limited exceptions provided in FAS 109 paragraphs 31-34 (relating to items specified in Accounting Principles Board Opinion No. 23) and for temporary differences related to goodwill for which amortization is not deductible for tax purposes.

- SSAP No. 101 – In addition to the exceptions provided in FAS 109, temporary differences do not include asset valuation reserve (AVR), interest maintenance reserve (IMR), Schedule F penalties and, in the case of a mortgage guaranty insurer, amounts attributable to its statutory contingency reserve to the extent that "tax and loss" bonds have been purchased.

1.5 Changes in Deferred Tax Assets and Liabilities

- FAS 109 – Changes in DTAs and deferred tax liabilities (DTLs) are included in income tax expense or benefit and are allocated to continuing operations, discontinued operations, extraordinary items and items charged directly to shareholders' equity.

- SSAP No. 101 – Changes in DTAs and DTLs are recognized as a separate component of gains and losses in surplus, except to the extent allocated to changes in unrealized gains and losses.

1.6 Regulated Enterprises

- FAS 109 – Regulated enterprises that meet the criteria for application of FAS 71, *Accounting for* the *Effects of Certain Types of Regulation*, are not exempt from the requirements of FAS 109. However, assets are reported on a net-of-tax basis (see paragraphs 29, 57, 58 and 59 of FAS 109).

- SSAP No. 101 – These special paragraphs do not apply pursuant to paragraph 30 of SSAP No. 101.

1.7 Business Combinations

- FAS 109 – Paragraphs 30 and 53-56 of FAS 109 provide certain guidance regarding the treatment of business combinations. In general, a deferred tax asset or liability is recognized for the differences between the assigned values and the tax bases of the assets and liabilities recognized in a purchased business combination. If financial statements for prior years are restated, all purchase business combinations that were consummated in those prior years shall be remeasured in accordance with FAS 109.

- SSAP No. 101 – These special paragraphs do not apply pursuant to paragraph 30 of SSAP No. 101.

1.8 Intraperiod Tax Allocation

- FAS 109 – Income tax expense or benefit is allocated among continuing operations, discontinued operations, extraordinary items, and items charged or credited directly to shareholders' equity pursuant to paragraphs 36 and 37 of FAS 109.

- SSAP No. 101 – These paragraphs of FAS 109 do not apply pursuant to paragraph 30 of SSAP No. 101. Instead, paragraphs 18 and 19 of SSAP No. 101 provide special rules for statutory accounting. See Question 10 for a further discussion of these rules.

1.9 Certain Quasi-Reorganizations

- FAS 109 – Paragraph 39 provides special rules relating to the treatment of deductible temporary differences and carryforwards as of the date of a quasi-reorganization.

- SSAP No. 101 – Paragraph 39 of FAS 109 does not apply pursuant to paragraph 30 of SSAP No. 101.

1.10 Financial Statement Classification of DTAs and DTLs

- FAS 109 – Pursuant to paragraphs 41 and 42 of FAS 109, DTAs and DTLs are to be classified separately as either current or noncurrent, depending on the classification of the related asset or liability. Furthermore, current DTAs and DTLs and noncurrent DTAs and DTLs are netted within the classification and with the net amount reported.

- SSAP No. 101 – These paragraphs do not apply to statutory accounting pursuant to paragraph 30 of SSAP No. 101. The net admitted DTA, or the net DTL, should be reported in the statutory financial statements.

1.11 Accounting for Uncertainty in Income Taxes

- FAS 109 – Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48) provides accounting and reporting guidance for uncertain tax positions under GAAP.

- SSAP No. 101 – FIN 48 is rejected for statutory accounting pursuant to paragraph 31 of SSAP No. 101. *SSAP No. 5~~R~~—Liabilities, Contingencies and Impairments of Assets* provides guidance in determining the amount of federal and foreign income tax loss contingencies with the following modifications. The term "probable" as used in SSAP No. 5~~R~~ is replaced by the term "more likely than not (a likelihood of more than 50%)". In determining the amount of a federal or foreign income tax loss contingency, it shall be assumed that the reporting entity will be examined by the tax authority that has full knowledge of all relevant information. If the estimated tax loss contingency is greater than 50% of the tax benefit originally recognized, the tax loss contingency recorded shall be equal to 100% of the original tax benefit recognized. See Question 9 for further discussion of income tax loss contingencies.

1.12 Classification of Interest and Penalties

- FAS 109 – FIN 48 allows interest on tax assessments to be reported as either income taxes or interest expense and penalties to be reported as either income taxes or another expense classification, based on the accounting policy election of the enterprise.

- SSAP No. 101 – Interest and penalties related to foreign or federal income tax are included in income taxes pursuant to paragraph 3.a. of SSAP No. 101.

1.13 Financial Statement Disclosures

- FAS 109 – Paragraphs 43-45 and 47-48 of FAS 109 provide various requirements for providing information in the financial statements regarding the income taxes of the reporting entity. In general, the reporting entity is to provide certain information regarding the components of its DTAs and DTLs, the amount of and changes in its valuation allowance, significant components of income tax expense, differences between the expected amount of income tax expense using current tax rates and the amount of reported income tax expense, and tax attributes being carried over. In addition, FIN 48 includes specific disclosures related to uncertain tax positions.

- SSAP No. 101 – In general, paragraphs 21-29 of SSAP No. 101 follow the disclosure requirements provided by FAS 109, but with the following modifications and additions:

    - The disclosures regarding valuation allowance are replaced with disclosures relating to the statutory valuation allowance adjustment and the nonadmitted portion of the DTA.

    - The amount of the gross DTA, adjusted gross DTA, DTL, admitted and nonadmitted DTA is required to be separately disclosed, by tax character (ordinary or capital).

    - Disclose the amount of each result or component of the admission calculation, by tax character, for paragraphs 11.a, 11.b.i, 11.b.ii, and 11.c. In addition, disclose the ExDTA Authorized Control Level (ACL) RBC Ratio, the ExDTA Surplus plus Contingency Reserves/Required Aggregate Risk Capital Ratio (see paragraph 11.b.), or the Adjusted Gross DTA/Adjusted Capital and Surplus Ratio used in the applicable Realization Threshold Limitation Table (the RBC Reporting Entity Table, the Financial Guaranty or

Mortgage Guaranty Non-RBC Reporting Entity Table, or the Other Non-RBC Reporting Entity Table) in paragraph 11.b., as applicable.

- The impact of tax-planning strategies on the determination of adjusted gross DTAs and the determination of net admitted adjusted gross DTAs, by percentage and by tax character, must be disclosed. In addition, disclose whether tax-planning strategies include the use of reinsurance-related tax planning strategies.

- FIN 48 and the associated disclosure requirements are rejected for statutory accounting purposes and replaced with the following disclosure. For any federal or foreign income tax loss contingencies for which it is reasonably possible that the total liability will significantly increase within 12 months of the reporting date, a disclosure of an estimate of the range of the reasonably possible increase is required. If determination of a reasonable range of the significant increase is not possible, the reporting entity is to provide a statement that an estimate cannot be made.

- The disclosures relating to deferred income tax expense or benefit are replaced with certain disclosures relating to the reporting entity's "change in DTAs and DTLs."

- Only the nature of significant reconciling items between the reported amount and "expected" amount of income tax expense and change in DTAs and DTLs are to be disclosed. This generally follows the disclosure requirements of FAS 109 for nonpublic entities.

- See Question 12 for a more detailed discussion of the disclosure requirements of SSAP No. 101.

2. Q – How should an entity measure its adjusted gross deferred tax assets and its gross deferred tax liabilities? [Paragraph 7]

2.1 A – An enterprise shall record a gross deferred tax liability or asset for all temporary differences and operating loss, capital loss and tax credit carryforwards. Temporary differences include unrealized gains and losses and nonadmitted assets but do not include AVR, IMR, Schedule F penalties and, in the case of a mortgage guaranty insurer, amounts attributable to its statutory contingency reserve to the extent that "tax and loss" bonds have been purchased. In general, temporary differences produce taxable income or result in tax deductions when the related asset is recovered or the related liability is settled. A deferred tax asset or liability represents the increase or decrease in taxes payable or refundable in future years as a result of temporary differences and carryforwards at the end of the current year. Additionally, gross DTAs are reduced by a statutory valuation allowance adjustment if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50%) that some portion or all of the gross DTAs will not be realized. The statutory valuation allowance adjustment, determined in a manner consistent with paragraphs 20-25 of FAS 109, shall reduce gross DTAs to the amount that is more likely than not to be realized (the adjusted gross deferred tax assets).[9] This answer only addresses the recognition of adjusted gross DTAs and gross DTLs and does not address the admissibility of such amounts. See Question 4 for a discussion of the admissibility criteria of SSAP No. 101.

2.2 Paragraph 7 of SSAP No. 101 states that temporary differences are identified and measured using a "balance sheet" approach whereby the statutory balance sheet and the tax basis balance sheet are compared. Operating loss, capital loss and tax credit carryforwards are computed in accordance with the applicable Internal Revenue Code.

[9] SSAP No. 101 requires the statutory valuation allowance adjustment to be presented in the annual statement as a direct reduction in the gross DTA. It is not included in non-admitted DTA.

2.3 The following illustrates the recognition and measurement of a typical book to tax difference for an insurance company:

Illustration

Assumptions:

1/1/X2 Purchase 100 shares of Darby/Allyn Corp. stock for $25 a share
3/31/X2 Fair Value of Darby/Allyn Corp. stock has increased to $35 a share
3/31/X2 Tax basis reserves are computed and determined to be 80% of the statutory basis reserves

Balance Sheet at 3/31/X2:

	Statutory Basis	**Tax Basis**	**Basis Difference**	**Tax Effect DTA (DTL) (21%)[10]**
Common Stock	$3,500	$2,500	($1,000) [11]	($210)
Reserves	$100,000	$80,000	$20,000 [12]	$4,200

Journal Entries:

1/1/X2	DR	Common stock	$2,500
	CR	Cash	($2,500)
		Acquisition of common stock at $25 per share	

3/31/X2	DR	Common stock	$1,000
	CR	Change in unrealized capital gains and losses	($1,000)
		Adjust carrying value to FV of $35 per share at end of quarter	

3/31/X2	DR	Change in reserves or unpaid losses	$100,000
	CR	Reserves or Unpaid losses	($100,000)
		Recognition of reserves computed on a statutory basis	
3/31/X2	DR	Deferred tax asset	$4,200
	CR	Change in deferred income taxes	($3,990)
	CR	Deferred tax liability	($210)
		Recognition of deferred taxes	

NOTE: Presentation of deferred tax amounts and unrealized gain or losses net of tax is addressed in Question 12.

2.4 As depicted in the Illustration, the deferred tax assets and liabilities are tracked gross in the entity's ledger and not netted until after consideration of the statutory valuation allowance adjustment, if any (see

[10] See Question 3 for a discussion of "enacted rates."

[11] The carrying value of the stock on the statutory balance sheet reflects the fair value of the common stock per *SSAP No. 30~~R~~—Unaffiliated Common Stock* whereas the carrying value of the stock for tax purposes is its original cost. This difference is defined as temporary in that the $1,000 appreciation in value will be recognized in the tax return when the stock is disposed of. The difference is a deferred tax liability in that the reversal of this temporary difference will increase future taxable income.

[12] The reserve difference arises because, even though tax reserves are based on statutory reserves, they generally are reduced below statutory reserves pursuant to various provisions of the Internal Revenue Code. This amount is a temporary difference in that the entity will recognize the difference between statutory and tax carrying values over the life of the reserve or upon settlement of the claim or payment of the reserve. The difference is a deferred tax asset in that the reversal of this temporary difference will decrease future taxable income.

below), and the admissibility of deferred tax assets.

Statutory Valuation Allowance Adjustment

2.5 SSAP No. 101 paragraph 7.e., provides that gross DTAs are reduced by a statutory valuation allowance *adjustment* if, based on the weight of available evidence, it is more likely than not that some portion or all of the gross DTAs will not be realized. The statutory valuation allowance adjustment is determined on a separate company, reporting entity basis. The determination of whether gross DTAs will be realized is based on the existence of sufficient taxable income of the appropriate character (ordinary income or capital gain) within the carryback, carryover period available under the tax law. Paragraph 13.a. through 13.d. of SSAP No. 101 identifies four sources of taxable income to be considered in evaluating the existence of sufficient taxable income. These sources are identical to those to be considered under FAS 109 paragraph 21. FAS 109 paragraph 20 provides that "all available evidence, both positive and negative, should be considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. Information about an enterprise's current financial position and its results of operations for the current and preceding years ordinarily is readily available. That historical information is supplemented by all currently available information about future years. Sometimes, however, historical information may not be available (for example, start-up operations) or it may not be as relevant (for example, if there has been a significant, recent change in circumstances) and special attention is required." A reporting entity is not required to consider all four sources of taxable income in determining the need for a statutory valuation allowance adjustment if one or more sources are alone sufficient to support the conclusion that the entity will realize the tax benefits of its gross deferred tax assets (i.e., a conclusion that no valuation allowance is necessary). However, the reporting entity is required to consider all of the potential sources of taxable income to determine the amount of the adjustment if a conclusion is reached that a statutory valuation allowance adjustment is necessary. SSAP No. 101 modifies FAS 109 related to admission of DTAs. Admission of DTAs is calculated irrespective of the conclusion reached in establishing or not establishing a statutory valuation allowance adjustment. See Question 4.13 for discussion regarding consideration of reversal patterns specific to paragraph 11.c. of the admissibility test.

2.6 Footnote 1 to paragraph 7.e. of SSAP No. 101 indicates that a reporting entity shall consider reversal patterns of temporary differences, and might be required to schedule such differences:

> …to the extent necessary to support establishing or not establishing a valuation allowance adjustment, determined in accordance with paragraphs 228 and 229 of FAS 109. For purposes of this accounting statement, consideration of reversal patterns does not require scheduling beyond that necessary to support establishing or not establishing a valuation allowance adjustment.

Paragraph 228 of FAS 109 generally holds that a company may need to schedule its temporary differences to determine the particular years in which the reversal of temporary differences is expected to occur. As discussed in Question 5b, paragraph 229 of FAS 109 indicates that future originating temporary differences and their subsequent reversal should be considered in determining the existence of future taxable income.

2.7 Although a reporting entity may need to consider the reversal pattern of temporary differences in evaluating the need for a statutory valuation allowance adjustment, scheduling the reversal pattern of such differences is not required in every instance. Under SSAP No. 101 and consistent with FAS 109, a general understanding of reversal patterns is, in many cases, relevant in assessing the need for a valuation allowance. Judgment is crucial in making this assessment. The amount of scheduling, if any, that will be required will depend on the facts and circumstances of each situation. For example, a reporting entity which relies upon future taxable income exclusive of reversing temporary differences and carryforwards[13] for realization of DTAs is not required to schedule the reversal pattern of its existing temporary differences.

[13] One of the four possible sources of taxable income that can be used to realize a tax benefit. See paragraph 13.b. of SSAP No. 101.

This is consistent with guidance provided by the Financial Accounting Standards Board (FASB) in its answer to question 2 of *A Guide to Implementation of Statement 109 on Accounting for Income Taxes: Question and Answers* (Special Report on Statement 109) which states that scheduling of existing temporary differences is unnecessary for purposes of determining the need for a valuation allowance "where it can be easily demonstrated that future taxable income will more likely than not be adequate to realize future tax benefits of existing deferred tax assets." In contrast, a reporting entity which relies upon the future reversal of existing taxable temporary differences to realize the tax benefits of its deductible temporary differences and carryforwards may be required to consider the reversal patterns of its taxable temporary differences.[14] The degree of scheduling required, however, depends on the facts and circumstances of each situation and the relative magnitude of the taxable and deductible temporary differences. In certain situations, the ability to reasonably conclude that reversing taxable temporary differences will more likely than not create sufficient taxable income to realize reversing deductible temporary differences can be done without detailed scheduling.[15]

2.8 If scheduling is considered necessary, the amount of scheduling required will depend on the particular facts and circumstances and be subject to judgment. There may be more than one acceptable approach. The FASB's answer to question 1 of the Special Report on Statement 109 indicates that the following concepts underlie the determination of reversal patterns under Statement 109:

a. The particular years in which temporary differences result in taxable or deductible amounts generally are determined by the timing of the recovery of the related asset or settlement of the related liability' (paragraph 228).

b. The tax law determines whether future reversals of temporary differences will result in taxable and deductible amounts that offset each other in future years' (paragraph 227).

In addition, the FASB noted that "minimizing complexity is an appropriate consideration in selecting a method for determining reversal patterns"[16], but that the methods used must be systematic and logical and should be consistently applied for all similarly categorized temporary differences and from year to year. Furthermore, the same method should be utilized in determining the reversal patterns in every taxing jurisdiction for which the temporary difference exists.

[14] For example, due to the relatively short loss carryback periods (or, in the case of entities taxed as life insurance companies, no carryback of operating losses) under current tax law, such consideration may be appropriate when taxable temporary differences are expected to reverse in a short number of future years while the deductible temporary differences are expected to reverse over a long number of future years. In addition, for "indefinite-lived" intangible assets (i.e., intangible assets like those discussed in paragraph 11 of FAS 142 for which no legal, regulatory, contractual, competitive, economic, or other factors limit their useful lives), predicting reversal of temporary differences related to such assets would be inconsistent with financial reporting assertions that the assets are indefinite-lived. In such a case, the reversal of taxable temporary differences with respect to such indefinite-lived intangible assets should not be considered a source of future taxable income when determining the statutory valuation allowance adjustment for entities taxed as non-life insurance companies. On the other hand, entities taxed as life insurance companies may, under current tax law, carry forward operating losses with no expiration period, subject to a utilization limit of 80% of taxable income (before the loss carry forward) in the carry forward year. In such case, the reversal of taxable temporary differences with respect to indefinite-lived intangible assets may be considered a source of taxable income, subject to the applicable tax law limitations.

[15] Q&A 2 from the Special Report on Statement 109 published by the FASB.

[16] Q&A 1 from the Special Report on Statement 109 published by the FASB.

Grouping of Assets and Liabilities for Measurement

2.9 The manner in which an entity groups its assets and liabilities for measurement shall be conducted in a reasonable and consistent manner. For instance, an entity may group its invested assets into annual statement classifications (stocks, bonds, preferred stocks, etc.) or other reasonable groupings (lines of business for grouping its reserves). Entities have the option of recognizing the DTA and DTL within each grouping on a net or gross basis. For instance, a portfolio of common stocks will have both unrealized gain and unrealized losses associated with them. The reporting entity may elect to combine the unrealized gains and losses and compute a single DTA or DTL or it may elect to segregate the unrealized gains from the unrealized losses and compute separate DTAs and DTLs. This option might also arise with respect to depreciable assets. Regardless of which method an entity elects, it is crucial that consistency is maintained to and within each grouping from period to period. An entity shall retain internal documentation to support its grouping in addition to the methodologies employed to arrive at such. An entity is permitted to modify its groupings should events or circumstances change from a previous period. Examples include a change in materiality of underlying assets and liabilities, administrative costs associated with detailing groupings increases or changes in the computer systems that allow more specificity. Entities that modify their groupings should be prepared to rationalize these changes. These entities should also disclose that a modification was made and general reason for such in the notes to the financial statements.

Measurement of Nonadmitted Assets

2.10 As noted in paragraph 7.b. of SSAP No. 101, temporary differences include nonadmitted assets. The measurement of these types of assets is not addressed in FAS 109 in that the concept of nonadmission is unique to statutory accounting. For assets that are nonadmitted for statutory accounting purposes, DTAs and DTLs should be measured after nonadmission.

Illustration:

	Statutory Before Nonadmit (Info Purpose)	**Statutory After Nonadmit**	**Tax**	**Basis Difference**[17]	**Tax Effect DTA (DTL)** (21%)
Furniture Fixtures and Equipment	$1,000	0	$1,000		
Accumulated Depreciation	200	0	400		
Basis	$800	0	$600	$600	$126

2.11 The effect of this illustration is a reduction of surplus by $674 ($800 decrease for nonadmitted asset and $126 increase for DTA), provided the resulting DTA meets the admissibility test in paragraph 11 of SSAP No. 101.

3. Q – A reporting entity's deferred tax assets and liabilities are computed using "enacted tax rates." What is **the meaning of the term "enacted tax rates"? [Paragraph 7.c.]**

3.1 A – Paragraph 7.c. of SSAP No.101 provides that total DTAs and DTLs are computed using enacted tax rates.

3.2 Consistent with FAS 109, SSAP No. 101 further requires that deferred tax assets and liabilities be measured using the enacted tax rate that is expected to apply to taxable income in the periods in which the deferred tax asset or liability is expected to be settled or realized. The effects of future changes in tax rates

[17] Difference is computed from the "Statutory After Nonadmit" balance.

are not anticipated in the measurement of deferred tax assets and liabilities. Deferred tax assets and liabilities are adjusted for changes in tax rates and other changes in the tax law, and the effects of those changes are recognized at the time the change is enacted.

3.3 Tax laws may apply different tax rates to ordinary income and capital gains. In instances where the enacted tax law provides for different rates on income of different character, deferred tax assets and liabilities should be measured by applying the appropriate enacted tax rate based on the type of taxable or deductible amounts expected to be realized from the reversal of existing temporary differences.

4a. Q – How should a reporting entity calculate the amount of its admitted adjusted gross DTAs? [Paragraph 11]

4.1 A – After a reporting entity has calculated the amount of its adjusted gross DTAs and gross DTLs pursuant to paragraph 7, it must determine the amount of its adjusted gross DTAs that can be admitted under paragraph 11, not to exceed the amount of total adjusted gross DTAs. The amount of adjusted gross DTAs is not recalculated under paragraph 11; rather, some or all of the adjusted gross DTA may not be currently admitted. As noted in paragraph 11, the net admitted DTA shall not exceed the excess of the adjusted gross DTAs over gross DTLs.

4.2 Paragraphs 11.a., 11.b. and 11.c. require three interdependent calculations or components that when added together equal the amount of the reporting entity's admitted adjusted gross DTAs. Each of the calculations starts with the total of the reporting entity's adjusted gross DTAs, and determines the amount of such adjusted gross DTAs that can be admitted under that part. For example, the consideration of existing temporary differences in the calculation of admitted adjusted gross DTAs under paragraph 11.a., does not prevent the reconsideration of the same temporary differences in the paragraph 11.b.i. calculation. However, to avoid duplication of admitted adjusted gross DTAs when adding the three parts together, the amount of admitted adjusted gross DTAs under paragraph 11.a. must be subtracted from the amount of adjusted gross DTAs in the paragraph 11.b.i. calculation. Similarly, the amount of admitted adjusted gross DTAs under paragraphs 11.a. and 11.b. must be subtracted from the total adjusted gross DTAs in the paragraph 11.c. calculation. For illustrations of the paragraph 11 DTA admission calculations, see Question 4.16 through Question 4.25.

First Component – Admission Based on Previously Paid Taxes [Paragraph 11.a.]

4.3 Under paragraphs 11.a. and 12.b., a reporting entity can admit adjusted gross DTAs to the extent that it would be able to recover federal income taxes paid in the carryback period, by treating existing temporary differences that reverse during a timeframe corresponding with Internal Revenue Code tax loss carryback provisions[18], not to exceed three years as ordinary or capital losses that originated in each such subsequent year. The reversing temporary differences are specific to each year in which they reverse, and in turn, to the specific year(s) to which they can be carried back corresponding with tax loss carryback provisions. Reversing temporary differences for unrealized losses and nonadmitted assets are treated as capital or ordinary losses depending on their character for tax purposes. The entity is not required to project an actual net operating loss in future periods. This first component of admission is available to all entities, regardless of whether they meet any of the threshold limitations in paragraph 11.b. for reversals expected to be realized against future taxable income.

4.4 Paragraph 12.b. limits the amount of federal income taxes recoverable under paragraph 11.a. to the amount that would be refunded to the reporting entity if a carryback claim was filed with the Internal Revenue Service (IRS). If some amount of taxes paid in the carryback period is not recovered because of

[18] For example, under the Federal Internal Revenue Code, ordinary losses can be carried back two years for entities taxed as nonlife insurance companies, while capital losses for entities taxed both as nonlife and life insurance companies can be carried back three years. For losses arising in tax years after 2017, entities taxed as life insurance companies are not permitted to carryback ordinary losses.

limitations imposed by the Alternative Minimum Tax system in effect in taxable years prior to 2018, the resulting AMT credit is not treated as a newly created DTA. Paragraph 12.c. further limits the amount of federal income taxes recoverable under paragraph 11.a. for a reporting entity that files a consolidated income tax return with one or more affiliates, to the amount that the reporting entity could reasonably expect to have refunded by its parent. See Question 8 for a further discussion of the impact of filing a consolidated federal income tax return.

Second Component – Admission Based On Projected Future Tax Savings [Paragraph 11.b.]

4.5 The amount of a reporting entity's adjusted gross DTAs that can be admitted pursuant to paragraph 11.b. is in part, dependent on the amount of the reporting entity's adjusted capital and surplus. Accordingly, a reporting entity must determine which Realization Threshold Limitation Table set forth in paragraph 11.b. is applicable to the reporting entity and then, based on its respective facts, determine what applicable period to apply under paragraph 11.b.i. and applicable percentage to use under paragraph 11.b.ii.

4.6 If the reporting entity is subject to risk-based capital requirements or is required to file a Risk-Based Capital Report with the domiciliary state, it should use the RBC Reporting Entity Table set forth in paragraph 11.b. Threshold limitations for this table are contingent upon the ExDTA ACL RBC ratio. See Question 4b for a discussion on the ExDTA ACL RBC ratio.

4.7 If the reporting entity is (1) either a mortgage guaranty insurer or financial guaranty insurer that is not subject to risk-based capital requirements, (2) is not required to file a Risk-Based Capital Report with the domiciliary state, and (3) the reporting entity meets the minimum capital and reserve requirements[19] for the state of domicile, then it should use the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table set forth in paragraph 11.b. Threshold limitations for this table are contingent upon the ratio of ExDTA Surplus plus contingency reserves divided by the minimum aggregate capital required (see further detail in paragraph 11.b.).

4.8 If the reporting entity (1) is not subject to risk-based capital requirements, (2) is not required to file a Risk-Based Capital Report with the domiciliary state, (3) is not a mortgage guaranty or financial guaranty insurer, and (4) meets the minimum capital and reserve requirements[19], it should use the Other Non-RBC Reporting Entity Table set forth in paragraph 11.b. Threshold limitations for this table are contingent upon the ratio of adjusted gross DTA less the amount of adjusted gross DTA admitted in paragraph 11.a. to adjusted capital and surplus.

4.9 The amount of admitted adjusted gross DTAs under paragraph 11.b.i., is limited to the amount that the reporting entity expects to realize within the applicable period as determined using the applicable Realization Threshold Limitation Table following the balance sheet date. See Question 6 for a further discussion of the meaning of "expected to be realized." See Question 4.2 regarding the amount of adjusted gross DTAs considered in the paragraph 11.b.i. calculation. The amount of admitted adjusted gross DTAs under the paragraph 11.a. calculation is subtracted from the amount of adjusted gross DTAs under paragraph 11.b.i., to prevent the counting of the same admitted adjusted gross DTAs more than once. If the reporting entity expects to realize an amount of adjusted gross DTAs under paragraph 11.b.i. that is equal to or less than the admitted adjusted gross DTAs calculated under paragraph 11.a., then the resulting admitted adjusted gross DTAs under paragraph 11.b.i. will be zero.

4.10 The reference to applicable period following the balance sheet date in 4.9 refers to the paragraph 11.b.i. column of the applicable Realization Threshold Limitation Table, the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table or the Other Non-RBC Reporting Entity Table.

4.11 The amount of admitted adjusted gross DTAs under paragraph 11.b.i. is also limited to an amount

[19] If a reporting entity is not at the minimum capital and reserve requirements, the admitted adjusted gross DTA for this component is zero.

that is no greater than the applicable percentage of adjusted statutory capital and surplus specified in paragraph 11.b.ii. See Question 4c for a discussion of the meaning of "an amount that is no greater than".

4.12 The reference to an amount no greater than the applicable percentage of statutory capital and surplus in 4.11 refers to the 11.b.ii. column of the applicable Realization Threshold Limitation Table; the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table or the Other Non-RBC Reporting Entity Table.

Third Component – Admission Based On Offset Against DTL [Paragraph 11.c.]

4.13 Under paragraph 11.c., a reporting entity can admit adjusted gross DTAs as an offset against gross DTLs in an amount equal to the lesser of: (1) its adjusted gross DTAs, after subtracting the amount of admitted adjusted gross DTAs under paragraphs 11.a. and 11.b., or (2) its gross DTLs. See Question 4.2 regarding the amount of adjusted gross DTAs considered in the paragraph 11.c. calculation. In determining the amount of adjusted gross DTAs that can be offset against existing gross DTLs in the paragraph 11.c. calculation, the character (i.e., ordinary versus capital) of the DTAs and DTLs must be taken into consideration such that offsetting would be permitted in the tax return under existing enacted federal income tax laws and regulations. For example, an adjusted gross DTA related to unrealized capital losses could not be offset against an ordinary income DTL. Ordinary DTAs can be admitted by offset with ordinary DTLs and/or capital DTLs. However, capital DTAs can only be admitted by offset with capital DTLs. In addition, for reporting entities that consider reversal of existing temporary differences in determining the need for a statutory valuation allowance adjustment, significant and relevant historical and/or currently available information may exist specific to the remaining amount of total adjusted gross DTAs and gross DTLs must also be taken into consideration in the determination of the admission of adjusted gross DTAs under paragraph 11.c. However, for those reporting entities, no scheduling is required beyond that necessary in determining the need for a statutory valuation allowance adjustment. As stated in paragraph 11.c., "for purposes of this component, the reporting entity shall consider the reversal patterns of temporary differences; however, this consideration does not require scheduling beyond that required in paragraph 7.e." See Question 2.5 through Question 2.8 for further discussion of scheduling for purposes of determining the reporting entity's statutory valuation allowance adjustment.) This consideration requires a scheduling exercise if scheduling is needed for determination of the statutory valuation allowance adjustment and, as a result, should be consistent with the determination of any statutory valuation allowance adjustment, which occurs prior to performing the admissibility calculations.[20] However, as noted in Question 2.7, scheduling reversal patterns of temporary differences in evaluating the need for a statutory valuation allowance adjustment where a reporting entity relies on sources of future taxable income, exclusive of reversals of temporary differences, is not required. In such case, that reporting entity is not required to schedule reversal patterns of temporary differences for purposes of paragraph 11.c. of SSAP No. 101. This is the case even if the reversal pattern of the temporary difference is readily determinable, such as straight-line amortization of a fixed amount. It also is the case if, for example, the reporting entity in determining its statutory valuation allowance adjustment has considered a source of future income reversal of existing temporary differences that are capital in character, but not those that are ordinary in character. In such case, the reporting entity is not required to schedule reversal patterns of ordinary temporary differences for purposes of paragraph 11.c.

[20] Footnote 1 of SSAP No. 101 provides that a reporting entity "shall consider reversal patterns of temporary differences *to the extent necessary* to support establishing or not establishing a valuation allowance adjustment." (Emphasis added).

Other Considerations

4.14 In certain situations, a reporting entity's expected federal income tax rate on its reversing temporary differences are expected to be less than the enacted tax rate used in the determination of its gross DTAs and DTLs. Examples of such entities include: Blue Cross-Blue Shield Organizations with section 833(b) deductions, reporting entities projecting a tax loss, and entities that file in a consolidated federal income tax return that cannot realize the full amount of their adjusted gross DTAs under the existing intercompany tax sharing or tax allocation agreement. Pursuant to paragraphs 231, 232 and 238 of FAS 109, such entities are required to report their gross DTLs at the enacted tax rate, and cannot take into consideration the impact of other adjustments such as the section 833(b) deduction to reduce their gross DTLs.

4.15 For those entities, the amount of admitted adjusted gross DTAs calculated under paragraph 11.a. will reflect the actual tax rate in the carryback period under paragraph 11.a. which takes into consideration the impact in the carryback years of the AMT and special deductions, as well as the provisions of the intercompany tax sharing or allocation agreement. Likewise, the amount of admitted adjusted gross DTAs calculated under paragraph 11.b. will reflect the expected tax rate in the applicable period as discussed in paragraph 4.14, which takes into consideration the impact of special deductions and the provisions of the intercompany tax sharing or allocation agreement. See Question 6 for further discussion of this issue. As such, the entity's admitted adjusted gross DTAs under paragraphs 11.a. and 11.b. may be less than its adjusted gross DTAs on temporary differences at the enacted rate. Any unused amount of DTAs resulting from this differential under paragraphs 11.a. and 11.b. can be used under paragraph 11.c. to offset existing DTLs.

4.16 The above principles can be illustrated by the following examples:

4.17 Facts:

RBC Reporting Entity Example

1. Life Insurance Company ABC[21] has $9,500,000 of deductible temporary differences ($6,000,000 ordinary and $3,500,000 capital) at 12-31-20X2 that generate $1,995,000 of gross DTAs ($1,260,000 ordinary, $735,000 capital), at the enacted federal income tax rate of 21%%. ABC has sufficient evidence of projected future taxable income exclusive of reversing temporary differences and carryforwards to support a conclusion that it will realize the full amount of its ordinary gross DTAs, and it was unnecessary in reaching that conclusion (i.e., that no valuation allowance adjustment need be established for ordinary DTAs) to consider reversal patterns of temporary differences. However, management has concluded, after considering all four sources of taxable income described in paragraph 13 of SSAP No. 101, that a statutory valuation allowance adjustment should be recognized for $168,000 of capital DTAs, reducing capital DTAs from $735,000 to $567,000. Thus, in total, management has concluded that ABC will more likely than not realize gross DTAs of $1,827,000 ($1,260,000 ordinary, $567,000 capital) related to its $9,500,000 of deductible temporary differences. ABC also has $4,000,000 of taxable temporary differences ($2,800,000 ordinary and $1,200,000 capital) resulting in $840,000 ($588,000 ordinary, $252,000 capital) of gross DTLs.

2. ABC has determined that $2,000,000 of its $6,000,000 existing deductible ordinary temporary differences will reverse in 20X3, another $1,500,000 will reverse in 20X4, and another $2,000,000 will reverse in 20X5. The remaining $500,000 of ABC's existing deductible ordinary temporary differences will reverse in years 20X6 or later. ABC has determined that $200,000, $300,000, and $400,000 of its $3,500,000 deductible capital temporary differences are

[21] Please note the results in this example may be different due to differences in the applicable carryback periods if ABC was taxed as a non-life insurance company.

expected to reverse in 20X3, 20X4, and 20X5, respectively, and the remaining $2,600,000 will reverse in years 20X6 or later.

3. ABC reported $400,000 ($300,000 ordinary, $100,000 capital) and $1,000,000 ($800,000 ordinary, $200,000 capital) of taxable income in 20X0 and 20X1, respectively. ABC reported $84,000 ($63,000 ordinary, $21,000 capital) and $210,000 ($168,000 ordinary, $42,000 capital) of tax expense on its 20X0 and 20X1 federal income tax returns, respectively. It has also projected taxable income of $1,500,000 ($1,200,000 ordinary, $300,000 capital) and $315,000 ($252,000 ordinary, $63,000 capital) of federal income taxes for 20X2 that have been reflected in its current statutory income tax provision calculation.

4. ABC expects to realize[22] a federal income tax benefit of 21% from 20X3 through 20X5 related to reversing ordinary temporary differences. ABC does not anticipate any capital gain income in 20X3 through 20X5.

5. ABC has an ExDTA ACL RBC Ratio at 12-31-20X2 of 600%. Adjusted statutory capital and surplus under paragraph 11.b.ii. is $7,000,000 at 12-31-20X2, and was computed by subtracting the admitted balances of net DTA's, goodwill and EDP from the current period statutory surplus. Statutory surplus is defined in paragraph 2 of SSAP No. 72.

6. The above facts are summarized in the following table:

	Ordinary	Capital	Total
20X2 – Current Year Taxable Income & Tax:			
Taxable Income in CY	$ 1,200,000	$ 300,000	$ 1,500,000
Tax Provision @ 21%	$ 252,000	$ 63,000	$ 315,000
Deductible Temporary Differences	$ 6,000,000	$ 3,500,000	$ 9,500,000
DTA @ 21%	$ 1,260,000	$ 735,000	$ 1,995,000
Taxable Temporary Differences	$ 2,800,000	$ 1,200,000	$ 4,000,000
DTL @ 21%	$ 588,000	$ 252,000	$ 840,000
Valuation Allowance		$ 168,000	$ 168,000
Carryback Taxable Income & Tax:			
20X0 Taxable Income	$ 300,000	$ 100,000	$ 400,000
Tax	$ 63,000	$ 21,000	$ 84,000
20X1 Taxable Income	$ 800,000	$ 200,000	$ 1,000,000
Tax	$ 168,000	$ 42,000	$ 210,000
Reversal of Deductible Temp Differences:			
20X3	$ 2,000,000	$ 200,000	$ 2,200,000
20X4	$ 1,500,000	$ 300,000	$ 1,800,000
20X5	$ 2,000,000	$ 400,000	$ 2,400,000
20X6 and later	$ 500,000	$ 2,600,000	$ 3,100,000
Total (before valuation allowance)	$ 6,000,000	$ 3,500,000	$ 9,500,000

4.18 Calculation of ABC's Admitted Adjusted Gross DTAs:

1. Paragraph 11.a. calculation. ABC cannot admit any ordinary adjusted gross DTAs under paragraph 11.a., because entities taxed as life insurance companies are not permitted to carry back ordinary tax losses under existing Federal income tax law. However, ABC can admit capital

[22] See Question 6 for discussion on the admittance calculation under paragraph 11.b.i. and what is meant by the phrase: "expected to be realized."

adjusted gross DTAs of $126,000 under paragraph 11.a. because all capital losses are permitted a 3-year carryback under existing Federal income tax law and ABC paid taxes on capital gains in each year 20X0-20X2.

a. ABC first carries $100,000 of the hypothetical capital loss[23] of $200,000 from 20X3 back to 20X0 recovering $21,000 in taxes paid. The remaining $100,000 of the 20X3 hypothetical capital loss ($200,000 – $100,000) is available for utilization in years 20X1 and 20X2.

b. ABC would carry the remaining $100,000 of the hypothetical capital loss from 20X3 back to 20X1 recovering $21,000 in taxes paid. In addition, ABC would carry back $100,000 of hypothetical capital loss from 20X4 to 20X1 to recover another $21,000 of taxes paid.[24]

c. ABC would carry the remaining $200,000 of the hypothetical capital loss from 20X4 plus an additional $100,000 of the hypothetical capital loss from 20X5 back to 20X2, recovering $63,000 in taxes projected to be paid.

2. Paragraph 11.b. calculation. ABC can admit $1,050,000 of adjusted gross DTAs under paragraph 11.b. Since ABC has an ExDTA ACL RBC ratio of 600%, the Realization Threshold Limitation Table provides that the company can use the thresholds of 3 years for projected realization and 15% of adjusted capital and surplus. The company expects to realize a federal income tax benefit of $1,155,000 ($5,500,000 X 21%) in 20X3 through 20X5 related to its reversing ordinary deductible temporary differences and $126,000 ($600,000 X 21%) in 20X3 through 20X5 related to its reversing capital deductible temporary differences (through carryback to 20X0-20X2).[25] The $1,281,000 amount ($1,155,000 + $126,000) must be reduced by the $126,000 of admitted adjusted gross DTAs under paragraph 11.a. to prevent double counting of the same income tax benefit. As a result, ABC has projected adjusted gross DTAs available for admission under this component of $1,155,000 ($1,281,000 – $126,000), all of which are ordinary in tax character. However, 15% of adjusted capital and surplus is a limiting factor in this example. As such, even though ABC has sufficient sources of future taxable income exclusive of reversing taxable temporary differences to realize a federal income tax benefit of $1,155,000 in 20X3 through 20X5 related to its reversing ordinary deductible temporary differences, admission of those temporary differences is limited to $1,050,000 ($7,000,000 X 15%).

3. Paragraph 11.c. calculation. ABC can admit $462,000 ($210,000 ordinary, $252,000 capital) of adjusted gross DTAs under paragraph 11.c. ABC has $1,827,000 of total adjusted gross DTAs available for admission under paragraph 11. These DTAs are made up of $1,260,000 ordinary DTAs and $567,000 of capital DTAs. To prevent double counting of admitted adjusted gross DTAs, the $1,260,000 of ordinary DTAs must be reduced by the $1,050,000 admitted under paragraph 11.b., leaving $210,000 for admission under paragraph 11.c. Likewise, the $567,000 of capital DTAs must be reduced by the $126,000 admitted under paragraph 11.a., leaving $441,000 for admission under paragraph 11.c. There are $588,000 of ordinary DTLs available to offset against the $210,000 of ordinary DTAs. There are $252,000 of capital DTLs available to offset against the $441,000 capital DTAs. However, the tax character of the DTAs and DTLs becomes a

[23] It should be noted that if ABC's hypothetical 20X3 carryback was insufficient to fully offset all capital gain income in 20X0, the company would not be allowed to carryback any of the hypothetical loss from 20X4 or 20X5 to 20X0 per paragraph 11.a., as 20X0 is outside of the timeframe corresponding with capital loss carryback provisions for an insurance company.

[24] If ABC would not have had sufficient hypothetical capital loss from 20X4 to carryback to 20X1, the company would not have been able to carryback its hypothetical capital loss of $400,000 from 20X5 back to 20X1 pursuant to the applicable tax loss carryback provisions.

[25] Because ABC projects no capital gain income in 20X3 through 20X5, it is not able to realize a federal income tax benefit on the remaining $300,000 of capital temporary differences reversing in that 3-year period.

limiting factor for this component. While ordinary DTAs can be offset against both ordinary and capital DTLs, the reverse is not allowed in the tax return (see Question 4.13). Because ABC did not consider reversal of existing temporary differences in determining that no valuation allowance was necessary for gross ordinary DTAs, it need not consider reversal patterns of temporary differences for admission of ordinary DTAs in its paragraph 11.c. calculation. On the other hand, because ABC was required to consider all four sources of taxable income specified in paragraph 13 of SSAP No. 101(including future reversals of existing taxable capital temporary differences) in establishing a valuation allowance for gross capital DTAs, it is required to consider reversal patterns of temporary differences for admission of capital DTAs in its paragraph 11.c. calculation, but this consideration does not require scheduling beyond that required by paragraph 7.e. of SSAP No. 101 (again see Question 4.13). In this situation, after the required consideration, ABC can admit $210,000 and $252,000 of its ordinary and capital DTAs, respectively.

4.19 Summary of ABC's Admitted Gross DTA Calculation:

	Ordinary	**Capital**	**Total**
Gross DTAs at Enacted Tax Rate	$1,260,000	$735,000	$1,995,000
Less: Statutory Valuation Allowance		$168,000	$168,000
Adjusted Gross DTAs at Enacted Tax Rate	$1,260,000	$567,000	$1,827,000
Admitted Gross DTAs (paragraph 11.a.)	0	$126,000	$126,000
Admitted Gross DTAs (paragraph 11.b.)	$1,050,000	0	$1,050,000
Admitted Gross DTAs (paragraph 11.c.)	$210,000	$252,000	$462,000
Total Admitted Adjusted Gross DTAs (sum of 11.a, 11.b., and 11.c)	$1,260,000	$378,000	$1,638,000
Nonadmitted Adjusted Gross DTAs	0	$239,000	$239,000
Admitted DTA	$1,260,000	$378,000	$1,638,000
Gross DTL	$(588,000)	$(252,000)	$(840,000)
Net Admitted DTA/DTL	$672,000	$126,000	$798,000

4.20 Facts:

Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Example

1. Financial Guaranty Insurance Company DEF has the same facts as Life Insurance Company ABC except:

a. DEF is not an RBC reporting entity and therefore does not calculate an RBC percentage. DEF is a financial guaranty insurer and has an ExDTA Surplus plus Contingency Reserve/Required Aggregate Risk Capital ratio of 105%. This ratio represents the sum of surplus to policyholders (excluding any admitted DTA from 11.a.) plus contingency reserves divided by the minimum aggregate capital required.

b. DEF reported $1,000,000 of taxable income and $210,000 of tax expense on its 20X1 federal income tax return. It has also projected taxable income of $1,500,000 and $315,000 of federal income taxes for 20X2 that has been reflected in its current statutory income tax provision calculation. DEF recognized no capital gain income in 20X1 or 20X2, so all of its taxable income in those years was ordinary in character. But DEF has $1,000,000 less deductible capital temporary differences than ABC and so, after considering all four sources of taxable income specified in paragraph 13 of SSAP No. 101, DEF establishes the same valuation allowance against gross capital DTAs as ABC. After the valuation allowance, DEF has $357,000 ($2,500,000 gross capital DTAs x 21% = $525,000 less $168,000 valuation allowance = $357,000) of adjusted gross capital DTAs.

4.21 Calculation of DEF's Admitted Adjusted Gross DTAs:

1. Paragraph 11.a. calculation. DEF can admit $525,000 ($210,000 + $315,000) of adjusted gross DTAs under paragraph 11.a, all of which are ordinary in tax character.

a. As an entity taxed as a nonlife insurance company, DEF, unlike ABC, is permitted to carry back ordinary tax losses. DEF first carries $1,000,000 of the hypothetical net operating loss[26] of $2,000,000 from 20X3 back to 20X1 recovering $210,000 in taxes paid. The remaining $1,000,000 of the hypothetical net operating loss ($2,000,000 – $1,000,000) is available for utilization in 20X2.

b. DEF would carry the remaining $1,000,000 of the hypothetical net operating loss from 20X3 plus an additional $500,000 of the hypothetical net operating loss from 20X4 back to 20X2 recovering $315,000 in taxes projected to be paid.[27]

2. Paragraph 11.b. calculation. DEF cannot admit any additional adjusted gross DTAs under paragraph 11.b. Since DEF has an ExDTA Surplus/Policyholders and Contingency Reserves ratio of 105%, the Realization Threshold Limitation Table provides that the company can use the thresholds of 1 year for projected realization and 10% of adjusted capital and surplus. The company expects to realize a federal income tax benefit of $420,000 ($2,000,000 X 21%) in 20X3 related to its reversing deductible temporary differences. The $420,000 amount must be reduced by the $525,000 of admitted adjusted gross DTAs under paragraph 11.a. to prevent double counting of the same income tax benefit. DEF admitted $105,000 ($525,000 - $420,000) more adjusted gross DTAs based on carryback of hypothetical net operating losses under paragraph 11.a. than is projected to be realized within the 1- year applicable threshold limitation. As a result, there is $0 of expected additional reversing deductible differences available for admission under paragraph 11.b.

3. Paragraph 11.c. calculation. DEF can admit $840,000 ($588,000 ordinary, $252,000 capital) of adjusted gross DTAs under paragraph 11.c. DEF has $1,617,000 of total adjusted gross DTAs available for admission under paragraph 11. These DTAs are made up of $1,260,000 ordinary DTAs and $357,000 of capital DTAs. To prevent double counting of admitted adjusted gross DTAs, the $1,260,000 of ordinary adjusted gross DTAs must be reduced by the $525,000 admitted under paragraph 11.a., leaving $735,000 for admission under paragraph 11.c. There are $588,000 of ordinary DTLs to offset against the $735,000 of ordinary DTAs. There are $252,000 of capital DTLs to offset against the $357,000 capital DTAs. However, the tax character of the DTAs and DTLs must be considered as a potential limiting factor for this component because while ordinary DTAs can be offset against both ordinary and capital DTLs, the reverse is not allowed in the tax return (see Question 4.13). In this situation, DEF can admit $588,000 and $252,000 of its ordinary and capital DTAs, respectively.28 If DEF's adjusted gross DTAs, after reduction for the amount of adjusted gross DTAs admitted under paragraphs 11.a. and 11.b., were less than $840,000 in this example, DEF would be

[26] It should be noted that if DEF's hypothetical 20X3 carryback was insufficient to fully offset all positive taxable income in 20X1, the company would not be allowed to carryback any of the hypothetical loss from 20X4 or 20X5 to 20X1 per paragraph 11.a., as 20X1 is outside of the timeframe corresponding with the tax loss carryback provisions for a non-life insurance company.

[27] If DEF would not have had sufficient hypothetical NOL from 20X4 to carryback to 20X2, the company would not have been able to carryback is hypothetical NOL of $2,000,000 from 20X5 back to 20X2 as 20X2 is outside of the timeframe corresponding with the tax loss carryback provisions for a nonlife insurance company.

[28] DEF's required consideration of reversal patterns of temporary differences is the same as ABC's. See Question 4.18.3.

limited to the balance of its adjusted gross DTAs in the paragraph 11.c. calculation, subject to the rules of offset under existing enacted federal income tax laws and regulations.

4.22 Summary of DEF's Admitted Gross DTA Calculation:

	Ordinary	**Capital**	**Total**
Gross DTAs at Enacted Tax Rate	$1,260,000	$525,000	$1,785,000
Less: Statutory Valuation Allowance		$168,000	$168,000
Adjusted Gross DTAs at Enacted Tax Rate	$1,260,000	$357,000	$1,617,000
Admitted Gross DTAs (paragraph 11.a.)	$525,000	$0	$525,000
Admitted Gross DTAs (paragraph 11.b.)	$0	0	$0
Admitted Gross DTAs (paragraph 11.c.)	$588,000	$252,000	$840,000
Total Admitted Adjusted Gross DTAs (sum of 11.a, 11.b., and 11.c)	$1,113,000	$252,000	$1,365,000
Nonadmitted Adjusted Gross DTAs	$147,000	$105,000	$352,000
Admitted DTA	$1,113,000	$252,000	$1,365,000
Gross DTL	$(588,000)	$(252,000)	$(840,000)
Net Admitted DTA/DTL	$525,000	$0	$525,000

4.23 Facts:

Other Non-RBC Reporting Entity Example

1. Title Insurance Company GHI has the same facts as Life Insurance Company ABC except:

a. GHI is not a RBC reporting entity and therefore does not calculate a RBC percentage. GHI is also not a financial guaranty or mortgage guaranty insurer. As such, GHI must use the Other Non-RBC Reporting Entity Threshold Limitation Table under paragraph 11.b.

b. GHI reported $1,000,000 of taxable income and $210,000 of tax expense on its 20X1 federal income tax return. It has also projected taxable income of $1,500,000 and $315,000 of federal income taxes for 20X2 that has been reflected in its current statutory income tax provision calculation. GHI recognized no capital gain income in 20X1 or 20X2, so all of its taxable income in those years was ordinary in character. But GHI has $1,000,000 less deductible capital temporary differences than ABC and so, after considering all four sources of taxable income specified in paragraph 13 of SSAP No. 101, GHI establishes the same valuation allowance against gross capital DTAs as ABC. After the valuation allowance, DEF has $357,000 ($2,500,000 gross capital DTAs x 21% = $525,000 less $168,000 valuation allowance = $357,000) of adjusted gross capital DTAs.

4.24 Calculation of GHI's Admitted Adjusted Gross DTAs:

1. Paragraph 11.a. calculation. GHI can admit $525,000 ($210,000 + $315,000) of adjusted gross DTAs under paragraph 11.a, all of which are ordinary in tax character.

a. As an entity taxed as a nonlife insurance company, GHI, unlike ABC, is permitted to carry back ordinary tax losses. GHI first carries $1,000,000 of the hypothetical net operating loss[29] of $2,000,000 from 20X3 back to 20X1 recovering $210,000 in taxes paid. The remaining $1,000,000 of the hypothetical net operating loss ($2,000,000 – $1,000,000) is available for utilization in 20X2.

b. GHI would carry the remaining $1,000,000 of the hypothetical net operating loss from 20X3 plus an additional $500,000 of the hypothetical net operating loss from 20X4 back to 20X2 recovering $315,000 in taxes projected to be paid.[30]

2. Paragraph 11.b. calculation. GHI can admit $630,000 of adjusted gross DTAs under paragraph 11.b. Since GHI has an Adjusted Gross DTA to Adjusted Capital and Surplus ratio of 15.6% ($1,092,000/$7,000,000), the Realization Threshold Limitation Table provides that the company can use the thresholds of 3 years for projected realization and 15% of adjusted capital and surplus. The company expects to realize a federal income tax benefit of $1,155,000 ($5,500,000 X 21%) in 20X3 through 20X5 related to its reversing deductible temporary differences. The $1,155,000 amount must be reduced by the $525,000 of admitted adjusted gross DTAs under paragraph 11.a. to prevent double counting of the same income tax benefit. As a result, GHI has projected adjusted gross DTAs available for admission under this component of $630,000 ($1,155,000 – $525,000), all of which is ordinary in tax character. 15% of adjusted capital and surplus ($7,000,000 X 15% = $1,050,000) is not a limiting factor in this example. As such, admission of reversing deductible temporary differences that are projected to be realized during 20X3 through 20X5 is $630,000.

3. Paragraph 11.c. calculation. GHI can admit $357,000 ($105,000 ordinary, $252,000 capital) of adjusted gross DTAs under paragraph 11.c. GHI has $1,617,000 of total adjusted gross DTAs available for admission under paragraph 11. These DTAs are made up of 1,260$,000 ordinary DTAs and $357,000 of capital DTAs. To prevent double counting of admitted adjusted gross DTAs, the $1,260,000 of ordinary adjusted gross DTAs must be reduced by the $525,000 admitted under paragraph 11.a. and the $630,00 admitted under paragraph 11.b., leaving $105,000 for admission under paragraph 11.c. There is $588,000 of ordinary DTLs available to offset against the $105,000 of ordinary DTAs. There is $252,000 of capital DTLs to offset against the $357,000 capital DTAs. Accordingly, the tax character of the DTAs and DTLs becomes a limiting factor for this component. While ordinary DTAs can be offset against both ordinary and capital DTLs, the reverse is not allowed in the tax return (see Question 4.13). In this situation, GHI can admit $105,000 and $252,000 of its ordinary and capital DTAs, respectively[31].

[29] It should be noted that if GHI's hypothetical 20X3 carryback was insufficient to fully offset all positive taxable income in 20X1, the company would not be allowed to carryback any of the hypothetical loss from 20X4 or 20X5 to 20X1 per paragraph 11.a., as 20X1 is outside of the timeframe corresponding with the tax loss carryback provisions for a non-life insurance company.

[30] If GHI would not have had sufficient hypothetical NOL from 20X4 to carryback to 20X2, the company would not have been able to carryback is hypothetical NOL of $2,000,000 from 20X5 back to 20X2 as 20X2 is outside of the timeframe corresponding with the tax loss carryback provisions for a nonlife insurance company.

[31] GHI's required consideration of reversal patterns of temporary differences is the same as ABC's. See Question 4.18.3.

4.25 Summary of GHI's Admitted Gross DTA Calculation:

	Ordinary	Capital	Total
Gross DTAs at Enacted Tax Rate	$1,260,000	$525,000	$1,785,000
Less: Statutory Valuation Allowance		$168,000	$168,000
Adjusted Gross DTAs at Enacted Tax Rate	$1,260,000	$357,000	$1,617,000
Admitted Gross DTAs (paragraph 11.a.)	$525,000	$0	$525,000
Admitted Gross DTAs (paragraph 11.b.)	$630,000	0	$630,000
Admitted Gross DTAs (paragraph 11.c.)	$105,000	$252,000	$357,000
Total Admitted Adjusted Gross DTAs (sum of 11.a, 11.b., and 11.c)	$1,260,000	$252,000	$1,512,000
Nonadmitted Adjusted Gross DTAs	$0	$105,000	$352,000
Admitted DTA	$1,260,000	$252,000	$1,512,000
Gross DTL	$(588,000)	$(252,000)	$(840,000)
Net Admitted DTA/DTL	$ 672,000	$0	$672,000

4b. Q – How is the ExDTA ACL RBC ratio calculated? [Paragraph 11.b.i.]

4.26 A – The December 31 ExDTA ACL RBC ratio is calculated in the same manner as in the ACL RBC Ratio computed in the Annual RBC Report, where Total Adjusted Capital (TAC) is divided by ACL RBC. However, for purposes of paragraph 11.b.i., TAC does not include any DTAs of the reporting entity. The ACL RBC would be the amount calculated in the Annual RBC Report.

4.27 The interim period (March 31, June 30, and September 30) ExDTA ACL RBC ratio calculation is discussed in 4.29-4.33.

4.28 For all companies, the TAC will include current period capital and surplus, excluding any DTAs of the reporting entity. Other TAC adjustments are dependent on whether the company is a Life, P&C or Health insurer.

4.29 For life companies, the AVR adjustment is calculated as a required part of the development of capital and surplus each quarter and is one of the major adjustments to TAC (added back to surplus). As noted on the illustrative interim TAC calculation in 4.33 for life companies, there are other TAC adjustments such as subsidiaries' dividend liabilities, etc., that are drawn from the quarterly statement.

4.30 For P&C and Health companies, except for the AVR and life subsidiaries' dividend liability amounts (both of which are only applicable to P&C companies with life subsidiaries), which are readily available on the quarter, the prior year's annual TAC adjustments should be used in the current quarter's TAC calculation. The P&C and Health interim TAC illustrations in 4.33 provide example details of various interim RBC TAC adjustments.

4.31 The ACL RBC used for the interim RBC calculation is the ACL RBC from the most recently filed annual statement for the most recent calendar year. For example, for June 30, 20X3, the ACL for the interim RBC calculation is taken from the 20X2 RBC Report based on the 20X2 annual statement.

4.32 In most instances, the prior year's annual ACL RBC will suffice. A company should only revise its interim ACL RBC for a material change in its risk profile when requested to do so by its domiciliary state or subject to domiciliary state approval.

4.33 The above principles are illustrated below:

Interim Life RBC Example			
Based on the 2018 Life RBC Report page LR033			
		Reported	Interim Period
	SOURCE OF THE DATA	12/31/20X2	3/31/20X3
Capital and Surplus	P3, L38	$1,800,000,000	$1,700,000,000
Adjustments:			
AVR	P3, L24.01	60,000,000	65,000,000
Dividend Liability	P3, L6.1, L6.2 in part	0	0
Sub AVR	P3, L24.01 of subs	5,000,000	4,500,000
Sub Dividend Liability	P3, L6.1, L6.2 in part of subs	0	0
P&C Non-Tabular Discounts and/or Alien Insurance Subsidiary: Other	P&C Subs P3, L1 & L3 in part	0	0
Hedging Fair Value Adjustment	Company Records	0	0
Credit for Capital Notes	P3, L24.11	0	0
Total Adjusted Capital (TAC)	5-Year Historical Data, P22, C1, L30	1,865,000,000	1,769,500,000
Less: Deferred Tax Asset	P2, C3, L18.2	190,000,000	200,000,000
TAC ExDTA		$1,675,000,000	$1,569,500,000
Authorized Control Level RBC	5-Year Historical Data	$175,000,000	$175,000,000*
Total Adjusted Capital ExDTA/Authorized Control Level RBC		957%	897%
*ACL RBC amount for interim period is the 12/31/20X2 amount			

Interim P&C RBC Example			
(Based on the 2018 P&C RBC Report page PR026			
		Reported	Interim Period
	SOURCE OF THE DATA	12/31/20X2	3/31/20X3
Capital and Surplus	P3, C1, L37 (Ann. & Qtrly. Stmt.)	$850,000,000	$765,000,000
Adjustments:			
Non-Tabular Discount-Losses	SCHEDULE P P1-SUM C32, L12 (Ann. Stmt. Only)	(800,000)	(800,000)
Non-Tabular Discount-Expense	SCHEDULE P P1-SUM C33. L12 (Ann. Stmt. Only)	(60,000)	(60,000)
Discount on Medical Loss Reserves Reported as Tabular in Schedule P	Company Records	0	0

Discount on Medical Expense Reserves Reported as Tabular in Schedule P	Company Records	0	0
P&C Subs Non-Tabular Discount-Losses	SCHEDULE P P1-SUM C32, L12 (Ann. Stmt. Only)	0	0
P&C Subs Non-Tabular Discount-Expenses	SCHEDULE P P1-SUM C33, L12 (Ann. Stmt. Only)	0	0
P&C Subs Discount on Medical Loss Reserves Reported as Tabular in Schedule P	Subs' Company Records	0	0
P&C Subs Discount on Medical Expense Reserves Reported as Tabular in Schedule P	Subs' Company Records	0	0
AVR - Life Subs	Subs P3, C1, L24.01 (Ann. & Qtrly. Stmt.)	5,000,000	6,000,000
Dividend Liability - Life Subs	Subs P3 C1 L6.1 + L6.2 (Ann. & Qtrly. Stmt.)	0	0
Total Adjusted Capital	5-Year Historical Data P17, C1, L28	854,140,000	770,140,000
	(Annual/Current calc. on Qtr.)		
Less: Deferred Tax Asset	P2, C3, L18.2 (Ann. & Qtrly. Stmt.)	82,000,000	72,000,000
Total Adjusted Capital ExDTA	PR026 (Annual RBC Report/Current Calc. on Qtr.)	772,140,000	698,140,000
Authorized Control Level Risk-Based Capital	5-Year Historical Data P17, C1, L29 (Annual)	171,000,000	171,000,000*
Total Adjusted Capital ExDTA/ Authorized Control Level Risk-Based Capital		452%	408%
*ACL RBC amount for interim period is the 12/31/20X2 amount			

Interim Health RBC Example			
(Based on the 2018 Health RBC Report page XR024			
		Reported	Interim Period
	SOURCE OF THE DATA	12/31/20X2	3/31/20X3
Capital and Surplus	P3, C3, L33 (Ann. & Qtrly. Stmt.)	$850,000,000	$765,000,000
Adjustments:			
AVR – Life Subs	Subs' Company Records	0	0
Dividend Liability – Life Subs	Subs' Company Records	0	0
Tabular Discounts – P&C subs	Subs' Company Records	0	0
Non-Tabular Discounts – P&C Subs	Subs' Company Records	0	0

Total Adjusted Capital	5-Year Historical Data P28, C1, L14 (Annual/ Current calc. on Qtr.)	850,000,000	765,000,000
Less: Deferred Tax Asset	P2, C3, L18.2 (Ann. & Qtrly. Stmt.)	82,000,000	72,000,000
Total Adjusted Capital ExDTA	XR 24 (Annual RBC Report/Current Calc. on Qtr.)	768,000,000	693,000,000
Authorized Control Level Risk-Based Capital	5-Year Historical Data P28, C1, L15 (Annual)	171,000,000	171,000,000*
Total Adjusted Capital ExDTA/ Authorized Control Level Risk-Based Capital		449%	405%
*ACL RBC amount for interim period is the 12/31/20X2 amount			

4c. Q – What is meant by the phrase "an amount that is no greater than"? [Paragraph 11.b.ii.]

4.34 A – As discussed in question 4.11 the amount of admitted adjusted gross DTAs under paragraph 11.b.i. is also limited to an amount that is no greater than the applicable percentage of statutory capital and surplus test specified in paragraph 11.b.ii. For purposes of this test, statutory capital and surplus as shown on the statutory balance sheet of the reporting entity for the current period's statement filed with the domiciliary state commissioner is adjusted to exclude any net DTAs, EDP equipment and operating system software and any net positive goodwill.

4.35 The phrase "an amount that is no greater than" in paragraph 11.b.ii. allows an entity to utilize an amount lower (e.g., from the reporting entity's most recently filed statement) than what would be allowed if it utilized the amount of statutory capital and surplus adjusted to exclude any net DTAs, EDP equipment and operating system software and any net positive goodwill as required to be shown on the statutory balance sheet of the reporting entity for the current period's statement filed with the domiciliary state commissioner. This ability to utilize a lower amount is for administrative ease if a reporting entity's surplus is increasing.

4.36 For example, at 12/31/20X2 if adjusted capital and surplus is $100M and at 9/30/20X2 it was $80M, the entity may utilize the $80M amount from the prior quarter.

4.37 If instead 12/31/20X2 adjusted capital and surplus were $60M, the entity may not utilize the $80M amount from the prior quarter as that would overstate the limitation under paragraph 11.b.ii.

4.38 If at 12/31/20X2 an entity's adjusted capital and surplus was initially determined to be $150M, the entity can still utilize that amount under paragraph 11.b.ii., if there is a late accounting adjustment that increases that amount to $160M.

5a. Q – How is the timing of reversals of temporary differences and carryforwards determined for SSAP No. 101 purposes? [Paragraphs 7, 11.a., 11.b.i. and 12.a.]

5.1 A – The timing of temporary difference reversals is critical in determining the amount of admitted adjusted gross DTAs. Determining the reversal of temporary differences impacts the adjusted gross DTA admitted pursuant to paragraphs 11.a., 11.b.i. and potentially 11.c. of SSAP No. 101. For purposes of paragraph 11.c., determining the reversal of temporary differences is necessary only to the extent required by paragraph 7.e. as discussed in Question 4.13.

5.2 Paragraph 12.a. of SSAP No. 101 states that "For purposes of paragraph 11.a., existing temporary differences that reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years, shall be determined in accordance with paragraphs 228 and 229 of FAS 109." The timing of reversals of temporary differences and carryforwards for purposes of paragraph 11.b. of SSAP No. 101 shall be determined under similar principles.

5.3 Paragraph 228 of FAS 109 states, in pertinent part, that "[t]he particular years in which temporary differences result in taxable or deductible amounts generally are determined by the timing of the recovery of the related asset or settlement of the related liability." Question 1 of the FASB's Special Report on Statement 109 provides additional guidance on scheduling. It defines "scheduling" as the analysis performed to determine the pattern and timing of the reversal of temporary differences. The FASB's Special Report also provides certain scheduling guidelines to be followed, including the need for the method employed to be systematic and logical, that a consistent method be used for each category of temporary differences, and that a change in the method used be considered a change in accounting principle.

5.4 Assume Company A purchases its only asset for $1,000, an asset that is admissible for statutory accounting purposes and depreciated over five years on a straight-line basis. Assume also that the asset is depreciated over seven years for tax purposes using the Modified Accelerated Cost Recovery System (MACRS). The following table summarizes the statutory and tax basis of the asset at the end of each year.

Year	Cost	Statutory Depreciation	Statutory Basis	Tax Depreciation	Tax Basis	Deductible/ (Taxable) Temporary Difference
1	$1,000	$200	$800	$143	$857	$57
2	-	200	600	245	612	12
3	-	200	400	175	437	37
4	-	200	200	125	312	112
5	-	200	-	89	223	223
6	-	-	-	89	134	134
7	-	-	-	89	45	45
8	-	-	-	45[32]	-	-

5.5 At the end of year one, the Company would conclude that $45 ($57 - $12) of the $57 outstanding deductible temporary difference would reverse within one year, leaving a temporary difference of $12 at the end of year two. However, for computing a two or three-year reversal, the Company would not project a reversal of the temporary difference by the end of year three or four as the deductible temporary difference is scheduled to increase (from $12 to $37 and from $37 to $112, respectively). If the Company had decided to sell the asset in year two, it may be appropriate to conclude that the outstanding deductible temporary difference of $57 would reverse in year two.

[32] Due to the mid-year convention applicable to most asset acquisitions for tax purposes, the asset is treated as acquired in mid-year, meaning that a seven (7) year asset is depreciated over eight (8) tax years.

5.6 A similar rationale would apply in the instance of a nonadmitted asset. Assume the same facts as aforementioned, except that the asset is nonadmitted for statutory accounting purposes. The results are summarized in tabular form below.

Year	Cost	Statutory Charge to Surplus	Statutory Basis	Tax Depreciation	Tax Basis	Deductible/ (Taxable) Temporary Difference
1	$1,000	$1,000	-	$143	$857	$857
2	-	-	-	245	612	612
3	-	-	-	175	437	437
4	-	-	-	125	312	312
5	-	-	-	89	223	223
6	-	-	-	89	134	134
7	-	-	-	89	45	45
8	-	-	-	45	-	-

5.7 In this example, the Company has a steady decline in the deductible temporary difference that is not complicated by competing depreciation regimes. This is due to the fact that the Company took the large surplus charge when the asset was nonadmitted, thereby creating a significant deductible temporary difference. The Company would project a $245 temporary difference reversal in year two (from $857 to $612), a $175 temporary difference reversal in year three (from $612 to $437), and a $125 temporary difference reversal in year four (from $437 to $312). Although the Company will take income statement charges for depreciation on the nonadmitted asset, the statutory basis is nonetheless zero from the moment the asset was nonadmitted. Future statutory depreciation deductions will not impact the statutory basis and have no impact on the analysis.

5.8 The above examples assume a single asset. However, the analysis becomes more complicated when the Company has hundreds or thousands of assets within its fixed asset pool. In this instance, it is expected that management will make its best estimate of the expected reversal pattern determined in a manner consistent with the grouping for measurement (see question 2 for more discussion about grouping).

5.9 As indicated above, the timing of the reversal of a particular balance sheet item will depend on the expected recovery of the related asset and liability. For example, the temporary difference associated with property & casualty loss reserves would be expected to reverse in a manner consistent with the payout pattern ("development") of the underlying loss reserves. Historical loss development triangles may be useful in substantiating a reversal pattern. For instance, assume Company A writes two types of property and casualty policies: auto liability and workers' compensation. The following table details the components of the statutory and tax reserves for Company A as of December 31, 20X2.[33]

Private Passenger Auto Liability	Statutory Reserves	Tax Reserves	Temporary Difference
AY + 0	$1,000	$900	$100
AY + 1	850	690	160
AY + 2	700	580	120
AY + 3	550	490	60
AY + 4	400	385	15
AY + 5	300	275	25
AY + 6	200	175	25
AY + 7	100	90	10
AY + 8	80	75	5

[33] Under current tax law, the loss payment period extends for more years, but the concepts illustrated herein are unchanged.

AY + 9	70	65	5
Prior	50	45	5
Total	$4,300	$3,770	$530

Workers' Compensation	Statutory Reserves	Tax Reserves	Temporary Difference
AY + 0	$1,000	$825	$175
AY + 1	900	800	100
AY + 2	850	770	80
AY + 3	790	695	95
AY + 4	725	610	115
AY + 5	695	600	95
AY + 6	655	575	80
AY + 7	605	545	60
AY + 8	575	505	70
AY + 9	550	495	55
Prior	505	450	55
Total	$7,850	$6,870	$980

5.10 One option in analyzing the reversal of the temporary difference would be to calculate the historical loss development patterns for the two lines of business by accident year for each year in the applicable reversal period. By applying these development patterns to the individual temporary differences, the Company could estimate the expected reversal of the temporary difference as a whole for each year in the applicable reversal period.

5.11 Another option would be to apply the average development factor by line of business to each reserve for each year in the applicable reversal period. If the average one-year development factor for all accident years for auto liability and workers' compensation were 70% and 35%, respectively, the one-year temporary difference reversal would be $371 ($530 x 70%) for auto liability and $343 ($980 x 35%) for workers' compensation. The same approach could be used in determining the reversal for any other year in the applicable reversal period.

5.12 The temporary difference related to property and casualty unearned premiums is typically 20% of the outstanding statutory unearned premium reserve. If a company issues only one-year policies, it is reasonable to assume that the entire temporary difference will reverse in one year. If a company writes multi-year contracts, management will be required to estimate the percentage of the unearned premium that will be earned within each year of the applicable reversal period and apply these percentages to the outstanding temporary difference.

5.13 The reversal of the temporary difference related to life insurance reserves may require actuarial assistance, normally involving anticipated development of the statutory and tax reserves for policies issued prior to the end of the current reporting year. In computing the anticipated development, it would be expected that reasonable assumptions be used, which may include cash-flow modeling of the entity's reserves. Deferred acquisition costs on life insurance policies are amortized over prescribed periods pursuant to federal tax law. The amortization schedules should provide management with the ability to estimate the reversal for each year in the applicable reversal period with reasonable accuracy.

5.14 For those temporary differences that do not have a defined reversal period, such as unrealized losses on common stock or deferred compensation liabilities, management will need to determine when the temporary difference is "expected" to reverse. For instance, assume a company has an unrealized loss of $200 in its equity portfolio and that, on average, the portfolio turns over 20% per year. It would be appropriate for the company to conclude that $40 of the temporary difference will reverse in each year in the applicable reversal period. When determining when the temporary difference would be "expected" to reverse, management should normally consider events that are likely to occur using information, facts and circumstances in existence as of the reporting date. The estimates used in this circumstance should not be extended to other tests of impairment. For instance, when the entity assumed a 20% turnover in its equity portfolio, it is not involuntarily required to record an impairment in accordance with paragraph 11 of *SSAP No. 30~~R~~—Unaffiliated Common Stock*.

5.15 In summary, the methodology used to develop the reversal pattern should be consistent, systematic, and rational. Although consistency is encouraged, business conditions may dictate that certain factors be given more or less weight than in previous periods. Factors to be considered include historical patterns, recent trends, and the likely impact of future initiatives (without regard to future originating temporary differences). For instance, if a company has migrated to a more efficient claims management system, outstanding reserves may be settled more quickly than historical payment patterns may indicate. A company that expects to enter into a loss portfolio transfer reinsurance transaction should consider the implications of that treaty in determining the reversal of the loss reserve temporary difference.

5b. Q – How should future originating differences impact the scheduling of temporary difference reversals during the applicable period? [Paragraphs 11.a., 11.b.i., 11.c. and 12.a]

5.16 A – Future originating differences, and their subsequent reversals, are considered in assessing the existence of future taxable income. However, they should not impact the scheduling of existing temporary difference reversals during the applicable period. Paragraph 229 of FAS 109 provides the following:

> 229. For some assets or liabilities, temporary differences may accumulate over several years and then reverse over several years. That pattern is common for depreciable assets. Future originating differences for existing depreciable assets and their subsequent reversals are a factor to be considered when assessing the likelihood of future taxable income (paragraph 21(b)) for realization of a tax benefit for existing deductible temporary differences and carryforwards.

6. Q – What is meant by the phrase "expected to be realized"? [Paragraph 11.b.i.]

6.1 A – A reporting entity calculates the amount of its adjusted gross DTAs and gross DTLs under paragraph 7 using the enacted tax rate. The amount of adjusted gross DTAs and gross DTLs is not recalculated under paragraph 11. The purpose of paragraph 11 is to determine the amount of adjusted gross DTAs that can be admitted in the reporting period.

6.2 An excerpt of SSAP No. 4 – *Assets and Nonadmitted Assets* indicates:

> 2. For purposes of statutory accounting, an asset shall be defined as: probable[34] future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.

6.3 The phrase "expected to be realized" encompasses a reasonable expectation as to the value of the DTAs consistent with SSAP No. 4. This means that if a reporting entity's management expects that deductible temporary differences that reverse in the applicable period will produce a federal income tax benefit at a rate that is lower than the enacted rate, the expected rate should be taken into consideration in the determination of the amount of admitted adjusted gross DTAs under paragraph 11.b.i. In other words, available evidence causes the reporting entity to expect the asset to be realized at less than the enacted rate. In such cases, it would not be appropriate to calculate the amount of admitted adjusted gross DTAs under

[34] *FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements* (CON 6) states, "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, par. 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."

paragraph 11.b.i. on the basis of reversing deductible temporary differences at the enacted tax rate.

6.4 The following examples illustrate situations where the amount of admitted adjusted gross DTAs under paragraph 11.b.i. would be less than the adjusted gross DTAs calculated using deductible temporary differences reversing in the applicable period at the enacted income tax rate. The approach in these examples is to determine the tax savings that the company would expect to realize from its reversing deductible temporary differences. This is accomplished through a calculation of the company's income tax liability "with and without" these temporary differences. It is assumed that in these examples there are no prudent and feasible tax-planning strategies that would cause the entity to expect the asset to be realized at a rate different than that presented in the examples.

Example 1:

6.5 BCBS is a Blue Cross/Blue Shield Organization that expects to fully offset its regular taxable income with available section 833 (b) deductions in 20X2. Prior to considering the section 833 (b) deduction, BCBS projects $8,000,000 of taxable income in 20X3, which includes $3,000,000 of reversing deductible temporary differences that were part of its def erred inventory at 12/31/X2. The Company's ExDTA ACL RBC percentage is 250% and therefore it is required to use the one-year applicable period under paragraph 11.b.i.

20X3	**Without Reversing Temporary Differences**	**With Reversing Temporary Differences**
Taxable Income Before 833(b)	$11,000,000	$11,000,000
Reversing Temporary Differences		(3,000,000)
Net	11,000,000	8,000,000
Section 833 (b) Deduction	(11,000,000)	(8,000,000)
Taxable Income	C 0	0
Tax	0	0

6.6 BCBS has a 0% effective tax rate on taxable income in 20X3Its regular taxable income is $0, both "with and without" the $3,000,000 reversing deductible temporary differences since the section 833 (b) deduction changes by an equal amount. Therefore, BCBS would admit zero adjusted gross DTAs under paragraph 11.b.i., before reduction for any adjusted gross DTAs admitted under paragraph 11.a. The unused amount of adjusted gross DTAs related to the 21% rate differential under paragraph 11.b.i. would be taken into account under paragraph 11.c. as part of the amount of adjusted gross DTAs, after reduction for adjusted gross DTAs admitted under paragraphs 11.a. and 11.b., that can be offset against existing gross DTLs. The same approach would be used in 20X4 and 20X5 if the Company instead qualified for the three-year applicable period under paragraph 11.b.i.

Example 2:

6.7 ABC, a company taxed as a nonlife insurance company, is projecting an income tax loss in 20X3 of $20,000,000, which includes $5,000,000 of reversing deductible temporary differences that were part of its deferred inventory at 12/31/X2. ABC expects to pay $0 federal income taxes in 20X3 as a result of its tax loss. The Company's ExDTA ACL RBC percentage is 250% and therefore, it is required to use the one-year applicable period under paragraph 11.b.i.

20X3	Without Reversing Temporary Differences	With Reversing Temporary Differences
Taxable Income (Loss)	($15,000,000)	($15,000,000)
Reversing Temporary Differences		(5,000,000)
Taxable Income (Loss)	(15,000,000)	(20,000,000)
Tax	0	0

6.8 In 20X3, ABC expects to realize no tax benefit related to the $5,000,000 of reversing deductible temporary differences since they simply increase the amount of an NOL. Its expected income tax rate for 20X3 would be 0% and ABC would have $0 admitted adjusted gross DTAs under paragraph 11.b.i. However, if some or all of the reversing temporary differences could be absorbed in the carryback period, ABC would have an admitted adjusted gross DTA under paragraph 11.a.[35] The adjusted gross DTAs of $1,050,000 ($5,000,000 x 21%), related to ABC's reversing temporary differences, would also be available as part of its total adjusted gross DTAs, after reduction for adjusted gross DTAs admitted under paragraphs 11.a. and 11.b., that can be offset against gross DTLs in the paragraph 11.c. calculation.

6.9 If a company qualified to utilize the three-year applicable period under paragraph 11.b.i. and within that applicable period forecasted a taxable loss in one or more of the years and taxable income in the other years, the loss may be utilized in determining the with and without calculation. This loss utilization must be within the applicable period and would be limited to the amount allowed to be carried back or carried forward under applicable tax law.

7. Q – SSAP No. 101 provides that a reporting entity may admit deferred tax assets in an amount equal to federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years, including any amounts established in accordance with the provisions of SSAP No. 5~~R~~ as described in paragraph 3.a. of this statement related to those periods. What is the meaning of the term "taxes paid"? [Paragraph 11.a.]

7.1 A – Under paragraph 11.a. of SSAP No. 101, the term "taxes paid" means the total tax (not including interest and penalties), that was or will be reported on the reporting entity's federal income tax returns for the applicable carryback period including any amounts established in accordance with the provision of SSAP No. 5~~R~~ as described in paragraph 3.a. of SSAP No. 101 related to those periods. If a federal income tax return in the applicable carryback period has been amended, or adjusted by the IRS, "taxes paid" would reflect the impact of the amended tax return, or settlement with the IRS.

7.2 In applying the term "taxes paid" to a reporting entity that is party to a consolidated federal income tax return, the term "taxes paid" means the total federal income tax that was paid, or is expected to be paid to the common parent of the reporting entity's affiliated group, in accordance with the intercompany tax sharing agreement, with respect to the income tax years included in the applicable carryback period. "Taxes paid" includes amounts established in accordance with the provision of SSAP No. 5~~R~~ as described in paragraph 3.a. of SSAP No. 101 related to those periods, including current federal income taxes payable (i.e., accrued in the entity's financial statements) related to the applicable carryback period. The ability of the reporting entity to recover (through loss or credit carrybacks) taxes that were paid to its common parent is generally governed by the terms and provisions of the affiliated group's intercompany tax sharing or tax allocation agreement.

7.3 For purposes of paragraphs 7.1 and 7.2, "taxes paid" includes both regular tax and alternative minimum tax for taxable years beginning before January 1, 2018. For taxable years beginning after

[35] For purposes of determining the amount of admitted adjusted gross DTAs under paragraph 11.a., ABC would look to the amount of existing temporary differences that reverse during a timeframe corresponding with the tax loss carryback provisions allowed by the applicable tax law, in this case 2 years, notwithstanding that it is limited to a one-year applicable period for purposes of paragraph 11.b.i.

December 31, 2017, the applicable carryback periods are two years for ordinary losses for entities taxed as nonlife insurance companies, and three years for capital losses for entities taxed both as nonlife and life insurance companies. Entities taxed as life insurance companies are not permitted to carryback ordinary losses arising in tax years after 2017.

8. Q – How is a company's computation of adjusted gross and admitted adjusted gross deferred tax assets impacted if it joins in the filing of a consolidated federal income tax return? [paragraphs 7, 11, 12 and 16]

8.1 A – For purposes of determining the amount of DTAs and the amount admitted under paragraph 11, the calculation should be made on a separate company, reporting entity basis. Under paragraph 7, a reporting entity's gross deferred tax assets and liabilities are determined by identifying its temporary differences. These temporary differences are measured using a "balance sheet" approach by comparing statutory and tax basis balance sheets for that entity. Once a reporting entity determines its gross DTAs, they are reduced for any statutory valuation allowance adjustment that may be necessary to determine the adjusted gross DTAs. The amount of adjusted gross DTAs that are admitted is determined in accordance with paragraph 11.

8.2 Under paragraph 11.a., an entity shall determine the amount of "federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years." Such amount shall include any amounts established for tax loss contingencies in accordance with paragraph 3.a. Consistent with guidance promulgated in other EAIWG interpretations, a reporting entity that files a consolidated federal income tax return with its parent should look to the amount of taxes it paid (or were allocable to it) as a separate legal entity in determining the admitted adjusted gross DTAs under paragraph 11.a. Furthermore, the admitted adjusted gross DTAs under paragraph 11.a. may not exceed the amount that the entity could reasonably expect to have refunded by its parent (paragraph 12.c.). The taxes paid by the reporting entity represent the maximum DTAs that may be admitted under paragraph 11.a., although the amount could be reduced pursuant to the group's tax allocation agreement.

8.3 The amount of admitted adjusted gross DTAs under paragraph 11.b.i. is limited to the amount that the reporting entity expects to realize within the applicable period (refer to the 11.b.i. column of the applicable Realization Threshold Limitation Table in paragraph 11.b.) following the balance sheet date on a separate company basis. The entity must estimate its separate company taxable income and the tax benefit that it expects to receive from reversing deductible temporary differences in the form of lower tax payments to its parent. If the reporting entity has reversing adjusted gross DTAs during the applicable period for which it does not expect to realize a benefit under paragraph 11.b. on a separate company basis, the reporting entity cannot admit an amount related to such DTAs under paragraph 11,b., even though the reporting entity may be paid a tax benefit for such items pursuant to its tax allocation agreement.

8.4 The following examples reflect this analysis and assume that the surplus limitation of paragraph 11.b.ii. is not applicable:

Example 1:

8.5 Assume Company A, an entity taxed as a nonlife insurance company, joins in the filing of a consolidated federal income tax return. Consolidated taxes paid in prior carryback years total $150, of which Company A paid $100. Company A has existing temporary differences that reverse by the end of the second calendar year following the balance sheet date[36] that, on a separate company reporting entity

[36] Corresponds to the timeframe permitted by the Internal Revenue Code for carrybacks of tax losses for a nonlife insurance company. For tax years beginning after 2017, entities taxed as life insurance companies are not permitted to carry back ordinary tax losses. However, entities taxed both as life insurance and nonlife insurance companies are permitted to carry back capital losses three taxable years. Accordingly, if this example involved a capital loss, it could apply either to an entity taxed as a life insurance company or as a nonlife insurance company.

basis and following the applicable carryback provisions of the Internal Revenue Code for each year in which temporary differences reverse, would give rise to a tax recovery of $125.

8.6 Under paragraph 11.a., Company A could record an admitted DTA of $100, equal to the taxes it paid. Due to the consolidated return filing, the $100 admitted under paragraph 11.a. could only be admitted provided this amount could reasonably be expected to be refunded by the parent [paragraph 12.c.] and would be available pursuant to a written income tax allocation agreement [paragraph 16.b.]. Additionally, assume Company A's ExDTA ACL RBC exceeds 300%, and that it expects to realize $175 from 3 years of DTA reversals, based on its separate company analysis. A 3-year period is applicable for paragraph 11.b.i., notwithstanding that only 2 years of DTA reversals may be taken int account under paragraph 11.a. due to tax limitations on operating loss carrybacks. In such case, Company A could admit an additional $75 under paragraph 11.b.i. ($175 less the $100 admitted under paragraph 11.a.).

Example 2:

8.7 Assume the same facts as in Example 1, except consolidated taxes paid in prior carryback years that could be recovered are $70 and, pursuant to a written income tax allocation agreement, taxes recoverable through loss carrybacks may not exceed consolidated taxes paid in prior carryback years.

8.8 In this situation, Company A would admit a DTA of $70 under paragraph 11.a. (recoverable taxes limited to consolidated taxes paid which could be refunded by the parent). In addition, $105 ($175-$70) of DTA may be admitted under paragraph 11.b.i., on the basis of Company A's separate company estimated taxable income and temporary differences that are expected to be realized within the applicable 3-year period following the balance sheet date.

Example 3:

8.9 Parent Company P files a consolidated federal income tax return with its nonlife insurance subsidiaries, R, S and T. Assume consolidated taxes that could be recovered through loss carryback total $450. However, in the prior carryback years $200 was paid by each of the subsidiaries, R, S and T. The difference between the amount paid by the subsidiaries ($600) and the amount available through loss carryback ($150) is attributable to interest expense incurred by Company P. Pursuant to the group's written income tax allocation agreement, in the case of loss carrybacks, taxes recoverable are limited to the consolidated taxes paid in the carryback years.

8.10 Because the adjusted gross DTA admitted under paragraph 11.a. for each reporting entity cannot exceed what each entity paid and could reasonably be expected to be refunded by P, no more than $450 in total may be admitted by the subsidiaries (under paragraph 11.a.). If the adjusted gross DTA associated with the subsidiaries' temporary differences that reverse in the 11.a. period exceed the $450 of taxes recoverable through loss carryback on a consolidated basis, the adjusted gross DTA admitted by the insurance subsidiaries under paragraph 11.a. should be allocated among the subsidiaries, consistent with the principles of its written income tax allocation agreement. This allocation would, in most instances, be based on each subsidiary's share of reversing temporary differences.

8.11 Under paragraph 11.c., an entity may admit its adjusted gross DTAs, after application of paragraphs 11.a. and 11.b., based upon offset against its own existing gross DTLs and not against gross DTLs of other members of the affiliated or consolidated group.

9a. Q – Current income taxes are defined by paragraph 3.a. to include tax loss contingencies for current and all prior years, computed in accordance with SSAP No. 5~~R~~, including the modifications in paragraphs 3.a.i, 3.a.ii. and 3.a.iii. How does the modification provided in paragraph 3.a.iii. impact the calculation of the tax contingencies recorded?

9.1 A – Paragraph 3.a.iii. provides the following rule: If the estimated tax loss contingency is greater than 50% of the tax benefit originally recognized, the tax loss contingency recorded shall be equal to 100% of the original tax benefit recognized.

9.2 For example, assume that a company claimed a deduction in its current year federal income tax return that resulted in a $100 permanent tax benefit[37]. Management must assume that the tax position will be examined by a taxing authority that has full knowledge of all relevant information (paragraph 3.a.ii.). In addition, management has determined that the probability of a liability is more likely than not (a likelihood of more than 50% pursuant to paragraph 3.a.i.) and that the liability can be reasonably estimated. Management's best estimate of the loss of the tax benefit is $40 (an amount not greater than 50% of the tax benefit originally recognized). Under these facts, the company would establish a current tax liability in the amount of $40, increasing its current income tax expense by $40.

DR	Current income tax expense	$40	
CR	Liability for current income tax		$40

9.3 Assume the same facts as 9.2, except that management determines the best estimate of the liability to be $60 (an amount greater than 50% of the tax benefit originally recorded). Under paragraph 3.a.iii., the company would be required to record a tax contingency of $100 offsetting the entire original tax benefit recorded. Under these facts, the company would establish a current tax liability in the amount of $100, increasing its current income tax expense by $100.

DR	Current income tax expense	$100	
CR	Liability for current income tax		$100

9b. Q – What impact, if any, does the inclusion of tax contingencies as a component of current income taxes have on the determination of deferred income taxes? [Paragraph 3.c.]

9.4 A – The purpose of this interpretation is to address when such contingencies should be "grossed-up" and reflected in the calculation of both statutory current and deferred federal income taxes.

9.5 Gross deferred tax assets and liabilities are determined in accordance with paragraph 7 of SSAP No. 101 and reflect the changes in temporary differences considered in estimating taxes currently payable and are manifested in the enterprise's tax basis balance sheet. If gross tax loss contingencies associated with temporary differences have been included in taxes currently payable, a corresponding adjustment must be made to the tax basis balance sheet used in the determination of gross deferred tax assets and liabilities. Deferred tax assets and liabilities are not adjusted for tax contingencies not associated with temporary differences (i.e. permanent differences).

9.6 For example, assume that a company determines, in accordance with SSAP No. 5~~R~~, including the modifications in paragraph 3.a. of SSAP No. 101, a tax loss contingency is required to be established for a $100 deduction claimed in a prior year federal income tax return. Assuming a 21% tax rate, the company would establish a current tax liability in the amount of $21, increasing its current income tax expense by $21.

DR	Current income tax expense	$21	
CR	Liability for current income tax		$21

[37] The treatment of tax contingencies related to temporary differences is discussed in Question 9b.

9.7 If the $100 deduction was associated with a temporary difference such as reserves, the company would make a corresponding adjustment to deferred taxes. The company would increase its gross deferred tax asset for reserves by $21 to reflect the future tax benefit associated with that reserve deduction. Any gross deferred tax asset recorded would still be subject to the admissibility requirements of paragraph 11.

DR	Gross deferred tax asset	$21	
CR	Change in net deferred tax (surplus)		$21

9.8 If the $100 deduction was associated with a permanent item such as meals and entertainment expenses, the company would make no corresponding adjustment to the deferred tax assets.

9.9 In determining the timing of when a tax loss contingency for a temporary item should be grossed up, paragraph 3.c. of SSAP No. 101 provides the following guidance:

> 3.c. In determining when tax loss contingencies associated with temporary differences should be included in current income taxes under Paragraph 3.a., and therefore included in deferred taxes under paragraph 7, a reporting entity is not required to "gross-up" its current and deferred taxes until such time as an event has occurred that would cause a re-evaluation of the contingency and its probability of assessment, e.g., the IRS has identified the item as one which may be adjusted upon audit. Such an event could be the reporting entity's (or its affiliate or parent in a consolidated income tax return) receipt of a Form 5701, Proposed Audit Adjustment, or could occur earlier upon receipt of an Information Document Request. At such time, the company must reassess the probability of an adjustment, reasonably re-estimate the amount of tax contingency as determined in accordance with paragraph 3.a., make any necessary adjustment to deferred taxes, and re-determine the admissibility of any adjusted gross deferred tax asset as provided in paragraph 11.

10a. Q – If the reporting entity adjusts the amount of regular taxable income and capital gains reported on a prior year income tax return from the amount originally determined for financial reporting purposes, how is the effect of the change reported in the current year? [Paragraph 19]

10.1 A – Paragraph 19 of SSAP No. 101 indicates that "income taxes incurred or received during the current year attributable to prior years shall be allocated, to the extent not previously provided, to net income in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors* unless attributable, in whole or in part, to realized capital gains or losses, in which case, such amounts shall be apportioned between net income and realized capital gains and losses, as appropriate". Paragraph 19 also indicates that income taxes incurred are to be allocated to ordinary income and realized capital gains consistent with paragraph 38 of FAS 109. Paragraph 38 of FAS 109 provides, in general, that the portion of the total income tax expense remaining after allocation to ordinary income would be allocated to realized capital gains or losses.

10.2 In accordance with paragraph 19, the amount of additional federal income taxes incurred in the current year with respect to the prior year would be allocated between ordinary income and realized capital gain items. The amount of additional federal income tax expense allocated to ordinary income should be determined by comparing the amount of additional tax expense actually incurred to the amount of tax expense that would have been incurred had the adjustment to ordinary income been zero (a "with and without" computation). The remaining amount of additional federal income tax expense would then be allocated to realized capital gains. The amounts of additional federal income tax expense allocated to ordinary income and realized capital gains would be included in the current period's federal income tax expense and not as a direct adjustment to surplus.

10.3 As an example, assume Company X files its 20X1 federal income tax return and reports $1,000,000 of taxable income comprised of $800,000 of ordinary income and $200,000 of capital gain income. Since the company is subject to taxation at a 21% tax rate on all its income, it incurred federal income tax expense of $210,000. In preparing its 20X1 statutory income tax provision, the company estimated that its liability for 20X1 federal income tax would be $147,000 based on $600,000 of ordinary income and $100,000 realized capital gains.

10.4 In determining the amount of "income taxes incurred" for its 20X2 financial statement, Company X must include the additional $63,000 of income tax expense incurred on its 20X1 federal income tax return ($210,000 actual tax incurred less $147,000 originally reported) in net income for 20X2 pursuant to paragraph 19 of SSAP No. 101 and not as a surplus adjustment. The $63,000 additional expense would be allocated to federal income taxes on net income and realized capital gains and losses as follows:

Total additional income tax expense	$63,000
Tax expense allocated to operations ($200,000 additional income x 34%)	42,000
Tax expense allocated to realized gains	$21,000

The tax expense allocated to operations was determined as follows:

Total recomputed tax expense	$210,000
Tax expense with only capital gain changes	168,000
Tax expense allocated to operations	$42,000

10.5 For all purposes of computing and allocating federal income taxes between operations and capital gains and losses, the character of the income or loss item as determined for statutory accounting purposes should be followed. Thus, if an income item is treated as a capital gain for statutory accounting purposes but as ordinary income for tax purposes, the federal income tax allocable to such income would be considered tax expense attributable to capital gains.

10b. Q – What is meant by the phrase in paragraph 18 "a reporting entity's unrealized gains and losses shall be recorded net of any allocated DTA or DTL"? [Paragraph 18]

10.6 A – Pursuant to Paragraph 18 of SSAP No. 101, a reporting entity's unrealized gains and losses shall be recorded net of any allocated DTA or DTL in accordance with paragraph 35 of FAS 109. Paragraph 35 of FAS 109 indicates that income taxes incurred are to be allocated between various items, including gains from operations and items charged or credited directly to shareholders' equity, such as the change in unrealized gains and losses.

10.7 To the extent a reporting entity's admitted DTA or its DTL changes during the year, the portion of such change allocable to changes in unrealized gains and losses during the year should be determined. The portion so allocable would be reported with, and netted against, the related change in unrealized gains and losses reported as a component of changes in surplus. The remaining portion of the change in DTA or DTL allocable to other temporary differences should be reported as a separate component of changes in surplus and/or change in nonadmitted assets.

10.8 For example, assume the reporting entity has DTAs of $1,000 relating to temporary differences other than unrealized losses, and a $100 DTL relating to unrealized gains as of the beginning of the year. Since the entity is subject to tax at 21% and all of its DTAs are expected to reverse within one year, the entity recorded a $900 net admitted DTA as of the beginning of the year.

10.9 During the current year, the DTAs relating to temporary differences other than unrealized losses did not change, but the DTL relating to the entity's unrealized gains increased by $100 (unrealized gains increased by $476 during the year). As a result, the amount of the entity's net admitted DTAs decreased by $100.

10.10 Pursuant to paragraph 18 of SSAP No. 101, the $100 decrease in the DTA during the year is to be allocated between changes attributable to temporary differences other than unrealized gains and losses and those attributable to unrealized gains and losses. Since the DTA relating to temporary differences other than unrealized gains and losses did not change during the year, the entire decrease is allocable to the change in unrealized gains. Therefore, the $100 decrease is to be allocated and netted against the $476 change in unrealized gains reported in change in surplus, resulting in a $376 net increase in surplus relating to its unrealized gains. If a portion of the unrealized loss DTA is determined to be nonadmitted, that amount is not recorded separately from the operating differences DTA. The change in the total nonadmitted DTA from period to period is recorded in surplus as a Change in Nonadmitted Assets.

11. Q – How are current and deferred income taxes to be accounted for in interim periods? [Paragraphs 12.d. and 20]

11.1 A – In setting forth the methodology for the computation of current income taxes (income taxes incurred) in interim periods, paragraph 20 states:

> 20. Income taxes incurred in interim periods shall be computed using an estimated annual effective current tax rate for the annual period in accordance with the methodology described in paragraphs 19 and 20 of *Accounting Principles Board Opinion No. 28, Interim Financial Reporting*. Estimates of the annual effective tax rate at the end of interim periods are, of necessity, based on estimates and are subject to subsequent refinement or revision. If a reliable estimate cannot be made, the actual effective tax rate for the year-to-date may be the best estimate of the annual effective tax rate. If an insurer is unable to estimate a part of its "ordinary" income (or loss) or the related tax (or benefit) but is otherwise able to make a reliable estimate, the tax (or benefit) applicable to the item that cannot be estimated shall be reported in the interim period in which the item is reported.

11.2 As a result, to the extent a reliable estimate can be made of an expected annual effective tax rate, reporting entities should apply this rate to net income before federal and foreign income taxes, in the case of property and casualty insurers and health insurers, and net income and realized capital gains before federal and foreign income taxes in the case of life insurers. If a reliable estimate of the expected annual effective tax rate cannot be made, reporting entities should compute current and deferred taxes at interim reporting dates using the most reliable information that is available.

11.3 The following examples illustrate the estimation process for income taxes incurred using the estimated annual effective rate:

Projected statutory net income[38] for current year		$10,000,000
Estimated annual permanent differences		(2,800,000)
Estimated annual temporary differences:		2,000,000
Projected taxable income for current year		$9,200,000
Projected federal tax for current year (at 21%)		$1,932,000
Estimated annual effective tax rate		19.322%

[38] For all examples in Question 11, statutory net income represents operating and capital gain income before federal and foreign income taxes.

11.4 As a result, assuming that during the calendar year the reporting entity's expectations as to its statutory and taxable income do not change, income tax incurred will be recorded on a quarterly basis as follows:

Quarter	Statutory Income (Loss)	Income Taxes Incurred
1	$(2,000,000)	$(386,400)
2	4,000,000	772,800
3	6,000,000	1,159,200
4	2,000,000	386,400
Total	$10,000,000	$1,932,000

11.5 If the reporting entity's expectations as to its statutory and taxable income change in the second quarter so that it expects that its annual effective rate will increase from 19.32% to 20%, it will record income taxes incurred in the second quarter of $786,400 (cumulative statutory income at end of the second quarter of $2,000,000 at 20% or $400,000 less $386,400 tax benefit recorded in first quarter).

11.6 As noted above, life insurers must estimate their annual effective tax rate and record income taxes incurred based on net income and realized capital gains before federal and foreign income taxes. With regard to intraperiod tax allocation, paragraph 19 states in relevant part:

> 19. Income taxes incurred shall be allocated to net income and realized capital gains or losses in a manner consistent with paragraph 38 of FAS 109.

11.7 As a result of the above and where the reporting entity expects realized capital gains or losses for the annual period, income taxes incurred must be allocated using a "with and without" methodology to net income before taxes and realized capital gains (see Question 10.4 for further discussion).

11.8 An example of this "with and without" methodology is as follows:

Projected statutory net income for current year		$10,000,000
Realized gains included above		(1,000,000)
		9,000,000
Estimated annual permanent differences:		(2,800,000)
Estimated annual temporary differences:		2,000,000
Projected ordinary taxable income for current year		$8,200,000
Projected ordinary federal tax for current year (at 21%)		$1,722,000
Projected capital gain federal tax for current year (at 21%)		210,000
Projected total federal tax for current year		$1,932,000
Estimated ordinary annual effective tax rate ($1,722,000 / $9,000,000)		19.13%
Estimated capital gain annual effective tax rate ($210,000 / $1,000,000)		21.0%
Estimated total annual effective tax rate ($1,932,000 / $10,000,000)		19.32%

11.9 As a result, assuming that during the calendar year the reporting entity's expectations as to its statutory and taxable income (including the amounts of ordinary and capital income) do not change, income tax incurred will be recorded on a quarterly basis as follows:

Quarter	Ordinary Income (Loss)	Capital Income (Loss)	Ordinary Taxes Incurred	Capital Taxes Incurred
1	$(1,000,000)	$(1,000,000)	$(191,333)	$(210,000)
2	3,000,000	1,000,000	573,999	210,000
3	5,000,000	1,000,000	956,667	210,000
4	2,000,000	0	383,667	0
Total	$9,000,000	$1,000,000	$1,722,000	$210,000

11.10 With respect to the recording of deferred taxes on an interim basis paragraph 12.d. states:

> 12.d. The phrases "reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years," "realized within one year of the balance sheet date" and "realized within three years of the balance sheet date" are intended to accommodate interim reporting dates and reporting entities that file on an other than calendar year basis for federal income tax purposes.

11.11 When considered in the context of paragraph 20, this paragraph requires the use of the annual effective rate when determining deferred taxes at an interim reporting date. As such, a reporting entity's admitted adjusted gross DTAs are determined in accordance with paragraph 11 by reference to the adjusted gross DTAs that will reverse each year in the applicable period. Note however, that due to the inherent unpredictability, and general inability to project changes in capital gains and losses on a quarter by quarter basis, the deferred tax implications of the changes in unrealized gains and losses should be recorded on a discrete period basis (i.e., based on the change in the amounts on a quarter by quarter basis). For example, in determining its admitted adjusted gross DTAs at March 31, 20X2, the reversal period referred to above is calendar years 20X3, 20X4 and 20X5 (i.e., expected adjusted gross DTAs at December 31, 20X2 that are expected to reverse in 20X3, 20X4 and 20X5).

11.12 This methodology is illustrated by the following example:

In this example, XYZ Co. is a nonlife insurance company[39] that has a two-year carryback potential and also has an ExDTA ACL RBC percentage of 700%.

Projected statutory net income for 20X3			$10,000,000
Estimated annual permanent differences:			(2,800,000)
Estimated annual temporary differences:			2,000,000
Projected ordinary taxable income for current year			$9,200,000
Temporary differences at December 31, 20X2:			$5,000,000
Estimated temporary differences at December 31, 20X3:			$7,000,000
Taxable income in carryback period (taxes paid at 21%):			
	Year ended December 31, 20X1	2,000,000	(420,000)
	Year ended December 31, 20X2	3,000,000	(630,000)
	Year ended December 31, 20X3	$9,200,000	($1,932,000)

Note: Year ended December 31, 20X3 taxable income and taxes paid considered in the calculation of its interim tax accruals are based on the reporting entity's estimate of its annual taxable income and taxes to be paid. This amount may differ from the quarterly federal income tax estimates it expects to make during the year.

	Reversing Period		
	20X3	**20X4**	**20X5**
December 31, 20X2 Temporary difference reversals:	$2,000,000	$1,500,000	$1,500,000
	20X4	20X5	20X6
December 31, 20X3 Temporary difference reversals:	$3,000,000	$2,000,000	$2,000,000

[39] Please note the results in this example could be different if XYZ Co. was a life insurance company because, under current Federal income tax law, life insurance companies are not permitted to carry back net operating losses. In such case, XYZ would not admit any deferred tax assets under paragraph 11.a. However, if XYZ were able to admit deferred tax assets for all of its 20X3-20X5 temporary difference reversals at December 31, 20X2 and for all of its 20X4-20X6 temporary difference reversals at December 31, 20X3 under paragraph 11.b. (based on adequate sources of projected taxable income in those reversal periods), then the results in this example would be unchanged.

Admitted deferred tax assets at December 31, 20X2:				
	Paragraph 11.a.			
		20X1	$2,000,000	
		20X2	1,500,000	
			3,500,000	
		Taxes paid at 21%		$735,000
	Paragraph 11.b.			315,000
	Paragraph 11.c.			0
	Total admitted			$1,050,000
Note: The recovery of federal income taxes paid in prior years under paragraph 11.a. is calculated in this example by carrying back 20X3's temporary difference reversals of $2,000,000 to offset 20X1's taxable income of $2,000,000; then carrying back 20X4's temporary difference reversals of $1,500,000 to offset $1,500,000 of 20X2's taxable income of $3,000,000 XYZ's projected taxable income for 20X3 ($9,200,000) is more than adequate to allow the remaining $315,000 of the $1,050,000 expected to be realized from temporary difference reversals in 20X3-20X5 ($5,000,000 x 21% = $1,050,000) to be recognized under paragraph 11.b.				
Admitted deferred tax assets at December 31, 20X3:				
	Paragraph 11.a.			
		20X2	$3,000,000	
		20X3	2,000,000	
			5,000,000	
		Taxes paid at 21%		$1,050,000
	Paragraph 11.b.			420,000
	Paragraph 11.c.			0
	Total admitted			$1,470,000
Note: The recovery of federal income taxes paid in prior years under paragraph 11.a. is calculated in this example by carrying back 20X4's temporary difference reversals of $3,000,000 to offset 20X2's taxable income of $3,000,000; then carrying back 20X5's temporary difference reversals of $2,000,00 to offset $2,000,000 of 20X3's taxable income. It is assumed for this example that XYZ has more than adequate amounts of projected income for 20X4-20X6 to allow the remaining $420,000 of the $1,470,000 expected to be realized from temporary difference reversals in 20X4-20X6 ($7,000,000 x 21% = $1,470,000) to be recognized under paragraph 11.b.				
Total estimated federal taxes for 20X3:				
	Income taxes incurred (current tax) ($9,200,000 X 21%)			$1,932,000
	Change in deferred tax ($1,050,000 – $1,470,000)			(420,000)
				$1,512,000

11.13 As a result of the above, the annual effective tax rate for current and deferred income taxes is as follows:

Current ($3,220,000/$10,000,000)	19.32%
Deferred (($700,000)/$10,000,000)	(4.2)%
Total annual effective rate	15.12%

Quarter	Statutory Income (Loss)	Income Taxes Incurred	Deferred Taxes
1	$(2,000,000)	$(386,400)	$84,000
2	4,000,000	772,800	(168,000)
3	6,000,000	1,159,200	(252,000)
4	2,000,000	386,400	(84,000)
Total	$10,000,000	$1,932,000	$(420,000)

11.14 To the extent that a reporting entity's estimated year end[40] admitted adjusted gross deferred tax assets are limited by its surplus pursuant to paragraph 11.b.ii., the annual effective deferred tax rate must be adjusted to consider the impact of this limitation on a quarterly basis.

12. Q – How do you present deferred taxes in the Annual Statement? [Paragraphs 8, 18, 21-28 and 36]

12.1 A – This answer is divided into three different parts.

Unrealized Capital Gains and Losses

12.2 SSAP No. 101 paragraph 18 states:

> 14. In accordance with paragraph 35 of FAS 109, a reporting entity's unrealized gains and losses shall be recorded net of any allocated DTA or DTL. The amount allocated shall be computed in a manner consistent with paragraph 38 of FAS 109.

12.3 The following illustrates the presentation of such requirement in the annual statement:

Illustration A Assumptions:

12.4 Entity grouped its investments in a reasonable and consistent manner and calculated the following gross amounts attributable to appreciation and depreciation in the fair value of its common stocks during 20X2 (see question 2 regarding grouping of assets and liabilities for measurement):

	Gross	Carrying Value	Rate	Tax Effected DTA (DTL)
Common stock carrying value 1/1/X2		$800,000		
Unrealized (loss)	($714,286)		21%	$150,000
Unrealized gain	571,429		21%	(120,000)
Net (loss) gain		(142,857)		$30,000
Common stock carrying value 12/31/X2		$657,143		

12.5 The journal entries need to present unrealized losses and gains net of tax are:

12/31/X2	DR	Change in unrealized capital gains and losses	$142,857
	CR	Common stock	($142,857)
	Recognition of net depreciation in FV of common stock		

12/31/X2	DR	Deferred tax asset	$150,000
	CR	Deferred tax liability	($120,000)
	CR	Change in deferred income taxes	($30,000)
	Recognition of gross deferred tax amounts		

[40] In the previous example, year-end is December 31, 20X3.

12/31/X2	DR	Change in deferred income taxes	$30,000
	CR	Change in unrealized capital gains and losses	($30,000)
		Reclass tax effect of net unrealized loss per paragraph 18 of SSAP No. 101	

12.6 Condensed 12/31/X2 Balance Sheet:

ASSETS	20X2	20X1		LIABILITIES, SURPLUS AND OTHER FUNDS	20X2	20X1
Common Stock	$657,143	$800,000		Surplus:		
Net deferred tax asset	30,000			Beginning of year	$800,000	
				Change in UNL	(112,857)[41]	
Total Assets	$687,143	$800,000		**Liabilities & Surplus**	$687,143	$800,000

Annual Statement Presentation

12.7 In accordance with SSAP No. 101, DTAs and DTLs shall be offset and presented as a single amount on the statement of financial position. The following illustrates this requirement:

Illustration B Assumptions:

12.8 The entity had the following balances:

	1/1/X2	12/31/X2	Change
Gross DTA	$200,000	$510,000	$310,000
Statutory Valuation Allowance Adjustment	0	10,000	10,000
Adjusted Gross DTA	200,000	500,000	300,000[42]
DTA Nonadmitted	25,000	150,000	125,000
Admitted Adjusted Gross DTA	175,000	350,000	175,000
Gross DTL	100,000	200,000	100,000
Net Admitted Adjusted Gross DTA	$75,000	$150,000	$75,000
Current FIT Recoverable	**$18,000**	**$20,000**	**$2,000**

12.9 Illustrative 12/31/X2 Balance Sheet for Illustration B:

ASSETS	Current Year			Prior Year
	1 Assets	2 Nonadmitted Assets	3 Net Admitted Assets (Cols. 1 - 2)	4 Net Admitted Assets
Current Federal and foreign income tax recoverable and interest thereon	$20,000	$0	$20,000	$18,000
Net deferred tax asset	$300,000	$150,000	$150,000	$75,000

[41] Computed at $142,857 (total change in UNG/UNL) - $30,000 tax effect.

[42] Includes $30,000 resulting from net unrealized losses as shown in Illustration A. As such the change in net deferred income taxes at 12/31/X2 is $170,000 ($300,000 (gross change in DTA) – $100,000 (gross change in DTL) – $30,000 reclass to net unrealized capital gains (losses)).

12.10 Illustrative 12/31/X2 Income Statement for Illustration B:

STATEMENT OF INCOME (P/C) SUMMARY OF OPERATIONS (Life & Health) STATEMENT OF REVENUES AND EXPENSES (Health)	1 Current Year	2 Prior Year
Gains and (losses) in surplus		
Change in net unrealized capital gains (losses) less capital gains tax of $30,000	$112,857	0
Change in net deferred income tax	$170,000	0
Change in nonadmitted assets	($125,000)	0

12.11 Illustrative 12/31/X2 Exhibit of Nonadmitted Assets for Illustration B:

	1 End of Current Year	2 End of Prior Year	3 Changes for Year (Increase) Decrease
Net deferred tax asset	$150,000	$25,000	($125,000)
Total	$150,000	$25,000	($125,000)

Illustration C Assumptions:

12.12 The entity had the following balances (1/1/X2 balances carried forward from Illustration B):

	1/1/X2	**12/31/X2**	**Change**
Gross DTA	$200,000	$510,000	$310,000
Statutory Valuation Allowance Adjustment	0	10,000	10,000
Adjusted Gross DTA	200,000	500,000	300,000[43]
DTA Nonadmitted	25,000	150,000	125,000
Net Admitted Adjusted Gross DTA	175,000	350,000	175,000
Gross DTL	100,000	200,000	100,000
Net Admitted Adjusted Gross DTA	$75,000	$150,000	$75,000
Current FIT Liability	**$7,000**	**$12,000**	**$5,000**

12.13 Illustrative 12/31/X2 Balance Sheet for Illustration C:

ASSETS	Current Year			Prior Year
	1 Assets	2 Nonadmitted Assets	3 Net Admitted Assets (Cols. 1 - 2)	4 Net Admitted Assets
Net deferred tax asset	$300,000	$150,000	$150,000	75,000

LIABILITIES, SURPLUS AND OTHER FUNDS	1 Current Year	2 Prior Year
Current Federal and foreign income taxes (including $0 on realized capital gains (Losses))	$12,000	$7,000

[43] Includes $30,000 resulting from net unrealized losses as shown in Illustration A. As such the change in net deferred income taxes at 12/31/X2 is $170,000 ($300,000 (gross change in DTA) – $100,000 (gross change in DTL) – $30,000 reclass to net unrealized capital gains (losses)).

12.14 Illustrative 12/31/X2 Income Statement for Illustration C:

STATEMENT OF INCOME (P/C) **SUMMARY OF OPERATIONS (Life & Health)** **STATEMENT OF REVENUES AND EXPENSES (Health)**	1 Current Year	2 Prior Year
Gains and (losses) in surplus		
Change in net unrealized capital gains (losses) less capital gains tax of $30,000	$112,857	0
Change in net deferred income tax	$170,000	0
Change in nonadmitted assets	($125,000)	0

12.15 Illustrative 12/31/X2 Exhibit of Nonadmitted Assets for Illustration C:

	1 End of Current Year	2 End of Prior Year	3 Changes for Year (Increase) Decrease
Net deferred tax asset	$150,000	$25,000	($125,000)
Total	$150,000	$25,000	($125,000)

Notes to the Financial Statements Disclosures:

12.16 SSAP No. 101 paragraphs 21-28 include extensive disclosure requirements. Although some of these amounts are presented on the face of the financial statements or in schedules or exhibits to the annual statement, they will be included in the Notes to the Financial Statements both in the annual statement and in the annual audited financial statements.

12.17 This section provides specific examples that illustrate the disclosures required in SSAP No. 101. The formats in the illustrations are not requirements. Some of the disclosure paragraphs of SSAP No. 101 are not specific as to whether the entity should disclose the nature of certain items or whether the entity should disclose specific amounts. The illustrations included herein use a combination of each method. The NAIC encourages a format that provides the information in the most understandable manner in the specific circumstances. The following illustrations are for a single hypothetical insurance enterprise, referred to as AlphaBeta Property & Casualty Insurance Company. All of the disclosures would be completed in the year-end annual statement and audited statutory financial statements.

12.18 Selected AlphaBeta P/C Company Financial Data at December 31, 20X2 (Balance Sheet information carried forward from Illustration B):

ASSETS	Current Year			Prior Year
	1 Assets	2 Nonadmitted Assets	3 Net Admitted Assets (Cols. 1 - 2)	4 Net Admitted Assets
Current federal and foreign income tax recoverable and interest thereon	$20,000	$0	$20,000	$18,000
Net deferred tax asset	$300,000	$150,000	$150,000	$75,000

CAPITAL AND SURPLUS ACCOUNT	1 Current Year	2 Prior Year
Change in net unrealized capital gains (losses) less capital gains tax of $30,000	($112,857)	0
Change in net deferred income tax	$170,000	0
Change in nonadmitted assets	($125,000)	0

EXHIBIT OF NONADMITTED ASSETS	1 End of Current Year	2 End of Prior Year	3 Changes for Year (Increase) Decrease
Net deferred tax asset	$150,000	$25,000	($125,000)

STATEMENT OF INCOME	20X2
UNDERWRITING INCOME	
Premiums earned	$5,250,000
DEDUCTIONS:	
Losses incurred	3,550,000
Loss adjustment expenses incurred	1,750,000
Other underwriting expenses incurred	525,000
Net underwriting gain (loss)	(575,000)
INVESTMENT INCOME	
Net investment gain (loss)	1,350,000
OTHER INCOME	
Total other income	125,000
Net income before dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	900,000
Dividends to policyholders	200,000
Net income, after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	700,000
Federal and foreign income taxes incurred	220,000
Net income	$480,000

Paragraph 22 Illustration:

12.19 The components of the net DTA recognized in the Company's Assets, Liabilities, Surplus and Other Funds are as follows:

	12/31/20X2			12/31/20X1			Change		
	Ordinary	Capital	Total	Ordinary	Capital	Total	Ordinary	Capital	Total
Gross Deferred Tax Assets	$375,000	$135,000	$510,000	$93,000	$107,000	$200,000	$282,000	$28,000	$310,000
Statutory Valuation Allowance Adjustments	0	10,000	10,000	0	0	0	0	10,000	10,000
Adjusted Gross Deferred Tax Assets	375,000	125,000	500,000	93,000	107,000	200,000	282,000	18,000	300,000
Deferred Tax Assets Nonadmitted	150,000	0	150,000	20,000	5,000	25,000	130,000	(5,000)	125,000
Subtotal Net Admitted Deferred Tax Asset	225,000	125,000	350,000	73,000	102,000	175,000	152,000	23,000	175,000
Deferred Tax Liabilities	21,000	179,000	200,000	15,000	85,000	100,000	6,000	94,000	100,000
Net Admitted Deferred Tax Asset/(Net Deferred Tax Liability)	$204,000	($54,000)	$150,000	$58,000	$17,000	$75,000	$146,000	($71,000)	$75,000
Admission Calculation Components SSAP No. 101 (Paragraph 11)									

	12/31/20X2			12/31/20X1			Change		
	Ordinary	Capital	Total	Ordinary	Capital	Total	Ordinary	Capital	Total
a. Federal Income Taxes Paid In Prior Years Recoverable Through Loss Carrybacks.	$85,000	$5,000	$90,000	$45,000	$5,000	$50,000	$40,000	0	$40,000
b. Adjusted Gross Deferred Tax Assets Expected To Be Realized (Excluding The Amount Of Deferred Tax Assets From a, above) After Application of the Threshold Limitation. (The Lesser of b.i. and b.ii. Below)	50,000	10,000	60,000	13,000	12,000	25,000	37,000	(2,000)	35,000
i. Adjusted Gross Deferred Tax Assets Expected to be Realized Following the Balance Sheet Date.	**NA**	**NA**	**60,000**	**NA**	**NA**	**25,000**	**NA**	**NA**	**35,000**
ii. Adjusted Gross Deferred Tax Assets Allowed per Limitation Threshold.	**NA**	**NA**	**900,000**	**NA**	**NA**	**750,000**	**NA**	**NA**	**150,000**
c. Adjusted Gross Deferred Tax Assets (Excluding the Amount Of Deferred Tax Assets From a. and b. above) Offset by Gross Deferred Tax Liabilities.	90,000	110,000	200,000	15,000	85,000	100,000	75,000	25,000	100,000
Deferred Tax Assets Admitted as the result of application of SSAP No. 101.Total (a. + b. + c.)	$225,000	$125,000	$350,000	$73,000	$102,000	$175,000	$152,000	$23,000	$175,000
	20X2 Percentage	20X1 Percentage							
Ratio Percentage Used to Determine Recovery Period and Threshold Limitation Amount[44]	600%	500%							
Amount of Adjusted Capital and Surplus Used to Determine Recovery Period And Threshold Limitation[45]	$6,000,000	$5,000,000							
The Company's tax-planning strategies include the use of reinsurance-related tax-planning strategies.									
Impact of Tax Planning Strategies	12/31/20X2			12/31/20X1			Change		
	Ordinary Percent	Capital Percent	Total Percent[46]	Ordinary Percent	Capital Percent	Total Percent	Ordinary Percent	Capital Percent	Total Percent
Adjusted Gross DTAs (% of Total Adjusted Gross DTAs)	6%	7%	13%	7%	7%	14%	-1%	0%	-1%
Net Admitted Adjusted Gross DTAs (% of Total Net Admitted Adjusted Gross DTAs)	14%	15%	29%	15%	15%	30%	-1%	0%	-1%

Paragraph 23 Illustration:

12.20 The Company has not recognized a deferred tax liability of approximately $30,000 of foreign withholding taxes for the undistributed earnings of its 100% owned foreign subsidiaries that arose in 20X2 and prior years because the Company does not expect those unremitted earnings to reverse and become taxable to the Company in the foreseeable future. A deferred tax liability will be recognized when the Company expects that it will recover those undistributed earnings in a taxable manner, such as through

[44] Disclose the ratio used by the reporting entity from the applicable Realization Threshold Limitation Table in paragraph 11.b. of SSAP No. 101 to determine the appropriate limitations of paragraph 11.b. In the event that late immaterial modifications to a reporting entity's statutory financial statements occur subsequent to initial completion of the statutory financial statements but prior to filing or similar deadline, these immaterial changes do not need to be reflected in this ratio if such modifications do not cause the reporting entity to change the threshold limitation from the applicable Realization Threshold Limitation Table.

[45] Provide the amount of adjusted capital and surplus used to calculate the limitation under paragraph 11.b.ii.

[46] The total percentage should be separately calculated and is not intended to be a summation of the percentages by tax character.

receipt of dividends or sale of the investments. As of December 31, 20X2, the undistributed earnings of these subsidiaries were approximately $200,000.

Paragraph 24 Illustration:

12.21 The provisions for incurred taxes on earnings for the years ended December 31 are:

	20X2	**20X1**
Federal	$180,000	$135,000
Foreign	40,000	15,000
	220,000	150,000
Federal income tax on net capital gains	52,000	36,000
Utilization of capital loss carry-forwards	(52,000)	(36,000)
Federal and foreign income taxes incurred	$220,000	$150,000

12.22 The tax effects of temporary differences that give rise to significant[47] portions of the deferred tax assets and deferred tax liabilities are as follows:

	12/31/20X2	12/31/20X1	Change
Deferred Tax Assets:			
Ordinary			
Discounting of unpaid losses	30,000	10,000	20,000
Unearned premium reserve	235,000	50,000	185,000
Investments	25,000	15,000	10,000
Pension accrual	65,000	15,000	50,000
Other (including items <5% of total ordinary tax assets)	20,000	3,000	17,000
Subtotal	375,000	93,000	282,000
Statutory valuation allowance adjustment	0	0	0
Nonadmitted	150,000	20,000	130,000
Admitted ordinary deferred tax assets	225,000	73,000	152,000
Capital			
Investments	125,000	45,000	80,000
Net capital loss carry-forward	10,000	62,000	(52,000)
Other (including items <5% of total capital tax assets)	0	0	0
Subtotal	135,000	107,000	28,000
Statutory valuation allowance adjustment	10,000	0	10,000
Nonadmitted	0	5,000	(5,000)
Admitted capital deferred tax assets	125,000	102,000	23,000
Admitted deferred tax assets	350,000	175,000	175,000
Deferred Tax Liabilities:			
Ordinary			
Investments	10,000	5,000	5,000
Fixed assets	6,000	5,000	1,000
Other (including items <5% of total ordinary tax liabilities)	5,000	5,000	0
Subtotal	21,000	15,000	6,000

[47] Significant is defined as any amount in excess of 5% of the total applicable DTAs or DTLs.

Capital:			
Investments	110,000	55,000	55,000
Real estate	64,000	25,000	39,000
Other (including items <5% of total capital tax liabilities)	5,000	5,000	
Subtotal	179,000	85,000	94,000
Deferred tax liabilities	200,000	100,000	100,000
Net deferred tax assets/liabilities	150,000	75,000	75,000

12.23 The change in net deferred income taxes is comprised of the following (this analysis is exclusive of nonadmitted assets as the Change in Nonadmitted Assets is reported separately from the Change in Net Deferred Income Taxes in the surplus section of the annual statement):

	Dec. 31, 20X2	**Dec. 31, 20X1**	**Change**
Adjusted gross deferred tax assets	$500,000	$200,000	$300,000
Total deferred tax liabilities	200,000	100,000	100,000
Net deferred tax assets (liabilities)	$300,000	$100,000	200,000
Tax effect of unrealized gains (losses)			(30,000)
Change in net deferred income tax			$170,000

Paragraph 25 Illustration[48]:

12.24 The provision for federal and foreign income taxes incurred is different from that which would be obtained by applying the statutory Federal income tax rate to income before income taxes. The significant items causing this difference are as follows:

	Dec. 31, 20X2	**Effective Tax Rate**
Provision computed at statutory rate	$147,000	21.0%
Tax exempt income deduction	(61,000)	(8.7)
Dividends received deduction	(50,000)	(7.1)
Tax differentials on foreign earnings	(21,000)	(3.0)
Change in statutory valuation allowance adjustment	10,000	1.4
Nondeductible goodwill	8,000	1.1
Other	7,000	2.4
Total	$50,000	7.1%
Federal and foreign income taxes incurred	$220,000	31.4%
Change in net deferred income taxes[49]	(170,000)	(24.3)
Total statutory income taxes	$50,000	7.1%

Paragraph 26 Illustration:

12.25 The Company has net capital loss carryforwards which expire as follows: 20X5, $9,000; 20X6; $1,000.

[48] This illustration includes both the rate reconciliation and the tax effected amounts although only one of these is required to be disclosed under SSAP No. 101.

[49] As reported in the surplus section of the annual statement. The change in net deferred income taxes is before nonadmission of any DTA. The change in nonadmitted DTA is reported together with the total change in nonadmitted assets and presented as a separate component of surplus.

Paragraph 27 Illustration:

12.26 The Company believes it is reasonably possible that the liability related to any federal or foreign tax loss contingencies may significantly increase within the next 12 months. However, an estimate of the reasonably possible increase cannot be made at this time.

Paragraph 28 Illustration:

12.27 The Company is included in a consolidated federal income tax return with its parent company, Alpha Corporation. The Company has a written agreement, approved by the Company's Board of Directors, which sets forth the manner in which the total combined federal income tax is allocated to each entity which is a party to the consolidation. Pursuant to this agreement, the Company has the enforceable right to recoup federal income taxes paid in prior years in the event of future net losses, which it may incur, or to recoup its net losses carried forward as an offset to future net income subject to federal income taxes.

13. Q – How are tax-planning strategies to be considered in determining adjusted gross DTAs [Paragraph 7.e.] and admitted adjusted gross DTAs [Paragraphs 11.a., 11.b.i., 14 and 15]?

Overview:

13.1 A – Paragraph 14 of SSAP No. 101 states:

> In some circumstances, there are tax-planning strategies (including elections for tax purposes) that (a) are prudent and feasible, (b) a reporting entity ordinarily might not take, but would take to prevent an operating loss or tax credit carryforward from expiring unused, and (c) would result in realization of deferred tax assets. A reporting entity shall consider tax-planning strategies in (1) determining the amount of the statutory valuation allowance adjustment necessary under paragraph 7.e. and (2) the realization of deferred tax assets when determining admission under paragraph 11…

13.2 Paragraph 248 of FAS 109 additionally states that:

> Tax-planning strategies also may shift the estimated pattern and timing of future reversals of temporary differences. A tax-planning strategy to accelerate the reversal of deductible temporary differences in time to offset taxable income that is expected in an early future year might be the only means to realize a tax benefit for those deductible temporary differences if they otherwise would reverse and provide no tax benefit in some later future year(s).

13.3 As also provided in paragraph 14 of SSAP No. 101, if a tax-planning strategy is used to accelerate the reversal or realization of an item, any significant net-of-tax potential costs or losses associated with the implementation of the strategy should reduce the adjusted gross or admitted DTA.

13.4 When considering a prudent and feasible tax-planning strategy that is more likely than not to enable realization of all or part of an adjusted gross DTA or admitted DTA, paragraph 15 of SSAP No. 101 states that "paragraph 3 of this statement related to tax loss contingencies shall be applied in determining admissibility of deferred tax assets under paragraph 11 of this statement." Accordingly, a reporting entity must evaluate the likelihood, if a tax-planning strategy were implemented, of whether a tax loss contingency would be required to be recorded under paragraph 3.a. If so, the admitted tax benefit of a tax-planning strategy must be reduced by the amount of tax loss contingency so required. For example, if a tax-planning strategy provided a $100 admitted DTA, but the reporting entity estimated that a tax loss contingency reserve of $40 would be required if the strategy was implemented, the admitted DTA resulting from the tax-planning strategy would be reduced by $40. Since the admitted DTA would be net of any applicable tax loss contingencies, no separate tax loss contingencies would actually be recorded for these items.

Statutory Valuation Allowance Adjustment:

13.5 As discussed in Question 2.5, future realization of gross DTAs ultimately depends on the existence of sufficient taxable income of the appropriate character within the carryback or carryforward period available under the tax law. In determining adjusted gross DTAs, a reporting entity shall consider the four sources of taxable income that may be available under the tax law, one of which is tax-planning strategies[50]. As noted in paragraph 13 of SSAP No. 101, a reporting entity is not required to consider all four sources of taxable income if one or more sources are alone sufficient to support the conclusion that the entity will realize the tax benefits of its adjusted gross DTAs (i.e., a conclusion that no statutory valuation allowance is necessary). Accordingly, tax-planning strategies need not be considered if the other sources of taxable income are sufficient to realize the benefits of reversing existing DTAs. However, the reporting entity is required to consider the impact of tax planning strategies to determine the amount of the adjustment if a conclusion is reached that a statutory valuation allowance adjustment is necessary.

Tax-Planning Strategies for Admission of DTAs:

13.6 In order for a tax-planning strategy to support admission of adjusted gross DTAs under paragraph 11, the reporting entity must demonstrate that (1) the admitted DTAs would be realized either within a period that would give rise to a carryback of tax losses under the Internal Revenue Code, not to exceed three years (for admission under paragraph 11.a.), or within the applicable period (refer to the 11.b.i. column of the applicable Realization Threshold Limitation Table in paragraph 11) and (2) it would have the ability to implement the strategy. In such circumstances an entity may recognize, as admitted assets, the related DTAs that are realizable as a result of the available tax-planning strategy in accordance with paragraphs 11.a., 11.b.i. and 11.c. of SSAP No. 101. Using tax-planning strategies in determining the admissible DTA is analogous to the use of tax-planning strategies in determining the amount of the statutory valuation allowance adjustment required under paragraph 7.e. of SSAP No. 101 and paragraph 22 of FAS 109. Although a reporting entity may use tax-planning strategies in determining the portion of its adjusted gross DTAs that are admissible, it is not required to do so.

13.7 The requirement in paragraph 11.a. and 11.b.i. of SSAP No. 101 to consider only those DTAs that reverse or are realized within a period that would give rise to a carryback of losses under the Internal Revenue Code not to exceed three years (paragraph 11.a.) or within the applicable period following the balance sheet date (paragraph 11.b.i.) causes those DTAs which would otherwise reverse beyond such period to potentially provide no tax benefit (unless admitted under paragraph 11.c.). The potential reversal beyond the appropriate period is comparable to an expiring operating loss or tax credit carryforward, in that the deduction would not provide a tax benefit under SSAP No. 101. Thus, to the extent prudent and feasible tax-planning strategies exist to accelerate the reversal or realization of these DTAs, these strategies are comparable to those contemplated in paragraph 248 of FAS 109 above.

13.8 An example of a prudent and feasible tax-planning strategy is as follows:

13.9 Company A, a property/casualty insurance company for federal income tax purposes, has paid federal income taxes of $500,000 in each of calendar years 20X1 and 20X2. The company has an ExDTA ACL RBC percentage of 250% and, therefore, is required to use the one-year applicable period under paragraph 11.b.i. of SSAP No. 101. It has capital and surplus for purposes of paragraph 11.b.ii. of SSAP No. 101 of $20,000,000. Company A has an obligation to provide post-retirement health benefits to its employees. At December 31, 20X2, Company A has included a liability for $1,000,000 on its statutory-basis financial statements for post-retirement health benefits. This liability is not currently deductible for federal income tax purposes, and only $25,000 reverses within each of the next two calendar years. This is Company A's only DTA under SSAP No. 101, and there are no DTLs. Company A, absent any tax-

[50] See paragraph 13 of SSAP No. 101 and paragraph 21 of FAS 109. Examples of tax-planning strategies as provided in paragraph 13.d. are (1) accelerate taxable amounts to utilize expiring carryforward, (2) change the character of taxable or deductible amounts from ordinary income or loss to capital gain or loss, and (3) switch from tax-exempt to taxable investments.

planning strategies, would compute a DTA of $210,000 ($1,000,000 X 21%), and would admit $10,500 ($50,000 X 21%) under paragraph 11.a., and has no additional admitted DTA under paragraph 11.b.

13.10 Company A could implement a welfare benefit fund for tax purposes and contribute assets to the fund to cover qualifying welfare benefits. The contribution, subject to limitations, would be deductible for federal income tax purposes, and would have the effect of accelerating the deduction for Company A's post-retirement health benefits. Company A has computed that $300,000 could be contributed during 20X3 to the welfare benefit fund, and to implement this strategy, it would cost $15,000 on an after-tax basis. Company A management believe that this strategy is prudent and feasible, and the Company would be able to implement this strategy if necessary. Company A would be able to admit an additional $48,000 of DTAs ($300,000 X 21%, or $63,000, less $15,000 in costs) under paragraph 11.a., with no additional admitted DTA under paragraph 11.b.

13.11 A tax-planning strategy would not be considered prudent or feasible if use of the strategy would be inconsistent with assumptions inherent in statutory or other accounting basis financial statements. For instance, a tax-planning strategy to sell securities identified as "held to maturity" for GAAP-basis financial statements at a loss would not be prudent or feasible. Additionally, if a potential tax planning strategy were to involve selling debt securities at a loss, it would not be prudent or feasible if the securities had not been identified as impaired and the loss recognized for statutory-basis financial statements. Additionally, a tax-planning strategy that could not be implemented to realize a tax benefit within the requisite period following the balance sheet date or is inconsistent with management's business plan objectives would not be prudent and/or feasible.

Statement of Statutory Accounting Principles No. 102

Pensions

STATUS

Type of Issue	Common Area
Issued	Finalized March 3, 2012
Effective Date	January 1, 2013
Affects	Supersedes SSAP No. 89; Nullifies INT 99-26, INT 01-16, INT 03-18, INT 04-03, INT 04-12 and INT 13-03
Affected by	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles and related reporting for employers' pension obligations.

2. This statement establishes financial accounting and reporting standards for an insurer that offers pension benefits to its employees. Ordinarily, such benefits are periodic pension payments to retired employees or their survivors, but they may also include benefits payable as a single lump sum and other types of benefits, such as death benefits provided through a pension plan. (This statement does not apply to life insurance benefits provided outside a pension plan or postretirement health and welfare benefits.) Arrangements to provide pension benefits may take a variety of forms and may be financed in different ways. This statement applies to any arrangement that is similar in substance to a pension plan regardless of form or financing. This statement applies to a written plan and to a plan whose existence may be implied from a well-defined, although perhaps unwritten, practice of paying postretirement benefits. This statement supersedes the guidance in *SSAP No. 89—Accounting for Pensions, A Replacement of SSAP No. 8*, nullifies and incorporates the guidance in *INT 99-26: Offsetting Pension Assets and Liabilities,* and *INT 04-12: Determining the Classification and Benefit Attribution Method for a "Cash Balance" Pension Plan*, and nullifies *INT 01-16: Measurement Date for SSAP No. 8 Actuarial Valuations*, *INT 03-18: Accounting for a Change in the Additional Minimum Liability in SSAP No. 8—Pensions* and *INT 04-03: Clarification for Calculating the Additional Minimum Pension Liability under SSAP No. 89—Accounting for Pensions, A Replacement of SSAP No. 8, paragraph 16.f.*. This statement also modifies *INT 04-17: Impact of Medicare Modernization on Postretirement Benefits* to remove reference to pensions as this interpretation only addresses postretirement benefits other than pensions.

SUMMARY CONCLUSION

Defined Benefit Plans

Single-Employer Defined Benefit Pension Plans

3. A defined benefit pension plan is one that defines an amount of pension benefit to be provided, usually as a function of one or more factors such as age, years of service, or compensation. (Hybrid pension plans that refer to an account balance, rather than a monthly annuity at retirement (also known as cash balance plans) are considered defined benefit plans for purposes of applying this statement.) For defined benefit plans, reporting entities shall adopt *FAS 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) and *FASB Staff Position FAS 136(R)-1, Employers' Disclosures about Postretirement Benefit Plan Assets* (FSP FAS 136(R)-1) with modifications as discussed within paragraph 87.

4. A pension benefit is part of the compensation paid to an employee for services. In a defined benefit pension plan, the employer promises to provide, in addition to current wages, retirement income payments in future years after the employee retires or terminates service. Generally, the amount of benefit to be paid depends on a number of future events that are incorporated in the plan's benefit formula, often including how long the employee and any survivors live, how many years of service the employee renders, and the employee's compensation in the years immediately before retirement or termination. In

most cases, services are rendered over a number of years before an employee retires and begins collecting the pension. Even though the services rendered by an employee are complete and the employee has retired, the total amount of benefit that the employer has promised and the cost to the employer of the services rendered are not precisely determinable but can only be estimated using the benefit formula and estimates of the relevant future events, many of which the employer cannot control.

Elements of Pension Accounting

5. Net periodic pension cost is made up of several components that reflect different aspects of the employer's financial arrangements as well as the cost of benefits earned by employees. The cost of a benefit can be determined without regard to how the employer decides to finance the plan. The service cost component of net periodic pension cost is the actuarial present value of benefits attributed by the plan's benefit formula to services rendered by employees during the period. The service cost component is conceptually the same for an unfunded plan, a plan with minimal funding, and a well-funded plan. The other components of net periodic pension cost are interest cost (interest on the projected benefit obligation, which is a discounted amount), actual[1] return on plan assets, amortization of any prior service cost or credit included in unassigned funds (surplus), and gain or loss, which includes, to the extent recognized, amortization of the net gain or loss included in unassigned funds (surplus) (refer to paragraph 24).

6. The projected benefit obligation is the actuarial present value of all benefits attributed by the plan's benefit formula to employee service rendered prior to that date. The projected benefit obligation is measured using an assumption as to future compensation levels if the pension benefit formula is based on those future compensation levels. The projected benefit obligation is a measure of benefits attributed to service to date assuming that the plan continues in effect and that estimated future events (including compensation increases, turnover, and mortality) occur.

7. The accumulated benefit obligation is the actuarial present value of benefits attributed by the pension benefit formula to employee service rendered prior to that date and based on current and past compensation levels. The accumulated benefit obligation differs from the projected benefit obligation in that it includes no assumption about future compensation levels. For plans with flat-benefit or non-pay-related pension benefit formulas, the accumulated benefit obligation and the projected benefit obligation are the same.

8. Plan assets are assets that have been segregated and restricted to provide for pension benefits. The amount of plan assets includes amounts contributed by the employer and amounts earned from investing the contributions, less benefits paid. Assets not segregated in a trust or otherwise effectively restricted so that they cannot be used by the employer for other purposes are not considered plan assets even though it may be intended that such assets be used to provide for pension benefits. Amounts accrued by the employer but not yet paid to the plan are also not considered plan assets. Securities of the employer held by the plan are includable in plan assets provided they are transferable.

Recognition of Net Periodic Pension Cost

9. The following components shall be included in the net pension cost for a period by an employer sponsoring a defined benefit pension plan: a) Service cost; b) Interest cost; c) Actual return on plan assets;

[1] To address a question on how the expected return on plan assets affects the determination of net periodic pension cost if the actual return on plan assets for a period is a component of net periodic pension cost, it is noted that the expected return on plan assets generally will be different from the actual return on plan assets for the year. This statement provides for recognition of that difference (a net gain or loss) in unassigned funds in the period it arises. The amount recognized in unassigned funds is also a component of net periodic pension cost for the current period. Thus, the amount recognized in unassigned funds and the actual return on plan assets, when aggregated, equal the expected return on plan assets. The amount recognized in unassigned funds affects future net periodic pension cost through subsequent amortization, if any, of the net gain or loss. (This footnote reflects guidance included in E12 of FSP FAS 158-1.)

d) Amortization of any prior service cost or credit included in unassigned funds (surplus); e) Gain or loss (including the effects of changes in assumptions) to the extent recognized; and f) Amortization of any net transition asset or obligation existing at the date of initial application of this statement and remaining in unassigned funds (surplus).

Service Cost

10. The service cost component recognized in a period shall be determined as the actuarial present value of benefits attributed by the pension benefit formula to employee service (including both vested and nonvested employees) during that period.

11. The prior service cost for nonvested employees not previously recognized[2] is not required to be included in net periodic pension cost entirely in the year this standard is adopted. 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 adjusted each period as prior service cost is amortized.

Interest Cost

12. The interest cost component recognized in a period shall be determined as the increase in the projected benefit obligation due to the passage of time. Measuring the projected benefit obligation as a present value requires accrual of an interest cost at rates equal to the assumed discount rates.

Actual Return on Plan Assets

13. For a funded plan, the actual return on plan assets shall be determined based on the fair value of plan assets at the beginning and the end of the period, adjusted for contributions and benefit payments.

Prior Service Cost

14. Plan amendments (including initiation of a plan) often include provisions that grant increased benefits based on services rendered in prior periods. Because plan amendments are granted with the expectation that the employer will realize economic benefits in future periods, the cost of providing such retroactive benefits (prior service cost) is not required to be included in net periodic pension cost entirely in the year of the amendment but provides for recognition during the future service periods of those employees active at the date of the amendment who are expected to receive benefits under the plan.

15. A plan amendment that retroactively increases benefits (including benefits that are granted to retirees) increases the projected benefit obligation. The cost of the benefit improvement shall be recognized as a charge to unassigned funds (surplus) at the date of the amendment. Except as specified in paragraphs 16-17, that prior service cost shall be amortized as a component of net periodic pension cost by assigning an equal amount to each future period of service of each employee active at the date of the amendment who is expected to receive benefits under the plan. If all or almost all of a plan's participants are inactive, the cost of retroactive plan amendments affecting benefits of inactive participants shall be amortized based on the remaining life expectancy of those participants instead of based on the remaining service period. Unassigned funds (surplus) is adjusted each period as prior service cost is amortized.

[2] The previous statutory accounting guidance in *SSAP No. 89—Accounting for Pensions, A Replacement of SSAP No. 8* excluded nonvested employees from the service cost calculation. This exclusion has been eliminated with the issuance of this SSAP.

16. Consistent use of an alternative approach that more rapidly amortizes the cost of retroactive amendments is acceptable. For example, a straight-line amortization of the cost over the average remaining service period of employees expected to receive benefits under the plan is acceptable. The alternative method used shall be disclosed.

17. In some situations, a history of regular plan amendments and other evidence may indicate that the period during which the employer expects to realize economic benefits from an amendment granting retroactive benefits is shorter than the entire remaining service period of the active employees. Identification of such situations requires an assessment of the individual circumstances and the substance of the particular plan situation. In those circumstances, the amortization of prior service cost shall be accelerated to reflect the more rapid expiration of the employer's economic benefits and to recognize the cost in the periods benefited.

18. A plan amendment that retroactively reduces, rather than increases, benefits decreases the projected benefit obligation. The reduction in benefits shall be recognized as a credit (prior service credit) to unassigned funds (surplus) that shall be used first to reduce any remaining prior service cost included in unassigned funds (surplus). Any remaining prior service credit shall be amortized as a component of net periodic pension cost on the same basis as the cost of a benefit increase.

Gains and Losses

19. Gains and losses are changes in the amount of either the projected benefit obligation or plan assets resulting from experience different from that assumed and from changes in assumptions. This statement does not distinguish between those sources of gains and losses. Gains and losses include amounts that have been realized, as well as amounts that are unrealized. Because gains and losses may reflect refinements in estimates as well as real changes in economic values and because some gains in one period may be offset by losses in another or vice versa, recognition of gains and losses as components of net pension cost of the period in which they arise is not required. Gains and losses that are not recognized immediately as a component of net periodic pension cost shall be recognized as increases or decreases in unassigned funds (surplus) as they arise.

20. The expected return on plan assets shall be determined based on the expected long-term rate of return on plan assets and the fair value of plan assets.

21. Asset gains and losses are differences between the actual return on assets during a period and the expected return on assets for that period. Asset gains and losses include changes reflected in the fair value of assets.

22. As a minimum, amortization of a net gain or loss included in unassigned funds (surplus) shall be included as a component of net pension cost for a year if, as of the beginning of the year, that net gain or loss exceeds 10% of the greater of the projected benefit obligation or the fair value of plan assets. If amortization is required, the minimum amortization shall be that excess divided by the average remaining service period of active employees expected to receive benefits under the plan. If all or almost all of a plan's participants are inactive, the average remaining life expectancy of the inactive participants shall be used instead of average remaining service.

23. Any systematic method of amortizing gains or losses may be used in lieu of the minimum specified in paragraph 22 provided that (a) the minimum is used in any period in which the minimum amortization is greater (reduces the net balance included in unassigned funds (surplus) by more), (b) the method is applied consistently, (c) the method is applied similarly to both gains and losses, and (d) the method used is disclosed.

24. The gain or loss component of net periodic pension cost shall consist of (a) the difference between the actual return on plan assets and the expected return on plan assets and (b) amortization of the net gain or loss included in unassigned funds (surplus).

Recognition of Liabilities and Assets

25. If the projected benefit obligation (considering both vested and nonvested participants) exceeds the fair value of plan assets, the employer shall recognize in its statement of financial position a liability that equals the unfunded projected benefit obligation. If the fair value of plan assets exceeds the projected benefit obligation, the employer shall recognize in its statement of financial position an asset that equals the overfunded projected benefit obligation. This prepaid asset resulting from the excess of the fair value of plan assets over the projected benefit obligation shall be nonadmitted.

26. If multiple single-employer plans exist, the employer shall aggregate the statuses of all overfunded plans and recognize that amount as an asset in its statement of financial position. It also shall aggregate the statuses of all underfunded plans and recognize that amount as a liability in its statement of financial position. It is not acceptable statutory accounting practice to offset pension or postretirement benefits other than pensions liability generated by one plan against the prepaid assets of another plan.

27. The asset or liability that is recognized pursuant to paragraph 25 may result in a temporary difference, as defined in *SSAP No. 101—Income Taxes*. The deferred tax effects of any temporary differences shall be recognized in income tax expense or benefit for the year and shall be allocated pursuant to SSAP No. 101.

28. If a new determination of the funded status of a plan to be recognized as an asset or a liability in the employer's statement of financial position is made, or when net gains or losses, prior service costs or credits, or the net transition asset or obligation existing at the date of initial application of this statement are amortized as components of net periodic pension cost, the related balances for those net gains or losses, prior service costs or credits, and transition asset or obligation in unassigned funds (surplus) shall be adjusted as necessary and reported in unassigned funds (surplus).

Measurement of Cost and Obligations

29. The service component of net periodic pension cost, the projected benefit obligation, and the accumulated benefit obligation are based on an attribution of pension benefits to periods of employee service and on the use of actuarial assumptions to calculate the actuarial present value of those benefits. Actuarial assumptions reflect the time value of money (discount rate) and the probability of payment (assumptions as to mortality, turnover, early retirement, and so forth).

Attribution

30. Pension benefits ordinarily shall be attributed to periods of employee service based on the plan's benefit formula to the extent that the formula states or implies an attribution. In some situations a history of regular increases and other evidence may indicate that an employer has a present commitment to make future amendments and that the substance of the plan is to provide benefits attributable to prior service that are greater than the benefits defined by the written terms of the plan. In those situations, the substantive commitment shall be the basis for the accounting, and the existence and nature of the commitment to make future amendments shall be disclosed.

31. In some situations a history of regular increases in non-pay-related benefits or benefits under a career-average-pay plan and other evidence may indicate that an employer has a present commitment to make future amendments and that the substance of the plan is to provide benefits attributable to prior service that are greater than the benefits defined by the written terms of the plan. In those situations, the

substantive commitment shall be the basis for the accounting, and the existence and nature of the commitment to make future amendments shall be disclosed.

32. Some plans may have benefit formulas that attribute all or a disproportionate share of the total benefits provided to later years of service, thereby achieving in substance a delayed vesting of benefits. For such plans the total projected benefit shall be considered to accumulate in proportion to the ratio of the number of completed years of service to the number that will have been completed when the benefit is first fully vested. If a plan's benefit formula does not specify how a particular benefit relates to services rendered, the benefit shall be considered to accumulate as follows:

a. For benefits of a type includable in vested benefits, in proportion to the ratio of the number of completed years of service to the number that will have been completed when the benefit is first fully vested.

b. For benefits of a type not includable in vested benefits, in proportion to the ratio of completed years of service to total projected years of service.

Assumptions

33. Each significant actuarial assumption used shall reflect the best estimate solely with respect to that individual assumption. All assumptions shall presume that the plan will continue in effect in the absence of evidence that it will not continue.

34. Assumed discount rates shall reflect the rates at which the pension benefits could be effectively settled. It is appropriate in estimating those rates to look to available information about rates implicit in current prices of annuity contracts that could be used to effect settlement of the obligation. In making those estimates, employers may also look to rates of return on high-quality fixed-income investments currently available and expected to be available during the period to maturity of the pension benefits. Assumed discount rates are used in measurements of the projected, accumulated, and vested benefit obligations and the service and interest cost components of net periodic pension cost.

35. The objective of selecting assumed discount rates using the method noted in paragraph 34 is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash flows to pay the pension benefits when due. Notionally, that single amount, the projected benefit obligation, would equal the fair value of a portfolio of high-quality zero-coupon bonds whose maturity dates and amounts would be the same as the timing and amount of the expected future benefit payments. Because cash inflows would equal cash outflows in timing and amount, there would be no reinvestment risk in the yields to maturity of the portfolio. However, in other than a zero coupon portfolio, such as a portfolio of long-term debt instruments that pay semiannual interest payments or whose maturities do not extend far enough into the future to meet expected benefit payments, the assumed discount rates (the yield to maturity) need to incorporate expected reinvestment rates available in the future. Those rates shall be extrapolated from the existing yield curve at the measurement date. The determination of the assumed discount rate is separate from the determination of the expected rate of return on plan assets whenever the actual portfolio differs from the hypothetical portfolio above. Assumed discount rates shall be reevaluated at each measurement date. If the general level of interest rates rises or declines, the assumed discount rates shall change in a similar manner.

36. Interest rates vary depending on the duration of investments; for example, U.S. Treasury bills, 7-year bonds and 30-year bonds have different interest rates. Thus, the weighted-average discount rate (interest rate) inherent in the prices of annuities (or a dedicated bond portfolio) will vary depending on the length of time remaining until individual benefit payment dates. A plan covering only retired employees would be expected to have significantly different discount rates from one covering a work force of 30-

year-olds. A properly weighted average rate can be used for aggregate computations such as the service cost and interest cost component of net pension cost for the period.

37. In addition to a properly weighted average rate, as stated in paragraph 36, an entity may elect to measure the service cost and interest cost components of net periodic benefit cost by using individual spot rates derived from an acceptable high-quality corporate bond yield curve and matched with separate cash flows for each future year (also known as the spot rate approach). If the election is made to switch from a weighted-average approach to the spot rate approach, this approach shall be consistently applied to all defined benefit plans and to the measurement of both service and interest cost. This change shall be reflected as a change in estimate as prescribed in *SSAP No. 3—Accounting Changes and Corrections of Errors* and once changed; the company should not revert back to the weighted-average discount rate in future periods. This change in estimate shall be appropriately disclosed in accordance with this statement, SSAP No. 3 and the Preamble.

38. An insurance company deciding on the price of an annuity contract will consider the rates of return available to it for investing the premium received and the rates of return expected to be available to it for reinvestment of future cash flows from the initial investment during the period until benefits are payable. That consideration is indicative of a relationship between rates inherent in the prices of annuity contracts and rates available in investment markets. It would be appropriate for employers to consider that relationship and information about investment rates in estimating the discount rates required for application of this statement.

39. The expected long-term rate of return on plan assets shall reflect the average rate of earnings expected on the funds invested or to be invested to provide for the benefits included in the projected benefit obligation. In estimating that rate, appropriate consideration should be given to the returns being earned by the plan assets in the fund and the rates of return expected to be available for reinvestment. The expected long-term rate of return on plan assets is used to compute the expected return on assets.

40. The service cost component of net periodic pension cost and the projected benefit obligation shall reflect future compensation levels to the extent that the pension benefit formula defines pension benefits wholly or partially as a function of future compensation levels. Future increases for which a present commitment exists shall be similarly considered. Assumed compensation levels shall reflect an estimate of the actual future compensation levels of the individual employees involved, including future changes attributed to general price levels, productivity, seniority, promotion, and other factors. All assumptions shall be consistent to the extent that each reflects expectations of the same future economic conditions, such as future rates of inflation. Measuring service cost and the projected benefit obligation based on estimated future compensation levels entails considering indirect effects, such as changes under existing law in social security benefits or benefit limitations that would affect benefits provided by the plan.

41. The accumulated benefit obligation shall be measured based on employees' history of service and compensation without an estimate of future compensation levels. Excluding estimated future compensation levels also means excluding indirect effects of future changes such as increases in the social security wage base. In measuring the accumulated benefit obligation, projected years of service shall be a factor only in determining employees' expected eligibility for particular benefits, such as:

a. Increased benefits that are granted provided a specified number of years of service are rendered

b. Early retirement benefits

c. Death benefits

d. Disability benefits

42. Automatic benefit increases specified by the plan (for example, automatic cost-of-living increases) that are expected to occur shall be included in measurements of the projected, accumulated, and vested benefit obligations, and the service cost component. Also, retroactive plan amendments shall be included in the computation of the projected and accumulated benefit obligations once they have been contractually agreed to, even if some provisions take effect only in future periods.

Measurement of Plan Assets

43. Plan investments, whether equity or debt securities, real estate, or other, shall be measured at their fair value as of the measurement date. The fair value of an investment shall be reduced by brokerage commissions and other costs normally incurred in a sale, if those costs are significant (similar to fair value less costs to sell).

44. Plan assets used in plan operations (for example, buildings, equipment, furniture and fixtures, and leasehold improvements) shall be measured at cost less accumulated depreciation or amortization for all purposes.

45. The measurements of plan assets and benefit obligations shall be as of the date of the employer's fiscal year-end statement of financial position. Requiring that the pension measurements be as of a particular date is not intended to require that all procedures be performed after that date. As with other financial statement items requiring estimates, much of the information can be prepared as of an earlier date and projected forward to account for events occurring between the most recent valuation date and the plan's year end (for example, employee service and benefit payments). Unless a business entity remeasures both its plan assets and benefit obligations during the fiscal year, the funded status it reports in its interim-period statement of financial position shall be the same asset or liability recognized in the previous year-end statement of financial position adjusted for (1) subsequent accruals of net periodic pension cost that exclude the amortization of amounts previously recognized in other unassigned funds (surplus) (for example, subsequent accruals of service cost, interest cost, and return on plan assets) and (2) contributions to a funded plan, or benefit payments. Sometimes, a business entity remeasures both plan assets and benefit obligations during the fiscal year. That is the case, for example, when a significant event such as a plan amendment, settlement, or curtailment occurs that calls for a remeasurement. Upon remeasurement, a business entity shall adjust its statement of financial position in a subsequent interim period to reflect the overfunded or underfunded status of the plan consistent with that measurement date.

46. If a significant event caused by the employer (such as a plan amendment, settlement, or curtailment) that requires an employer to re-measure both plan assets and benefit obligations does not coincide with a month-end, the employer may elect to re-measure plan assets and benefit obligations using the month-end that is closest to the date of the significant event. This re-measurement would not eliminate the requirement for a year-end measurement of plan assets and benefit obligations required in paragraph 45.

47. If an employer re-measures plan assets and benefit obligations during the fiscal year in accordance with paragraph 46, the employer shall adjust the fair value of plan assets and the actuarial present value of benefit obligations for any effects of the significant event that may or may not be captured in the month-end measurement (for example, if the closest month-end is before the date of a partial settlement, then the measurement of plan assets may include assets that are no longer part of the plan). An employer shall not adjust the fair value of plan assets and the actuarial present value of benefit obligations for other events occurring between the month-end date used to re-measure plan assets and benefit obligations and the employer's fiscal year-end that may be significant to the measurement of defined benefit plan assets and obligations, but are not caused by the employer (for example, changes in market prices or interest rates).

48. Measurements of net periodic pension cost for both interim and annual financial statements shall be based on the assumptions used for the previous year-end measurements unless more recent

measurements of both plan assets and obligations are available or a significant event occurs, such as a plan amendment, that would ordinarily call for such measurements.

Employers with Two or More Plans

49. An employer that sponsors two or more separate defined benefit pension plans shall determine net periodic pension cost, liabilities, and assets by separately applying the provisions of this statement to each plan. In particular, unless an employer clearly has a right to use the assets of one plan to pay benefits of another, a liability required to be recognized for one plan shall not be reduced or eliminated because the employer has recognized an asset for another plan that has assets in excess of its projected benefit obligation. (As noted within paragraph 26, overfunded plans shall be aggregated for asset reporting (nonadmitted) and underfunded plans shall be aggregated for liability reporting.)

Annuity Contracts

50. An annuity contract is a contract in which an insurance company unconditionally undertakes a legal obligation to provide specified benefits to specific individuals in return for a fixed consideration or premium. An annuity contract is irrevocable and involves the transfer of significant risk from the employer to the insurance company. Some annuity contracts include participation rights (participating annuity contract), which provide that the purchaser (either the plan or the employer) may participate in the experience of the insurance company. Under those contracts, the insurance company ordinarily pays dividends to the purchaser. If the substance of a participating annuity contract is such that the employer remains subject to all or most of the risks and rewards associated with the benefit obligation covered and the assets transferred to the insurance company, that contract is not an annuity contract for purposes of this statement.

51. To the extent that benefits currently earned are covered by annuity contracts, the cost of those benefits shall be the cost of purchasing the contracts, except as provided in paragraph 54. That is, if all the benefits attributed by the plan's benefit formula to service in the current period are covered by nonparticipating annuity contracts, the cost of the contracts determines the service cost component of net pension cost for that period.

52. Benefits provided by the pension benefit formula beyond benefits provided by annuity contracts (for example, benefits related to future compensation levels) shall be accounted for according to the provisions of this statement applicable to plans not involving insurance contracts.

53. Benefits covered by annuity contracts shall be excluded from the projected benefit obligation and the accumulated benefit obligation. Except as provided in paragraph 54, annuity contracts shall be excluded from plan assets.

54. Some annuity contracts provide that the purchaser (either the plan or the employer) may participate in the experience of the insurance company. Under those contracts, the insurance company ordinarily pays dividends to the purchaser, the effect of which is to reduce the cost of the plan. The purchase price of a participating annuity contract ordinarily is higher than the price of an equivalent contract without participation rights. The difference is the cost of the participation right. The cost of the participation right shall be recognized at the date of purchase as a nonadmitted asset. In subsequent periods, the participation right shall be nonadmitted and measured at its fair value if the contract is such that fair value is reasonably estimable. Otherwise, the participation right shall be measured at its amortized cost (not in excess of its net realizable value), and the cost shall be amortized systematically over the expected dividend period under the contract.

Other Contracts with Insurance Companies

55. Insurance contracts that are in substance equivalent to the purchase of annuities shall be accounted for as such. Other contracts with insurance companies shall be accounted for as investments and measured at fair value. For some contracts, the best available evidence of fair value may be contract value. If a contract has a determinable cash surrender value or conversion value, that is presumed to be its fair value.

Defined Benefit Plans – Settlements and Curtailments

56. A settlement is defined as a transaction that (a) is an irrevocable action, (b) relieves the employer (or the plan) of primary responsibility for a pension benefit obligation, and (c) eliminates significant risks related to the obligation and the assets used to effect the settlement. Examples of transactions that constitute a settlement include (a) making lump-sum cash payments to plan participants in exchange for their rights to receive specified pension benefits and (b) purchasing nonparticipating annuity contracts to cover vested benefits.

57. A transaction that does not meet all of the above three criteria does not constitute a settlement for purposes of this statement. For example, investing in a portfolio of high-quality fixed-income securities with principal and interest payment dates similar to the estimated payment dates of benefits may avoid or minimize certain risks. However, that does not constitute a settlement because the investment decision can be reversed, and such a strategy does not relieve the employer (or the plan) of primary responsibility for a pension obligation nor does it eliminate significant risks related to the obligation.

58. The definition of an annuity contract is included in paragraph 50. If the substance of a participating annuity contract is such that the employer remains subject to all or most of the risks and rewards associated with the benefit obligation covered or the assets transferred to the insurance company, the purchase of the contract does not constitute a settlement.

Curtailment

59. A curtailment is an event that significantly reduces the expected years of future service of present employees or eliminates for a significant number of employees the accrual of defined benefits for some or all of their future services. Curtailments include:

a. Termination of employees' services earlier than expected, which may or may not involve closing a facility or discontinuing a component of an entity.

b. Termination or suspension of a plan so that employees do not earn additional defined benefits for future services. In the latter situation, future service may be counted toward vesting of benefits accumulated based on past service.

Relationship of Settlements and Curtailments to Other Events

60. A settlement and a curtailment may occur separately or together. If benefits to be accumulated in future periods are reduced but the plan remains in existence and continues to pay benefits, to invest assets, and to receive contributions, a curtailment has occurred but not a settlement. If an employer purchases nonparticipating annuity contracts for vested benefits and continues to provide defined benefits for future service, either in the same plan or in a successor plan, a settlement has occurred but not a curtailment. If a plan is terminated (that is, the obligation is settled and the plan ceases to exist) and not replaced by a successor defined benefit plan, both a settlement and a curtailment have occurred (whether or not the employees continue to work for the employer).

Accounting for Settlement of the Pension Obligation

61. The maximum gain or loss subject to recognition in earnings when a pension obligation is settled is the net gain or loss remaining in unassigned funds (surplus) plus any transition asset remaining in unassigned funds (surplus) from initial application of SSAP No. 89. That maximum amount includes any gain or loss first measured at the time of settlement. The maximum amount shall be recognized in earnings if the entire projected benefit obligation is settled. If only part of the projected benefit obligation is settled, the employer shall recognize in earnings a pro rata portion of the maximum amount equal to the percentage reduction in the projected benefit obligation.

62. If the purchase of a participating annuity contract constitutes a settlement, the maximum gain (but not the maximum loss) shall be reduced by the cost of the participation right before determining the amount to be recognized in earnings.

63. If the cost of all settlements in a year is less than or equal to the sum of the service cost and interest cost components of net periodic pension cost for the plan for the year, gain or loss recognition is permitted but not required for those settlements. However, the accounting policy adopted shall be applied consistently from year to year.

Accounting for a Plan Curtailment

64. The prior service cost included in unassigned funds (surplus) associated with years of service no longer expected to be rendered as the result of a curtailment is a loss. For example, if a curtailment eliminates half of the estimated remaining future years of service of those who were employed at the date of a prior plan amendment and were expected to receive benefits under the plan, then the loss associated with the curtailment is half of the prior service cost included in unassigned funds (surplus) related to that amendment that has not been amortized as a component of net periodic pension cost. For purposes of applying the provisions of this paragraph, prior service cost includes the cost of retroactive plan amendments and any transition obligation remaining in unassigned funds (surplus) from initial application of SSAP No. 89.

65. The projected benefit obligation may be decreased (a gain) or increased (a loss) by a curtailment.

a. To the extent that such a gain exceeds any net loss included in unassigned funds (surplus) (or the entire gain, if a net gain exists), it is a curtailment gain.

b. To the extent that such a loss exceeds any net gain included in unassigned funds (surplus) (or the entire loss, if a net loss exists), it is a curtailment loss.

For purposes of applying the provisions of this paragraph, any transition asset remaining in unassigned funds (surplus) from initial application of SSAP No. 89 shall be treated as a net gain and shall be combined with the net gain or loss arising subsequent to transition to SSAP No. 89.

66. If the sum of the effects identified in paragraphs 64 and 65 is a net loss, it shall be recognized in earnings when it is probable that a curtailment will occur, and the effects described are reasonably estimable. If the sum of those effects is a net gain, it shall be recognized in earnings when the related employees terminate, or the plan suspension or amendment is adopted.

Termination Benefits

67. An employer may provide benefits to employees in connection with their termination of employment. They may be either special termination benefits offered only for a short period of time or contractual termination benefits required by the terms of a plan only if a specified event, such as a plant closing, occurs. An employer that offers special termination benefits to employees shall recognize a liability and a loss when the employees accept the offer and the amount can be reasonably estimated. An employer that provides contractual termination benefits shall recognize a liability and a loss when it is probable that employees will be entitled to benefits and the amount can be reasonably estimated. Termination benefits may take various forms including lump-sum payments, periodic future payments, or both. They may be paid directly from an employer's assets, an existing pension plan, a new employee benefit plan, or a combination of those means. The cost of termination benefits recognized as a liability and a loss shall include the amount of any lump-sum payments and the present value of any expected future payments. A situation involving termination benefits may also involve a curtailment to be accounted for under paragraphs 64-66.

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, 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 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,[3] 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.

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: discount rates, rates of compensation increase (for pay-related plans), 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).

[3] 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.

l. If applicable, the amounts and types of securities of the employer and related parties included in plan assets.

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:

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.

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 projected benefit obligation and fair value of plan assets for plans with projected benefit obligations in excess of plan assets.

b. The accumulated benefit obligation and 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.

Interim Financial Disclosures –Defined Benefit Plans

71. The following shall be disclosed within interim financial statements that include a statement of income:

a. The amount of net periodic benefit cost recognized, for each period for which a statement of income is presented, 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 amount of prior service cost or credit component, the transition asset or obligation component, and the gain or loss recognized due to a settlement or curtailment.

b. The total amount of the employer’s contributions paid, and expected to be paid, during the current fiscal year, if significantly different from amounts previously disclosed pursuant to paragraph 68.g. Estimated contributions may be presented in the aggregate combining (1) contributions required by funding regulations or laws, (2) discretionary contributions, and (3) noncash contributions.

Defined Contribution Plans

72. A defined contribution pension plan is a plan that provides pension benefits in return for services rendered, provides an individual account for each participant, and has terms that specify how contributions to the individual's account are to be determined rather than the amount of pension benefits the individual is to receive. Under a defined contribution plan, the pension benefits a participant will receive depend only on the amount contributed to the participant's account, the returns earned on investments of those contributions, and forfeitures of other participants' benefits that may be allocated to the participant's account.

73. To the extent that a plan's defined contributions to an individual's account are to be made for periods in which that individual renders services, the net pension cost for a period shall be the contribution called for in that period. If a plan calls for contributions for periods after an individual retires or terminates, the estimated cost shall be accrued during the employee's service period.

74. A pension plan having characteristics of both a defined benefit plan and a defined contribution plan requires careful analysis. If the substance of the plan is to provide a defined benefit, as may be the case with some "target benefit" plans, the accounting requirements shall be determined in accordance with the provisions applicable to a defined benefit plan and the disclosure requirements within paragraph 68 shall be followed.

Disclosures - Defined Contribution Plans

75. An employer shall disclose the amount of cost recognized for defined contribution pension plans and for other defined contribution postretirement benefit plans for all periods presented separately from the amount of cost recognized for defined benefit plans. The disclosures shall include a description of the nature and effect of any significant changes during the period affecting comparability, such as a change in the rate of employer contributions, a business combination, or a divestiture.

Multiemployer Plans

76. A multiemployer plan is a pension plan to which two or more unrelated employers contribute, usually pursuant to one or more collective-bargaining agreements. A characteristic of multiemployer plans is that assets contributed by one participating employer may be used to provide benefits to employees of other participating employers since assets contributed by an employer are not segregated in a separate account or restricted to provide benefits only to employees of that employer.

77. A reporting entity participating in a multiemployer plan shall recognize as net pension cost the required contribution for the period and shall recognize as a liability any contributions due and unpaid.

78. In some situations, withdrawal from a multiemployer plan may result in a reporting entity having an obligation to the plan for a portion of its unfunded benefit obligations. If withdrawal under circumstances that would give rise to an obligation is either probable or reasonably possible, the provisions of *SSAP No. 5~~R~~—Liabilities, Contingencies and Impairment of Assets* shall apply.

Disclosures - Multiemployer Plans

79. A reporting entity shall disclose the amount of contributions to multiemployer plans for each annual period for which a statement of income is presented. A reporting entity may disclose total contributions to multiemployer plans without disaggregating the amounts attributable to pension plans and other postretirement benefit plans. The disclosures shall include a description of the nature and effect of any changes affecting comparability, such as a change in the rate of employer contributions, a business combination, or a divestiture. This disclosure shall identify whether the contributions represent more than 5% of total contributions to the plan as indicated in the plan's most recently available annual report.

80. In addition to the requirements of paragraph 79, the following information shall be disclosed:

a. Whether a funding improvement plan or rehabilitation plan had been implemented or is pending.

b. Whether the reporting entity paid a surcharge to the plan.

c. A description of minimum contributions required for future periods, if applicable.

d. A qualitative description of the extent to which the employer could be responsible for the obligations of the plan, including benefits earned by employees during employment with another employer.

81. In some situations, withdrawal from a multiemployer plan may result in a reporting entity having an obligation to the plan for a portion of the unfunded benefit obligation of the pension plans and other postretirement benefit plans. If withdrawal under circumstances that would give rise to an obligation is either probable or reasonably possible, the provisions of SSAP No. 5~~R~~ shall apply. If it is either probable or reasonably possible that (a) an employer would withdraw from the plan under circumstances that would give rise to an obligation or (b) an employer's contribution to the fund would be increased during the remainder of the contract period to make up a shortfall in the funds necessary to maintain the negotiated level of benefit coverage (a "maintenance of benefits" clause), the employer shall apply the provisions and disclosures of SSAP No. 5~~R~~.

Multiple-Employer Plans

82. Some pension plans to which two or more unrelated employers contribute are not multiemployer plans. Rather, they are in substance aggregations of single-employer plans combined to allow participating employers to pool their assets for investment purposes and to reduce the costs of plan administration. Those plans ordinarily do not involve collective-bargaining agreements. They may also have features that allow participating employers to have different benefit formulas, with the employer's contributions to the plan based on the benefit formula selected by the employer. Such plans shall be considered single-employer plans rather than multiemployer plans, and each reporting entity's accounting shall be based on its respective interest in the plan.

Non-U.S. Pension Plans

83. Except for its effective date, this statement includes no special provisions applicable to pension arrangements outside the United States. To the extent that those arrangements are in substance similar to pension plans in the United States, they are subject to the provisions of this statement. The substance of an arrangement is determined by the nature of the obligation and by the terms or conditions that define the amount of benefits to be paid, not by whether (or how) a plan is funded, whether benefits are payable at intervals or as a single amount, or whether the benefits are required by law or custom or are provided under a plan the employer has elected to sponsor.

84. It is customary or required in some countries to provide benefits in the event of a voluntary or involuntary severance of employment (also called termination indemnities). If such an arrangement is in substance a pension plan (for example, if the benefits are paid for virtually all terminations), it is subject to the provisions of this statement.

Business Combinations

85. When an employer is acquired in a business combination and that employer sponsors a single-employer defined benefit pension plan, the assignment of the purchase price to individual assets acquired and liabilities assumed shall include a liability for the projected benefit obligation in excess of plan assets or an asset for plan assets in excess of the projected benefit obligation, thereby eliminating any previously existing net gain or loss, prior service cost or credit, or transition asset or obligation recognized in unassigned funds (surplus). If it is expected that the plan will be terminated or curtailed, the effects of those actions shall be considered in measuring the projected benefit obligation.

Consolidated/Holding Company Plans

86. The employees of many reporting entities are members of a plan sponsored by a parent company or holding company. A reporting entity who participates in these plans and is not directly liable for obligations under the plan shall recognize pension expense equal to its allocation from the holding company or parent company of the required contribution to the plan for the period. A liability shall be established for any such contributions due and unpaid. Furthermore, the reporting entity shall disclose in the notes to 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 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 obligations under the plan, then the requirements outlined above in paragraphs 1-85 and 90-101 of this statement shall be applied.

Relevant Literature

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*. 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* 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* 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.

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.

88. This statement adopts the revisions to ASC 715-30 as it relates to interim re-measurement due to a *significant* event as detailed in *ASU 2015-04, Practical Expedient for the Measurement Date of An Employer's Defined Benefit Obligation and Plan Assets*. Other revisions are rejected as statutory accounting requires the annual measurement of benefit obligations and plan assets to be measured as of a year-end measurement date.

89. This statement rejects *ASU 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. Existing statutory disclosures on the components of pension costs shall be completed.

Effective Date and Transition

90. Reporting entities are required to disclose the projected benefit obligation, the accumulated benefit obligation and the fair value of plan assets for defined benefit pension plans in the first reporting period after the effective date of this standard and in each subsequent reporting period. This disclosure shall specifically note the funded/underfunded status of the pension plan based on the projected benefit obligation. Reporting entities shall also specifically note the surplus impact necessary, at each reporting date, to reflect the full projected benefit obligation within the financial statements.

91. This statement is effective for quarterly and annual reporting periods beginning on or after January 1, 2013 (transition date) with early adoption permitted. Any unfunded defined benefit pension amounts, as determined when the projected benefit obligation exceeds the fair value of plan assets, is a liability under SSAP No. 5~~R~~ and shall be reported in the first quarter statutory financial statements after the transition date with a corresponding entry to unassigned funds (surplus). If the fair value of plan assets exceeds the projected benefit obligation, the asset shall be considered a nonadmitted asset. Net periodic pension cost shall include a component for unrecognized prior service cost for nonvested employees beginning in 2013.

92. The requirement to measure plan assets and benefit obligations as of the date of the reporting entity's financial statement year-end is effective for financial statement years beginning January 1, 2014. (The measurement date change will be initially reflected in the December 31, 2014 financial statements.)

93. In order to transition to a fiscal year-end measurement date, the reporting entity shall remeasure plan assets and benefit obligations as of the beginning of the fiscal year that the measurement date

provisions are applied. The reporting entity shall use those new measurements to determine the effects of the measurement date change as of the beginning of the fiscal year that the measurement date provisions are applied.

94. The reporting entity shall measure plan assets and benefit obligations as of the beginning of the fiscal year that the measurement date provisions are applied. This would result with the following:

a. Net periodic benefit cost for the period between the measurement date that is used for the immediately preceding fiscal year-end and the beginning of the fiscal year that the measurement date provisions are applied, exclusive of any curtailment or settlement gain or loss, shall be recognized, net of tax, as a separate adjustment of the opening balance unassigned funds (surplus). That is, the pretax amount recognized as an adjustment to unassigned funds (surplus) is the net periodic benefit cost that without a change in measurement date otherwise would have been recognized on a delayed basis during the first interim period for the fiscal year that the measurement date provisions are applied.

b. Any gain or loss arising from a curtailment or settlement between the measurement date that is used for the immediately preceding fiscal year-end and the beginning of the fiscal year that the measurement date provisions are applied shall be recognized in earnings in that period and not as an adjustment to unassigned funds (surplus). This provision prohibits a reporting entity from early application of the measurement date provisions when the reporting entity has issued financial statements for the prior year without recognition of such a settlement or curtailment.

c. Other changes in the fair value of plan assets and the benefit obligations (for example, gains or losses) for the period between the measurement date that is used for the immediately preceding fiscal year-end and the beginning of the fiscal year that the measurement date provisions are applied shall be recognized, net of tax, as a separate adjustment of the opening balance of unassigned funds (surplus) for the fiscal year that the measurement date provisions are applied.

95. Earlier application of the recognition or measurement date provisions is encouraged, however, early applications must be for all of the reporting entity's benefit plans. If early application is elected, the transition date shall reflect the January 1st of the year in which this standard is initially applied. Retrospective application is not permitted.

REFERENCES

Other

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- *SSAP No. 89—Accounting for Pensions, A Replacement of SSAP No. 8*

Relevant Issue Papers

- *Issue Paper No. 8—Accounting for Pensions*
- *Issue Paper No. 123—Accounting for Pensions, A Replacement of SSAP No. 8*
- *Issue Paper No. 132—Accounting for Pensions, A Replacement of SSAP No. 89*

EXHIBIT A - CHANGES IN THE MEASUREMENT DATE AND PLAN SETTLEMENT

Note: Footnote references in this section link numbers together for ease of reference.

The reporting entity adopted this SSAP as of the transition date (January 1, 2013.) In accordance with this SSAP, Company B is changing the measurement date for its defined benefit pension plan from September 30 to December 31 for its December 31, 2014, financial statements. In accordance with this SSAP, statutory accounting principles require that change to be implemented by remeasuring plan assets and obligations as of December 31, 2013. Company B has a plan settlement on November 30, 2013, and remeasures its plan assets and benefit obligations as of November 30, 2013, resulting in a settlement loss before taxes of $60,000[6], which is a portion of the net loss in unassigned funds (surplus). However, the effects of remeasuring plan assets and obligations as of November 30, 2013, on the funded status reported in Company B's statement of financial position are not recognized until the following fiscal year because the change in measurement date has not been adopted at November 30, 2013. In recognizing the effects of the plan settlement and change in measurement date:

a. Recognize the settlement loss in net income in the fourth quarter of 2013 and a corresponding decrease in the cumulative net loss in unassigned funds (surplus).

b. Recognize the net periodic pension cost incurred from October 1, 2013, to December 31, 2013, net of tax, as an adjustment to beginning unassigned funds (surplus) for 2014.

c. Recognize any gains or losses arising during the period from October 1, 2013, to December 31, 2013, net of tax, as an adjustment to unassigned funds (surplus) for 2014.

d. Recognize corresponding changes in pension liability and deferred tax amounts for the above items.

The funded status of Company B's Plan assets as of September 30, 2013, November 30, 2013, December 31, 2013 and December 31, 2014, and amounts included in unassigned funds (surplus) to be recognized as a component of net periodic pension cost are shown below. Company B has no remaining transition asset or obligation. Company B is not required to amortize the cumulative net loss because it is less than 10% of the greater of the fair value of plan assets or the projected benefit obligation for all years presented. The applicable tax rate for 2013 and 2014 is 40%.

	9/30/13	**11/30/13**	**12/31/13**	**12/31/14**
Projected Benefit Obligation	(3,660)	(3,200)	(3,210)	(3,700)
Plan Asset – Fair Value	2,600	2,200	2,225	2,200
Funded Status	**(1,060)**	**(1,000)**	**(985)**	**(1,500)**
Items not yet recognized as a component of net periodic cost:	380	360	350	230
Prior Service Cost	265[5]	220	315[4]	365
Net Loss	**645**	**580**	**665**	**595**

Based on actuarial valuations performed as of September 30, 2013, and November 30, 2013, the reporting entity determines its net periodic pension cost for the two-month period from October 1, 2013, to November 30, 2013, and for the one-month period from December 1, 2013, to December 31, 2013, as follows:

Net Periodic Pension Cost	2 Months	1 Month	Total
Service Cost	25	15	40
Interest Cost	30	15	45
Expected Return on Plan Assets	(30)	(15)	(45)
Total service cost, interest cost, and expected return on plan assets	**25**	**15**	**40**[2]
Amortization of prior service cost	20	10	30[3]
Amortization of net loss	0	0	0
Total Amortization	20	10	30
Net Periodic Benefit Cost	**45**	**25**	**70**[1]

a. In the fourth quarter of 2013, the reporting entity makes the following journal entry to recognize the $60,000[6] settlement loss: (40% tax rate - $24,000)

Net Periodic Pension Cost (settlement loss)	60	
Deferred Tax Asset	24	
Unassigned Funds (Surplus)		84

b. In 2014, the reporting entity makes the following net journal entry to apply the measurement date provisions and adjust the beginning balances of unassigned funds (surplus), pension liability and deferred tax accounts for the amortization of prior service cost and the service cost, interest cost, and expected return on plan assets.

Unassigned Funds (Surplus)	24	
Deferred Tax Asset	16	
Accrued Benefit Cost		40

This journal entry reflects the following considerations:

- Debit to unassigned funds (surplus) for the $70[1] net periodic benefit cost
- Debit to deferred tax asset for $16 calculated as 40% of the $40[2] total service cost, interest cost, and expected return on plan assets
- Debit to unassigned funds (surplus) for $12 for the tax impact calculated as 40% of the $30[3] amortization of the prior service cost
- Credit to Unassigned funds (surplus) for $28 for the tax impact calculated as 40% of the $70[1] net periodic benefit cost
- Credit to Unassigned funds (surplus) for $30[3] for the amortization of the prior service cost.
- Credit to liability for pension benefits for the $40[2] total service cost, interest cost, and expected return on plan assets

c. The following entry adjusts the beginning balances of unassigned funds (surplus), pension liability and deferred tax accounts for the net loss arising during the period. (Net loss is calculated as follows: Net loss at December 31, 2013 of $315[4], less net loss at November 30, 2013 of $265[5], plus settlement loss of $60[6] to equal $110.)

Unassigned Funds (Surplus)	66	
Deferred Tax Asset	44	
Accrued Benefit Cost		110

Statement of Statutory Accounting Principles No. 103

Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

STATUS

Type of Issue	Common Area
Issued	March 3, 2012; Substantively revised June 9, 2016
Effective Date	January 1, 2013; Substantive revisions detailed in Issue Paper No. 152 effective January 1, 2017
Affects	Supersedes SSAP No. 91R; Nullifies and incorporates INT 99-22 and INT 03-05
Affected by	No other pronouncements
Interpreted by	INT 01-31; INT 04-21; INT 20-06
Relevant Appendix A Guidance	None

SCOPE OF STATEMENT

1. Transfers of financial assets take many forms. Accounting for transfers in which the transferor has no continuing involvement with the transferred financial assets or with the transferee are generally straightforward. However, transfers of financial assets often occur in which the transferor has some continuing involvement either with the assets transferred or with the transferee. Examples of continuing involvement include, but are not limited to, servicing arrangements, recourse or guarantee arrangements, agreements to purchase or redeem transferred financial assets, options written or held, derivative financial instruments that are entered into contemporaneously with, or in contemplation of the transfer, arrangements to provide financial support, pledges of collateral, and the transferor's beneficial interests in the transferred financial assets. Transfers of financial assets with continuing involvement raise issues about the circumstances under which the transfers should be considered as sales of all or part of the assets or as secured borrowings. An objective in accounting for transfers of financial assets is for each reporting entity that is a party to the transaction to recognize only assets it controls and liabilities it has incurred, to derecognize assets only when control has been surrendered, and to derecognize liabilities only when they have been extinguished. Sales and other transfers may frequently result in a disaggregation of financial assets and liabilities into components, which become separate assets and liabilities. The guidance in this statement also applies to transactions in which servicing assets are transferred with loans retained by the transferor.

2. This statement focuses on the issues of accounting for transfers and servicing of financial assets and extinguishments of liabilities. This statement establishes statutory accounting principles for transfers and servicing of financial assets, including asset securitizations and securitizations of policy acquisition costs, extinguishments of liabilities, repurchase agreements, repurchase financing and reverse repurchase agreements, including dollar repurchase and dollar reverse repurchase agreements that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts). This statement discusses generalized situations. Facts and circumstances and specific contracts need to be considered carefully in applying this statement. Securitizations of nonfinancial assets are outside the scope of this statement. Transfers of financial assets that are in substance real estate shall be accounted for in accordance with *SSAP No. 40~~R~~—Real Estate Investments*. Additionally, retained beneficial interests from the sale of ~~loan-backed or structured~~asset-backed securities are to be accounted for in accordance with the statutory accounbting statement that is applicable to the investment retained.~~*SSAP No. 43R—Loan-Backed and Structured Securities, Revised.*~~ If the retained security does not qualify for reporting as a bond under the bond definition detailed in *SSAP No. 26—Bonds*, it shall be reported as a debt security that does not qualify as a bond in scope of *SSAP No. 21—Other Admitted Assets*.

3. *SSAP No. 25—Affiliates and Other Related Parties* shall be followed for accounting and disclosure requirements for all related party transactions.

4. *SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* has been superseded by this statement.

5. This statement does not address the securitization of mortality or morbidity risk. The National Association of Insurance Commissioners' (NAIC's) Insurance Securitization Working Group of the Financial Condition (E) Committee is charged with the development of model laws, model regulations and proposed accounting guidance for the securitization of mortality and morbidity risk. When such proposed accounting guidance is finalized the development of a statement will be considered.

SUMMARY CONCLUSION

Accounting for Transfers and Servicing of Financial Assets

6. The objective of paragraph 8 and related implementation guidance is to determine whether a transferor has surrendered control over transferred financial assets. This determination must consider the transferor's continuing involvement in the transferred financial assets and requires the use of judgment that must consider all arrangements or agreements made contemporaneously with, or in contemplation of, the transfer, even if they were not entered into at the time of the transfer.

7. The requirements of paragraph 8 apply to transfers of an entire financial asset, transfers of a group of entire financial assets, and transfers of a participating interest in an entire financial asset (all of which are referred to collectively in this statement as transferred financial assets). A participating interest has all of the following characteristics:

a. From the date of the transfer, it represents a proportionate (pro rata) ownership interest in an entire financial asset. The percentage of ownership interests held by the transferor in the entire financial asset may vary over time, while the entire financial asset remains outstanding as long as the resulting portions held by the transferor (including any participating interest retained by the transferor or its agents) and the transferee(s) meet the other characteristics of a participating interest. For example, if the transferor's interest in an entire financial asset changes because it subsequently sells another interest in the entire financial asset, the interest held initially and subsequently by the transferor must meet the definition of a participating interest.

b. From the date of the transfer, all cash flows received from the entire financial asset are divided proportionately among the participating interest holders in an amount equal to their share of ownership. Cash flows allocated as compensation for services performed, if any, shall not be included in that determination provided those cash flows are not subordinate to the proportionate cash flows of the participating interest and are not significantly above an amount that would fairly compensate a substitute service provider, should one be required, which includes the profit that would be demanded in the marketplace. In addition, any cash flows received by the transferor as proceeds of the transfer of the participating interest shall be excluded from the determination of proportionate cash flows provided that the transfer does not result in the transferor receiving an ownership interest in the financial asset that permits it to receive disproportionate cash flows.

c. The rights of each participating interest holder (including the transferor in its role as a participating interest holder) have the same priority, and no participating interest holder's interest is subordinated to the interest of another participating interest holder. That priority does not change in the event of bankruptcy or other receivership of the transferor, the original debtor, or any other participating interest holder. Participating interest holders have no recourse to the transferor, its agents or to each other, other than standard representations and warranties, ongoing contractual obligations to service the entire financial asset and administer the transfer contract, and contractual obligations to share in any set-off benefits received by any participating interest holder. That is, no participating interest holder is entitled to receive cash before any other participating interest holder under its contractual rights as a participating interest holder. For example, if a participating interest holder also is the servicer of the entire financial asset and receives cash in its role as servicer, that arrangement would not violate this requirement.

d. No party has the right to pledge or exchange the entire financial asset unless all participating interest holders agree to pledge or exchange the entire financial asset.

If a transfer of a portion of an entire financial asset meets the definition of a participating interest, the transferor shall apply the guidance in paragraph 8. If a transfer of a portion of a financial asset does not meet the definition of a participating interest, the transferor and transferee shall account for the transfer in accordance with the guidance in paragraph 14 as a secured borrowing. However, if the transferor transfers an entire financial asset in portions that do not individually meet the participating interest definition, paragraph 8 shall be applied to the entire financial asset once all portions have been transferred.

8. A transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset in which the transferor surrenders control over those financial assets shall be accounted for as a sale if, and only if, all of the following conditions are met:

a. The transferred financial assets have been isolated from the transferor—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership. Transferred financial assets are isolated in bankruptcy or other receivership only if the transferred financial assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor.

b. Each transferee (or, if the transferee is an entity whose sole purpose is to engage in securitization or asset-backed financing activities and that entity is constrained from pledging or exchanging the assets it receives, each third-party holder of its beneficial interests) has the right to pledge or exchange the assets (or beneficial interests) it received, and no condition both constrains the transferee (or third-party holder of its beneficial interests) from taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the transferor (paragraphs 43-46).

c. The transferor or its agents do not maintain effective control over the transferred financial assets or third-party beneficial interests related to those transferred assets (paragraph 50). Examples of a transferor's effective control over the transferred financial assets include, but are not limited to (1) an agreement that both entitles and obligates the transferor to repurchase or redeem them before their maturity (paragraphs 51-52), (2) an agreement that provides the transferor with both the unilateral ability to cause the holder to return specific financial assets and a more-than-trivial benefit attributable to that ability, other than through a cleanup call (paragraphs 53-57), or (3) an agreement that permits the transferee to require the transferor to repurchase the transferred financial assets at a price that is so favorable to the transferee that it is probable that the transferee will require the transferor to repurchase them (paragraph 58).

Accounting for Transfers of Participating Interests

9. Upon completion of a transfer of a participating interest that satisfies the conditions to be accounted for as a sale (paragraph 8), the transferor (seller) shall:

a. Allocate the previous carrying amount of the entire financial asset between the participating interests sold and the participating interest that continues to be held by the transferor on the basis of their relative fair values at the date of the transfer (paragraph 61).

b. Derecognize the participating interest(s) sold.

c. Recognize and initially measure at fair value servicing assets, servicing liabilities, and any other assets obtained and liabilities incurred in the sale (such as cash) (paragraphs 62-66).

d. Recognize in earnings any gain or loss on the sale.

e. Report any participating interest or interests that continue to be held by the transferor as the difference between the previous carrying amount of the entire financial asset and the amount derecognized.

The transferee shall recognize the participating interest(s) obtained, other assets obtained, and any liabilities incurred and initially measure them at fair value.

10. Upon completion of a transfer of participating interests that does not satisfy the conditions to be accounted for as a sale, the guidance in paragraph 14 shall be applied.

Accounting for Transfers of an Entire Financial Asset or Group of Entire Financial Assets

11. Upon completion of a transfer of an entire financial asset or a group of entire financial assets that satisfies the conditions to be accounted for as a sale (see paragraph 8), the transferor (seller) shall:

a. Derecognize the transferred financial assets;

b. Recognize and initially measure at fair value servicing assets, servicing liabilities, and any other assets obtained (including a transferor's beneficial interest in the transferred financial assets) and liabilities incurred[1] in the sale (paragraphs 60 and 62-66).

[1] Some assets that might be obtained and liabilities that might be incurred include cash, put or call options that are held or written (for example, guarantee or recourse obligations), forward commitments (for example, commitments to deliver additional receivables during the revolving periods of some securitizations) and swaps (for example, provisions that convert interest rates from fixed to variable).

c. For reporting entities required to maintain an Interest Maintenance Reserve (IMR), the accounting for realized and unrealized capital gains and losses shall be determined per the guidance in the SSAP for the specific type of investment~~ (e.g., SSAP No. 43R for loan-backed and structured securities)~~, or if not specifically stated in the related SSAP, in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. For reporting entities not required to maintain an IMR, realized capital gains and losses shall be reported as net realized capital gains or losses in the statement of income, and unrealized capital gains and losses shall be reported as net unrealized gains and losses in unassigned funds (surplus).

The transferee shall recognize all assets obtained and any liabilities incurred, and initially measure them at fair value.

12. Repurchase agreements, reverse repurchase agreements, repurchase financing, collateral requirements and dollar repurchase agreements are described in paragraphs 102-118. When an asset is sold and the proceeds are reinvested within 30 days in the same or substantially the same security, such transfers shall be considered to be wash sales and shall be accounted for as sales as discussed in paragraphs 96-101 and disclosed as required by paragraph 28[2]. Unless there is a concurrent contract to repurchase or redeem the transferred financial assets from the transferee, the transferor does not maintain effective control over the transferred financial assets.

13. Upon completion of a transfer of an entire financial asset or a group of entire financial assets that does not satisfy the conditions to be accounted for as a sale in its entirety, the guidance in paragraph 14 shall be applied.

Secured Borrowing

14. If a transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset does not meet the conditions for a sale in paragraph 8, or if a transfer of a portion of an entire financial asset does not meet the definition of a participating interest (paragraph 7), the transferor and transferee shall account for the transfer as a secured borrowing with pledge of collateral (paragraph 19). The transferor shall continue to report the transferred financial assets in its statement of financial position with no change in their measurement (that is, basis of accounting).

Recognition and Measurement of Servicing Assets and Liabilities

15. An entity shall recognize and initially measure at fair value, a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in either of the following situations:

a. A servicer's transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset that meets the requirements for sale accounting; or

b. An acquisition or assumption of a servicing obligation that does not relate to financial assets of the servicer.

An entity that transfers its financial assets to an entity in a transfer that qualifies as a sale in which the transferor obtains the resulting securities and classifies them as debt securities shall separately recognize its servicing assets or servicing liabilities.

[2] Paragraph 28.l. also details the items that are excluded from the wash sale disclosure.

16. A servicer that transfers or securitizes financial assets in a transaction that does not meet the requirements for sale accounting and is accounted for as a secured borrowing with the underlying assets remaining on the transferor's balance sheet shall not be recognized as a servicing asset or servicing liability.

17. If distinct servicing rights exist in accordance with the above guidelines, the reporting entity shall recognize a servicing asset or liability. When the servicing fees to be received exceed the cost of servicing the transferred assets, a servicing asset is recognized and nonadmitted. When the cost of servicing the transferred assets is greater than the servicing fees to be received, a liability shall be recorded for the excess to recognize this obligation. A corresponding loss shall be recorded through the Summary of Operations in other income. Servicing assets or liabilities shall be measured subsequently at fair value at each reporting date with fluctuations in fair value reported as unrealized gains and losses. Declines in fair value which are determined to be other than temporary shall be recorded as realized losses.

Financial Assets Subject to Prepayment

18. Financial assets, except for instruments that are within the scope of *SSAP No. 86—Derivatives*, that can contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment shall be assessed in accordance with the bond definition captured in SSAP No. 26 to determine appropriate accounting and reporting. Securities that do not qualify for bond reporting shall be captured as debt securities that do not qualify as bonds in scope of SSAP No. 21.~~subsequently measured like investments in debt securities and loan-backed and structured securities in accordance with SSAP No. 43R. Examples of such financial assets include, but are not limited to, interest-only strips, other beneficial interests, loans, or other receivables.~~

Secured Borrowings and Collateral

19. A debtor may grant a security interest in certain assets to a lender (the secured party) to serve as collateral for its obligation under a borrowing, with or without recourse to other assets of the debtor. An obligor under other kinds of current or potential obligations, for example, interest rate swaps, also may grant a security interest in certain assets to a secured party. If collateral is transferred to the secured party, the custodial arrangement is commonly referred to as a pledge. Secured parties sometimes are permitted to sell or repledge (or otherwise transfer) collateral held under a pledge. The same relationships occur, under different names, in transfers documented as sales that are accounted for as secured borrowings (paragraph 14). The accounting for noncash[3] collateral by the debtor (or obligor) and the secured party depends on whether the secured party or its agent has the right to sell or repledge the collateral and on whether the debtor has defaulted. (Paragraphs 85-121 provide application guidance for securities lending, securities borrowing and repurchase agreements.)

a. If the secured party (transferee) or its agent has the right by contract or custom to sell or repledge the collateral, then the debtor (transferor) shall report that asset in its balance sheet.

b. If the secured party (transferee) sells collateral pledged to it, it shall recognize the proceeds from the sale and its obligation to return the collateral. The sale of the collateral is a transfer subject to the provisions of this statement.

c. If the debtor (transferor) defaults under the terms of the secured contract and is no longer entitled to redeem the pledged asset, it shall derecognize the pledged asset, and the secured party (transferee) shall recognize the collateral as its asset initially measured at fair value or, if it has already sold the collateral, derecognize its obligation to return the collateral.

[3] Cash "collateral," sometimes used, for example, in securities lending transactions, shall be derecognized by the payer and recognized by the recipient, not as collateral, but rather as proceeds of either a sale or a borrowing.

d. Except as provided in paragraph 19.c., the debtor (transferor) shall continue to carry the collateral as its asset, and the secured party (transferee) shall not recognize the pledged asset.

20. Reporting entities may enter into certain transactions that require the granting of a security interest in certain assets to another party to serve as collateral for their performance under a contract. If the assets pledged are recorded as admitted assets under *SSAP No. 4—Assets and Nonadmitted Assets* and *INT 01-31: Assets Pledged as Collateral* and are not impaired under the provisions of *SSAP No. 5~~R~~—Liabilities, Contingencies and Impairments of Assets*, the pledging entity records the collateral as an admitted asset until committing a contract default that has not been cured in accordance with the contract provisions. At the time of an uncured default, the provisions of paragraph 19 shall be used to determine the appropriate accounting treatment for the collateral. If the secured party utilizes collateral to offset all or a portion of the liability owed by the pledging entity as a result of the default, then the collateral amount utilized to offset the liability shall be removed from the balance sheet. At the same time, the amount of the liability that was offset shall be removed from the balance sheet since that obligation has been satisfied through the secured party's utilization of that collateral. To the extent that an uncured default remains without the secured party utilizing the collateral to offset the obligation, the pledging insurer shall only record an admitted asset for the amount of collateral that it can redeem.

Extinguishments of Liabilities

21. A debtor shall derecognize a liability if and only if it has been extinguished (see *SSAP No. 15—Debt and Holding Company Obligations*). A liability has been extinguished if either of the following conditions is met:

a. The debtor pays the creditor and is relieved of its obligation for the liability. Paying the creditor includes delivery of cash, other financial assets, goods, or services or reacquisition by the debtor of its outstanding debt securities whether the securities are canceled or held as so-called treasury bonds; or

b. The debtor is legally released[4] from being the primary obligor under the liability, either judicially or by the creditor.

22. An exchange of debt instruments with substantially different terms is also considered a debt extinguishment and shall be accounted for in accordance with paragraph 21. A debtor's exchange of debt instruments (in a nontroubled debt situation) is accomplished with debt instruments that are substantially different if the present value of the cash flows under the terms of the new debt instrument is at least 10% different from the present value of the remaining cash flows under the terms of the original instrument. If the difference between the present value of the cash flows under the terms of the new debt instrument and the present value of the remaining cash flows under the terms of the original debt instrument is less than 10%, a creditor should evaluate whether the modification is more than minor based on the specific facts and circumstances (and other relevant considerations) surrounding the modification.

Disclosures

23. The principal objectives of the disclosures required by this statement are to provide users of the financial statements with an understanding of all of the following:

a. A transferor's continuing involvement (as defined in the glossary of this statement), if any, with transferred financial assets.

[4] If nonrecourse debt (such as certain mortgage loans) is assumed by a third party in conjunction with the sale of an asset that serves as sole collateral for that debt, the sale and related assumption effectively accomplish a legal release of the seller-debtor for purposes of applying this statement.

b. The nature of any restrictions on assets reported by an entity in its statement of financial position that relate to a transferred financial asset, including the carrying amounts of those assets.

c. How servicing assets and servicing liabilities are reported under this statement.

d. For transfers accounted for as sales when a transferor has continuing involvement with the transferred financial assets and for transfers of financial assets accounted for as secured borrowings, how the transfer of financial assets affects a transferor's financial position, financial performance, and cash flows.

Those objectives apply regardless of whether this statement requires specific disclosures. The specific disclosures required by this statement are minimum requirements and an entity may need to supplement the required disclosures specified in paragraph 28 depending on the facts and circumstances of a transfer, the nature of an entity's continuing involvement with the transferred financial assets, and the effect of an entity's continuing involvement on the transferor's financial position, financial performance, and cash flows. Disclosures required by other statement of statutory accounting principles (SSAPs) for a particular form of continuing involvement shall be considered when determining whether the disclosure objectives of this statement have been met.

24. Disclosures required by this statement may be reported in the aggregate for similar transfers if separate reporting of each transfer would not provide more useful information to financial statement users. A transferor shall disclose how similar transfers are aggregated. A transferor shall distinguish transfers that are accounted for as sales from transfers that are accounted for as secured borrowings. If specific disclosures are required for a particular form of a transferor's continuing involvement by other SSAPs, the transferor shall provide the information required in (a) through (c) with a cross-reference to the separate notes to financial statements so a financial statement user can understand the risks retained in the transfer. In determining whether to aggregate the disclosures for multiple transfers, the reporting entity shall consider quantitative and qualitative information about the characteristics of the transferred financial assets. For example, consideration should be given, but not limited, to the following:

a. The nature of the transferor's continuing involvement.

b. The types of financial assets transferred.

c. Risks related to the transferred financial assets to which the transferor continues to be exposed after the transfer and the change in the transferor's risk profile as a result of the transfer.

25. The disclosures shall be presented in a manner that clearly and fully explains to financial statement users the transferor's risk exposure related to the transferred financial assets and any restrictions on the assets of the entity. An entity shall determine, in light of the facts and circumstances, how much detail it must provide to satisfy the disclosure requirements of this statement and how it aggregates information for assets with different risk characteristics. The entity must strike a balance between obscuring important information as a result of too much aggregation and excessive detail that may not assist financial statement users to understand the entity's financial position. For example, an entity shall not obscure important information by including it with a large amount of insignificant detail. Similarly, an entity shall not disclose information that is so aggregated that it obscures important differences between the different types of involvement or associated risks.

26. The disclosures in paragraph 28.g. of this statement apply to transfers accounted for as sales when the transferor has continuing involvement with transferred financial assets as a result of a securitization, asset-backed financing arrangement, or a similar transfer. If specific disclosures are required for a particular form of the transferor's continuing involvement by other SSAPs, the transferor shall provide the

information required in paragraphs 28.f.i.(a) and 28.f.ii.(a) of this statement with a cross-reference to the separate notes to financial statements so a financial statement user can understand the risks retained in the transfer. The entity need not provide each specific disclosure required in paragraphs 28.f.i.(b), 28.f.ii.(a)(1)–(4), and 28.f.ii.(b)–(e) if the disclosure is not required by other SSAPs and the objectives of paragraph 23 are met. For example, if the transferor's only form of continuing involvement is a derivative, the entity shall provide the disclosures required in paragraphs 28.f.i.(a) and 28.f.ii.(a) of this statement and the disclosures about derivatives required by applicable SSAPs. In addition, the entity would evaluate whether the other disclosures in paragraph 28.g. are necessary for the entity to meet the objectives in paragraph 23.

27. To apply the disclosures in paragraph 28, an entity shall consider all involvements by the transferor or its agents to be involvements by the transferor.

28. A reporting entity shall disclose the following[5]:

a. For Repurchase and Reverse Repurchase Agreements:

i. If the entity has entered into repurchase or reverse repurchase agreements, information regarding the company policy or strategies for engaging in repo programs, policy for requiring collateral, as well as whether transactions have been accounted for as secured borrowings or as sale transactions. This disclosure shall include the terms of reverse repurchase agreements whose amounts are included in borrowing money. The following information shall be disclosed by type of agreement:

(a) Whether repo agreements are bilateral and/or tri-party trades;

(b) Maturity time frame divided by the following categories: open or continuous term contracts for which no maturity date is specified, overnight, 2 days to 1 week, from 1 week to 1 month, greater than 1 month to 3 months, greater than 3 months to 1 year, and greater than 1 year[6];

(c) Aggregate narrative disclosure of the fair value of securities sold and/or acquired that resulted in default. (This disclosure is not intended to capture "failed trades", which are defined as instances in which the trade did not occur as a result of an error and was timely corrected. Rather, this shall capture situations in which the non-defaulting party exercised their right to terminate after the defaulting party failed to execute.)

ii. For repurchase transactions accounted for as secured borrowings[7], the maximum amount and end balance as of each reporting period (quarterly and annual) for the following:

[5] All repurchase and reverse repurchase transactions (collectively referred to as "repos"), and securities borrowing and securities lending transactions shall be reported gross for disclosure purposes and when detailed on the respective investment schedules. However, repurchase and reverse repurchase transactions, and securities borrowing and securities lending transactions may be reported net in the financial statements (pages 2 and 3 of the statutory financial statements) in accordance with *SSAP No. 64—Offsetting and Netting of Assets and Liabilities* when a valid right to offset exists. When these transactions are offset in accordance with SSAP No. 64 and reported net in the financial statements, the disclosure requirements in SSAP No. 64, paragraph 6, shall be followed.

[6] Only short-term repo agreements (with a stated short-term maturity date) are allowed as admitted assets. Long-term repo agreements (agreements with maturity dates in excess of 365 days) are nonadmitted.

[7] For secured borrowing repurchase transactions, the insurance reporting entity is selling a security, and receiving collateral (generally cash) in an exchange that does not qualify as a sale.

(a) Fair value of securities sold. (Book adjusted carrying value shall be provided as an end balance only.) This information is required in the aggregate, and by type of security categorized by NAIC designation, with identification of nonadmitted assets. Although legally sold as a secured borrowing, these assets are still reported by the insurer and shall be coded as restricted pursuant to the annual statement instructions, disclosed in accordance with *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures*, reported in the general interrogatories, and included in any other statutory schedules or disclosure requirements requesting information for restricted assets.

(b) Cash collateral and the fair value of security collateral (if any) received. This information is required in the aggregate and by type of security categorized by NAIC designation with identification of collateral securities received that do not qualify as admitted assets.

(1) For collateral received, aggregate allocation of the collateral by the remaining contractual maturity of the repurchase agreements (gross): overnight and continuous, up to 30 days, 30-90 days, greater than 90 days. This disclosure shall also include a discussion of the potential risks associated with the agreements and related collateral received, including the impact arising changes in the fair value of the collateral received and/or the provided security and how those risks are managed.

(2) For cash collateral received that has been reinvested, the total reinvested cash and the aggregate amortized cost and fair value of the invested asset acquired with the cash collateral. This disclosure shall be reported by the maturity date of the invested asset: under 30 days, 60 days, 90 days, 120 days, 180 days, less than 1 year, 1-2 years, 2-3 years and greater than 3 years. To the extent that the maturity dates of the liability (collateral to be returned) does not match the invested assets, the reporting entity shall explain the additional sources of liquidity to manage those mismatches.

(c) Liability recognized to return cash collateral, and the liability recognized to return securities received as collateral as required pursuant to the terms of the secured borrowing transaction.

iii. For reverse repurchase transactions accounted for as secured borrowings[8], the maximum amount and end balance as of each reporting period (quarterly and annual) for the following:

(a) Fair value of securities acquired. This information shall be reported in the aggregate, and by type of security categorized by NAIC designation, with identification of whether acquired assets would not qualify as admitted assets.

(b) Cash collateral and the fair value of security collateral (if any) provided. (If security collateral was provided, book adjusted carrying value shall be

[8] For secured borrowing reverse repurchase transactions, the insurance reporting entity is buying a security and providing collateral (generally cash) in an exchange that does not qualify as a sale.

provided as an end balance only.) Disclosure shall identify the book adjusted carrying value of any nonadmitted securities provided as collateral. For collateral pledged, the aggregate allocation of the collateral by the remaining contractual maturity of the reverse-repurchase agreements (gross): overnight and continuous, up to 30 days, 30-90 days, greater than 90 days. This disclosure shall also include a discussion of the potential risks associated with the agreements and related collateral pledged, including obligations arising from a decline in the fair value of the collateral pledged and how those risks are managed.

(c) Recognized receivable for the return of collateral. (Generally cash collateral, but including securities provided as collateral as applicable under the terms of the secured borrowing transaction. Receivables are not recognized for securities provided as collateral if those securities are still reported as assets of the reporting entity.)

(d) Recognized liability to return securities acquired under the reverse-repurchase agreement as required pursuant to the secured borrowing transaction. (Generally, a liability is required if the acquired securities are sold.)

iv. For repurchase transactions accounted for as a sale[9], the maximum amount and end balance as of each reporting period (quarterly and annual) for the following:

(a) Fair value of securities sold (derecognized from the financial statements). (Book adjusted carrying value shall be provided as an end balance only, reflecting the amount derecognized from the sale transaction.) This information is required in the aggregate, and by type of security categorized by NAIC designation, with information on the book adjusted carrying value of nonadmitted assets sold.

(b) Cash and the fair value of securities (if any) received as proceeds and recognized in the financial statements. This information is required in the aggregate and by type of security categorized by NAIC designation, with identification of received assets nonadmitted in the financial statements. All securities received shall be coded as restricted pursuant to the annual statement instructions, disclosed in accordance with SSAP No. 1, reported in the general interrogatories, and included in any other statutory schedules or disclosure requirements requesting information for restricted assets.

(c) The forward repurchase commitment recognized to return the cash or securities received. Amount reported shall reflect the stated repurchase price under the repurchase transaction.

v. For reverse repurchase transactions accounted for as sale[10], the maximum amount and end balance as of each reporting period (quarterly and annual):

[9] For sale repurchase transactions, the insurance reporting entity sold a security and received "proceeds" in exchange. With a sale transaction, the insurer removes the asset from their financial statements and recognizes the proceeds from the sale. This transaction requires recognition of a forward repurchase commitment.

[10] For sale reverse repurchase transactions, the insurance reporting entity has purchased a security and provided "proceeds" in exchange. With a sale transaction, the insurer reports the acquired asset in their financial statements and removes the proceeds provided. This transaction requires recognition of a forward resale commitment.

(a) Fair value of securities acquired and recognized on the financial statements. (Book adjusted carrying value shall be provided as an end balance only.) This information shall be reported in the aggregate, and by type of security categorized by NAIC designation. The disclosure also requires the book adjusted carrying value of nonadmitted assets acquired.

(b) Cash collateral and the fair value of security collateral (if any) provided. (If security collateral was provided, book adjusted carrying value shall be provided as an end balance only.) Disclosure shall also identify whether any nonadmitted assets were provided as collateral (derecognized from the financial statements).

(c) The forward resale commitment recognized (stated repurchase price) to sell the acquired securities.

b. Collateral:

i. If the entity has entered into securities lending transactions, its policy for requiring collateral or other security and the fair value of the loaned security;

ii. If the entity has pledged any of its assets as collateral that are not reclassified and separately reported in the statement of financial position pursuant to paragraph 19.a., the carrying amounts and classifications of both those assets and associated liabilities as of the date of the latest statement of financial position presented, including qualitative information about the relationship(s) between those assets and associated liabilities. For example, if assets are restricted solely to satisfy a specific obligation, the carrying amounts of those assets and associated liabilities, including a description of the nature of restrictions placed on the assets, shall be disclosed.

iii. If the entity or its agent has accepted collateral that it is permitted by contract or custom to sell or repledge, the fair value as of the date of each statement of financial position presented of that collateral and of the portion of that collateral that it has sold or repledged, and information about the sources and uses of that collateral. Additionally, the reporting entity shall disclose the aggregate amount of contractually obligated open collateral positions (aggregate amount of securities at current fair value or cash received for which the borrower may request the return of on demand) and the aggregate amount of contractually obligated collateral positions under 30-day, 60-day, 90-day, and greater than 90-day terms.

iv. If the entity has accepted collateral that it is not permitted by contract or custom to sell or repledge, provide detail on these transactions, including the terms of the contract, and the current fair value of the collateral.

v. For all securities lending transactions, disclose collateral for transactions that extend beyond one year from the reporting date; and

vi. For securities lending transactions administered by an affiliated agent in which "one-line" reporting (paragraph 89.a.) of the reinvested collateral per paragraph 89.c. is optional, at the discretion of the reporting entity, disclose the aggregate value of the reinvested collateral which is "one line" reported and the aggregate value of items which are reported in the investment schedules (paragraph 89.b.). Identify the rationale between the items which are one line reported and those that are investment schedule reported and if the treatment has changed from the prior period and

vii. For securities lending transactions, include separately, the amount of any loaned securities within the separate account and if the policy and procedures for the separate account differ from the general account.

c. The reporting entity shall provide the following information by type of program (securities lending or dollar repurchase agreement) with respect to the reinvestment of the cash collateral and any securities which it or its agent receives as collateral that can be sold or repledged.

i. The aggregate amount of the reinvested cash collateral (amortized cost and fair value). Reinvested cash collateral shall be broken down by the maturity date of the invested asset – under 30 days, 60 days, 90 days, 120 days, 180 days, less than 1 year, 1-2 years, 2-3 years and greater than 3 years.

ii. To the extent that the maturity dates of the liability (collateral to be returned) does not match the invested assets, the reporting entity shall explain the additional sources of liquidity to manage those mismatches.

d. For in-substance defeasance of debt

i. If debt was considered to be extinguished by in-substance defeasance, a general description of the transaction and the amount of debt that is considered extinguished at the end of each the period so long as that debt remains outstanding.

e. For all servicing assets and servicing liabilities:

i. A description of the risks inherent in servicing assets and servicing liabilities and, if applicable, the instruments used to mitigate the income statement effect of changes in fair value to the servicing assets and servicing liabilities. (Disclosure of quantitative information about the instruments used to manage the risks inherent in servicing assets and servicing liabilities is encouraged but not required.)

ii. The amount of contractually specified servicing fees, late fees and ancillary fees earned for each period for which results of operations are presented, including a description of where each amount is reported in the statement of income.

iii. Quantitative and qualitative information about the assumptions used to estimate the fair value (for example, discount rates, anticipated credit losses, and prepayment speeds). An entity that provides quantitative information about the instruments used to manage the risks inherent in the servicing assets and servicing liabilities, as encouraged by paragraph 28.e.i., also is encouraged, but not required to disclose the quantitative and qualitative information about the assumptions used to estimate the fair value of those instruments.

f. When servicing assets and servicing liabilities are subsequently measured at fair value:

i. For each class of servicing assets and servicing liabilities, the activity in the balance of servicing assets and the activity in the balance of servicing liabilities (including a description of where changes in fair value are reported in the statement of income for each period for which results of operations are presented), including, but not limited to, the following:

(a) The beginning and ending balances

(b) Additions (through purchases of servicing assets, assumptions of servicing obligations, and recognition of servicing obligations that result from transfers of financial assets)

(c) Disposals

(d) Changes in fair value during the period resulting from (i) changes in valuation inputs or assumptions used in the valuation model and (ii) other changes in fair value and a description of those changes

(e) Other changes that affect the balance and a description of those changes.

g. For securitizations, asset-backed financing arrangements, and similar transfers accounted for as sales when the transferor has continuing involvement (as defined in the glossary) with the transferred financial assets:

i. For each income statement presented:

(a) The characteristics of the transfer including a description of the transferor's continuing involvement with the transferred financial assets, the nature and initial fair value of the assets obtained as proceeds and the liabilities incurred in the transfer, and the gain or loss from sale of transferred financial assets. For initial fair value measurements of assets obtained and liabilities incurred in the transfer, the following information:

(1) The level within the fair value hierarchy in which the fair value measurements in their entirety fall, 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) The key inputs and assumptions[11] used in measuring the fair value of assets obtained and liabilities incurred as a result of the sale that relate to the transferor's continuing involvement (including, at a minimum, but not limited to, and if applicable, quantitative information about discount rates, expected prepayments including the expected weighted-average life of prepayable[12] financial

[11] If an entity has aggregated multiple transfers during a period in accordance with paragraphs 24 and 25, it may disclose the range of assumptions.

[12] The weighted-average life of prepayable assets in periods (for example, months or years) can be calculated by multiplying the principal collections expected in each future period by the number of periods until that future period, summing those products, and dividing the sum by the initial principal balance.

assets, and anticipated credit losses, including expected static pool losses[13, 14]).

(b) Cash flows between a transferor and transferee, including proceeds from new transfers, proceeds from collections reinvested in revolving-period transfers, purchases of previously transferred financial assets, servicing fees, and cash flows received from a transferor's beneficial interests.

ii. For each statement of financial position presented, regardless of when the transfer occurred:

(a) Qualitative and quantitative information about the transferor's continuing involvement with transferred financial assets that provides financial statement users with sufficient information to assess the reasons for the continuing involvement and the risks related to the transferred financial assets to which the transferor continues to be exposed after the transfer and the extent that the transferor's risk profile has changed as a result of the transfer (including, but not limited to, credit risk, interest rate risk, and other risks), including:

(1) The total principal amount outstanding (BACV), the amount that has been derecognized, and the amount that continues to be recognized in the statement of financial position. The amount recognized (allocated fair value) by the reporting entity for the acquired participation in the transferred assets. The reporting schedules of both the transferred and reacquired assets. The percentage of beneficial interests from the reporting entity's transferred assets acquired by affiliated entities.

(2) The terms of any arrangements that could require the transferor to provide financial support (for example, liquidity arrangements and obligations to purchase assets) to the transferee or its beneficial interest holders, including a description of any events or circumstances that could expose the transferor to loss and the amount of the maximum exposure to loss.

(3) Whether the transferor has provided financial or other support during the periods presented that it was not previously contractually required to provide to the transferee or its beneficial interest holders, including when the transferor assisted the transferee or its beneficial interest holders in obtaining support, including:

(i.) The type and amount of support

(ii.) The primary reasons for providing the support

[13] Expected static pool losses can be calculated by summing the actual and projected future credit losses and dividing the sum by the original balance of the pool of assets.

[14] The timing and amount of future cash flows for transferor's interests in transferred financial assets are commonly uncertain, especially if those interests are subordinate to more senior beneficial interests. Thus, estimates of future cash flows used for a fair value measurement depend heavily on assumptions about default and prepayment of all the financial assets transferred, because of the implicit credit or prepayment risk enhancement arising from the subordination.

(4) Information is encouraged about any liquidity arrangements, guarantees, and/or other commitments provided by third parties related to the transferred financial assets that may affect the transferor's exposure to loss or risk of the related transferor's interest.

(b) The entity's accounting policies for subsequently measuring assets and liabilities that relate to the continuing involvement with the transferred financial assets;

(c) The key inputs and assumptions used in measuring the fair value of assets or liabilities that relate to the transferor's continuing involvement (including, at a minimum, but not limited to, and if applicable, quantitative information about discount rates, expected prepayments including the expected weighted-average life of prepayable financial assets, and anticipated credit losses, including expected static pool losses);

(d) For the transferor's interests in the transferred financial assets, a sensitivity analysis or stress test showing the hypothetical effect on the fair value of those interests (including any servicing assets or servicing liabilities) of two or more unfavorable variations from the expected levels for each key assumption that is reported under paragraph 28.g.ii.(c) independently from any change in another key assumption, and a description of the objectives, methodology, and limitations of the sensitivity analysis or stress test;

(e) Information about the asset quality of transferred financial assets and any other assets that it manages together with them. This information shall be separated between assets that have been derecognized and assets that continue to be recognized in the statement of financial position. This information is intended to provide financial statement users with an understanding of the risks inherent in the transferred financial assets as well as in other assets and liabilities that it manages together with transferred financial assets. For example, information for receivables shall include, but is not limited to:

(i.) Delinquencies at the end of the period; and

(ii.) Credit losses, net of recoveries, during the period.

h. Disclosure requirements for transfers of financial assets accounted for as secured borrowing (excluding repurchase and reverse repurchase transactions disclosed under paragraph 28.a.):

i. The carrying amounts and classifications of both assets and associated liabilities recognized in the transferor's statement of financial position at the end of each period presented, including qualitative information about the relationship(s) between those assets and associated liabilities. For example, if assets are restricted solely to satisfy a specific obligation, the carrying amounts of those assets and associated liabilities, including a description of the nature of restrictions placed on the assets.

i. Description of any loaned securities, including the amount, a description of, and the policy for, requiring collateral, and whether or not the collateral is restricted;

j. A description of the securities underlying, dollar repurchase and dollar reverse repurchase agreements, including book values and fair values, and maturities for the following categories: (i) securities subject to dollar repurchase agreements; and (ii.) securities subject to dollar reverse repurchase agreements.

k. Disclose any transfers of receivables with recourse.

l. A reporting entity shall disclose the following information for wash sales, as defined in paragraph 12, for all affiliated investment transactions (including items originally classified as cash equivalents and short-term investments) and for non-affiliated investment transactions with an NAIC designation of 3 or below, or that do not have an NAIC designation. (For non-affiliated investments, all cash equivalents, derivative instruments and short-term investments with credit assessments equivalent to an NAIC 1-2 designation are excluded from this disclosure.) This disclosure shall be included in the financial statements for when the investment was initially sold and is only applicable for sales and purchases that cross quarter-end or year-end reporting periods. For example, if the investment was sold December 20, 2017, and reacquired on January 10, 2018, the transaction shall be captured in the wash sale disclosure included in the year-end 2017 financial statements, while an investment sold on May 1, 2019, and reacquired on May 20, 2019, would not be required to be disclosed:

   i. A description of the reporting entity's objectives regarding these transactions;

   ii. An aggregation of transactions by NAIC designation 3 or below, or that do not have an NAIC designation;

   iii. The number of transactions involved during the reporting period;

   iv. The book value of securities sold;

   v. The cost of securities repurchased; and

   vi. The realized gains/losses associated with the securities involved.

m. For reporting entities that have sold securities short within the reporting period, provide the following disclosures:

   i. Unsettled Short Sale Transactions (outstanding at reporting date) – The amount of proceeds received and the fair value of the securities to deliver, with current unrealized gains and/or losses, and the expected settlement timeframe (number of days). This disclosure shall include the fair value of current transactions that were not settled within three days and the fair value of the short sales expected to be satisfied by a securities borrowing transaction. This disclosure shall be aggregated by security type. (For example, short sales of common stock shall be aggregated and reported together.)

   ii. Settled Short Sale Transactions (settled during the reporting period) – The aggregate amount of proceeds received and the fair value of the security as of the settlement date with recognized gains and/or losses. This disclosure shall identify the aggregated fair value of settled transactions that were not settled within three days and the fair value of transactions that were settled through a securities borrowing transaction.

29. Refer to the Preamble for further discussion regarding disclosure requirements. The disclosures required by paragraph 28 shall be made for the current quarter in the quarterly statement and for the year in the annual statement.

Application Guidance

30. This application guidance describes certain provisions of this statement in more detail and describes how they apply to certain types of transactions. It also discusses generalized situations. Facts and circumstances and specific contracts need to be considered carefully in applying this statement. This application guidance is an integral part of the standards provided in this statement.

31. Paragraph 6 of this statement states that the objective of paragraph 8 and related implementation guidance is to determine whether a transferor has surrendered control over transferred financial assets.

Unit of Account

32. Paragraph 7 establishes the unit of account to which the sale accounting conditions in paragraph 8 shall be applied. Paragraph 7 states that paragraph 8 shall be applied to transfers of an entire financial asset, transfers of a group of entire financial assets, and transfers of a participating interest in an entire financial asset. Inherent in that principle is that to be eligible for sale accounting an entire financial asset cannot be divided into components before a transfer unless all of the components meet the definition of a participating interest.

33. The legal form of the asset and what the asset conveys to its holders shall be considered in determining what constitutes an entire financial asset. The following examples illustrate the application of what constitutes an entire financial asset:

a. A loan to one borrower in accordance with a single contract that is transferred to a securitization entity before securitization shall be considered an entire financial asset. Similarly, a beneficial interest in securitized financial assets after the securitization process has been completed shall be considered an entire financial asset. In contrast, a transferred interest in an individual loan shall not be considered an entire financial asset; however, if the transferred interest meets the definition of a participating interest, the participating interest would be eligible for sale accounting.

b. In a transaction in which the transferor creates an interest-only strip from a loan and transfers the interest-only strip, the interest-only strip does not meet the definition of an entire financial asset (and an interest-only strip does not meet the definition of a participating interest; therefore, sale accounting would be precluded). In contrast, if an entire financial asset is transferred to a securitization entity and the transfer meets the conditions for sale accounting, the transferor may obtain an interest-only strip as proceeds from the sale. An interest-only strip received as proceeds of a sale is an entire financial asset for purposes of evaluating any future transfers that could then be eligible for sale accounting.

c. If multiple advances are made to one borrower in accordance with a single contract (such as a line of credit, credit card loan, or a construction loan), an advance on that contract would be a separate unit of account if the advance retains its identity, does not become part of a larger loan balance, and is transferred in its entirety. However, if the transferor transfers an advance in its entirety and the advance loses its identity and becomes part of a larger loan balance, the transfer would be eligible for sale accounting only if the transfer of the advance does not result in the transferor retaining any interest in the larger balance or if the transfer results in the transferor's interest in the larger balance meeting the definition of a participating interest. Similarly, if the transferor transfers an interest in an advance that has lost its identity, the interest must be a participating interest in the larger balance to be eligible for sale accounting.

Participating Interests in an Entire Financial Asset

34. Paragraph 7.b. requires that all cash flows received from the entire financial asset be divided among the participating interest holders (including any interest retained by the transferor or its agents) in proportion to their share of ownership. That is, the participating interest definition does not allow for the allocation of specified cash flows unless each cash flow is proportionately allocated to the participating interest holders. For example, in the case of an individual loan in which the borrower is required to make a contractual payment that consists of a principal amount and interest amount on the loan, the transferor and transferee shall share in the principal and interest payments on the basis of their proportionate ownership interest in the loan. In contrast, if the transferor is entitled to receive an amount that represents the principal payments and the transferee is entitled to receive an amount that represents the interest payments on the loan, that arrangement would not be consistent with the participating interest definition because the transferor and transferee do not share proportionately in the cash flows received from the loan. In other cases, a transferor may transfer a portion of an individual loan that represents either a senior interest or a junior interest in an individual loan. In both of those cases, the transferor would account for the transfer as a secured borrowing because the senior interest or junior interest in the loan does not meet the requirements to be participating interests (see paragraph 38).

35. Paragraph 7.b. states that cash flows allocated as compensation for services performed, if any, shall not be included in that determination provided that those cash flows are not subordinate to the proportionate cash flows of the participating interest and are not significantly above an amount that would fairly compensate a substitute service provider, should one be required, including any profit that would be demanded in the marketplace. Cash flows allocated as compensation for services performed that are significantly above an amount that would fairly compensate a substitute service provider would result in a disproportionate division of cash flows of the entire financial asset among the participating interest holders and, therefore, would preclude the portion of a transferred financial asset from meeting the definition of a participating interest. Examples of cash flows that are compensation for services performed include loan origination fees paid by the borrower to the transferor, fees necessary to arrange and complete the transfer paid by the transferee to the transferor, and fees for servicing the financial asset.

36. The transfer of a portion of an entire financial asset may result in a gain or loss on the transfer when the contractual interest rate on the entire financial asset differs from the market rate at the time of transfer. Paragraph 7.b. states that any cash flows received by the transferor as proceeds of a transfer of a participating interest shall be excluded from the determination of whether the cash flows of the participating interest are proportionate provided that the transfer does not result in the transferor receiving an ownership interest in the financial asset that permits it to receive disproportionate cash flows. For example, if the transferor transfers an interest in an entire financial asset and the transferee agrees to incorporate the excess interest (between the contractual interest rate on the financial asset and the market interest rate at the date of transfer) into the contractually specified servicing fee, the excess interest would likely result in the conveyance of an interest-only strip to the transferor from the transferee. An interest-only strip would result in a disproportionate division of cash flows of the financial asset among the participating interest holders and would preclude the portion from meeting the definition of a participating interest.

37. Paragraph 7.c. requires that the rights of each participating interest holder (including the transferor in its role as participating interest holder) have the same priority and that no participating interest holder's interest is subordinated to the interest of another participating interest holder. In certain transfers, recourse is provided to the transferee that requires the transferor to reimburse any premium paid by the transferee if the underlying financial asset is prepaid within a defined timeframe of the transfer date. Such recourse would preclude the transferred portion from meeting the definition of a participating interest. However, once the recourse provision expires, the transferred portion shall be reevaluated to determine if it meets the participating interest definition.

38. Paragraph 7.c. also requires that participating interest holders have no recourse to the transferor (or its agents) or to each other, other than standard representations and warranties, ongoing contractual obligations to service the entire financial asset and administer the transfer contract, and contractual obligations to share in any set-off benefits. Recourse in the form of an independent third-party guarantee shall be excluded from the evaluation of whether the participating interest definition is met. Similarly, cash flows allocated to a third-party guarantor for the guarantee fee shall be excluded from the determination of whether the cash flows are divided proportionately among the participating interest holders.

Isolation Beyond the Reach of the Transferor and Its Creditors

39. The nature and extent of supporting evidence required for an assertion in financial statements that an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset (which are referred to collectively in this statement as transferred financial assets) have been isolated—put presumptively beyond the reach of the transferor and its creditors, either by a single transaction or a series of transactions taken as a whole—depend on the facts and circumstances. All available evidence that either supports or questions an assertion shall be considered, including whether the contract or circumstances permit the transferor to revoke the transfer. It also may include consideration of the legal consequences of the transfer in the jurisdiction in which bankruptcy or other receivership would take place, whether a transfer of financial assets would likely be deemed a true sale at law (as described in paragraph 40.a.) or otherwise isolated (as described in paragraph 40.b.), whether the transferor is affiliated with the transferee, and other factors pertinent under applicable law. Derecognition of transferred financial assets is appropriate only if the available evidence provides reasonable assurance that the transferred financial assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor and its creditors (paragraph 74.c.). Transactions between related parties or affiliates are accounted for in accordance with SSAP No. 25.

40. In the context of U.S. bankruptcy laws, a true sale opinion from an attorney is often required to support a conclusion that transferred financial assets are isolated from the transferor, and its creditors. In addition, a nonconsolidation opinion is often required if the transfer is to an affiliated entity. In the context of U.S. bankruptcy laws:

a. A true sale opinion is an attorney's conclusion that the transferred financial assets have been sold and are beyond the reach of the transferor's creditors and that a court would conclude that the transferred financial assets would not be included in the transferor's bankruptcy estate.

b. A nonconsolidation opinion is an attorney's conclusion that a court would recognize that an entity holding the transferred financial assets exists separately from the transferor. Additionally, a nonconsolidation opinion is an attorney's conclusion that a court would not order the substantive consolidation of the assets and liabilities of the entity holding the transferred financial assets and the assets and liabilities of the transferor in the event of the transferor's bankruptcy or receivership.

A legal opinion may not be required if a transferor has a reasonable basis to conclude that the appropriate legal opinion(s) would be given if requested. For example, the transferor might reach a conclusion without consulting an attorney if (1) the transfer is a routine transfer of financial assets that does not result in any continuing involvement by the transferor or (2) the transferor had experience with other transfers with similar facts and circumstances under the same applicable laws and regulations.

41. For insurers that are subject to conservatorship, or other receivership procedures, judgments about whether transferred financial assets have been isolated need to be made in relation to the powers of conservators or receivers in those jurisdictions.

42. Whether securitizations isolate transferred financial assets may depend on such factors as whether the securitization is accomplished in one step or multiple step transfers (paragraphs 71-76). Some common financial transactions, for example, typical repurchase agreements and securities lending transactions, may isolate transferred financial assets from the transferor, although they may not meet the other conditions for surrender of control (paragraph 8).

Conditions That Constrain a Transferee

43. Sale accounting is allowed under paragraph 8.b. only if each transferee (or, if the transferee is an entity whose sole purpose is to engage in securitization or asset-backed financing arrangements and that entity is constrained from pledging or exchanging the assets it receives, each third-party holder of its beneficial interests) has the right to pledge or exchange the assets or beneficial interests it received, and no condition both constrains the transferee (or third-party holder of its beneficial interests) from taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the transferor. Many transferor-imposed or other conditions on a transferee's right to pledge or exchange both constrain a transferee from pledging or exchanging and, through that constraint, provide more than a trivial benefit to the transferor. Judgment is required to assess whether a particular condition results in a constraint. Judgment also is required to assess whether a constraint provides a more-than-trivial benefit to the transferor. If the transferee is an entity whose sole purpose is to engage in securitization or asset-backed financing activities, that entity may be constrained from pledging or exchanging the transferred financial assets to protect the rights of beneficial interest holders in the financial assets of the entity. Paragraph 8.b. requires that the transferor look through the constrained entity to determine whether each third-party holder of its beneficial interests has the right to pledge or exchange the beneficial interests that it holds. The considerations in paragraphs 47-49 apply to the transferee or the third-party holders of its beneficial interests in an entity that is constrained from pledging or exchanging the assets it receives and whose sole purpose is to engage in securitization or asset-backed financing activities

44. Some conditions may constrain a transferee from pledging or exchanging the financial asset and may provide the transferor with more than a trivial benefit. For example, a provision that prohibits selling or pledging a transferred loan receivable not only constrains the transferee but also provides the transferor with the more-than-trivial benefit of knowing who holds the financial asset (a prerequisite to repurchasing the financial asset) and of being able to block the financial asset from being transferred to a competitor for the loan customer's business. Transferor-imposed contractual constraints that narrowly limit timing or terms, for example, allowing a transferee to pledge only on the day assets are obtained or only on terms agreed to with the transferor, also constrain the transferee and presumptively provide the transferor with more-than-trivial benefits. In some circumstances in which the transferor has no continuing involvement with the transferred financial assets, some conditions may constrain a transferee from pledging or exchanging the financial assets. If the transferor and its agents have no continuing involvement with the transferred financial assets, the condition under paragraph 8.b. is met. For example, if a transferor receives only cash in return for the transferred financial assets and the transferor and its agents have no continuing involvement with the transferred financial assets, sale accounting is allowed under paragraph 8.b. even if the transferee entity is significantly limited in its ability to pledge or exchange the transferred assets.

45. However, some conditions may not constrain a transferee from pledging or exchanging the transferred financial asset. For example, a transferor's right of first refusal on the occurrence of a bona fide offer to the transferee from a third party presumptively would not constrain a transferee. This is because the right in itself does not enable the transferor to compel the transferee to sell the financial asset and the transferee would be in a position to receive the sum offered by exchanging the financial asset, albeit possibly from the transferor rather than the third party. Further examples of conditions that presumptively would not constrain a transferee for purposes of this statement include (a) a requirement to obtain the transferor's permission to sell or pledge that is not to be unreasonably withheld, (b) a prohibition on sale to the transferor's competitor if other potential willing buyers exist, (c) a regulatory limitation such as on the number or nature of eligible transferees (as in the case of securities issued under Securities Act Rule 144A or debt placed privately), and (d) illiquidity, for example, the absence of an active market. However,

judgment is required to assess the significance of some conditions. For example, a prohibition on sale to the transferor's competitor would be a constraint if that competitor were the only potential willing buyer other than the transferor.

46. A condition imposed by a transferor that constrains the transferee presumptively provides more than a trivial benefit to the transferor. A condition not imposed by the transferor that constrains the transferee may or may not provide more than a trivial benefit to the transferor. For example, if the transferor refrains from imposing its usual contractual constraint on a specific transfer because it knows an equivalent constraint is already imposed on the transferee by a third party, it presumptively benefits more than trivially from that constraint. However, the transferor cannot benefit from a constraint if it is unaware at the time of the transfer that the transferee is constrained.

Transferor's Rights or Obligations to Reacquire Transferred Assets or Beneficial Interests

47. Some rights or obligations to reacquire transferred financial assets or beneficial interests both constrain the transferee and provide more than a trivial benefit to the transferor, thus precluding sale accounting under paragraph 8.b. A freestanding call option written by a transferee to the transferor may benefit the transferor and, if the transferred financial assets are not readily obtainable in the marketplace, is likely to constrain a transferee because the transferee might have to default if the call was exercised and the transferee had pledged or exchanged the financial assets. For example, if a transferor in a securitization transaction has a call option to repurchase third-party beneficial interests at the price paid plus a stated return, that arrangement conveys more than a trivial benefit to the transferor (paragraphs 53 and 54). If the third-party holders of its beneficial interests are constrained from pledging or exchanging their beneficial interests due to that call option, the transferor would be precluded from accounting for the transfer of financial assets to the securitization entity as a sale. Similarly, a freestanding forward purchase-sale contract between the transferor and the transferee on transferred financial assets not readily obtainable in the marketplace would benefit the transferor and is likely to constrain a transferee in much the same manner. Alternatively, freestanding rights to reacquire transferred assets that are readily obtainable presumptively do not constrain the transferee from pledging or exchanging them and thus do not preclude sale accounting under paragraph 8.b.

48. Other rights or obligations to reacquire transferred financial assets, regardless of whether they constrain the transferee, may result in the transferor's maintaining effective control over the transferred financial assets, as discussed in paragraphs 50-58, thus precluding sale accounting under paragraph 8.c. For example, an attached call in itself would not constrain a transferee who is able, by exchanging or pledging the asset subject to that call, to obtain substantially all of its economic benefits. However, an attached call could result in the transferor's maintaining effective control over the transferred asset(s) because the attached call gives the transferor the unilateral ability to cause whoever holds that specific asset to return it.

49. The concept of qualified special-purpose entities (QSPEs) was previously included within SSAP No. 91R. With the issuance of this statement, this concept is no longer included within statutory accounting guidance. Although this concept has been eliminated and is no longer a factor in determining whether a transfer of assets qualifies for sale accounting, reporting entities may continue to form, conduct transfers between, or have investments in trusts or other such legal vehicles that may have previously met the conditions to be considered a QSPE. Accounting for transfers of assets between the insurer and such trusts or other legal vehicles, including whether such transfers qualify for sale accounting, are subject to the provisions of this statement. As noted within paragraph 4, SSAP No. 25 shall be followed for accounting and disclosure requirements for all related party transactions.

Effective Control Over Transferred Financial Assets or Beneficial Interests

50. Judgment is required to assess whether the transferor maintains effective control over transferred financial assets or third-party beneficial interests. The transferor must evaluate whether a combination of

multiple arrangements maintains effective control of transferred financial assets. When the transferee issues beneficial interests in the transferred financial assets, the evaluation of whether the transferor maintains effective control over the transferred financial assets also shall consider whether the transferor maintains effective control over the transferred financial assets through its control over the third-party beneficial interests. To assess whether the transferor maintains effective control over the transferred financial assets, all continuing involvement by the transferor or its agents shall be considered continuing involvement by the transferor. When assessing effective control, the transferor only considers the involvements of an agent when the agent acts for and on behalf of the transferor. In other words, if the transferor and transferee have the same agent, the agent's activities on behalf of the transferee would not be considered in the transferor's evaluation of whether it has effective control over a transferred financial asset. For example, an investment manager may act as a fiduciary (agent) for both the transferor and the transferee; therefore, the transferor need only consider the involvements of the investment manager when it is acting on its behalf.

Agreement to Repurchase or Redeem Transferred Financial Assets

51. An agreement that both entitles and obligates the transferor to repurchase or redeem transferred financial assets from the transferee maintains the transferor's effective control over those assets as described in paragraph 8.c.(1) when all of the following conditions are met:

a. The financial assets to be repurchased or redeemed are the same or substantially the same as those transferred (paragraph 52).

b. The agreement is to repurchase or redeem them before maturity, at a fixed or determinable price.

c. The agreement is entered into contemporaneously with, or in contemplation of, the transfer.

52. To be substantially the same, the financial asset that was transferred and the financial asset that is to be repurchased or redeemed need to have all of the following characteristics:

a. The same primary obligor (except for debt guaranteed by a sovereign government, central bank, government-sponsored enterprise or agency thereof, in which case the guarantor and the terms of the guarantee must be the same);

b. Identical form and type so as to provide the same risks and rights;

c. The same maturity (or in the case of mortgage-backed pass-through and pay-through securities similar remaining weighted-average maturities that result in approximately the same market yield);

d. Identical contractual interest rates;

e. Similar assets as collateral; and

f. The same aggregate unpaid principal amount or principal amounts within accepted "good delivery" standards for the type of security involved.

Unilateral Ability to Cause the Return of Specific Transferred Financial Assets

53. A transferor maintains effective control over transferred financial assets when the transferor has the unilateral ability to cause the holder to return specific financial assets and that ability provides more than a trivial benefit to the transferor. A cleanup call, however, is permitted as an exception to that general principle. A call on a transferred financial asset provides the transferor with effective control over that financial asset if, under its price and other terms, the call provides the transferor with the unilateral ability to reclaim the transferred financial asset and conveys more than a trivial benefit to the transferor. A call or

other right conveys more than a trivial benefit if the price to be paid is fixed, determinable, or otherwise potentially advantageous, unless because that price is so far out of the money or for other reasons it is probable when the option is written that the transferor will not exercise it. A transferor's unilateral ability to cause a securitization entity to return to the transferor or otherwise dispose of specific transferred financial assets, for example, in response to its decision to exit a market or a particular activity, would provide the transferor with effective control over the transferred financial assets if it provides more than a trivial benefit to the transferor. However, a call on readily obtainable assets at fair value may not provide the transferor with more than a trivial benefit. (Paragraph 56 provides an example in which, due to the combination of arrangements, the transferor would maintain effective control.)

54. Effective control over transferred financial assets can be present even if the right to reclaim is indirect. For example, if a call allows a transferor to buy back the beneficial interests at a fixed price, the transferor may maintain effective control of the financial assets underlying those beneficial interests. If the transferee is an entity whose sole purpose is to engage in securitization or asset-backed financing activities, that entity may be constrained from choosing to pledge or exchange the transferred financial assets. In that circumstance, any call held by the transferor on third-party beneficial interests is effectively an attached call on the transferred financial assets. Depending on the price and other terms of the call, the transferor may maintain effective control over the transferred financial assets.

55. An embedded call would not result in the transferor's maintaining effective control because it is the issuer rather than the transferor who holds the call and the call does not provide more than a trivial benefit to the transferor. For example, a call embedded by the issuer of a callable bond or the borrower of a prepayable mortgage loan would not provide the transferor with effective control over the transferred financial asset.

56. A right to reclaim specific transferred financial assets by paying their fair value when reclaimed generally does not maintain effective control when it does not convey a more than trivial benefit to the transferor. However, a transferor has maintained effective control if it has such a right and also holds the residual interest in the transferred financial assets. For example, if a transferor holds the residual interest in securitized financial assets and can reclaim the transferred financial assets at termination of the securitization entity by purchasing them in an auction, and thus at what might appear to be fair value, then sale accounting for the transfer of those financial assets it can reclaim would be precluded. Such circumstances provide the transferor with a more than trivial benefit and effective control over the financial assets because it can pay any price it chooses in the auction and recover any excess paid over fair value through its residual interest in the transferred financial assets.

57. Removal-of-account provisions do not result in the transferor's maintaining effective control, and are thus precluded from being accounted for as sales under statutory accounting as discussed in paragraph 78.

Arrangements to Reacquire Transferred Financial Assets

58. A transferor maintains effective control over the transferred financial asset as described in paragraph 8.c.(3) through an agreement that permits the transferee to require the transferor to repurchase the transferred financial asset at a price that is so favorable to the transferee at the date of the transfer that it is probable that the transferee will require the transferor to repurchase the transferred financial asset. For example, a put option written to the transferee generally does not provide the transferor with effective control over the transferred financial asset. However, a put option that is sufficiently deep in the money when it is written would provide the transferor effective control over the transferred financial asset because it is probable that the transferee will exercise the option and the transferor will be required to repurchase the transferred financial asset. In contrast, a sufficiently out-of-the-money put option held by the transferee would not provide the transferor with effective control over the transferred financial asset if it is probable when the option is written that the option will not be exercised. Likewise, a put option held by the transferee at fair value would not provide the transferor with effective control over the transferred financial asset.

Changes That Result in the Transferor's Regaining Control of Financial Assets Sold

59. A change in law or other circumstance may result in a transferred portion of an entire financial asset no longer meeting the conditions of a participating interest (paragraph 7) or the transferor's regaining control of transferred financial assets after a transfer that was previously accounted for as a sale, because one or more of the conditions in paragraph 8 are no longer met. Such changes, unless they arise solely from the initial application of this statement or from a change in market prices (for example, an increase in price that moves into-the-money a freestanding call on a non-readily-obtainable transferred financial asset that was originally sufficiently out-of-the-money that it was judged not to constrain the transferee), are accounted for in the same manner as a purchase of the transferred financial assets from the former transferee(s) in exchange for liabilities assumed (paragraph 9 or 11). (This "re-purchase" premise is consistent with *INT 04-21: EITF 02-09: Accounting for Changes that Result in a Transferor Regaining Control of Financial Assets Sold*.) After that change, the transferor recognizes in its financial statements those transferred financial assets together with liabilities to the former transferee(s) or beneficial interest holders of the former transferee(s). The transferor initially measures those transferred financial assets and liabilities at fair value on the date of the change, as if the transferor purchased the transferred financial assets and assumed the liabilities on that date. The former transferee would derecognize the transferred financial assets on that date, as if it had sold the transferred financial assets in exchange for a receivable from the transferor.

Measurement of Interests Held after a Transfer of Financial Assets

Assets Obtained and Liabilities Incurred as Proceeds

60. The proceeds from a sale of financial assets consist of the cash and any other assets obtained, including beneficial interests and separately recognized servicing assets, in the transfer less any liabilities incurred, including separately recognized servicing liabilities. Any asset obtained is part of the proceeds from the sale. Any liability incurred, even if it is related to the transferred financial assets, is a reduction of the proceeds. Any derivative financial instrument entered into concurrently with a transfer of financial assets is either an asset obtained, or a liability incurred and part of the proceeds received in the transfer. All proceeds and reductions of proceeds from a sale shall be initially measured at fair value.

Participating Interests in Financial Assets That Continue to be Held by a Transferor

61. Participating interests in financial assets that continue to be held by a transferor are not part of the proceeds of the transfer, and the carrying amount of those participating interests shall be measured at the date of the transfer by allocating the previous carrying amount between the participating interests transferred and sold, and the participating interests that are not transferred and continue to be held by a transferor, based on their relative fair values.

Servicing Assets and Liabilities

62. Servicing of mortgage loans, credit card receivables, or other financial assets commonly includes, but is not limited to, collecting principal, interest, and escrow payments from borrowers; paying taxes and insurance from escrowed funds; monitoring delinquencies; executing foreclosure if necessary; temporarily investing funds pending distribution; remitting fees to guarantors, trustees, and others providing services; and accounting for and remitting principal and interest payments to the holders of beneficial interests or participating interests in the financial assets. Servicing is inherent in all financial assets; it becomes a distinct asset or liability for accounting purposes only in the circumstances described in paragraph 63. If a transferor sells a participating interest in an entire financial asset, it will recognize a servicing asset or a servicing liability only related to the participating interest sold.

63. An entity that undertakes a contract to service financial assets shall recognize either a servicing asset or a servicing liability, each time it undertakes an obligation to service a financial asset that (a) results

from a servicer's transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset that meets the requirements for sale accounting, or (b) is acquired or assumed and the servicing obligation does not relate to financial assets of the servicer. However, if the transferor transfers the assets to an entity in a transfer that qualifies as a sale in which the transferor obtains the resulting securities, and classifies them as debt securities, the servicing asset or servicing liability may be reported together with the asset being serviced and not recognized separately. A servicer of financial assets commonly receives the benefits of servicing—revenues from contractually specified servicing fees, a portion of the interest from the financial assets, late charges, and other ancillary sources, including "float," all of which it is entitled to receive only if it performs the servicing—and incurs the costs of servicing the financial assets. Typically, the benefits of servicing are expected to be more than adequate compensation to a servicer for performing the servicing, and the contract results in a servicing asset. However, if the benefits of servicing are not expected to adequately compensate a servicer for performing the servicing, the contract results in a servicing liability. (A servicing asset may become a servicing liability, or vice versa, if circumstances change, and the initial measure for servicing may be zero if the benefits of servicing are just adequate to compensate the servicer for its servicing responsibilities.) A servicer would account for its servicing contract that qualifies for separate recognition as a servicing asset or a servicing liability initially measured at its fair value regardless of whether explicit consideration was exchanged.

64. A servicer that transfers or securitizes financial assets in a transaction that does not meet the requirements for sale accounting and is accounted for as a secured borrowing with the underlying financial assets remaining on the transferor's balance sheet shall not recognize a servicing asset or a servicing liability.

65. A servicer that recognizes a servicing asset or servicing liability shall account for the contract to service financial assets separately from those financial assets, as follows:

a. Report servicing assets separately from servicing liabilities as a nonadmitted asset in the statement of financial position.

b. Initially measure servicing assets and servicing liabilities at fair value, (paragraph 15).

c. Account separately for rights to future interest income from the serviced assets that exceed contractually specified servicing fees. Those rights are not servicing assets; they are financial assets, effectively interest-only strips to be accounted for in accordance with paragraph 18 of this statement. (Interest-only strips preclude a portion of a financial asset from meeting the definition of a participating interest; see paragraph 36.)

d. Identify classes of servicing assets and servicing liabilities based on (1) the availability of market inputs used in determining the fair value of servicing assets and servicing liabilities, (2) an entity's method for managing the risks of its servicing assets and servicing liabilities, or (3) both.

e. Subsequently measure each class of separately recognized servicing assets and servicing liabilities at fair value. Changes in fair value should be reported as unrealized gains and losses (paragraph 17). Declines in fair value which are determined to be other-than-temporary shall be recorded as realized losses.

66. As indicated above, transferors sometimes agree to take on servicing responsibilities when the future benefits of servicing are not expected to adequately compensate them for performing that servicing. In that circumstance, the result is a servicing liability rather than a servicing asset. For example, if in the transaction illustrated in Exhibit B – Illustration 3 the transferor had agreed to service the loans without explicit compensation and it estimated the fair value of that servicing obligation at $50, net proceeds would be reduced to $980, gain on sale would become a loss on sale of $20, and the transferor would report a servicing liability of $50.

Securitizations

67. Financial assets, such as mortgage loans, are commonly transferred in securitizations. Securitizations of mortgage loans may include pools of single-family residential mortgages or other types of real estate mortgage loans, for example, multifamily residential mortgages and commercial property mortgages. Both financial and nonfinancial assets can be securitized; life insurance policy loans, patent and copyright royalties, and even taxi medallions also have been securitized. But securitizations of nonfinancial assets are outside the scope of this statement.

68. An originator of a typical securitization (the transferor) transfers a portfolio of financial assets to a securitization entity, commonly a trust. In “pass-through” and “pay-through” securitizations, receivables are transferred to the entity at the inception of the securitization, and no further transfers are made; all cash collections are paid to the holders of beneficial interests in the entity.

69. Beneficial interests in the securitization entity are sold to investors and the proceeds are used to pay the transferor for the assets transferred financial assets. Those beneficial interests may comprise either a single class having equity characteristics or multiple classes of interests, some having debt characteristics and others having equity characteristics. The cash collected from the portfolio is distributed to the investors and others as specified by the legal documents that established the entity.

70. Pass-through and pay-through securitizations that meet the conditions in paragraph 8 qualify for sale accounting under this statement. All financial assets obtained and liabilities incurred by the transferor of a securitization that qualifies as a sale shall be recognized and measured as provided in paragraphs 9 and 11; that includes the implicit forward contract to sell additional financial assets during a revolving period, which may become valuable or onerous to the transferor as interest rates and other market conditions change.

Isolation of Transferred Financial Assets in Securitizations

71. A securitization carried out in one transfer or a series of transfers may or may not isolate the transferred financial assets beyond the reach of the transferor and its creditors. Whether it does depends on the structure of the securitization transaction taken as a whole, considering such factors as the type and extent of further involvement in arrangements to protect investors from credit, and interest rate, and other risks, the availability of other financial assets, and the powers of bankruptcy courts or other receivers. The discussion in paragraphs 72-74 relates only to the isolation condition in paragraph 8.a. The conditions in paragraphs 8.b. and 8.c. also must be considered to determine whether a transferor has surrendered control over the transferred financial assets.

72. In certain securitizations, a corporation that, if it failed, would be subject to the U.S. Bankruptcy Code transfers financial assets to a securitization entity exchange for cash. The entity raises that cash by issuing to investors beneficial interests that pass through all cash received from the financial assets, and the transferor has no further involvement with the trust or the transferred financial assets. The Board understands that those securitizations generally would be judged as having isolated the assets, because, in the absence of any continuing involvement, there would be reasonable assurance that the transfer would be found to be a true sale at law that places the assets beyond the reach of the transferor, and its creditors, even in bankruptcy or other receivership.

73. In other securitizations, a similar corporation transfers financial assets to a securitization entity in exchange for cash and beneficial interests in the transferred financial assets. That entity raises the cash by issuing to investors commercial paper that gives them a senior beneficial interest in cash received from the financial assets. The beneficial interests obtained by the transferring corporation represent a junior interest to be reduced by any credit losses on the financial assets in the entity. The senior beneficial interests (commercial paper) are highly rated by credit rating agencies only if both (a) the credit enhancement from the junior interest is sufficient and (b) the transferor is highly rated. Depending on facts and circumstances,

the Board understands that those "single-step" securitizations often would be judged in the United States as not having isolated the financial assets, because the nature of the continuing involvement may make it difficult to obtain reasonable assurance that the transfer would be found to be a true sale at law that places the financial assets beyond the reach of the transferor and its creditors in U.S. bankruptcy (paragraph 39). If the transferor fell into bankruptcy and the transfer was found not to be a true sale at law, investors in the transferred financial assets might be subjected to an automatic stay that would delay payments due them, and they might have to share in bankruptcy expenses and suffer further losses if the transfer was recharacterized as a secured loan.

74. Still other securitizations use multiple transfers intended to isolate transferred financial assets beyond the reach of the transferor and its creditors, even in bankruptcy. For example, in "two-step" structures:

a. First, the corporation transfers a group of financial assets to a special-purpose corporation that, although wholly owned, is so designed that the possibility is remote that the transferor or its creditors could reclaim the financial assets. This first transfer is designed to be judged to be a true sale at law, in part because the transferor does not provide "excessive" credit or yield protection to the special-purpose corporation, and the Board understands that transferred financial assets are likely to be judged beyond the reach of the transferor or the transferor's creditors even in bankruptcy or other receivership.

b. Second, the special-purpose corporation transfers a group of financial assets to a trust or other legal vehicle with a sufficient increase in the credit or yield protection on the second transfer (provided by a transferor's junior beneficial interest or other means) to merit the high credit rating sought by third-party investors who buy senior beneficial interests in the trust. Because of that aspect of its design, that second transfer might not be judged to be a true sale at law and, thus, the transferred financial assets could at least in theory be reached by a bankruptcy trustee for the special-purpose corporation.

c. However, the special-purpose corporation is designed to make remote the possibility that it would enter bankruptcy. For example, its charter forbids it from undertaking any other business or incurring any liabilities, so that there can be no creditors to petition to place it in bankruptcy. Furthermore, its dedication to a single purpose is intended to make it extremely unlikely, even if it somehow entered bankruptcy, that a receiver under the U.S. Bankruptcy Code could reclaim the transferred financial assets because it has no other assets to substitute for the transferred financial assets.

75. The Board understands that the "two-step" securitizations described above, taken as a whole, generally would be judged under present U.S. law as having isolated the financial assets beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership. However, each entity involved in a transfer must be evaluated under the applicable accounting guidance.

76. The powers of receivers vary considerably by state of domicile, and therefore some receivers may be able to reach financial assets transferred under a particular arrangement and others may not. A securitization may isolate transferred financial assets from a transferor subject to such a receiver and its creditors even though it is accomplished by only one transfer directly to a securitization entity that issues beneficial interests to investors and the transferor provides credit or yield protection.

Sales of Future Revenues

77. In addition to securitization of assets, some reporting entities have entered into transactions characterized as a sale of future revenues. These transactions are sometimes referred to as securitizations and are sometimes characterized as selling deferred acquisition costs. A sale of future revenues by a

reporting entity shall not result in the immediate recognition of income or surplus. The proceeds of any such sale shall be established as a liability and shall be reduced as the proceeds are repaid.

Removal-of-Accounts Provisions

78. Many transfers of financial assets that involve transfers of a group of entire financial assets to an entity whose sole purpose is to engage in securitization or asset-backed financing activities empower the transferor to reclaim assets subject to certain restrictions. Such a power is sometimes called a removal-of-accounts provision (ROAP). Transfers of assets that include ROAP provisions are precluded from being accounted for as sales under statutory accounting and shall follow the guidance in paragraph 14 for secured borrowing.

Short Sales

79. A short sale, as defined for statutory accounting, is the sale of a security that a selling reporting entity (seller) does not own at the time of sale or a sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller. Short sales are normally settled by the delivery of a security borrowed by or on behalf of the seller. The seller later closes out the position by returning the borrowed security to the lender, typically by purchasing securities on the open market. If the price of the security rises, short sellers who buy it at the higher price will incur a loss.

80. In a "naked" short sale, the seller does not borrow or arrange to borrow the securities in time to make delivery to the buyer within the standard three-day settlement period (T+3). As a result, the seller fails to deliver securities to the buyer when delivery is due (known as a "failure to deliver" or "fail").

81. Consistent with U.S. GAAP guidance, short sales generally do not meet the definition of a derivative unless a forward purchase or forward sale is involved. Even if a forward purchase or forward sale element is included, if the contract meets the regular-way security trade exception, it would not be subject to the derivative guidance.

82. State statutes or state laws may have restrictions regarding whether a reporting entity is permitted to sell securities short. In situations in which state regulations do not prohibit, or otherwise provide specific guidance, short-sale transactions shall be accounted for in accordance with this statement.

83. Selling a security short is an action by a reporting entity, which results with the reporting entity recognizing proceeds from the sale and an obligation to deliver the sold security. For statutory accounting purposes, obligations to deliver securities resulting from short sales shall be reported as contra-assets (negative assets) in the respective investment schedule for the type of asset sold, with an investment code detailing the item as a short sale. The obligation (negative asset) shall be initially reflected at fair value, with changes in fair value recognized as unrealized gains and losses. These unrealized gains and losses shall be realized upon settlement of the short sale obligation. Interest on short sale positions shall be accrued periodically and reported as interest expense.

84. If short sales are supported by a securities borrowing transaction, the accounting and reporting guidelines in paragraphs 93-95 shall also be followed.

Securities Lending Transactions

85. Securities lending transactions are generally initiated by broker-dealers and other financial institutions that need specific securities to cover a short sale or a customer's failure to deliver securities sold. Securities lending transactions typically extend less than one year. Transferees (borrowers) of securities generally are required to provide collateral to the transferor (lender) of securities, commonly cash but sometimes other securities or standby letters of credit, with a value slightly higher than that of the securities borrowed. If the collateral is cash, the transferor typically earns a return by investing that cash at rates higher than the rate paid or rebated to the transferee. If the collateral is other than cash, the transferor

typically receives a fee. Securities custodians or other agents commonly carry out securities lending activities on behalf of clients. Because of the protection of collateral (typically valued daily and adjusted frequently for changes in the market price of the securities transferred) and the short terms of the transactions, most securities lending transactions in themselves do not impose significant credit risks on either party. Other risks arise from what the parties to the transaction do with the assets they receive. For example, investments made with cash collateral impose market and credit risks on the transferor.

86. If the criteria conditions in paragraph 8 (sales criteria) are met, securities lending transactions shall be accounted for:

a. By the transferor as a sale of the "loaned" securities for proceeds consisting of the cash collateral[15] and a forward repurchase commitment.

b. By the transferee as a purchase of the "borrowed" securities in exchange for the collateral and a forward resale commitment. During the term of that agreement, the transferor has surrendered control over the securities transferred and the transferee has obtained control over those securities with the ability to sell or transfer them at will. In that case, creditors of the transferor have a claim only to the "collateral" and the forward repurchase commitment.

87. Many securities lending transactions are accompanied by an agreement that entitles and obligates the transferor to repurchase or redeem the transferred financial assets before their maturity under which the transferor maintains effective control over those financial assets (paragraphs 51-52). Those transactions shall be accounted for as secured borrowings, in which cash (or securities that the holder or its agent is permitted by contract or custom to sell or repledge) received as collateral is considered the amount borrowed, the securities loaned are considered pledged as collateral against the cash or securities borrowed and reclassified as set forth in paragraph 19.a., and any rebate paid to the transferee of securities is interest on the cash or securities the transferor is considered to have borrowed.

88. The transferor of securities being "loaned" accounts for cash received in the same way whether the transfer is accounted for as a sale or a secured borrowing. The cash received shall be recognized as the transferor's asset – as shall investments made with that cash, even if made by agents or in pools with other securities lenders – along with the obligation to return the cash. If securities that may be sold or repledged are received, the transferor of the securities being "loaned" accounts for those securities in the same way as it would account for cash received.

89. The transferor of securities being "loaned" accounts for collateral received in the same way whether the transfer is accounted for as a sale or a secured borrowing. The collateral received shall be recognized as the transferor's asset – as shall investments made with that collateral, even if made by agents or in pools with other securities lenders – along with the obligation to return the collateral. If securities that may be sold or repledged are received by the transferor or its agent, the transferor of the securities being "loaned" accounts for those securities in the same way as it would account for collateral received. Collateral which may be sold or repledged by the transferor or its agent is reflected on balance sheet, along with the obligation to return the asset[16]. Collateral received which may not be sold or repledged by the transferor or its agent is

[15] If the "collateral" in a transaction that meets the criteria in paragraph 8 is a financial asset that the holder or its agent is permitted by contract or custom to sell or repledge, that financial asset is proceeds of the sale of the "loaned" securities. To the extent that the "collateral" consists of letters of credit or other financial instruments that the holder or its agent is not permitted by contract or custom to sell or repledge, a securities lending transaction does not satisfy the sale criteria and is accounted for as a loan of securities by the transferor to the transferee.

[16] If cash is received by the transferor or its agent and reinvested or repledged it is reported on balance sheet. It is explicitly intended that when the lender bears reinvestment risk, that collateral is on balance sheet.

off balance sheet[17]. For collateral on the balance sheet, the reporting is determined by the administration of the program.

a. Securities lending programs where the collateral received by the reporting entity's unaffiliated agent that can be sold or repledged is reported on the balance sheet. The collateral received and reinvestment of that collateral by the reporting entity's unaffiliated agent shall be reflected as a one-line entry on the balance sheet (Securities Lending Collateral) and a detailed schedule will be required each quarter and at year-end to list the description of the collateral asset. This description shall include the NAIC designation, fair value; book adjusted carrying value and maturity date. A separate liability shall also be established to record the obligation to return the collateral (Collateral from Securities Lending Activities).

b. Securities lending programs where the collateral received by the reporting entity that can be sold or repledged is reported on the balance sheet. If the reporting entity is the administrator of the program, then, the collateral received and any reinvestment of that collateral is reported with the invested assets of the reporting entity based on the type of investment (i.e. bond, common stock, etc.). A separate liability shall also be established to record the obligation to return the collateral (Collateral from Securities Lending Activities).

c. Securities lending programs where the collateral received by the reporting entity's affiliated agent can report using either one-line reporting (paragraph 89.a.) or investment schedule reporting (paragraph 89.b.).

90. Reinvestment of the collateral by the reporting entity or its agent shall follow the same impairment guidance as other similar invested assets reported on the balance sheet. Any fees received by the transferor for loaning the securities shall be recorded as miscellaneous investment income.

Securities Lending Transactions – Collateral Requirements[18]

91. The reporting entity shall receive collateral having a fair value as of the transaction date at least equal to 102% of the fair value of the loaned securities at that date. If at any time the fair value of the collateral received from the counterparty is less than 100% of the fair value of the loaned securities, the counterparty shall be obligated to deliver additional collateral by the end of the next business day, the fair value of which, together with the fair value of all collateral then held in connection with the transaction at least equals 102% of the fair value of the loaned securities. If the collateral received from the counterparty is less than 100% at the reporting date, the difference between the actual collateral and 100% will be nonadmitted. Collateral value is measured and compared to the loaned securities in aggregate by counterparty.

92. In the event that foreign securities are loaned and the denomination of the currency of the collateral is other than the denomination of the currency of the loaned foreign securities, the amount of collateral shall be at least equal to 105% of the fair value of the loaned securities at that date. If at any time the fair value of the collateral received from the counterparty is less than 102% of the fair value of the loaned securities, the reporting entity must obtain additional collateral by the end of the next business day, the fair value of which together with the fair value of all collateral then held in connection with the transaction at least equals 105% of the fair value of the loaned securities. If the collateral received from the counterparty is less than

[17] An example of collateral which is off balance sheet is when securities are received by the transferor or its agent in which the collateral must be held and returned, without the ability to transfer or repledge the collateral. This would involve limited situations in which the transferor or agent is prohibited from reinvesting the collateral.

[18] The collateral requirements are required for determining admitted assets under statutory accounting, but the receipt of collateral is not a factor in determining whether the transferor has effective control over the loaned assets in accordance with paragraph 51.

100% at the reporting date, the difference between the actual collateral and 100% will be nonadmitted. Collateral value is measured and compared to the loaned securities in aggregate by counterparty.

Securities Borrowing Transactions – Sale Criteria is Not Met (Secured Borrowing)

93. In addition to being the transferor of securities being loaned and receiving collateral under a securities lending arrangement, reporting entities may be a transferee of borrowed securities, and provide collateral under a securities borrowing arrangement.

94. A transferee that sells borrowed securities shall recognize the proceeds from the sale of the securities and an obligation, at fair value, to return the borrowed securities to the transferor. If cash proceeds from the sale of borrowed securities are invested into other assets, or if non-cash proceeds are received from the sale, the assets acquired shall be shown as assets on the reporting entity's (transferee's) financial statements and accounted and reported in accordance with the SSAP for the type of assets acquired. For all instances in which the transferee sells borrowed securities, the reporting entity shall designate restricted assets equivalent to the fair value of the obligation to return the borrowed securities to the transferor.

95. A reporting entity transferee that borrows securities captured under this section (sale criteria is not met) and uses the borrowed securities to settle a short sale transaction shall eliminate the contra-asset recognized under the short sale (paragraph 83) and establish a liability to return the borrowed security. The liability to return the borrowed security shall remain on the books until the reporting entity acquires the security to return to the transferor. The accounting/reporting for the short sale and the secured borrowing transaction shall be separately reflected within the financial statements. As such, use of the borrowed asset for the short sale would be similar to recognizing "proceeds" from selling a borrowed asset, as such, if the borrowed asset is used to settle a short sale, the reporting entity shall recognize the borrowed asset and the obligation to return the asset under the secured borrowing agreement until the asset has been returned under the secured borrowing transaction. and recognize an obligation, at fair value, to return the borrowed securities.

Repurchase Agreements and "Wash Sales"

96. Government securities dealers, banks, other financial institutions, and corporate investors commonly use repurchase agreements to obtain or use short-term funds. Under those agreements, the transferor ("repo party") transfers a security to a transferee ("repo counterparty" or "reverse party") in exchange for cash[19] and concurrently agrees to reacquire that security at a future date for an amount equal to the cash exchanged plus a stipulated "interest" factor. Repurchase agreements, reverse repurchase agreements and dollar repurchase agreements 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.

97. Repurchase agreements can be affected in a variety of ways. Some repurchase agreements are similar to securities lending transactions in that the transferee or its agent has the right to sell or repledge the securities to a third party during the term of the repurchase agreement. In other repurchase agreements, the transferee does not have the right to sell or repledge the securities during the term of the repurchase agreement. For example, in a tri-party repurchase agreement, the transferor transfers securities to an independent third-party custodian that holds the securities during the term of the repurchase agreement. Also, many repurchase agreements are for short terms, often overnight, or have indefinite terms that allow either party to terminate the arrangement on short notice. However, other repurchase agreements are for longer terms, sometimes until the maturity of the transferred financial asset. Some repurchase agreements call for repurchase of securities that need not be identical to the securities transferred.

[19] Instead of cash, other securities or letters of credit sometimes are exchanged. Those transactions are accounted for in the same manner as securities lending transactions (paragraphs 85-92).

98. If the conditions in paragraph 8 are met, the transferor shall account for the repurchase agreement as a sale of financial assets and a forward repurchase commitment, and the transferee shall account for the agreement as a purchase of financial assets and a forward resale commitment. Other transfers that are accompanied by an agreement to repurchase the transferred financial assets that may be accounted for as sales include transfers with agreements to repurchase at maturity. (Repurchase financing is addressed in paragraphs 105-110.)

99. Furthermore, "wash sales" that previously were not recognized if the same financial asset was purchased within 30 days before or after the sale shall be accounted for as sales under this statement. Unless there is a concurrent contract to repurchase or redeem the transferred financial assets from the transferee, the transferor does not maintain effective control over the transferred financial assets.

100. As with securities lending transactions, under many agreements to repurchase transferred financial assets before their maturity the transferor maintains effective control over those financial assets. Repurchase agreements that do not meet all the conditions in paragraph 8 shall be treated as secured borrowings. Fixed-coupon and dollar-roll repurchase agreements, and other contracts under which the securities to be repurchased need not be the same as the securities sold, qualify as borrowings if the return of substantially the same (paragraph 52) securities as those concurrently transferred is assured. Therefore, those transactions shall be accounted for as secured borrowings by both parties to the transfer.

101. If a transferor has transferred securities to an independent third-party custodian, or to a transferee, under conditions that preclude the transferee from selling or repledging the assets during the term of the repurchase agreement (as in most tri-party repurchase agreements), the transferor has not surrendered control over those assets.

Repurchase Agreements

102. Repurchase agreements are defined as agreements under which a reporting entity sells securities and simultaneously agrees to repurchase the same or substantially the same securities at a stated price on a specified date. For securities to be substantially the same, the criteria defined in paragraph 52 must be met, and for mortgage-backed securities excluding mortgage pass-through securities, the projected cash flows of the securities must be substantially the same under multiple scenario prepayment assumptions.

103. For repurchase agreements that are accounted for as collateralized borrowings in accordance with paragraph 100 of this statement, the underlying securities shall continue to be accounted for as an investment owned by the reporting entity. The proceeds from the sale of the securities shall be recorded as a liability, and the difference between the proceeds and the amount at which the securities will be subsequently reacquired shall be reported as interest expense, calculated on the straight-line method or the scientific interest (constant yield) method, over the term of the agreement.

104. Reporting entities generally take possession of the underlying collateral under repurchase agreements and in many cases may obtain additional collateral when the estimated fair value of such securities falls below their current contract value. However, to the extent that the current fair value of the collateral is less than the recorded amount, the shortfall shall reduce the admitted asset value of the repurchase agreement.

Repurchase Financing

105. Repurchase financing is a repurchase agreement that relates to a previously transferred financial asset between the same counterparties (or affiliates of either counterparty) that is entered into contemporaneously with, or in contemplation of, the initial transfer.

106. A repurchase financing involves the transfer of a previously transferred financial asset back to the initial transferor as collateral for a financing between the initial transferee (the borrower) and the initial transferor (the lender). A repurchase financing also typically involves the initial transferor returning the

transferred financial asset (or substantially the same asset) to the initial transferee when the financing is repaid on a stated date. A repurchase financing is entered into in contemplation of the initial transfer if both transactions are considered together at the execution of the initial transfer.

107. When the transferor transfers a financial asset and also enters into a repurchase financing with the transferee, there are typically three transfers of the financial assets:

a. Initial transfer – An initial transferor transfers a financial asset to an initial transferee.

b. Repurchase financing – The initial transferee (the borrower) transfer the previously transferred financial asset back to the initial transferor (the lender) as collateral for a financing between the initial transferor and initial transferee.

c. Settlement – The initial transferor (the lender) returns the financial asset (or substantially the same asset) to the initial transferee (the borrower) upon receipt of payment from the initial transferee.

108. Repurchase financing that is entered into contemporaneously with, or in contemplation of, an initial transfer of financial asset between the same counterparties (or affiliates of either counterparty) shall not be separately accounted for as a transfer of a financial asset and a related repurchase financing unless (a) the two transactions have a valid and distinct business or economic purpose for being entered into separately and (b) the repurchase financing does not result in the initial transferor regaining control over the financial asset. Unless the provisions in paragraph 109 are met, the initial transfer and repurchase financing shall be evaluated as a linked transaction. The linked transaction shall be evaluated to determine whether it meets the requirements for sale accounting per paragraph 8. If the linked transaction does not meet the requirements for sale accounting, the linked transaction shall be accounted for based on the economies of the combined transactions, which generally represent a forward contract. SSAP No. 86 shall be used to evaluate whether the linked transaction shall be accounted for as a derivative.

109. An initial transfer of a financial asset and repurchase financing that are entered into contemporaneously with, or in contemplation of, one another shall be considered linked unless all of the following criteria are met at the inception of the transaction:

a. The initial transfer and the repurchase financing are not contractually contingent on one another. Even if no contractual relationship exists, the pricing and performance of either the initial transfer or the repurchase financing must not be dependent on the terms and execution of the other transaction.

b. The repurchase financing provides the initial transferor with recourse to the initial transferee upon default. That recourse must expose the initial transferor to the credit risk of the initial transferee, or its affiliates, and not solely to the market risk of the transferred financial asset. The initial transferee's agreement to repurchase the previously transferred financial asset (or substantially the same asset) for a fixed price and not fair value.

c. The financial asset subject to the initial transfer and repurchase financing is readily obtainable in the marketplace. In addition, the initial transfer of a financial asset and the repurchase financing are executed at market rates. This criterion may not be circumvented by embedding off-market terms in a separate transaction contemplated with the initial transfer or the repurchase financing.

d. The financial asset and repurchase agreement are not coterminous (the maturity of the repurchase financing must be before the maturity of the financial asset).

110. In accordance with paragraph 108, an initial transfer of assets and a repurchase financing shall not be considered separate transactions unless the provisions of paragraph 109 are met. If the provisions of

paragraph 109 are met, the initial transfer shall be evaluated to determine whether it meets the requirements for sale accounting without taking into consideration the repurchase financing. In such situations, the repurchase financing shall then be separately analyzed as a repurchase agreement.

Reverse Repurchase Agreements

111. Reverse repurchase agreements are defined as agreements under which a reporting entity purchases securities and simultaneously agrees to resell the same or substantially the same securities at a stated price on a specified date. For securities to be substantially the same, the criteria defined in paragraph 52 must be met, and for mortgage-backed securities excluding mortgage pass-through securities, the projected cash flows of the securities must be substantially the same under multiple scenario prepayment assumptions.

112. For reverse repurchase agreements that are accounted for as collateralized lendings in accordance with paragraph 100 of this statement, the underlying securities shall not be accounted for as investments owned by the reporting entity. The amount paid for the securities shall be reported as a short-term investment, and the difference between the amount paid and the amount at which the securities will be subsequently resold shall be reported as interest income, calculated on the straight-line method or the scientific interest (constant yield) method, over the term of the agreement.

Collateral Requirements – Repurchase and Reverse Repurchase Agreements[20]

113. The collateral requirements for repurchase and reverse repurchase agreements are as follows:

Repurchase Transaction

a. The reporting entity shall receive collateral having a fair value as of the transaction date at least equal to 95% of the fair value of the securities transferred by the reporting entity in the transaction as of that date. If at any time the fair value of the collateral received from the counterparty is less than 95% of the fair value of the securities so transferred, the counterparty shall be obligated to deliver additional collateral by the end of the next business day the fair value of which, together with the fair value of all collateral then held in connection with the transaction, at least equals 95% of the fair value of the transferred securities. If the collateral is less than 95% at the reporting date, the difference between the actual collateral and 95% will be nonadmitted.

Reverse Repurchase Transaction

b. The reporting entity shall receive as collateral transferred securities having a fair value at least equal to 102% of the purchase price paid by the reporting entity for the securities. If at any time the fair value of the collateral is less than 100% of the purchase price paid by the reporting entity, the counterparty shall be obligated to provide additional collateral, the fair value of which, together with fair value of all collateral then held in connection with the transaction, at least equals 102% of the purchase price.

Dollar Repurchase Agreements

114. Dollar repurchase and dollar reverse repurchase agreements are defined as repurchase and reverse repurchase agreements involving debt instruments that are pay-through securities collateralized with Government National Mortgage Association (GNMA), Federal Home Loan Mortgage Corporation (FHLMC) and Federal National Mortgage Association (FNMA) collateral, and pass-through certificates sponsored by GNMA, mortgage participation certificates issued by the FHLMC or similar securities issued by the FNMA. Dollar repurchase agreements are also commonly referred to as dollar roll transactions. To

[20] The collateral requirements are required for determining admitted assets under statutory accounting, but the receipt of collateral is not a factor in determining whether the transferor has effective control over the loaned assets in accordance with paragraph 50.

meet the definition of dollar repurchase and dollar reverse repurchase agreements, the securities underlying the agreements must meet the criteria defined in paragraph 52, and for mortgage-backed securities excluding mortgage pass-through securities, the projected cash flows of the securities must be substantially the same under multiple scenario prepayment assumptions.

115. For the seller in a dollar repurchase agreement accounted for as collateralized borrowing in accordance with paragraph 100 of this statement, a liability is recorded for the amount of proceeds of the sale and the sold mortgage-backed securities are not removed from the accounting records. During the period of the agreement, interest income is recorded as if the mortgage-backed security had been held during the term of the agreement. This is offset by an equal amount of interest expense related to the proceeds received from the sale. Additional interest expense is recorded representing the difference between the sales price and the repurchase price of the mortgage-backed securities sold.

116. When the mortgage-backed securities are repurchased under the agreement, the original mortgage-backed securities sold are removed from the accounting records and the purchased mortgage-backed securities are recorded. The principal amount of the mortgage-backed securities repurchased must be in good delivery form consistent with paragraph 52.

117. If the principal amount repurchased is greater than the amount sold, the cash paid is recorded as an additional investment in the newly acquired certificates. If the principal amount repurchased is less than the amount sold, a gain or loss relating to the original certificates held is recorded.

118. For the purchaser in a dollar reverse repurchase agreement accounted for as collateralized lending in accordance with paragraph 100 of this statement, an asset is recorded for the amount of the purchase. Upon completion of the reverse repurchase agreement, cash is received in exchange for a "substantially the same" security. The difference between the purchase and reselling price represents interest income for the lending of short-term funds.

Separate Transactions

119. Agreements to repurchase and resell securities that do not meet the definitions in paragraphs 85-101 of this statement shall be accounted for as two separate transactions, that is, as a sale and purchase or as a purchase and sale, in accordance with the relevant statutory accounting guidance. For example, sales of bonds would result in recognition of realized gains or losses.

Offsetting

120. Reporting entities may operate on both sides of the repurchase agreement market resulting in recording of liabilities and assets representing repurchase and reverse repurchase agreements, respectively.

121. Reporting entities shall offset such liabilities and assets only to the extent that a legal right to offset exists as defined in SSAP No. 64, paragraph 2. Otherwise, separate assets and liabilities shall be recognized.

Loan Syndications

122. Borrowers often borrow amounts greater than any one lender is willing to lend. Therefore, it is common for groups of lenders to jointly fund those loans. That may be accomplished by a syndication under which several lenders share in lending to a single borrower, but each lender loans a specific amount to the borrower and has the right to repayment from the borrower.

123. A loan syndication is not a transfer of financial assets. Each lender in the syndication shall account for the amounts it is owed by the borrower. Repayments by the borrower may be made to a lead lender who then distributes the collections to the other lenders of the syndicate. In those circumstances, the lead lender is also functioning as a servicer and, therefore, shall only recognize its portion of the loan as a financial asset.

Loan Participations

124. Groups of banks or other entities also may jointly fund large borrowings through loan participations in which a single lender makes a large loan to a borrower and subsequently transfers interests in the loan to other entities.

125. Transfers by the originating lender may take the legal form of either assignments or participations. The transfers are usually on a nonrecourse basis, and the transferor (originating lender) continues to service the loan. The transferee (participating entity) may or may not have the right to sell or transfer its participation during the term of the loan, depending upon the terms of the participation agreement.

126. If the loan participation agreement transfers a participating interest in an entire financial asset (as described in paragraph 7 of this statement) and the conditions in paragraph 8 are met, the transfer shall be accounted for by the transferor as a sale of a participating interest. A transferor's right of first refusal on a bona fide offer from a third party, a requirement to obtain the transferor's permission that shall not be unreasonably withheld, or a prohibition on sale to the transferor's competitor is a limitation on the transferee's rights but presumptively does not constrain a transferee from exercising its right to pledge or exchange. However, if the loan participation agreement constrains the transferees from pledging or exchanging its participating interest and that constraint provides a more-than-trivial benefit to the transferor, the transferor has not relinquished control and shall account for the transfer as a secured borrowing.

Factoring Arrangements

127. Factoring arrangements are a means of discounting accounts receivable on a nonrecourse, notification basis. Accounts receivable in their entireties are sold outright, usually to a transferee (the factor) that assumes the full risk of collection, without recourse to the transferor in the event of a loss. Debtors are directed to send payments to the transferee. Factoring arrangements that meet the conditions in paragraph 8 shall be accounted for as sales of financial assets because the transferor surrenders control over the receivables to the factor.

Transfers of Receivables with Recourse

128. In a transfer of an entire receivable, a group of entire receivables, or a portion of an entire receivable with recourse, the transferor provides the transferee with full or limited recourse. The transferor is obligated under the terms of the recourse provision to make payments to the transferee or to repurchase receivables sold under certain circumstances, typically for defaults up to a specified percentage. A transfer of receivables with recourse shall not be recognized as a sale, but rather as secured borrowing. (This provision is applied regardless if the transfer was comprised of the entire receivable, a group of the entire receivable, or a portion of the entire receivable.) A transfer of receivables without recourse shall only be recognized if the transferor receives cash for the receivables. The sale shall be recognized when cash is received. Sales of premium receivables are addressed in *SSAP No. 42—Sale of Premium Receivables*.

Extinguishments of Liabilities

129. If a creditor releases a debtor from primary obligation on the condition that a third party assumes the obligation and that the original debtor becomes secondarily liable, that release extinguishes the original debtor's liability. However, in those circumstances, whether or not explicit consideration was paid for that guarantee, the original debtor becomes a guarantor. As a guarantor, it shall recognize a guarantee obligation in the same manner as would a guarantor that had never been primarily liable to that creditor, with due regard for the likelihood that the third party will carry out its obligations. The guarantee obligation shall be initially measured at fair value, and that amount reduces the gain or increases the loss recognized on extinguishment.

130. Exchanges of debt instruments or debt instrument modifications are considered extinguishments if the exchange or modification results with substantially different terms or is considered more than minor. If

the cash flows under the terms of the new debt instrument are at least 10% different from the present value of the remaining cash flows under the terms of the original instrument, then the exchange of, or modification to, debt instruments is consider substantially different and/or more than minor.

Relevant Literature

131. The accounting guidance in this statement adopts with modification *FAS 166, Accounting for the Transfers of Financial Assets, an Amendment to FAS 140* (FAS 166), *FAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FAS 140), as amended by FAS 166, and FAS 156, *Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140*, as amended by FAS 166. Statutory modifications from these adoptions include:

a. Rejects the U.S. GAAP consideration for "consolidated affiliates" as the concept of consolidation has not been adopted for statutory accounting.

b. Rejects reference to U.S. GAAP standards and U.S. GAAP methods not adopted for statutory as well as concepts that are not pertinent for insurers. For example, references to investments "held-to-maturity", "available for sale" or "trading" and reference to FASB standards are replaced with statutory terms and references to statutory standards.

c. Rejects U.S. GAAP reference and guidance regarding "Revolving-Period Securitizations" as this U.S. GAAP guidance is not applicable to statutory accounting. This concept was also deemed not applicable to statutory accounting under SSAP No. 91R.

d. Rejects U.S. GAAP guidance for "Sale-Type and Direct-Financing Lease Receivables" as leases shall be accounted for in accordance with *SSAP No. 22~~R~~—Leases*. This conclusion is consistent with SSAP No. 91R.

e. Rejects U.S. GAAP guidance for "Banker's Acceptances and Risk Participations in Them," as not applicable for statutory accounting. This U.S. GAAP guidance was also deemed not applicable to statutory accounting under SSAP No. 91R.

f. Rejects U.S. GAAP guidance for "Removal of Account Provisions" that allows recognition of sale accounting. For statutory, transfers that would empower the transferor to reclaim assets under certain conditions (considered "removal-of-accounts provisions") are precluded from being accounted for as sales. This conclusion is consistent with SSAP No. 91R.

g. Rejects U.S. GAAP guidance for "Transfers of Receivables with Recourse" that allows transfers of receivables in their entirety with recourse to be accounted for as sales. For statutory, a transfer of receivables with recourse shall be accounted for as a secured borrowing. This conclusion is consistent with SSAP No. 91R.

h. Rejects illustrations for transactions involving transfers of lease financing receivables with residual values and banker's acceptances with a risk participation as the U.S. GAAP guidance in FAS 166 related to these topics has been rejected for statutory accounting.

i. Rejects the optionality provided within FAS 156 for subsequent measurement of servicing assets and servicing liabilities using either fair value or an amortization method. This statement requires application of a fair value method for subsequent measurement.

j. Incorporates guidance previously included in SSAP No. 91R specific to insurance entities, and guidance that was adopted from U.S. GAAP guidance not revised through the issuance of FAS 166. Items incorporated include:

i. Clarification that transfers of financial assets that are in substance real estate shall be accounted for in accordance with *SSAP No. 40~~R~~—Real Estate Investments* (paragraph 2).

ii. Clarification that transactions between related parties or affiliates are accounted for in accordance with *SSAP No. 25—Affiliates and Other Related Parties* (paragraph 4).

iii. Clarification that the guidance does not address the securitization of mortality or morbidity risk (paragraph 5).

iv. Guidance on the accounting of sale transactions for entities required to maintain an interest maintenance reserve (IMR). This guidance requires such entities to account for realized and unrealized capital gains and losses per the guidance in the SSAP for the specific type of investment, or if not specifically stated in the related SSAP, in accordance with SSAP No. 7 (paragraph 11.c.).

v. Clarification of when servicing assets and servicing liabilities shall be recognized as well as measurement of these items. Continues prior statutory decision that servicing rights assets shall be nonadmitted (paragraphs 15-17).

vi. Guidance on the accounting for transactions that require the granting of a security interest in certain assets to another party to serve as collateral for their performance under a contract (paragraph 20).

vii. Disclosures on security lending transactions, loaned securities; securities underlying repurchase and reverse repurchase agreements, dollar repurchase and dollar reverse repurchase agreements; receivables with recourse; and wash sales (paragraphs 28.a., 28.b., and 28.h.-28.l.).

viii. Guidance on the sales of future revenues (paragraph 77).

ix. Guidance on collateral requirements for securities lending transactions (paragraph 91).

x. Clarification that repurchase agreements, reverse repurchase agreements and dollar repurchase agreements 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 guidance (paragraph 96).

xi. Guidance on Repurchase Agreements (paragraphs 96-110).

xii. Guidance on Reverse Repurchase Agreements (paragraphs 111-112).

xiii. Guidance on Collateral for Reverse and Repurchase Agreements (paragraph 113).

xiv. Guidance on Dollar Repurchase Agreements (paragraph 114-118).

xv. Guidance for Separate Transactions (paragraph 119).

xvi. Guidance for Offsetting (paragraph 121). (This guidance was revised in November 2012 to only allow offsetting when a valid right to offset exists in accordance with SSAP No. 64. This is different from previous guidance reflected in SSAP No. 91R.)

xvii. Guidance for Transfers of Receivables with Recourse (paragraph 129).

132. This statement also adopts *FASB Staff Position 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions* (FSP FAS 140-3), *ASU 2011-03, Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements* and *AICPA Statement of Position 90-3, Definition of the Term Substantially the Same for Holders of Debt Instruments, as used In Certain Audit Guides and a Statement of Position.* This statement adopts *FASB Emerging Issues Task Force (EITF) No. 87-34, Sale of Mortgage Servicing Rights with a Subservicing Agreement, FASB EITF No. 88-11, Allocation of Recorded Investment When a Loan as Part of a Loan is Sold, FASB EITF No. 88-18, Sales of Future Revenues, FASB EITF No. 88-22, Securitization of Credit Card and Other Receivable Portfolios, FASB EITF No. 90-21, Balance Sheet Treatment of a Sale of Mortgage Servicing Rights with a Subservicing Agreement, FASB EITF No. 95-5, Determination of What Risks and Rewards, If Any, Can Be Retained and Whether Any Unresolved Contingencies May Exist in a Sale of Mortgage Loan Servicing Rights, FASB EITF No. 96-19, Debtor's Accounting for a Modification or Exchange of Debt Instruments*, as amended by FAS 166, and *FASB EITF No. 01-7, Creditor's Accounting for a Modification or Exchange of Debt Instruments*. This statement adopts ASC guidance for short sales with modification to require the short sale obligation to be reflected as a contra-asset rather than a liability. Also, the recognition of unrealized gains and losses is consistent with statutory accounting recognition, rather than directly to net income under U.S. GAAP. (The adopted ASC guidance includes guidance reflected in 942-405-25-1 through 25-2, 942-405-35-1, and 942-405-45-1. Additionally, the guidance in ASC 815-10-55-57 through 59 and 815-10-15-15 through 17, which addresses whether short sales are within the scope of SSAP No. 86, and the definition of a regular-way security trade is also adopted.)

133. This statement rejects FASB *EITF No. 84-5, Sale of Marketable Securities with a Put Option*, and FASB *EITF No. 92-2, Measuring Loss Accruals by Transferors of Receivables with Recourse* and *FTB 01-1:* Effective *Date for Certain Financial Institutions of Certain Provisions of Statement 140 related to Isolation of Transferred Financial Assets*. This statement rejects *FIN 41, Offsetting Amounts Related to Certain Repurchase and Reverse Repurchase Agreements*. This rejection, as it is a reversal of the prior adoption of this guidance in SSAP No. 45, and the revisions to paragraphs 121-122 adopted November 2012, are effective January 1, 2013. This guidance has been rejected as it permits optionality as to whether offsetting and net reporting occurs for repurchase and reverse purchase agreements under master netting agreements. The provisions of SSAP No. 64 shall be used in determining whether assets and liabilities shall be offset and reported net.

134. Effective December 31, 2023, this statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses,* and *ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

Effective Date and Transition

135. This standard shall be effective for years beginning on and after January 1, 2013 (effective date) and shall be applied prospectively. This statement must be applied as of the beginning of the reporting entity's first annual reporting period after the effective date, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. This statement must be applied to transfers occurring on or after the effective date. On and after the effective date, the concept of a qualifying special purpose entity is no longer relevant for statutory accounting purposes. The disclosure provisions of this statement shall be applied to transfers that occurred both before and after the effective date of this statement. Guidance reflected in paragraph 22 added from *INT 03-05,*

EITF 01-7: Creditor's Accounting for a Modification or Exchange of Debt Instruments has been in effect since June 22, 2003. Guidance in paragraphs 22 and 121 was originally contained in *INT 99-14: EITF No. 96-19, Debtor's Accounting for a Modification or Exchange of Debt Instruments, as amended by FAS 166* and was effective October 4, 1999. Revisions to incorporate guidance for short sales, detailed in *Issue Paper No. 152—Short Sales*, are effective on a prospective basis for transactions occurring on or after January 1, 2017, unless a reporting entity has previously been following an approach similar to the adopted guidance. Reporting entities that have previously been following a similar approach shall not deviate from that approach prior to the effective date of the adopted guidance. Revisions to paragraph 28.a. of this statement to incorporate enhanced disclosures on repurchase and reverse repurchase transactions are effective December 31, 2017.

REFERENCES

Other

- *SSAP No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
- *SSAP No. 33—Securitization*
- *SSAP No. 45—Repurchase Agreements, Reverse Repurchase Agreements and Dollar Repurchase Agreements*
- *SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
- *Purposes and Procedures Manual of the NAIC Investment Analysis Office*

Relevant Issue Papers

- *Issue Paper No. 122—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
- *Issue Paper No. 134—Servicing Assets/Liabilities, An Amendment of SSAP No. 91*
- *Issue Paper No. 141—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
- *Issue Paper No. 144—Substantive Revisions to SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities – Revised*
- *Issue Paper No. 152—Short Sales*

EXHIBIT A ‑ GLOSSARY

Adequate Compensation

The amount of benefits of servicing that would fairly compensate a substitute servicer should one be required, which includes the profit that would be demanded in the marketplace.

Agent

A party that acts for and on behalf of another party. For example, a third-party intermediary is an agent of the transferor if it acts on behalf of the transferor.

Attached Call

A call option held by the transferor of a financial asset that becomes part of and is traded with the underlying instrument. Rather than being an obligation of the transferee, an attached call is traded with and diminishes the value of the underlying instrument transferred subject to that call.

Beneficial Interests

Rights to receive all or portions of specified cash inflows received by a trust or other entity, including, but not limited to, senior and subordinated shares of interest, principal, or other cash inflows to be "passed-through" or "paid-through," premiums due to guarantors, commercial paper obligations, and residual interests, whether in the form of debt or equity.

Benefits of Servicing

Revenues from contractually specified servicing fees, late charges, and other ancillary sources, including "float."

Cleanup Call

An option held by the servicer or its affiliate, which may be the transferor, to purchase the remaining transferred financial assets, or the remaining beneficial interests not held by the transferor, its affiliates, or its agents in an entity (or in a series of beneficial interests in transferred financial assets within an entity), if the amount of outstanding financial assets or beneficial interests falls to a level at which the cost of servicing those assets or beneficial interests becomes burdensome in relation to the benefits of servicing.

Collateral

Personal or real property in which a security interest has been given.

Continuing Involvement

Any involvement with the transferred financial assets that permits the transferor to receive cash flows or other benefits that arise from the transferred financial assets or that obligates the transferor to provide additional cash flows or other assets to any party related to the transfer. All available evidence shall be considered, including, but not limited to, explicit written arrangements, communications between the transferor and the transferee or its beneficial interest holders, and unwritten arrangements customary to similar transfers. Examples of continuing involvement with the transferred financial assets include, but are not limited to, servicing arrangements, recourse or guarantee arrangements, agreements to purchase or redeem transferred financial assets, options written or held, derivative financial instruments that are entered into contemporaneously with, or in contemplation of, the transfer, arrangements to provide financial support, pledges of collateral, and the transferor's beneficial interests in the transferred financial assets.

Contractually Specified Servicing Fees

All amounts that, per contract, are due to the servicer in exchange for servicing the financial asset and would no longer be received by a servicer if the beneficial owners of the serviced assets (or their trustees or agents) were to exercise their actual or potential authority under the contract to shift the servicing to another servicer. Depending on the servicing contract, those fees may include some or all of the difference between the interest rate collectible on the financial asset being serviced and the rate to be paid to the beneficial owners of those financial assets.

Derecognize

Remove previously recognized assets or liabilities from the statement of financial position.

Derivative Financial Instrument

A derivative instrument (as defined in *SSAP No. 86—Derivatives*) that is a financial instrument (refer to *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures*, paragraph 2).

Embedded Call

A call option held by the issuer of a financial instrument that is part of and trades with the underlying instrument. For example, a bond may allow the issuer to call it by posting a public notice well before its stated maturity that asks the current holder to submit it for early redemption and provides that interest ceases to accrue on the bond after the early redemption date. Rather than being an obligation of the initial purchaser of the bond, an embedded call trades with and diminishes the value of the underlying bond.

Financial Asset

Cash, evidence of an ownership interest in an entity, or a contract that conveys to a one entity a right (a) to receive cash or another financial instrument from a second entity or (b) to exchange other financial instruments on potentially favorable terms with the second entity.

Financial Liability

A contract that imposes on one entity an obligation (a) to deliver cash or another financial instrument to a second entity or (b) to exchange other financial instruments on potentially unfavorable terms with the second entity.

Freestanding Call

A call that is neither embedded in nor attached to an asset subject to that call.

Interest-Only Strip

A contractual right to receive some or all of the interest due on a bond, mortgage loan, collateralized mortgage obligation, or other interest-bearing financial asset.

Naked Short Sale

A short sale in which the seller does not borrow or arrange to borrow the securities in time to make delivery to the buyer within the standard three-day settlement period (T+3). As a result, the seller fails to deliver securities to the buyer when delivery is due (known as a "failure to deliver" or "fail").

Participating Interest

A participating interest has the following characteristics:

a. From the date of the transfer, it represents a proportionate (pro rata) ownership interest in an entire financial asset. The percentage of ownership interests held by the transferor in the entire financial asset may vary over time, while the entire financial asset remains outstanding as long as the resulting portions held by the transferor or its agents) and the transferee(s) meet the other characteristics of a participating interest. For example, if the transferor's interest in an entire financial asset changes because it subsequently sells another interest in the entire financial asset, the interest held initially and subsequently by the transferor must meet the definition of a participating interest.

b. From the date of the transfer, all cash flows received from the entire financial asset are divided proportionately among the participating interest holders in an amount equal to their share of ownership. Cash flows allocated as compensation for services performed, if any, shall not be included in that determination provided those cash flows are not subordinate to the proportionate cash flows of the participating interest and are not significantly above an amount that would fairly compensate a substitute service provider, should one be required, which includes the profit that would be demanded in the marketplace. In addition, any cash flows received by the transferor as proceeds of the transfer of the participating interest shall be excluded from the determination of proportionate cash flows provided that the transfer does not result in the transferor receiving an ownership interest in the financial asset that permits it to receive disproportionate cash flows.

c. The rights of each participating interest holder (including the transferor in its role as a participating interest holder) have the same priority, and no participating interest holder's interest is subordinated to the interest of another participating interest holder. That priority does not change in the event of bankruptcy or other receivership of the transferor, the original debtor, or any other participating interest holder. Participating interest holders have no recourse to the transferor, its agents or to each other, other than standard representations and warranties, ongoing contractual obligations to service the entire financial asset and administer the transfer contract, and contractual obligations to share in any set-off benefits received by any participating interest holder. That is, no participating interest holder is entitled to receive cash before any other participating interest holder under its contractual rights as a participating interest holder. For example, if a participating interest holder also is the servicer of the entire financial asset and receives cash in its role as servicer, that arrangement would not violate this requirement.

d. No party has the right to pledge or exchange the entire financial asset unless all participating interest holders agree to pledge or exchange the entire financial asset.

Proceeds

Cash, beneficial interests, servicing assets, derivatives, or other assets that are obtained in a transfer of financial assets, less any liabilities incurred.

Recourse

The right of a transferee of receivables to receive payment from the transferor of those receivables for (a) failure of debtors to pay when due, (b) the effects of prepayments, or (c) adjustments resulting from defects in the eligibility of the transferred receivables.

Regular-Way Security Trade

Contracts that provide for delivery of a security within a period of time after the trade date generally established by regulations or conventions in the marketplace or exchange in which it is being executed.

Securitization

The process by which financial assets are transformed into securities.

Security Interest

A form of interest in property that provides that upon default of the obligation for which the security interest is given, the property may be sold in order to satisfy that obligation.

Seller

A transferor that relinquishes control over financial assets by transferring them to a transferee in exchange for consideration.

Servicing Asset

A contract to service financial assets under which the estimated future revenues from contractually specified servicing fees, late charges, and other ancillary revenues are expected to more than adequately compensate the servicer for performing the servicing. A servicing contract is either (a) undertaken in conjunction with selling or securitizing the financial assets being serviced or (b) purchased or assumed separately.

Short Sale

A short sale, as defined for statutory accounting, is the sale of a security that a selling reporting entity (seller) does not own at the time of sale or a sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller.

Servicing Liability

A contract to service financial assets under which the estimated future revenues from contractually specified servicing fees, late charges, and other ancillary revenues are not expected to adequately compensate the servicer for performing the servicing.

Standard Representations and Warranties

Representations and warranties that assert the financial asset being transferred is what it is purported to be at the transfer date. Examples include representations and warranties about (a) the characteristics, nature, and quality of the underlying financial asset, including characteristics of the underlying borrower and the type and nature of the collateral securing the underlying financial asset, (b) the quality, accuracy, and delivery of documentation relating to the transfer and the underlying financial asset, and (c) the accuracy of the transferor's representations in relation to the underlying financial asset.

Transfer

The conveyance of a noncash financial asset by and to someone other than the issuer of that financial asset. Thus, a transfer includes selling a receivable, putting it into a securitization trust, or posting it as collateral but excludes the origination of that receivable, the settlement of that receivable, or the restructuring of that receivable into a security in a troubled debt restructuring.

Transferee

An entity that receives a financial asset, an interest in a financial asset, or a group of financial assets from a transferor.

Transferor

An entity that transfers a financial asset, an interest in a financial asset, or a group of financial assets that it controls to another entity.

Unilateral Ability (See paragraphs 53 and 54)

A capacity for action not dependent on the actions (or failure to act) of any other party.

EXHIBIT B ‑ ILLUSTRATIONS

Illustration—Recording Transfers with Proceeds of Cash, Derivatives, and Other Liabilities

1. Company A transfers entire loans with a carrying amount of $1,000 to a subsidiary and receives proceeds with a fair value of $1,030 and the transfer is accounted for as a sale. Company A undertakes no servicing responsibilities and assumes a limited recourse obligation to repurchase delinquent loans.

Company A agrees to provide the transferee a return at a floating rate of interest even though the contractual terms of the loan are fixed rate in nature (that provision is effectively an interest rate swap).

<u>Fair Values</u>	
Cash proceeds	$1,050
Interest rate swap asset	40
Recourse obligation	60

<u>Net Proceeds</u>	
Cash received	$1,050
Plus: Interest rate swap asset	40
Less: Recourse obligation	<u>(60)</u>
Net proceeds	<u>$1,030</u>

<u>Gain on Sale</u>	$1,030
Net proceeds	<u>1,000</u>
Carrying amount of loans sold	<u>$30</u>
Gain on sale	

<u>Journal Entry</u>		
Cash	1,050	
Interest rate swap asset	40	
Loans		1,000
Recourse obligation		60
Gain on sale		30
To record transfer		

Illustration—Recording Transfers of Participating Interests

2. Company B transfers a nine-tenths participating interest in a loan with a fair value of $1,100 and a carrying amount of $1,000, and the transfer is accounted for as a sale. The servicing contract has a fair value of zero because Company B estimates that the benefits of servicing are just adequate to compensate it for its servicing responsibilities.

Fair Values	
Cash proceeds for nine-tenths sold ($1,100 x 9/10)	$990
One-tenth interest continued to be held by the transferor ($1,100 x 1/10)	110

Allocated Carrying Amount Based on Relative Fair Values

	Fair Value	**Percentage Of Total Fair Value**	**Allocated Carrying Amount**
Nine-tenths participating interest sold ($1,100 x 9/10)	$990	90	$900
One-tenth participating interest continued to be held by the transferor ($1,100 x 1/10)	110	10	100
Total	$ 1,100	100	$1,000

Gain on Sale	
Net proceeds	$ 990
Less: Carrying amount of loans sold	(900)
Gain on sale	$90

Journal Entry		
Cash	990	
Loans		900
Gain on sale		90
To record transfer		

Illustration—Sale of Receivables with Servicing Obtained

3. Company C originates $1,000 of loans that yield 10% interest income for their estimated lives of 9 years. Company C transfers the entire loans to an entity and the transfer is accounted for as a sale. Company C receives as proceeds $1,000 cash, a beneficial interest to receive 1% on the contractual interest on the loans (an interest-only strip receivable), and an additional 1% of the contractual interest as compensation for servicing the loans. The fair values of the servicing asset and the interest-only strip receivable are $40 and $60, respectively.

Fair Values

Cash proceeds	$1,000
Servicing asset	40
Interest-only strip receivable	60

Net Proceeds

Cash proceeds	$1,000
Servicing Asset	40
Interest-only strip receivable	60
Net Proceeds	$1,100

Gain on Sale

Net proceeds	$1,100
Less: Carrying amount of loans sold	(1,000)
Gain on sale	$ 100

Journal Entries

Cash	1,000	
Interest-only strip receivable	60	
Servicing Asset	40	
Loans		1,000
Gain on sale		100
To record transfer and to recognize interest-only strip receivable and servicing asset		

Illustration—Securities Lending Transaction Treated as a Secured Borrowing

4. The following example illustrates the accounting for a securities lending transaction treated as a secured borrowing, in which the securities borrower sells the securities upon receipt and later buys similar securities to return to the securities lender:

Facts	
Transferor's carrying amount and fair value of security loaned	$1,000
Cash "collateral"	1,020
Transferor's return from investing cash collateral at a 5% annual rate	5
Transferor's rebate to the securities borrower at a 4% annual rate	4

For simplicity, the fair value of the security is assumed not to change during the 35-day term of the transaction.

Journal Entries for the Transferor

At inception:		
Cash	1,020	
Payable under securities loan agreements		1,020
To record the receipt of cash collateral		
Securities pledged to creditors	1,000	
Securities		1,000
To reclassify loaned securities that the secured party has the right to sell or repledge		
Money market instrument	1,020	
Cash		1,020
To record investment of cash collateral		
At conclusion:		
Cash	1,025	
Interest		5
Money market instrument		1,020
To record results of investment		
Securities	1,000	
Securities pledged to creditors		1,000
To record return of security		
Payable under securities loan agreements	1,020	
Interest ("rebate")	4	
Cash		1,024
To record repayment of cash collateral plus interest		

Journal Entries for the Transferee

At inception:		
Receivable under securities loan agreements	1,020	
Cash		1,020
To record transfer of cash collateral		

Cash	1,000	
Obligation to return borrowed securities		1,000

To record sale of borrowed securities to a third party and the resulting obligation to return securities that it no longer holds

At conclusion:

Obligation to return borrowed securities	1,000	
Cash		1,000

To record the repurchase of securities borrowed

Cash	1,024	
Receivable under securities loan agreements		1,020
Interest revenue (“rebate”)		4

To record the receipt of cash collateral and rebate interest

Illustration—Short Sale Settled with Securities Borrowed Under a Secured Borrowing Agreement

5. The following example illustrates the accounting for a securities borrowing transaction treated as a secured borrowing, in which the insurer borrows securities and delivers the borrowed securities to a different counterparty to settle a short sale transaction.

Cash
    Contra-Asset – Securities Sold Short

To recognize the cash received and the obligation to delivery securities under a short sale.

Receivable Under Securities Loan Agreement (Borrow Securities)
    Cash

To recognize transfer of cash under the security borrowing agreement, with recognition of a receivable for the return. The actual securities borrowed under the agreement (as sale accounting criteria is not met) shall not be recognized on the financial statements.

Borrowed Asset ("Proceeds" of selling asset)
    Obligation to return Securities Borrowed

To recognize the use of the borrowed security to settle a short-sale transaction. This transaction would be similar to receiving "proceeds" from the sale of a borrowed security – but instead of "cash" recognition of the actual borrowed asset, with an obligation to return the borrowed securities.

Contra-Asset – Securities Sold Short
    Borrowed Asset

Close out the short sale by delivering the asset to the counterparty.

Obligation to Return Securities Borrowed
    Cash

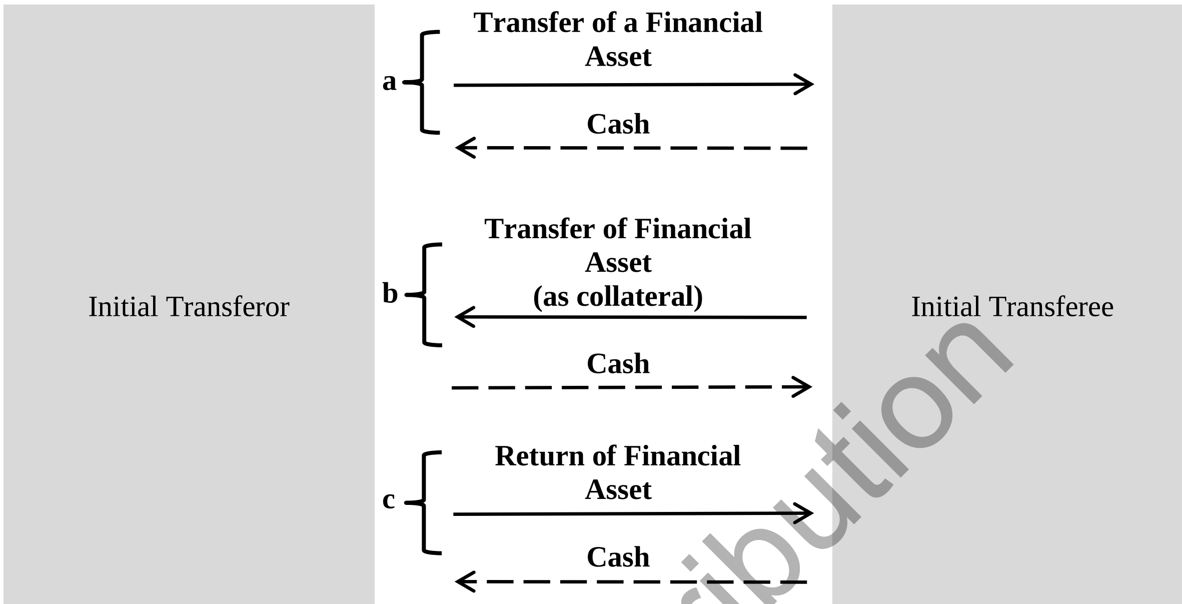
Eliminate the liability to return the borrowed asset by purchasing the asset and re-establishing it as off-balance sheet collateral for the securities borrowing transaction.

Cash
    Receivable Under Securities Loan Agreement

To recognize the return of cash collateral from the transferor and the unwinding of the securities borrowing agreement.

Illustration—Initial Transfer and Repurchase Financing

6. The following diagram is an example of an initial transfer of a financial asset and a subsequent repurchase financing, as described in paragraphs 105-110.



Statement of Statutory Accounting Principles No. 104

Share-Based Payments

STATUS

Type of Issue	Common Area
Issued	August 11, 2012; Substantively revised December 15, 2013
Effective Date	January 1, 2013
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

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

[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.

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 is to recognize in the financial statements the goods or services received in exchange for equity instruments granted or liabilities incurred and the related cost to the entity as those goods or services are received. This statement uses the terms "compensation" and "payment" in their broadest senses to refer to the consideration paid for goods, services, or the consideration paid to a customer.

3. 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 .

Scope and Scope Exceptions

4. This statement applies to all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in the grantor's own operations, or provides consideration payable to a customer 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:

a. The amounts are based, at least in part[3], on the price of the entity's shares or other equity instruments.

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 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 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 grantee that is unrelated to goods or services to be used or consumed in a grantor's own operations.

[2] Accounting pronouncements that require fair value measurements but that are excluded from *SSAP No. 100~~R~~—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. 100~~R~~. However, for certain share-based payment transactions, 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. 100~~R~~. To be consistent with U.S. 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.

6. The guidance in this statement does not apply to:

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*.

b. Transactions involving equity instruments granted to a lender or investor that provides financing to the issuer.

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 116-123 apply 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.

Recognition

8. An entity shall recognize the goods acquired or services received in a share-based payment transaction when it obtains the goods or as services are received, as further described in paragraphs 9-10. 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 15-29).

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.

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.

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.

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 for a note that provides no recourse to other assets of the 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.

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.

Determining the Grant Date

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 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:

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 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 practices.

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

15. Paragraphs 15-29 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.

16. Unless paragraphs 17-29 require otherwise, an entity shall apply the classification criteria in Exhibit A in determining whether to classify as a liability a freestanding financial instrument given to a grantee in a share-based payment transaction. Paragraphs 78-83 provide criteria for determining when instruments subject to this statement subsequently become subject to other applicable statutory accounting principles.

17. In determining the classification of an instrument, an entity shall take into account the classification requirements 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.

18. Exhibit A does not apply to outstanding shares embodying a conditional obligation to transfer assets, for example, shares that give the grantee the right to require the grantor to repurchase them for cash equal to their fair value (puttable shares). A put right may be granted to the 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 grantee as compensation shall be classified as a liability if either of the following conditions is met:

a. The repurchase feature permits the 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 service is rendered, and the share is issued. A grantee begins to bear the risks and rewards normally associated with equity share ownership when all the goods are delivered, or all the 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 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 grantor would prevent the 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.

19. A puttable (or callable) share that does not meet either of those conditions shall be classified as equity.

20. Options or similar instruments on shares shall be classified as liabilities if either of the following conditions is met:

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 grantee's control (such as an initial public offering) would not meet this condition until it becomes probable that event will occur.

21. For example, a reporting entity that is a Securities and Exchange Commission (SEC) registrant may grant an option to a 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.

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.

23. For this purpose, an award of equity share options granted to a 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, 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 are paid in euros.

24. For purposes of applying paragraph 22, 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.

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 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, and the entity thus incurs a liability to the grantee. In contrast, if the choice is the entities, 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:

a. It has the ability to deliver the shares. 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 20-21).

26. A provision that permits grantees 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:

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

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

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.

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.

29. Cash paid to a tax authority by an 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.

Market, Performance, and Service Conditions

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 a grantee 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.

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 service is rendered, and no compensation cost shall be recognized if the good is not delivered or the service is not rendered.

Payroll Taxes

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.

Initial Measurement

33. While some of the material in paragraphs 33-63 was written in terms of awards classified as equity, it applies equally to awards classified as liabilities.

34. A share-based payment transaction 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.

35. An entity shall account for the compensation cost from share-based payment transactions in accordance with the fair-value-based method set forth in this statement. That is, the cost of goods obtained or services received 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 goods obtained or services received is net of any amount that a grantee pays (or becomes obligated to pay) for that instrument when it is granted. For example, if a grantee pays $5 at the grant date for an option with a grant-date fair value of $50, the amount attributed to goods or services provided by the grantee is $45.

36. However, this statement provides certain exceptions (paragraph 56) 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 38.b. and 52*)*.

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 the grantee is required to pay nonrefundable interest on the note.

Measurement Objective – Fair Value at Grant Date

38. The measurement objective for equity instruments awarded to grantees 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 rendered the 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.

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 grantees as described in paragraph 38. However, the measurement date for liability instruments is the date of settlement.

b. Intrinsic Value Option for Awards Classified as Liabilities: A reporting entity shall make a policy decision of whether to measure all of its liabilities incurred under share-based payment arrangements (for employee and nonemployee awards) issued in exchange for goods or services at fair value or at intrinsic value. However, the reporting entity shall initially and subsequently measure awards determined to be consideration payable to a customer at fair value.

39. 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.

40. Such market prices for equity share options and similar instruments granted in share-based payment transactions 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.

41. To satisfy the measurement objective in paragraph 38, the restrictions and conditions inherent in equity instruments awarded 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, 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 termination behavior in estimating fair value (referred to as an option's expected term).

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. 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.

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, it must apply the practical expedient to all nonemployee awards that meet the condition in paragraph 54. 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.

44. A restriction that stems from the forfeitability of instruments to which grantees 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 render the service.

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

46. The fair-value-based method described in paragraphs 38 and 41-47 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.

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 service is rendered, regardless of when, if ever, the market condition is satisfied.

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.

49. A nonvested equity share or nonvested equity share unit shall be measured at its fair value as if it were vested and issued on the grant date.

50. Nonvested shares granted in share-based payment transactions 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.

51. A restricted share awarded to a grantee, 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.

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 (permitted value). A reporting entity's use of permitted 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.

53. For an award that meets the conditions in paragraph 54, a reporting entity may make an entity-wide accounting policy election to estimate the expected term using the following practical expedient:

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).

(b) 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.

54. A reporting entity that elects to apply the practical expedient in paragraph 53 shall apply the practical expedient to a share option or similar award that has all of the following characteristics:

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

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

c. The grantee can only exercise the award. The 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 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 42. However, a reporting entity must apply the practical expedient in paragraph 53 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.

55. If a reporting entity is not able to reasonably estimate the current share price (fair value) as a practical expedient, a reporting entity may use a value determined by the reasonable application of a reasonable valuation method as the current price of its underlying share for purposes of determining the fair value of an award that is classified as equity at grant date or upon a modification. The determination of whether a valuation method is reasonable, or whether an application of a valuation method is reasonable, shall be made on the facts and circumstances as of the measurement date. Factors to be considered under a reasonable valuation method include, as applicable:

a. The value of tangible and intangible assets.

b. The present value of anticipated future cash flows.

c. The market value of stock or equity interests in similar corporations and other entities engaged in trades or businesses substantially similar to those engaged by the entity for which the stock is to be valued, the value of which can be readily determined through nondiscretionary, objective means (such as through trading prices on an established securities market or an amount in an arm's length transaction).

d. Recent arm's length transactions involving the sale or transfer of stock or equity interest.

e. Other relevant factors such as control premiums or discounts for lack of marketability and whether the valuation method is used for other purposes that have a material economic effect on the entity, its stockholders, or its creditors.

f. The entity's consistent use of a valuation method to determine the value of its stock or assets for other purposes, including purposes unrelated to compensation of service providers.

56. 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.

57. 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 85) for measurement after issue date.

58. 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.

59. A contingent feature of an award that might cause 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 not be reflected in estimating the grant-date fair value of an equity instrument.

60. 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.

61. 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:

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.

62. 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 grantees 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 47). 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.

63. 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 grantee would be eligible to vest in the award regardless of whether the 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 service or goods already have been provided. 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 service or goods have not yet been provided 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 68 or paragraph 72 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 end when the grantee 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.

Subsequent Measurement

64. Guidance that equally applies to both liabilities and equity is generally found in paragraphs 64-84. Paragraphs 85-95 provide additional subsequent measurement guidance for awards classified as equity and paragraphs 96-99 provide additional subsequent measurement guidance for awards classified as liabilities.

Recognition of Nonemployee Compensation Costs

65. A grantor shall recognize the goods acquired or services received in a share-based payment transaction with nonemployees 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.)

66. If fully vested, nonforfeitable equity instruments are granted at the date the grantor and nonemployee enter into an agreement for goods or services (no specific performance is required by the nonemployee to retain those equity instruments), then, because of the elimination of any obligation on the part of the nonemployee to earn the equity instruments, a grantor shall recognize the equity instruments when they are granted (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 awards that are issued at the date the grantor and nonemployee enter into an agreement for goods or services (and no specific performance is required by the nonemployee in order to retain those equity instruments). Such an asset shall not be displayed as contra-equity by the grantor of the. The transferability (or lack thereof) of the awards shall not affect the balance sheet display of this nonadmitted prepaid asset. This guidance is limited to transactions in which awards are transferred to nonemployees in exchange for goods or services.

67. An entity may grant fully vested, nonforfeitable equity instruments that are exercisable by the nonemployee only after a specified period of time if the terms of the agreement provide for earlier exercisability if the 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 instead of paying with, or using, the share-based payment awards.

68. 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, including share-based payment awards granted to customers, to do either of the following:

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.

69. A recognized nonadmitted prepaid asset or expense shall not be reversed if a stock option that the nonemployee has the right to exercise expires unexercised.

70. 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 15-29. 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.

Recognition of Employee Compensation Costs

71. 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.

72. 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:

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.

73. An entity shall reverse previously recognized compensation cost for an award with a market condition only if the requisite service is not rendered.

74. 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 77).

75. 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).

76. 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 61 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.

77. 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:

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

78. Paragraphs 80-83 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 grantees of the acquired business and are outstanding as of the date of the business combination..

79. 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.

80. A freestanding financial instrument issued to a grantee 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 after a grantee vests in the award and is no longer providing goods or services, a grantee vests in the award and is no longer a customer, 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:

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.

81. Other modifications of that instrument that take place after a grantee vests in the award and is no longer providing goods or services, is no longer a customer, or is no longer an employee shall be subject to the modification guidance in paragraph 83. Following modification, recognition and measurement of the instrument shall be determined through reference to other applicable statutory accounting principles.

82. 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 80. 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 on their substantive characteristics and when certain criteria are met.

83. 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 the holder of the financial instrument. 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 (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 80 for a discussion of changes to awards made solely to reflect an equity restructuring.

84. 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 (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 compensation arrangements. That is, the guidance included in this paragraph is not applicable, by analogy or otherwise, to instruments outside share-based payment arrangements.

Subsequent Measurement - Awards Classified as Equity

85. 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.

86. A contingent feature of an award that might cause 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.

Modification of An Award

87. An entity shall account for the effects of a modification as described in paragraphs 88-95, 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.

The disclosure requirements in paragraph 114 apply regardless of whether an entity is required to apply modification accounting.

88. Except as described in paragraph 87, 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:

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 52, 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 68 or 72.

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 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 68 or 72.

c. A change in compensation cost for an equity award measured at intrinsic value in accordance with paragraph 85 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.

89. An entity that has an accounting policy to account for forfeitures when they occur in accordance with paragraph 68 or 72 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 87. However, the entity shall apply its accounting policy to account for forfeitures when they occur when subsequently accounting for the modified award.

90. Paragraphs 78-83 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.

Short-Term Inducements

91. Except as described in paragraph 87, a short-term inducement shall be accounted for as a modification of the terms of only the awards of grantees who accept the inducement, and other inducements shall be accounted for as modifications of the terms of all awards subject to them.

Equity Restructuring or Business Combination

92. 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 87 to those exchanges or changes to determine whether it shall account for the effects of those modifications. See paragraph 80 for an exception.

Repurchase or Cancellation

93. 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 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.

Cancellation and Replacement

94. Except as described in paragraph 87, 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 88. 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 service is expected to be rendered (or has already been rendered) at that date plus the incremental cost resulting from the cancellation and replacement.

95. 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.

Subsequent Measurement - Awards Classified as Liabilities

96. The fair value of liabilities incurred in share-based payment transactions shall be remeasured at the end of each reporting period through settlement.

97. Changes in the fair value (or intrinsic value for a reporting entity that elects that method) of a liability incurred under a share-based payment arrangement issued in exchange for goods or services 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 issued in exchange for goods or services 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 issued in exchange for goods or services 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.

98. Reporting entities shall measure a liability award under a share-based payment arrangement based on the award's fair value (or 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. A reporting entity shall subsequently measure awards determined to be consideration payable to a customer at fair value.

99. 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.

Accounting for Tax Effects of Share-Based Arrangements

100. 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.

101. 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 16-29. Incremental guidance is also provided for issues related to employee stock ownership plans.

Tax Effects for Instruments Classified as Equity

102. 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*. 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.

103. 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.

Tax Effects for Instruments Classified as Liability

104. 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.

Accounting for Tax Effects

105. 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.

106. 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 102-103 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.

107. 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. The appropriate period depends on the type of award and the guidance in SSAP No. 101.

Tax Benefits of Dividends on Share-Based Payment Awards

108. 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:

a. Nonvested equity shares

b. Nonvested equity share units

c. Outstanding equity share options.

Accounting for Rabbi Trusts

109. 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 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:

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

b. Shares of 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.

110. The guidance in this section addresses the accounting for deferred compensation that have characteristics in paragraphs 110.a. or 110.b. This section does not address the accounting for stock appreciation rights, even if they are funded through a rabbi trust.

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.

111. 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.

112. The following are the four types of deferred compensation arrangements involving rabbi trusts covered in this guidance:

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).

113. The accounts of the rabbi trust should be consolidated with the accounts of the employer in the financial statements of the employer.

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.

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.

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 an unaffiliated common stock security, that security would be accounted for in accordance with *SSAP No. 30~~R~~—Unaffiliated Common Stock*. 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~~R~~.

Disclosures

114. 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:

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.

115. The disclosures in paragraph 114 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 114 of this statement, noting that a reporting entity may need to disclose additional information to achieve the objectives.

Employee Share Purchase Plans

Overview and Background

116. 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 117-118). 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.)

Recognition

117. 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):

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% or less from the market price shall be considered to comply with this condition without further justification. A purchase discount greater than 5% 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% 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).

118. 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.

119. 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.

Initial Measurement

120. Paragraph 38 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.

Look-Back Plans

121. Many employee share purchase plans with a look-back option have differing features. For example, some plans contain multiple purchase periods, others 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 85 provides guidance on the measurement requirements if it is not possible to reasonably estimate fair value at the grant date.

Subsequent Measurement

122. 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% 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% 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% of the grant date stock price).

123. 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 63 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).

Consolidated / Holding Company Plans

124. Except for the disclosure requirement in paragraph 125, 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.

125. 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.

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

Relevant Literature

127. 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 paragraphs 127.a. through 127.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 2019-08, Compensation—Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606): Codification Improvements—Share-Based Consideration Payable to a Customer.*

b. *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.

c. *ASU 2017-09, Scope of Modification Accounting*

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

e. *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*

f. *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*

128. 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. U.S. 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. U.S. GAAP references are revised to reference applicable statutory accounting guidance.

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

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

f. U.S. 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.

129. The adoption with modification of FASB Codification Topic 718 detailed in paragraph 127 of this statement reflects adoption with modification of the following pre-codification U.S. GAAP standards:

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 97-14: Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested* (EITF 97-14);

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

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

130. The adoption with modification of FASB Codification Topic 718 in this statement reflects rejection of the following pre-codification U.S. 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

131. This statement was effective January 1, 2013, with interim and annual financial reporting thereafter. 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).

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

a. *ASU 2021-07, Compensation – Stock Compensation, Determining the Current Price of an Underlying Share for Equity-Classified Share-Based Awards.* This SAP clarification effective August 10, 2022.

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

c. *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.

d. *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.

e. *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.

f. *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 January 1, 2013.

133. 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*; and

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

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*

EXHIBIT A – Classification Criteria: Liability or Equity

Classification Criteria

1. As detailed in paragraph 16 of this statement, unless paragraphs 17-29 require otherwise, an entity shall apply the classification criteria in this Exhibit in determining whether to classify a freestanding financial instrument given to a grantee as a liability

2. The guidance in this 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 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.

Mandatorily Redeemable Financial Instruments

3. 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.

4. 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.

5. 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:

   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.

6. 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.

Obligations to Repurchase Issuer's Equity Shares by Transferring Assets

7. 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:

   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.

8. 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.

9. Examples of financial instruments that meet the criteria in paragraph 7 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.

10. 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.

11. 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.

12. 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 7-11 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

13. 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

14. A freestanding financial instrument that is within the scope of this statement shall not be combined with another freestanding financial instrument in applying paragraphs 3-13 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

15. The guidance in paragraphs 15-29 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.

16. 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.

Statement of Statutory Accounting Principles No. 105

Working Capital Finance Investments

STATUS

Type of Issue	Common Area
Issued	December 15, 2013; Substantively revised May 20, 2020
Effective Date	January 1, 2014; Substantive revisions detailed in Issue Paper No. 163 effective June 30, 2020.
Affects	No other pronouncements
Affected by	No other pronouncements
Interpreted by	INT 06-07
Relevant Appendix A Guidance	None

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for working capital finance investments held by reporting entities. This statement amends *SSAP No. 20—Nonadmitted Assets* (SSAP No. 20) to allow working capital finance investments as admitted assets to the extent they conform to the requirements of this statement.

SUMMARY CONCLUSION

2. Working capital finance investments represent a confirmed short-term obligation[1] to pay a specified amount owed by one party (the obligor) to another (typically a supplier of goods), generated as a part of a working capital finance investment program currently designated by the NAIC Securities Valuation Office.

[1] All references to short-term obligations in this statement to refer to obligations not exceeding one year.

Pursuant to the working capital finance investment program, this short-term obligation has been transferred by the entity entitled to payment (typically a supplier of goods) to a third party investor.

3. Working capital finance investments held by a reporting entity represent a right of the reporting entity to receive future payment. This statement provides accounting and reporting guidelines for the right to receive payment under working capital finance programs that meet particular criteria.

Working Capital Finance Program - Definitions and Conditions

4. A "working capital finance program" is an open account program under which an investor may purchase interests, or evidence thereof, in commercial non-insurance receivables. A working capital finance program is created for the benefit of a commercial investment-grade obligor and its suppliers of goods or services, and facilitated by a finance agent.

5. A working capital finance program transfers a right to payment to an investor from a short term obligation and arises from transactions among:

a. a buyer of goods or services that becomes an obligor to the supplier of goods or services,

b. the supplier(s) of those goods or services,

c. a finance agent, and

d. an investor.

6. A "working capital finance investment" is an interest in payment(s) from a confirmed supplier receivable issued pursuant to a working capital finance program. The payment (maturity) date must not exceed one year from the date of invoice from the supplier to the obligor. This investment is created when the investor purchases from a working capital finance program that is currently designated as NAIC "1" or "2" by the NAIC Securities Valuation Office, any of the following:

a. One or more confirmed supplier receivables;

b. in case of a participation, a participation interest in one or more confirmed supplier receivables issued by the finance agent or lead lender holding confirmed supplier receivables; or

c. a certificate, note or other interest manifestation, documented in a way that is verifiable, representing a legally enforceable interest in a right to payment either directly to the investor or from a trust, other special purpose entity or pool holding confirmed supplier receivables.

7. "Obligor" is the party that purchases the goods or services that generates the original supplier receivable (which is the payable for that Obligor). The obligor must have an NAIC designation of "1" or "2" or a Credit Rating Provider equivalent. The obligor must confirm the supplier receivable described in paragraph 11 as described in the confirmation process in paragraphs 12 and 13.

8. "Supplier" is the party that sells the goods or services to the obligor. The supplier sells the confirmed supplier receivable in accordance with the terms of the working capital finance program designated by the NAIC Securities Valuation Office at a price agreed to by the finance agent and/or investor.

9. "Investor" is the party purchasing a working capital finance investment in accordance with the terms of the working capital finance program designated by the NAIC Securities Valuation Office.

10. The "finance agent" is a bank, financial institution, other financial intermediary, or service provider that facilitates the working capital finance program, arranges the sale, assignment or transfer of the confirmed supplier receivable to the investor for a fee and administers the payment mechanism. In the case of participation, the finance agent must inform the reporting entity investor of a default or event of default as soon as it becomes aware of such default or event of default. For the working capital finance program to qualify under this SSAP, the finance agent must meet the requirements of either paragraph 10.a. or 10.b.:

a. The finance agent is directly regulated by, or falls under the supervision of, a financial regulator of its domiciliary country provided that such country appears on the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* List of Jurisdictions Eligible for Netting; or

b. Payments from the obligor must be paid directly to the reporting entity (investor) or into an account maintained by a regulated financial institution for the benefit of investors in the working capital finance program and, in either case, the finance agent cannot be the beneficiary of such payment.

11. A "confirmed supplier receivable" is a first priority perfected security interest or right to payment of a monetary obligation from the obligor arising from the sale of goods or services from the supplier to the obligor the payment of which has been confirmed by the obligor committing and stating that the obligations under the agreement and any payment shall not be affected by the invalidity, unenforceability, existence, performance or non-performance of the underlying commercial trade transaction or any related contract or undertaking nor that it will not protest, delay, or deny, nor offer nor assert any defenses, personal or otherwise, against payment to the supplier or any party taking claims, interests, or rights to payments made by the supplier.

a. The confirmed supplier receivable must be sold, assigned or otherwise transferred in a manner that results in an absolute, irrevocable and legally enforceable obligation that has been confirmed by the Obligor.

b. In the case of a participation, the certificates or other evidence of participation provide an absolute, irrevocable, and legally enforceable obligation of the finance agent or holder of the confirmed supplier receivable to pay to the reporting entity investor all of the amounts due to it under the confirmed supplier receivable, without reduction or delay arising from any claims that the finance agent may have against the reporting entity investor. The reporting entity investor's ability to exercise its rights as creditor, or to direct the finance agent to exercise the rights of a creditor on its behalf, shall not be subject to, other than during a cure period not to exceed thirty days, the discretion of the finance agent or other lenders or investors.

Confirmation Process

12. In the case of a purchase, the investor shall verify, prior to the sale that the obligor has confirmed the respective amounts, payment dates and related invoice numbers' specified dates and has waived all defenses to payment. In the case of a participation, the finance agent must verify that the obligor has confirmed the respective amounts, payment dates and related invoice reference numbers' specified due dates, and has waived all defenses to payment in accordance with the confirmation process.

13. The obligor must commit and state that upon confirmation of a supplier receivable it is obligated to pay to the investor, the finance agent, or any third party acting as agent or trustee for the investor, a sum equal to the full amount of that confirmed supplier receivable(s) on a date certain stated in the confirmation and that it waives any right of setoff or other defenses to avoid or delay the full and timely payment of that Confirmed Supplier Receivable. The documents establishing the working capital finance program or the confirmation must state and confirm that the obligation to pay must be independent of any other contracts

or claims that might be raised in defense arising from any transaction financed in connection with the WCFI program, the confirmed supplier receivable, or any other courses of performance or courses of dealing with the supplier.

Program Requirements

14. The working capital finance program investor must provide in its annual filing with the NAIC Securities Valuation Office one of the following:

a. An annual independent report according to Statement on Standards for Attestation Engagements (SSAE) No. 16 (or functional equivalent), reporting on controls at a service organization related to the administration of the investment; or

b. An annual audit of the financial statements and internal controls of the consolidated group of which the finance agent is part, which does not note any material weaknesses related to servicing working capital financial investments.

The NAIC Securities Valuation Office would review the materiality of the report findings in making their determination of the assignment of a designation.

15. If the credit rating of the working capital finance program or obligor falls to non-investment grade (below the equivalent of NAIC designation “1” or “2”), the reporting entity shall nonadmit, the working capital finance investments obtained under the related working capital finance program and/or the related obligor. Due to the short-term nature of these investments, once an investment is nonadmitted due to the credit rating of the working capital finance program or the obligor, those investments will continue to be nonadmitted.

16. Reporting entity investors must have the ability to monitor the working capital finance program and the credit-related activities of the obligor. Reporting entity investors must provide information as requested to the state of domicile indicating that they have the ability to monitor on an ongoing basis the activities of the working capital finance program.

17. All contracts or agreements that are a part of or that together constitute a working capital finance program must provide that if a dispute arises among any of the parties under any of the contracts or agreements that are a part of or that together constitute the working capital finance program, each party agrees that the dispute will be submitted to a court of competent jurisdiction in the United States or a constituent state thereof or of an alternative dispute resolution process recognized thereby. All contracts or agreements that are a part of or that together constitute a working capital finance program must provide that any dispute arising under any of the contracts or agreements that are a part of or that together constitute the working capital finance program must be resolved pursuant to the laws of the United States or a constituent state thereof that address the substance of the dispute but excluding those laws addressing conflicts of law.

Exclusions

18. A working capital finance investment excludes any receivables financed through:

a. Factoring: the purchase of receivables in bulk from a supplier where the receivables represent the payment obligations of potentially thousands of buyers to a single supplier, in which the buyers have no relationship with or contractual obligation to pay the factor and retain all legal defenses to payment they may have against the supplier;

b. Forfaiting: the purchase of one or a series of receivables from exporters by a forfaiter to enable the exporter (seller) to finance a commercial transaction with a buyer in which the Obligor has no relationship with or contractual obligation to pay the forfaiter and retains all legal defenses to pay it may have against the seller; or

c. Invoice discounting: the advancement of funds by a finance company to a business entity with the funds advanced limited to a defined percentage of the business entity's eligible and outstanding receivables.

19. Eligible Confirmed Supplier Receivables must not:

a. Include insurance or insurance related assets;

b. Be impaired or in default at the time of purchase;

c. Have a payment (maturity) date longer than one year from the date of the invoice from the Supplier to the Obligor giving rise to the confirmed supplier receivable, and the maturity date must not be subject to change or rolling; nor

d. Include any receivable of any parent or affiliate of the reporting entity investor, and neither the Obligor nor any Supplier may be affiliated with the reporting entity investor. Working Capital Finance Investments that have obligors or vendors that are affiliated with the investor are ineligible, and therefore, nonadmitted assets.

Accounting and Reporting

20. The right to receive payment generated by a working capital finance investment issued under a working capital finance program is considered to meet the definition of an asset as defined in *SSAP No. 4—Assets and Nonadmitted Assets*, and is an admitted asset to the extent the investment conforms to the requirements set forth in this statement and the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. For programs that comply with all of these elements, working capital finance investments shall be valued and reported in accordance with this statement, the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*, and the designation assigned in the NAIC Valuations of Securities product. Programs that do not comply with the elements set forth in this statement, or the provisions set forth in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* are nonadmitted. Working capital finance investments are reported as other invested assets in the financial statements.

21. A working capital finance investment shall be recorded on the trade date. At acquisition, the Working Capital Finance Investment shall be initially reported at cost, excluding brokerage and other related fees, and all other costs (internal costs, or costs paid for origination, purchase or commitment to purchase such investments), which shall be expensed as incurred.

22. After initial acquisition, the Working Capital Finance Investment shall be reported at amortized cost until the specified maturity date, unless the investment, or a portion thereof, is deemed uncollectible or when an other-than-temporary impairment has occurred. In the event that a working capital finance investment is purchased by a reporting entity investor at a premium (amount to be received by the entity under the confirmed supplier receivable is less than the price paid for the investment), the excess paid by the reporting entity investor in comparison to the amount receivable under the confirmed supplier receivable must be immediately expensed.

23. For reporting entities required to maintain an Interest Maintenance Reserve (IMR), the accounting for realized capital gains and losses from working capital finance investments shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. For reporting entities not required to maintain an IMR, realized gains and losses from working capital finance investments shall be reported as net realized capital gains or losses in the statement of income. For reporting entities not required to maintain an AVR, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus).

24. A Working Capital Finance Investment may provide for a prepayment penalty or acceleration fee in the event the working capital finance investment is liquidated prior to its scheduled termination date. Such fees shall be reported as investment income when received.

25. *SSAP No. 34—Investment Income Due and Accrued* shall be followed for determining and recording investment income earned on working capital finance investments acquired at a discount. In accordance with *SSAP No. 34—Investment Income Due and Accrued*, investment income shall be reduced for amounts that have been determined to be uncollectible, however amounts more than 15 days overdue are nonadmitted.

Default

26. A working capital finance investment payment that is uncollected by the reporting entity within 30 days after the due date shall be considered in default and nonadmitted. If the reporting entity has any other working capital finance investment assets from the same defaulting counterparty, all other working capital finance investments from that counterparty shall be nonadmitted. All working capital finance investments from a counterparty identified in default shall be evaluated for impairment.

Impairment

27. An other-than-temporary impairment[INT 06-07] shall be considered to have occurred if it is probable that the reporting entity will be unable to collect all amounts due according to the contractual terms of a confirmed supplier receivable including the payment on the established due date. Pursuant to this guidance, assessment of other-than-temporary impairment shall include an evaluation of the financial condition and short-term prospects of the obligor. If it is determined that a decline in the fair value of a working capital finance investment below book/adjusted carrying value is due to an other-than-temporary impairment, an impairment loss shall be recognized as a realized loss equal to the entire difference between the working capital finance investment's carrying value and fair value as of the reporting period for which the assessment is made. Fair value shall be determined in accordance with *SSAP No. 100~~R~~—Fair Value*, and reflect the price to sell the asset in an orderly market between market participants. As such, the fair value shall reflect the assumptions market participants will use in pricing the asset, including assumptions about risk.

28. For reporting entities required to maintain an AVR/IMR, the entire amount of the realized loss from the other-than-temporary impairment shall be recorded through the AVR, in accordance with SSAP No. 7.

29. Upon recognition of an other-than-temporary impairment, the fair value of the working capital finance investment on the measurement date shall become the new cost basis of the working capital finance investment and the new cost basis shall not be adjusted for subsequent recoveries in fair value. Once an investment is determined to be other-than-temporarily impaired, until all expected payments are received, the reporting entity must re-evaluate the investment quarterly and reassess fair value, with recognized realized losses for the difference between the book/adjusted carrying value and the current fair value. This process shall continue until either all expected payments are received, or the entity has recognized a realized loss for the entire uncollected carrying value.

Disclosures

30. The financial statements shall include the following disclosures:

a. Fair value in accordance with SSAP No. 100~~R~~.

b. Concentrations of credit risk in accordance with *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures* in the annual audited statutory financial reports only.

c. Information regarding the aggregate book/adjusted carrying value of working capital finance investment by designation including gross assets with nonadmitted and net admitted amounts annually. (Note that programs designated 3-6 are nonadmitted.)

	Gross Asset CY	Non-Admitted Asset CY	Net Admitted Asset CY
WCFI Designation 1			
WCFI Designation 2			
WCFI Designation 3			
WCFI Designation 4			
WCFI Designation 5			
WCFI Designation 6			
Total			

d. Annual and quarterly information regarding the aggregate book/adjusted carrying value maturity distribution on the underlying working capital finance investments by the categories of maturities up to 180 days and 181 to 365 days.

e. Any events of default of working capital finance investments during the reporting period.

31. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

32. *ASU 2022-04, Disclosure of Supplier Finance Program Obligations* is rejected.

33. Effective December 31, 2023, this statement rejects *ASU 2016-13, Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments; ASU 2018-19, Codification Improvements to Topic 326, Financial Instruments—Credit Losses; ASU 2019-04, Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842); ASU 2019-11, Codification Improvements to Topic 326, Financial Instruments—Credit Losses;* and *ASU 2020-03, Codification Improvements to Financial Instruments.* Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

Effective Date and Transition

34. This statement is effective for years on or after January 1, 2014. Substantive revisions documented in *Issue Paper No. 163—Working Capital Finance Investment Updates* are effective for financial reporting periods on or after June 30, 2020. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors.*

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 147—Working Capital Finance Investments*
- *Issue Paper No. 163—Working Capital Finance Investment Updates*

Statement of Statutory Accounting Principles No. 107

Risk-Sharing Provisions of the Affordable Care Act

STATUS

Type of Issue	Common Area
Issued	December 12, 2014
Effective Date	December 15, 2014
Affects	Nullifies INT 13-04
Affected by	No other pronouncements
Interpreted by	INT 15-01
Relevant Appendix A Guidance	A-791

SCOPE OF STATEMENT

1. The Affordable Care Act (ACA) imposes fees and premium stabilization provisions on health insurance issuers offering commercial health insurance. This statement provides accounting for three programs known as risk adjustment, reinsurance and risk corridors that take effect in 2014. Risk adjustment is a permanent risk-spreading program (ACA Section 1343). The temporary transitional reinsurance program (ACA Section 1341) and temporary risk corridors program (ACA Section 1342) are for years 2014 through 2016.

SUMMARY CONCLUSION

2. Specific terms included in Exhibit A are unique to these programs and should not be applied to other aspects of statutory accounting. The required payments to the programs by reporting entities are described as "contributions" in the program literature but are referred to in this guidance as assessments for clarity. Amounts redistributed by the programs back to reporting entities are termed "payments" by the programs. These "payments" are recoverables / receivables for the reporting entity and are termed program distributions or receivables (to the reporting entity) in this guidance. The reporting of payable or receivable amounts in this guidance is from the perspective of the reporting entity. This statement nullifies *INT 13-04: Accounting for the Risk-Sharing Provisions of the Affordable Care Act.*

3. This statement establishes statutory accounting principles for the risk-sharing provisions of the ACA. The manner in which these provisions are applied in the determination of the medical loss ratios (MLR) and rebates may be different from these as the MLR calculations are based on the ACA Section 2718(b).

Risk Adjustment Program – Description and Overview

4. The risk adjustment program based on Section 1343 of the ACA is effective beginning in the 2014 benefit year and continues as a permanent program.

5. The risk adjustment program includes health plans (except certain exempt and grandfathered plans) in the individual or small group markets both on and off the exchange. All covered risk adjustment plans are required to participate in the risk adjustment program.

6. The purpose of the risk adjustment program is to transfer funds from lower risk plans to higher risk plans within similar plans in the same state in order to adjust premiums for adverse selection among carriers caused by membership shifts due to guarantee issue and community rating mandates. States may set up their own risk adjustment programs, or they may permit the U.S. Department of Health and Human Services (HHS) to develop and manage the program in the state. In addition to the risk adjustment amount, HHS determines the user fee. In states operating their own risk adjustment program, the state will determine the fee.

7. Risk adjustment assessments and distributions will be computed based on the reporting entity's risk score versus the overall market risk score after applying adjustments. Effective for 2018 benefit plan years, the risk adjustments and distributions are calculated including the high-cost risk pool aspect of this program (see high-cost risk pool in paragraphs 10-11, paragraph 15 and paragraph 16). Risk adjustment assessments will be made if the plan average actuarial risk of all of their enrollees in a market and state is lower than the plan average risk of all enrollees in fully insured plans in that market and state risk pool. Risk adjustment distributions will be made to health plan issuers whose plans have an average actuarial risk that is greater than the plan average actuarial risk scores in that market and state risk pool. The reinsurance program is not considered in the computation.

8. HHS will collect a user fee to support the administration of the HHS-operated risk adjustment program. This fee applies to issuers of risk adjustment covered plans in states in which HHS is operating the risk adjustment program. For example, HHS projects that the per capita risk adjustment user fee for 2014 is approximately $1 per enrollee per year. Similar terms will apply for the user fees of state operated programs.

9. All risk adjustment distributions made to issuers are completely funded through the amounts assessed to other issuers within the same market in the same state to ensure equality between program distributions and assessments. Consequently, risk adjustment assessments will be invoiced prior to processing program distributions to issuers. Once applicable risk adjustment assessments by issuers are received by HHS or the state, funds will be redistributed to the higher risk plans. Each issuer that offers a

risk adjustment covered plan will be notified of risk adjustment distributions or assessments by June 30 of the year following the benefit year to align with the program distributions and assessment processing. Risk adjustment assessments owed by an issuer to HHS or the state are required to be remitted within 30 days of notification of the assessment. Once applicable assessments are received by HHS or the state, funds will be redistributed to the higher risk plans.

10. In December 2016, the HHS adopted a new regulation that changed how the ACA risk adjustment program would function, beginning with the 2018 benefit year. Specifically, the ACA risk adjustment methodology will incorporate a high-cost risk pool calculation. This adds a reinsurance-like element to the risk adjustment program, which is referred to as high-cost risk pooling. The operation of the high-cost risk pools will exclude a percentage of costs above a threshold level in the calculation of enrollee-level plan liability risk scores so that risk adjustment factors in the risk adjustment program described in paragraphs 4-9 would be calculated for risk excluding these extreme costs as determined by federal regulations. The program will operate two national high-cost risk pools, one for individuals and one for small groups. An overview of the new high-cost risk pool aspect of ACA risk adjustment is as follows:

a. HHS will establish two new high-cost risk pool parameters: a threshold and a coinsurance rate. For 2018, the threshold has been set at $1 million, and the coinsurance rate has been set at 60%. For 2018, the high-cost risk pools for high-cost enrollees would fund 60% of an issuer's costs for individual enrollees with claims above $1 million.

b. In the calculation of each issuer's annual risk adjustment transfer amount, the issuer will be reimbursed for a portion (specifically, the coinsurance rate) of actual enrollee-level claims above the threshold. Conforming changes will be made to how each issuer's enrollee-level plan liability risk scores are calculated. For example, in 2018, claims in excess of $1 million per enrollee will be reimbursed from the respective high-cost risk pool at a 60% coinsurance rate. This payment is referred to hereafter as the high-cost risk pool claims reimbursement.

c. In order to maintain the zero-sum nature of risk adjustment across each market in light of the new high-cost risk pool claims reimbursements detailed in paragraph 10.b., each issuer's risk adjustment transfer amount payable to HHS will include an assessment to all risk adjustment entities, which will be calculated as a percentage of the issuer's total premiums in the applicable market. The sum of the assessments across all issuers is intended to equal the sum of the high-cost risk pool claims reimbursements across all issuers.

d. HHS will report the high-cost risk pool amounts as part of the risk adjustment payment transfer formula including all components as a single amount, which should be reported on a net basis.

11. Conceptually, high-cost risk pool can be thought of as an involuntary reinsurance pool or as an aspect of the risk adjustment program. Combining the estimates of the various parts of the risk adjustment program reduces the potential impact of misestimating each element.

Risk Adjustment Program – Accounting Treatment

12. The accounting elements of the ACA permanent risk adjustment program, which are considered separately, include the user fee and the risk adjustment assessments and distributions.

13. The user fee is paid to HHS in states where the risk adjustment program is being operated by HHS and to the state program if operated by the state. Risk adjustment user fees shall be treated as government assessments. These fees are treated the same as other non-income-based governmental taxes

and fees in that they are recognized as an expense and liability when the premium subject to the assessment is written.

14. Premium adjustments pursuant to the risk adjustment program will be based upon the risk scores (health status) of enrollees, participating in risk adjustment covered plans rather than the actual loss experience of the insured. This program bears some similarities to the Medicare Advantage risk adjustment program[1] under which the plan receives additional funding (or pays additional amounts) based on adjustments to risk scores of enrollees (see *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage*).

15. The risk adjustment payables and receivables shall be accounted for as premium adjustments subject to redetermination as specified in this statement. Effective beginning with 2018 benefit plan years, the risk adjustment assessments and distributions are calculated including the high-cost risk pool aspect of this program and should be reported on a net basis.

a. Risk adjustment payables meet the definition of liabilities as set forth in *SSAP No. 5~~R~~—Liabilities, Contingencies and Impairments of Assets*. Risk adjustment receivables meet the definition of an asset and are admissible to the extent that they meet all of the criteria in this statement.

b. Risk adjustment payables and receivables shall be estimated based on experience to date. The method used to estimate the payables and receivables shall be reasonable and consistent between reporting periods. Reporting entities shall be aware of the significant uncertainties involved in preparing estimates and be both diligent and conservative in their estimations. In exercising the judgment required to prepare reasonable estimates for the financial reporting of risk adjustment program payables and receivables, the statutory accounting concept of conservatism shall be followed. In addition, reporting entities are required to have sufficient data to determine a reasonable estimate. Ensuring sufficient data requires that the reporting entity's estimate is based on demonstrated knowledge of the marketplace and annual information which includes patient encounter and diagnosis code data to determine the differences in the actuarial risk profile of the reporting entity's insureds versus the market participants in the particular market and state risk pool. Sufficient data shall incorporate patient default scores, if applicable, under the terms of the risk adjustment program. In addition, the estimates shall be consistent with other financial statement assertions and the pricing scenarios used by the reporting entity.

c. Premium revenue adjustments for the risk adjustment program are estimated for the portion of the policy period that has expired and shall be reported as an immediate adjustment to premium. Accrued risk adjustment receivables shall be recorded in premium and considerations receivable, with a corresponding entry to written premiums. Accrued risk adjustment payables shall be recorded as a liability[2] with a corresponding entry to written premiums. Reporting entities shall record additions or reductions to revenue resulting from the risk adjustment program in the period in which the changes in risk scores of enrollees result in reasonably estimable additions or reductions. The risk adjustment program receivables shall be reported gross of payables.

[1] The ACA program also has significant differences from the Medicare Advantage risk adjustment program, which is retrospective, administered as a single national program, with most enrollees administered by the federal government. By contrast, the ACA risk adjustment is not retrospective, and is administered by each entity by state and by plan.

[2] The annual statement liability lines will vary by the type of annual statement the reporting entity files. Managed care/accident and health reporting entities report as aggregate health policy reserves; life and accident and health reporting entities report as aggregate reserves for accident and health contracts; and property and casualty reporting entities report as aggregate write-ins for liabilities.

d. The risk adjustment receivables are administered through a federal governmental program. Once amounts are collected by the governmental entity, there is an obligation to distribute the funds. Amounts over 90 days due shall not cause the receivable to be treated as a nonadmitted asset based solely on aging.

e. Provided that the risk adjustment receivables due the reporting entity are determined in a manner that is consistent with the requirements of this statement, the receivables are admitted assets until determination of impairment or payment denial is received from the governmental entity or government-sponsored entity administering the program. Upon notification that payments to be paid to the reporting entity will be less than the recorded receivables, any amount in excess of the confirmed amount shall be written off and charged to income, except for amounts that are under appeal. Any receivable for risk adjustment amounts under appeal shall be reflected as a nonadmitted asset.

f. Evaluation of the collectibility of all amounts receivable from the risk adjustment program shall be made for each reporting period. If, in accordance with SSAP No. 5~~R~~, it is probable that the risk adjustment receivables are uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. If it is reasonably possible that a portion of the balance determined in accordance with this paragraph is not anticipated to be collected and is therefore not written off, the disclosure requirements outlined in SSAP No. 5~~R~~ shall be followed.

Risk Adjustment Program – High-Cost Risk Pool – Accounting Treatment

16. The individual and small group high-cost risk pools of the ACA risk adjustment program shall be accounted for consistent with the rest of the ACA risk adjustment program. Reporting entity issuers in the individual or small group markets need to account for the following risk adjustment payables and receivables including the impairment and aging guidance reflected in paragraph 15 and paragraph 16:

a. The high-cost risk pool assessment payable by the reporting entity, which is the percent-of-premium charge to the issuer in order to fund reimbursements across all issuers of claims above the high cost risk pool threshold, shall be accounted for as decreases to written premium subject to redetermination.

b. High-cost risk pool distributions, which represent proportionate reimbursement for the issuer's claims above the high cost risk pool threshold, would be accounted for as increases to written premium subject to redetermination.

c. As the risk adjustments and distributions described in paragraphs 4-9 are calculated after excluding the percentage of costs above the threshold specified in the high-cost risk pool aspect of this program, the payments described in paragraphs 4-9 will continue to be accounted for consistent with guidance in paragraph 15 and paragraph 16 (i.e., as a premium adjustment subject to redetermination).

Transitional Reinsurance Program – Description and Overview

17. The transitional reinsurance program based on Section 1341 of the ACA is effective for plan years 2014 through 2016. Reinsurance assessments will be collected and distributions will be issued during the three-year term.

18. All issuers of major medical commercial products and third party administrators (TPAs) on behalf of uninsured group health plans are required to contribute funding at the national contribution rate to HHS. States establishing reinsurance programs may collect additional funding. Non-grandfathered individual plans are eligible to receive benefit program distributions via an excess-of-loss reinsurance

system. Grandfathered plans are ineligible. Group plans are required to contribute funding, but are not eligible to receive reinsurance program distributions.

19. In general, this transitional reinsurance program provides funding to issuers in the individual market that incur high claims costs for enrollees. The program requires assessments from all issuers and TPAs on behalf of group health plans based on a per member annual fee established by HHS. The reinsurance assessment will fund reinsurance program distributions plus disbursements to the U.S. Treasury, in addition to covering administrative expenses of the program.

20. Consequently, the term "reinsurance" does not represent actual reinsurance between licensed insurers as defined by *SSAP No. 61~~R~~—Life, Deposit-Type and Accident and Health Reinsurance*. This program is similar to an involuntary pool in *SSAP No. 63—Underwriting Pools* for the individual insured health products subject to the 2014 ACA market reforms. For the group plans, which are required to contribute funding but are not eligible to receive program distributions, the program is an assessment payable by the reporting entity and not a pool.

21. The national transitional reinsurance program assessment rate for all issuers and TPAs will be established by HHS and will be designed to collect more than $12 billion in 2014 to cover the required $10 billion for the reinsurance program, the $2 billion contribution to the U.S. Treasury, and additional amounts to cover the administrative costs of the federal government entity and applicable reinsurance entities. States electing to operate their own reinsurance program have the option to increase the reinsurance assessment rate to provide additional funding for the reinsurance program or to fund the administrative expenses of the applicable reinsurance entity. Assessments for the reinsurance program must fund the reinsurance program of $10 billion in 2014, $6 billion in 2015 and $4 billion in 2016, plus disbursements to the U.S. Treasury of $2 billion, $2 billion and $1 billion for years 2014 through 2016, in addition to covering administrative expenses of the applicable reinsurance entity or HHS.

22. Reinsurance program distributions will be processed either by the applicable reinsurance entity or by HHS and will be made to issuers of non-grandfathered individual market plans for high claim costs of enrollees. Distributions from the applicable reinsurance entity to insurers providing individual coverage will be calculated as a coinsurance rate multiplied by the eligible claims submitted for an individual enrollee's covered benefits between an attachment point and the reinsurance cap for each benefit year. The coinsurance rate, attachment point and reinsurance cap are initially determined by HHS, but may be modified by the state, if the state chooses to establish its own reinsurance program.

23. Each state is eligible to establish a reinsurance program, regardless of whether the state establishes a Marketplace Exchange. If a state establishes a reinsurance program, the state must enter into a contract with an applicable reinsurance entity or entities or establish a reinsurance entity to carry out the program. If a state does not elect to establish its own reinsurance program, HHS will administer the reinsurance program on behalf of that state. HHS establishes the annual administrative portion for the fee. (For example, the 2014 fee will be $0.11 per-member per-year resulting in $20.3 million of administrative expense funding).

24. Reinsurance assessments to fund the program are made on an annual basis with billing beginning December 15, 2014. An insurer may submit claims for reimbursement when an enrollee of the reinsurance-eligible plan has met the applicable criteria as determined by either the state or HHS. Claims may be submitted through April 30 of the year following the benefit year. HHS will distribute reinsurance program funds among issuers nationally based on submitted claims. Issuers will be notified of pending reinsurance distributions by June 30 following the benefit year. If the requests for distributions exceed the actual assessments collected, HHS will reduce reinsurance distributions on a pro-rata basis. If the requests for distributions are less than actual assessments collected, HHS will increase reinsurance distributions on a pro-rata basis.

Transitional Reinsurance Program – Accounting Treatment

25. Due to the diverse elements of the transitional reinsurance program, which includes characteristics of traditional reinsurance, involuntary pools and governmental assessments, a hybrid accounting approach is required. The accounting treatment for the transitional reinsurance program outlined below is discussed in terms of the payables and receivables and the impact to the health insurance products subject to the program.

26. The following are the broad groupings of the health insurance products subject to the transitional reinsurance program:

a. Individual insured health products subject to the 2014 ACA market reforms. This excludes grandfathered and non-grandfathered 2013 products (referred to as subject individual insured products);

b. Other insured health products. This encompasses products which are not subject to the ACA market reforms including individual grandfathered and non-grandfathered (referred to as other insured health products);

c. Self-insured health products.

27. The guidance in this section will provide treatment for each of the assessments payable and program distribution receivable elements of the program listed below for the health insurance products listed in paragraph 26.

a. Assessments for reinsurance

b. Administrative costs assessments

c. Additional U.S. Treasury assessment

d. Reinsurance distributions

Subject Individual Insured Health Products

Subject Individual Insured Issuers - Assessments Payable for Reinsurance

28. Transitional reinsurance assessments attributable to enrollees in individual plans are treated as ceded reinsurance premium. This applies both to assessments made at the national assessment rate and to any state-elected additional assessments that will fund reinsurance program distributions. Ceded premiums would be reported as a reinsurance cession and follow reinsurance accounting in accordance with SSAP No. 61~~R~~, paragraph 17 and paragraphs 25-27.

29. For the individual coverage issuers, this is an involuntary pool and under the terms of the transitional reinsurance program, the transfer of risk and timely reimbursement requirements of SSAP No. 61~~R~~ are deemed to be met.

30. With regard to individual coverage issuers, the transitional reinsurance program is more similar to traditional reinsurance than it is to an assessment, because program assessments are made to and program distributions are received from the government or government-sponsored entity. Accordingly, the program is accounted for as reinsurance for individual insured products subject to the transitional reinsurance program.

31. The provisions of SSAP No. 63, paragraph 3, define involuntary pools.

32. The transitional reinsurance program differs from an involuntary pool, in that there is not a proportionate sharing of the entire results of a pool. However, the purpose is very similar: to address the additional costs associated with high-risk individuals. Furthermore, HHS has noted, *"the Affordable Care Act … requires that states eliminate or modify high-risk pools to the extent necessary to carry out the reinsurance program,"* which likewise highlights the similar purposes of the two mechanisms. Therefore, SSAP No. 63, paragraph ~~8~~9, provides additional relevant guidance. As the transitional reinsurance program is a mechanism for sharing the additional costs associated with high-risk individuals, it is accounted for as traditional reinsurance.

Subject Individual Insured Issuers - Reinsurance Administrative Expense Assessments

33. The assessment payable by the reporting entity for administrative expenses attributable to individual coverage is reflected as ceded premium. This applies both to assessments made at the national assessment rate and to any state-required assessments that will provide additional funding for administrative expenses.

34. Normally reinsurance premiums are set at a level intended to cover anticipated claim costs and include an administrative charge component. Therefore, as a matter of consistency, it is appropriate to include the administrative charge component for the transitional reinsurance program in ceded premium for individual insured products.

Subject Individual Insured Issuers - U.S. Treasury Assessment

35. Because this portion of the assessment is earmarked for the U.S. Treasury and not for the reimbursement of claims or to cover the operating costs of the reinsurance program, it is a federal assessment not based on income. This portion of the assessment is not treated as ceded premium, but as an assessment under SSAP No. 35~~R~~ and is reflected in the same expense category as taxes, licenses and fees. This is also consistent with annual statement expense reporting categories.

Subject Individual Insured Issuers - Reinsurance Program Distributions

36. Program distributions received from the ACA transitional reinsurance program for individual insurance is reflected as ceded claim benefit recoveries. This applies both to distributions received pursuant to the uniform federal reinsurance parameters and to any state distribution received.

37. In keeping with the rationale for reinsurance assessments above, distributions receivable from the transitional reinsurance program for individual insurance products is reflected the same as traditional reinsurance recoveries as described in SSAP No. 61~~R~~, paragraph 27.

38. Therefore, recoveries received are reported in the summary of operations and will reduce the ceding entity's reported benefits paid.

39. HHS and all applicable reinsurance entities shall be reported consistent with providers to an involuntary pool and will be treated as authorized reinsurers for the purposes of financial reporting for subject individual health products.

40. All receivables from the transitional reinsurance program are subject to the 90-day nonadmission rule beginning from when program receivables are due to be disbursed by the government or a government-sponsored entity. That is, the 90-day rule begins when governmental receivables are due, not from the date of initial accrual. The announced governmental or government-sponsored entity distribution date shall be the contractual due date similar to Appendix A-791, paragraph 2.h., which requires that payments due from the reinsurer are made in cash within ninety (90) days of the settlement date. The receivable is also subject to impairment analysis.

Other Insured Health Products

Other Insured Health Products – Assessments Payable for Reinsurance

41. Transitional reinsurance program reinsurance assessments made for enrollees in fully insured plans other than individual plans are treated as an assessment payable by the reporting entity and charged to taxes, licenses and fees. This applies both to assessments made at the national assessment rate and to any state assessments that will fund reinsurance program distributions. In this case, for fully insured non-individual plans, the entity cannot, under the terms of the program, be deemed to be "participating," as funds for claim recoveries will not be re-distributed back to the issuer for the coverage that is being assessed. Therefore, issuers of other insured health products that are not for individuals are paying an involuntary fee but are not participating in an involuntary pool.

42. The treatment of the transitional reinsurance program reinsurance assessments for non-individual fully insured plans differs from the treatment for individual plans. Since the non-individual plans are not eligible for reimbursement, they are not participating in a reinsurance arrangement, and thus, the assessments are not treated as ceded premium. As an involuntary assessment, the transitional reinsurance program reinsurance assessments, consistent with SSAP No. 35~~R~~ are treated as an assessment payable by the reporting entity and charged to taxes, licenses and fees expense. The expense is accrued in proportion to the other insured health enrollees base that will be used to determine the assessments payable as the premium subject to the assessment is written.

Other Insured Health Products - Reinsurance Administrative Expense Assessments

43. The reinsurance program administrative costs for other insured health products are an assessment payable by the reporting entity. This applies both to assessments made at the national assessment rate and to any state assessment that will fund administrative expenses and is reflected in the same expense category as taxes, licenses and fees.

Other Insured Health Products - U.S. Treasury Assessment

44. The additional U.S. Treasury assessment for other insured health products is a federal assessment payable by the reporting entity which is not based on income and is reflected in the same expense category as taxes, licenses and fees.

Other Insured Health Products - Reinsurance Program Distributions (not applicable)

45. Reinsurance recoveries will not occur for insured health products other than individual. Other insured health products will pay the transitional reinsurance program assessments payable but not receive program distributions for claims.

Self-Insured Health Products

Self-Insured Health Products - Assessments Payable for Reinsurance

46. Assessments made on behalf of self-insured plans which are administered by the reporting entity are uninsured plans and are excluded from the reporting entity's statement of operations, with respect to both monies received from the plans and assessments disbursed by the reporting entity. Any resulting liabilities or receivables shall be reported as liabilities and receivables held in connection with uninsured plans. This treatment is consistent with *SSAP No. 47—Uninsured Plans,* paragraphs 5 and 8-11.

47. The self-insured plan, not the reporting entity, is legally liable for assessments for the transitional reinsurance program. The funds are a bona fide pass-through by the reporting entity, which is merely

providing a service for the self-insured (uninsured) plan. Therefore, the reporting entity will not report revenues or expenses for the assessments for the transitional reinsurance program.

48. The reporting entity may have received funds from the self-insured plans in advance of making disbursements. In that event, a liability is established for funds held in connection with self-insured plans.

49. The reporting entity, depending on its arrangement with the (uninsured) plan, may make a disbursement before receiving full funding from the plan. In that event, an asset is established for amounts receivable in connection with uninsured plans. The asset would be subject to the rules for admissibility and impairment as prescribed in SSAP No. 47, paragraphs 9-10.

Self-Insured Health Products - Reinsurance Administrative Expense Assessments Payable and U.S. Treasury Assessment

50. A reporting entity providing a service for a self-insured plan that is uninsured shall apply the pass-through treatment for the transitional reinsurance program's administrative cost assessments and additional U.S. Treasury contribution amounts. The uninsured plan, not the reporting entity, is legally liable. Therefore, the reporting entity will not report revenues or expenses with respect to the transitional reinsurance program's administrative cost assessments and additional U.S. Treasury contribution amounts.

Self-Insured Health Products - Reinsurance Payments (not applicable)

51. Reinsurance recoveries will not occur for self-insured health products, as these products will pay fees but not receive claims reimbursements.

Risk Corridors – Description and Overview

52. The risk corridors program based on Section 1342 of the ACA is effective for benefit years beginning in 2014 through 2016. The risk corridors program applies to Qualified Health Plans (QHPs) in the individual and small group markets whether sold on or outside of an exchange.

53. The purpose of the risk corridors program is to provide limitations on issuer losses and gains for QHPs through additional protection against initial pricing risk. The program creates a mechanism for sharing the risk for Allowable Costs between the federal government and the QHP issuers. The program is applied at the QHP level, not the issuer or market segment level. Although the risk corridors program provides protection against extreme bounds of experience, there is a substantial corridor in which all variance in experience directly affects the financial return of the reporting entity.

54. To determine whether an issuer pays into (contributes), or receives distributions from, the risk corridors program, HHS will compare Allowable Costs[3] and the Target Amount[4] based on a formula that compares Allowable Costs. Below is an example (before transition requirements) for a QHP.

a. When a QHP's Allowable Costs for any benefit year are more than 103% but not more than 108% of the Target Amount, HHS will pay the QHP issuer an amount equal to 50% of the Allowable Costs in excess of 103% of the Target Amount.

[3] With respect to a QHP, Allowable Costs is an amount equal to the sum of incurred claims of the QHP issuer, adjusted to include qualifying expenditures by the QHP for activities that improve health care quality, expenditures for health information technology and meaningful use requirements and other required adjustments.

[4] With respect to a QHP, the Target Amount is an amount equal to the total premiums earned with respect to a QHP, including any premium tax credit under any governmental program, reduced by the allowable administrative costs of the plan.

b. When a QHP's Allowable Costs for any benefit year are more than 108% of the Target Amount, HHS will pay the QHP issuer an amount equal to 2.5% of the Target Amount plus 80% of the Allowable Costs in excess of 108% of the Target Amount.

c. If a QHP's Allowable Costs for any benefit year are less than 97% but not less than 92% of the Target Amount, the QHP issuer must remit assessments payable to HHS in an amount equal to 50% of the difference between 97% of the Target Amount and the Allowable Costs.

d. When a QHP's Allowable Costs for any benefit year are less than 92% of the Target Amount, the QHP issuer must remit assessments payable to HHS in an amount equal to the sum of 2.5% of the Target Amount plus 80% of the difference between 92% of the Target Amount and the Allowable Costs.

55. The risk corridors program creates a mechanism for sharing risk for Allowable Costs between the federal government and QHP issuers. The ACA establishes the risk corridors program as a federal program; consequently, HHS will operate the risk corridors program under federal rules without state variations. The risk corridors program is intended to protect against inaccurate rate setting in the early years of the exchanges by limiting the extent of issuer losses and gains. In the event that risk corridors program collections are not sufficient to cover all the required distributions, the ACA requires the use of other sources of federal funding for the required distributions, subject to the availability of appropriations.

56. The final risk corridors settlement calculation will be communicated by HHS after the end of the benefit year and after premium and loss adjustments related to the reinsurance and risk adjustment programs have been determined.

Risk Corridors – Accounting Treatment[(INT 15-01)]

57. This program is similar to the risk corridors program established for the Medicare Part D prescription drug coverage[5]. However, due to the asymmetrical nature of the risk corridors calculation, an overstatement of expense in one cell, which is theoretically offset by the understatement of expense in another cell, does not necessarily result in zero financial impact.

58. Payables and receivables pursuant to the temporary risk corridors program shall be accounted for as specified in this statement.

59. Risk corridors assessments meet the definition of liabilities as set forth in SSAP No. 5~~R~~. Risk corridors receivables due to the reporting entity meet the definition of an asset and are admissible to the extent that they meet all of the criteria in this statement.

a. Assumptions used in estimating retrospective premium adjustments shall be consistent with the assumptions made in recording other assets and liabilities necessary to reflect the underwriting results of the reporting entity such as claim and loss reserves (including IBNR) and contingent commissions. Contingent commissions and other related expenses shall be adjusted in the same period the additional or return retrospective premiums are recorded.

b. The additions or reductions to premium revenue resulting from the risk corridors program are recognized over the contractual period of coverage, to the extent that such additions or reductions are reasonably estimable. Reporting entities shall be aware of the significant uncertainties involved in preparing estimates and be both diligent and

[5] The ACA risk corridors program also has significant differences between the Medicare risk corridors program. The ACA risk corridors program is performed at a significantly more granular plan specific level with a pro-rata allocation of the issuer's overall claim costs for the plan's state/market cell.

conservative in their estimations. Risk corridors payables and receivables shall be estimated based on experience to date. The method used to estimate the payables and receivables shall be reasonable and consistent between reporting periods. In exercising the judgment required to prepare reasonable estimates for the financial reporting of risk corridors program payables and receivables, the statutory accounting concept of conservatism shall be followed. In addition, reporting entities are required to have sufficient information to determine a reasonable estimate. Part of ensuring sufficient information requires that the reporting entity's estimate is based on demonstrated knowledge of the impacts of the other risk-sharing programs on the risk corridors program and the terms of the risk corridors program. In addition, the estimates shall be consistent with other financial statement assertions and the pricing scenarios used by the reporting entity.

c. The risk corridors receivables are from a federal governmental program. Amounts over 90 days due shall not cause the receivable to be treated as a nonadmitted asset based solely on aging.

d. Provided that the risk corridors receivables due the reporting entity are determined in a manner that is consistent with the requirements of this statement, the receivables are admitted assets until determination of impairment or payment denial is received from the governmental entity or government-sponsored entity administering the program. Upon notification that payments to be paid to the reporting entity will be less than the recorded receivables, any amount in excess of the confirmed amount shall be written off and charged to income, except for amounts that are under appeal. Any receivable for risk corridors amounts under appeal shall be reflected as a nonadmitted asset.

e. Evaluation of the collectibility of all amounts receivable from the risk corridors program shall be made for each reporting period. If, in accordance with SSAP No. 5~~R~~, it is probable that the risk corridors receivables are uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. If it is reasonably possible, that a portion of the balance determined in accordance with this paragraph is not anticipated to be collected and is therefore not written off, the disclosure requirements outlined in SSAP No. 5~~R~~ shall be followed.

f. Reporting shall be consistent with *SSAP No. 66—Retrospectively Rated Contracts*, paragraph 9 guidance on reporting for retrospective premium.

Disclosures

60. The financial statements shall disclose on an annual and quarterly basis beginning in the first quarter of 2014, the assets, liabilities and revenue elements ~~by~~<u>for the permanent risk adjustment</u> program regarding the risk-sharing provisions of the Affordable Care Act for the reporting periods which are impacted by the programs including the listing in paragraph~~s~~ 60.a.~~ through 60.c.~~ Reporting entities shall also indicate if they wrote any accident and health insurance premium, which is subject to the Affordable Care Act risk-sharing provisions. In the event that the balances are zero, the reporting entity should provide context to explain the reasons for the zero balances, including insufficient data to make an estimate, no balances or premium was excluded from the program, etc. Asset balances shall reflect admitted asset balances. The disclosure shall include the following:

a. ACA Permanent Risk Adjustment Program

i. Premium adjustments receivable due to ACA Risk Adjustment (including high-cost risk pool payments)

ii. Risk adjustment user fees payable for ACA Risk Adjustment

iii. Premium adjustments payable due to ACA Risk Adjustment (including high-cost risk pool ceded premium)

iv. Reported as revenue in premium for accident and health contracts (written/collected) due to ACA Risk Adjustment

v. Reported in expenses as ACA risk adjustment user fees (incurred/paid)

~~b. ACA Transitional Reinsurance Program~~

~~i. Amounts recoverable for claims paid due to ACA Reinsurance~~

~~ii. Amounts recoverable for claims unpaid due to ACA Reinsurance (contra-liability)~~

~~iii. Amounts receivable relating to uninsured plans for contributions for ACA Reinsurance~~

~~iv. Liabilities for contributions payable due to ACA Reinsurance – not reported as ceded premium~~

~~v. Ceded reinsurance premiums payable due to ACA Reinsurance~~

~~vi. Liability for amounts held under uninsured plans contributions for ACA Reinsurance~~

~~vii. Ceded reinsurance premiums due to ACA Reinsurance~~

~~viii. Reinsurance recoveries (income statement) due to ACA Reinsurance payments or expected payments~~

~~ix. ACA Reinsurance Contributions – not reported as ceded premium~~

~~c. ACA Temporary Risk Corridors Program~~

~~i. Accrued retrospective premium due from ACA Risk Corridors~~

~~ii. Reserve for rate credits or policy experience rating refunds due to ACA Risk Corridors~~

~~iii. Effect of ACA Risk Corridors on net premium income (paid/received)~~

~~iv. Effect of ACA Risk Corridors on change in reserves for rate credits~~

61. In addition, beginning in annual 2014 and both quarterly and annual thereafter, a roll forward of prior year ACA risk-sharing provisions for the risk adjustment program specified asset and liability balances shall be disclosed in the annual statutory Notes to Financial Statements, as illustrated in Exhibit B. Note for the roll forward illustration, assets shall be reflected gross of any nonadmission. The reasons for adjustments to prior year balances (i.e. federal audits, revised participant counts, information which impacted risk score projections, etc.) shall also be disclosed. ~~For year-end 2014, all columns and rows are expected to be zero since 2014 is the first year that a receivable or liability will be recorded. For reporting periods on or after March 31, 2016, the risk corridors roll forward is amended to require disclosure of the risk corridors asset and liability balances and subsequent adjustments by program benefit year.~~ The

beginning receivable or payable in the roll forward will reflect the prior year-end balance for the specified benefit.

~~62. For reporting periods ending on or after March 31, 2016, for both quarterly and annual reporting, the following information is required for risk corridors balances by program benefit year:~~

- ~~a. Estimated amount to be filed or final amounts filed with federal agency~~
- ~~b. Amounts impaired or amounts not accrued for other reasons (not withstanding collectability concerns)~~
- ~~c. Amounts received from federal agency~~
- ~~d. Asset balance gross of nonadmission~~
- ~~e. Nonadmitted amounts~~
- ~~f. Net admitted assets~~

Relevant Literature

Generally Accepted Accounting Principles

~~63.~~62. U.S. GAAP did not issue additional guidance to address the risk-sharing provisions of the ACA.

Effective Date and Transition

~~64.~~63. This statement is effective for years ending on or after December 15, 2014. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. Risk-sharing provisions guidance was previously reflected within *INT 13-04: Accounting for the Risk-Sharing Provisions of the Affordable Care Act* and was effective January 1, 2014. Upon adoption of this statement, INT 13-04 was nullified. Disclosures in paragraphs 60 and 61 were adopted in *SSAP No. 35~~R~~—Guaranty Fund and Other Assessments,* but were incorporated into this statement prior to publication. Statement revisions in paragraphs 10-11 and paragraphs 15-16 for risk adjustment high-cost risk pools and related disclosure changes are effective for reporting periods beginning on or after January 1, 2018.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 150—Accounting for the Risk-Sharing Provisions of the Affordable Care Act*

EXHIBIT A – GLOSSARY

The terms included in this exhibit are specific to the risk-sharing provisions of the ACA; accordingly, they are not intended to be applied to other topics.

Affordable Care Act (ACA) – The Patient Protection and Affordable Care Act (PPACA), commonly called the Affordable Care Act (ACA), is a United States federal statute signed into law on March 23, 2010.

Applicable Reinsurance Entity – A tax-exempt not-for-profit organization, the duties of which shall be to carry out the transitional reinsurance program by coordinating the funding and operation of the risk-spreading mechanisms designed to stabilize the individual markets during the implementation of health reform.

Cell – The risk corridor calculation is done at the QHP (Qualified Health Plan) level – the cell is state, market (individual or small group), QHP.

Assessment – Required payments into the applicable reinsurance entity by all issuers of major medical commercial products and third-party administrators to fund the transitional reinsurance program.

Exchange – Health insurance marketplaces, also called Health Exchanges, are organizations set up to facilitate the purchase of health insurance in every state of the United States in accordance with the Patient Protection and Affordable Care Act. The exchanges are regulated, online marketplaces, administered by either federal or state government, where individuals, families and small businesses can purchase qualified health insurance plans starting October 1, 2013, with coverage beginning January 1, 2014. Exchanges will also determine who qualifies for subsidies and make subsidy payments to insurers on behalf of individuals receiving them. They will also accept applications for other health coverage programs such as Medicaid and Children's Health Insurance Program (CHIP).

Exempt Plans – Certain health plans that are determined not to be a risk adjustment covered plan in the applicable federally certified risk adjustment methodology (45 C.F.R. § 153.20), grandfathered health plans, group health insurance coverage benefits that are not an integral part of a group health plan, are limited scope, or supplemental benefits (45 C.F.R. § 146.145(c)), and individual health insurance coverage excepted benefits (45 C.F.R. § 148.220).

Grandfathered Plans – A group health plan that was created or an individual health insurance policy that was purchased on or before March 23, 2010. Grandfathered plans are exempted from many changes required under the ACA. Plans or policies may lose their "grandfathered" status if they make certain significant changes that reduce benefits or increase costs to consumers. New employees and new family members may be added to grandfathered group plans after March 23, 2010.

Health and Human Services (HHS) – The Department of Health and Human Services (HHS) is the United States government's principal agency that oversees CMS, which administers programs for protecting the health of all Americans and providing essential human services.

Market Segment – Subset of consumers with its own set of demographic and other assumptions such as individual, state/federal, small group, group, Medicaid or Medicare.

Program Distribution– Amounts payable to or redistributed by the applicable reinsurance entity or the HHS to issuers of non-grandfathered individual market plans that incur high claims costs for enrollees and are eligible to receive benefit payments (recoveries).

Qualified Health Plan (QHP) – Under the Affordable Care Act, starting in 2014, an insurance plan that is certified by the Health Insurance Marketplace, provides essential health benefits and follows established limits on cost-sharing (such as deductibles, copayments, and out-of-pocket maximum amounts).

Risk Score – Individual risk score means a relative measure of predicted health care costs for a particular enrollee that is the result of a risk adjustment model. Claims-based risk-assessment models use data, typically from a 12-month period, to identify underlying conditions and assign a risk score for each individual based on an algorithm.

EXHIBIT B – ACA RISK-SHARING PROVISIONS ROLL-FORWARD ILLUSTRATION

Receivables are reflected gross of any nonadmission for this illustration.

	Accrued During the Prior Year on Business Written Before December 31 of the Prior Year		Received or Paid as of the Current Year on Business Written Before December 31 of the Prior Year		Differences		Adjustments			Unsettled Balances as of the Reporting Date	
					Prior Year Accrued Less Payments (Col 1 – 3)	Prior Year Accrued Less Payments (Col 2 – 4)	To Prior Year Balances	To Prior Year Balances		Cumulative Balance from Prior Years (Col 1 – 3 + 7)	Cumulative Balance from Prior Years (Col 2 – 4 + 8)
	1	2	3	4	5	6	7	8	9	10	11
	Receivable	(Payable)	Receivable	(Payable)	Receivable	(Payable)	Receivable	(Payable)	Ref	Receivable	(Payable)
a. Permanent ACA Risk Adjustment Program											
1. Premium adjustments receivable	4,000,000		3,000,000		1,000,000		-800,000		A	200,000	0
2. Premium adjustments (payable)		8,000,000		9,000,000		-1,000,000		1,000,000	B		0
3. ~~Subt~~Total ACA Permanent Risk Adjustment Program	**4,000,000**	**8,000,000**	**3,000,000**	**9,000,000**	**1,000,000**	**-1,000,000**	**-800,000**	**1,000,000**		**200,000**	**0**
~~b. Transitional ACA Reinsurance Program~~											
~~1. Amounts recoverable for claims paid~~	~~22,000,000~~		~~15,000,000~~		~~7,000,000~~		~~-7,000,000~~		~~C~~	~~0~~	
~~2. Amounts recoverable for claims unpaid (contra liability)~~	~~8,000,000~~		~~9,000,000~~		~~-1,000,000~~		~~990,000~~		~~D~~	~~-10,000~~	
~~3. Amounts receivable relating to uninsured plans~~	~~3,000,000~~		~~2,800,000~~		~~200,000~~		~~-100,000~~		~~E~~	~~100,000~~	
~~4. Liabilities for contributions payable due to ACA Reinsurance – not reported as ceded premium~~		~~90,000~~		~~75,000~~		~~15,000~~		~~-14,000~~	~~F~~		~~1,000~~
~~5. Ceded reinsurance premiums payable~~		~~100~~		~~200~~		~~-100~~		~~100~~	~~G~~		~~0~~
~~6. Liability for amounts held under uninsured plans~~		~~125,000~~		~~15,000~~		~~110,000~~		~~90,000~~	~~H~~		~~200,000~~
~~7. Subtotal ACA Transitional Reinsurance Program~~	**~~33,000,000~~**	**~~215,100~~**	**~~26,800,000~~**	**~~90,200~~**	**~~6,200,000~~**	**~~124,900~~**	**~~-6,110,000~~**	**~~76,100~~**		**~~90,000~~**	**~~201,000~~**
~~c. Temporary ACA Risk Corridors Program~~											
~~1. Accrued retrospective premium~~	~~12,000,000~~		~~14,000,000~~		~~-2,000,000~~		~~1,750,000~~		~~I~~	~~-250,000~~	
~~2. Reserve for rate credits or policy experience rating refunds~~		~~150,000~~		~~250,000~~		~~-100,000~~		~~100,000~~	~~J~~		~~0~~
~~3. Subtotal ACA Risk Corridors Program~~	**~~12,000,000~~**	**~~150,000~~**	**~~14,000,000~~**	**~~250,000~~**	**~~-2,000,000~~**	**~~-100,000~~**	**~~1,750,000~~**	**~~100,000~~**		**~~-250,000~~**	**~~0~~**
~~d. Total for ACA Risk-Sharing Provisions~~	**~~49,000,000~~**	**~~8,365,100~~**	**~~43,800,000~~**	**~~9,340,200~~**	**~~5,200,000~~**	**~~-975,100~~**	**~~-5,160,000~~**	**~~1,176,100~~**		**~~40,000~~**	**~~201,000~~**

Explanation of adjustments:

A. Adjusted due to federal audit.

B. Adjusted because of revised participant count.

~~C. Adjusted due to poor experience of other participants in the reinsurance pool.~~

~~D. Revised risk score information in the state of substantially impacted risk scores.~~

Statement of Statutory Accounting Principles No. 108

Derivatives Hedging Variable Annuity Guarantees

STATUS

Type of Issue	Common Area
Issued	November 15, 2018
Effective Date	January 1, 2020, with early adoption permitted January 1, 2019
Affects	No other pronouncements
Affected by	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

SCOPE OF STATEMENT

1. Current statutory accounting guidance for derivatives qualifying for hedging effectiveness is in *SSAP No. 86—Derivatives*. Pursuant to the direction from the Financial Condition (E) Committee, this statement allows special accounting treatment for limited derivatives hedging variable annuity guarantee benefits subject to fluctuations as a result of interest rate sensitivity. The provisions within this statement are separate and distinct from the guidance in SSAP No. 86, as the items subject to the scope of this guidance, and the provisions within, would not qualify for hedge effectiveness under SSAP No. 86. The provisions provided within this statement are only permitted if all of the components of the statement are met and shall not be inferred as an acceptable statutory accounting approach for derivative transactions that do not meet the stated qualifications or that are not specifically addressed within this guidance.

SUMMARY CONCLUSION

2. This statement establishes statutory accounting principles to address certain, limited derivative transactions hedging variable annuity guarantees subject to fluctuations as a result of interest rate sensitivity. Eligibility for the special accounting provision within this standard is strictly limited to variable annuity contracts and other contracts involving certain guaranteed benefits similar to those offered with

variable annuities that are reserved for in accordance with Valuation Manual 21: Requirements for Principal-Based Reserves for Variable Annuities (VM-21)[1]. The statutory accounting guidance within this statement is considered a special accounting provision, only permitted if all the components in the standard are met, and shall not be inferred as an acceptable statutory accounting approach for situations that do not meet the stated qualifications or that are not specifically addressed within this guidance.

Terms/Concepts (for purposes of this statement)

3. The following terms reflect concepts specific to this statement. (This listing only details the key concepts. Specific guidelines are reflected throughout the guidance.)

a. Derivative Instrument: An agreement, option, instrument or series or combination thereof: (1) To make or take delivery of, or assume or relinquish, a specified amount of one or more underlying interests, or to make a cash settlement in lieu thereof; or (2) That has a price, performance, value or cash flow based primarily upon the actual or expected price, level, performance, value or cash flow of one or more underlying interests.

b. Dynamic Hedging Approach: A dynamic hedging strategy allows for the portfolio of derivatives comprising the hedging instrument to be rebalanced in accordance with changes to the hedged item in order to adhere to the specified, documented hedging strategy.

c. Hedged Item: The hedged item shall consist of declared guarantee benefits on a pool, or portion thereof, of variable annuity contracts exposed to interest rate risk. The hedged item may relate to an open or flexible portfolio (e.g., group of variable annuity contracts with different characteristics and liability durations) that allows for addition of newly issued contracts, subtraction of surrenders and fluctuations in balances. The portfolio of variable annuity contracts may consist of an entire book of business or declared components thereof.

d. Hedging Instrument: The hedging instrument shall reflect a specified derivative, or a portfolio of specified derivatives, that hedges the interest rate sensitivity of the designated hedged item. The hedging instrument may reflect a dynamic hedging strategy in which a portfolio of derivatives comprising the hedging instrument is rebalanced in accordance with changes to the hedged item.

Special Accounting Provision

4. The special accounting provision within this statement permits reporting entities to utilize a form of "macro-hedging" in which a portfolio of variable annuity policies, which could include the entire book of business or subsections thereof, are jointly designated as the host contracts containing the hedged item, in a fair value hedge[2], pursuant to a Clearly Defined Hedging Strategy (throughout this issue paper also referred to as "CDHS" or "hedging strategy"). This is considered a macro-hedge, as the designated hedged item (rate sensitive guarantee benefits) may be attached to a portfolio of variable annuity contracts with different characteristics and liability durations. Under this special accounting provision, the portfolio of contracts giving rise to the hedged item is not required to be static, but can be revised to remove policies and/or include new policies to allow for continuous risk management (hedging) of the variable annuity guarantees in accordance with the specific risks being hedged and the hedge objectives of the specified, documented hedging strategy. In designating the hedged item, reporting entities are permitted to exclude specific components of the variable annuity contracts, but such exclusions must apply collectively to all

[1] Actuarial Guideline XLIII, CARVM for Variable Annuities (AG 43) shall apply in states that have not adopted the Valuation Manual.

[2] As detailed in paragraph 10, these hedges are required to be highly effective in achieving offsetting changes in fair value attributed to the hedged risk between the derivative hedging instruments and the hedged item during the period that the hedge is designated.

policies included within the portfolio. For example, reporting entities may elect to only hedge the interest rate risk of rider cash flows, and if making this election, would define the hedged item as the "fair value of rider claims net of rider fees" for the portfolio of policies designated as giving rise to the hedged item.

5. This special accounting provision permits reporting entities to utilize a specified derivative, or a portfolio of specified derivatives, as the hedging instrument within a fair value hedge to hedge the interest rate sensitivity, or a specific percentage[3] of the interest rate sensitivity, of the designated hedged item. The hedging instrument may reflect a dynamic hedging strategy in which a portfolio of derivatives comprising the hedging instrument is rebalanced in accordance with changes to the hedged item in order to adhere to the specified, documented hedging strategy. Although the hedging instruments must address interest rate risk, this guidance does not preclude use of derivative instruments that may offset risks other than interest rate risk from being designated as the hedging instruments. For derivative instruments that are affected by multiple risk factors, including interest rate risk, reporting entities shall apply this special accounting treatment to the change in fair value due to interest rate risk. Reporting entities shall bifurcate the change in fair value due to the various risk factors - e.g., fair value volatility due to interest rates (rho), and other risk factors, such as equity level (delta) or volatility (vega). Pursuant to paragraphs 10 and 13, fair value fluctuations not attributed to the hedged risk, including fair value changes from excluded open components, shall be recognized as unrealized gains or losses.

6. With the provisions in this standard to allow for flexibility in the hedged item (changes to variable annuity contracts within a portfolio) coupled with a dynamic hedging approach (rebalancing of derivative hedging instruments), there is a greater risk of misrepresentation of successful risk management and achievement of a highly effective hedging relationship. Although this risk cannot be eliminated, the following provisions intend to ensure governance of the program and provide sufficient tools to allow for regulator review:

a. Prior to implementing a hedging program for application within scope of this standard, the reporting entity must obtain explicit approval from the domiciliary state commissioner allowing use of this special accounting provision. The domiciliary state commissioner may subsequently disallow use of this special accounting provision at their discretion. Although this guidance does not restrict the state domiciliary commissioner on when to prohibit future use, disallowance should be considered upon finding that the reporting entity's documentation, controls, measurement, prior execution of strategy or historical results are not adequate to support future use.

b. Actuarial certifications of VM-21 reserves, consistent with Valuation Manual requirements, which explicitly include the following:

   i. Certification as to whether the hedging strategy is incorporated within the establishment of VM-21 reserves, and the impact of the hedging strategy within the VM-21 Conditional Tail Expectation Amount.

   ii. Certification by a financial officer of the company (CFO, treasurer, CIO, or designated person with authority over the actual trading of assets and derivatives) that the hedging strategy meets the definition of a Clearly Defined Hedging Strategy within ~~VM-21~~VM-01 and that the Clearly Defined Hedging Strategy is the hedging strategy being used by the company in its actual day-to-day risk mitigation efforts. This provision does not require reporting entities to use a hedging strategy in determining VM-21 reserves, nor does it require entities to use the special accounting provision within this standard. However, it does require reporting entities that use the special accounting provisions within this standard to

[3] In identifying the hedged risk, reporting entities must identify whether they are hedging the full, or a portion of (e.g., 40%), the interest rate sensitivity.

certify that the hedging strategy within scope of this standard is a Clearly Defined Hedging Strategy and is reflected in the establishment of VM-21 reserves.

7. As identified in paragraph 2, eligibility for the special accounting provision within this standard is strictly limited to variable annuity contracts and other contracts involving certain guaranteed benefits similar to those offered with variable annuities that are reserved for in accordance with ~~VM-21~~VM-01. This special accounting provision requires the reporting entity to engage in highly effective fair value hedges that follow a Clearly Defined Hedging Strategy, as defined in VM-21, meeting all required provisions of VM-21 allowing the reporting entity to reduce the amount of the Conditional Tail Expectation (CTE) Amount. In order to qualify as a Clearly Defined Hedging Strategy (which may be dynamic, static, or a combination thereof), the strategy must meet the principles outlined in VM-21, be in place (implemented) for at least three months[4], and shall at a minimum, identify:

a. The ~~S~~specific risks being hedged,[5]

b. The hedging~~Hedge~~ objectives,

c. The material ~~R~~risks that are not ~~being~~ hedged,

d. The ~~F~~financial instruments ~~that will be~~ used to hedge the risks,

e. The hedging strategy's~~Hedge~~ trading rules, including permitted tolerances from hedging objectives,

f. The metrics, criteria, and frequency for measuring effectiveness~~Metric(s) used for measuring hedging effectiveness~~,

~~g. Criteria that will be used to measure effectiveness,~~

~~h. Frequency of measuring hedging effectiveness,~~

~~i.~~g. The ~~C~~conditions under which hedging will not take place, and for how long the lack of hedging can persist,

~~j.~~h. The group or area, including whether internal or external, ~~The individuals~~ responsible for implementing the hedging strategy~~.~~,

i. Areas where basis, gap, or assumption risk related to the hedging strategy have been identified, and

j. The circumstances under which hedging strategy will not be effective in hedging the risks.

8. While an initially documented hedging strategy may subsequently change, any change in hedging strategy, which includes a change in hedge target, shall be documented, with notification to the domiciliary state commissioner, and include an effective date of the change in strategy. Reporting entities that elect to change a documented hedging strategy prior to the end of the three-month minimum implementation timeframe shall identify the hedging strategy, and all hedging instruments executed under the strategy, as ineffective. The three-month timeframe begins with the stated effective date of the hedging strategy

[4] As detailed in VM-21, before a new or revised hedging strategy can be used to reduce the amount of the Conditional Tail Expectation (CTE) otherwise calculated, the hedging strategy should be in place (effectively implemented) for at least three months. As detailed in VM-21, the reporting entity may meet the time requirement by having evaluated the effective implementation of the hedging strategy for at least three months without actually having executed the trades indicated by the hedging strategy (e.g., mock testing or by having effectively implemented the strategy with similar annuity products for at least three months.)

[5] The specific risk being hedged shall include a measure of the hedge coverage (e.g., percentage of interest rate sensitivity being hedged).

regardless if any hedging instruments have been executed under the hedging strategy. Changes in a documented hedging strategy that occur after the three-month implementation timeframe do not necessitate an ineffective determination as long as hedged items and hedging instruments under the revised/new strategy continue to meet the requirements of a highly effective fair value hedge. Reporting entities are permitted to have more than one hedging strategy implemented, but all implemented strategies must qualify as a component of a Clearly Defined Hedging Strategy pursuant to paragraph 7.

Assessing Hedge Effectiveness

9. The provisions within this standard require the entity to use a specific method, as detailed in paragraph 10, to assess hedge effectiveness at inception and on an ongoing basis. At a minimum, hedge effectiveness assessment is required whenever financial statements are reported, at least every three months. Documentation requires prospective and retrospective[6] hedge effectiveness assessments, with on-going assessment consistent with the originally documented risk management strategy.

10. Both at inception, and on an ongoing basis, the hedging relationship must be highly effective in achieving offsetting changes in fair value attributed to the hedged risk during the period that the hedge is designated. Reporting entities electing to use this special accounting provision must calculate the fair value of the hedged item at inception and on an ongoing basis, and compare the fair value change of the hedged item to the fair value change of the hedging instruments in assessing whether the relationship is highly effective on a cumulative basis. This comparison is specific to the designated hedged risks and exposures, therefore, if only a portion of the interest rate risk is hedged or if the designated hedge only include specific components of the variable annuity policies (e.g., riders), for determining hedge effectiveness, the fair value comparisons is limited to those designated items. If an entity's defined risk management strategy for a particular hedging relationship excludes specific components of the hedging derivative from the assessment of hedge effectiveness, the excluded open components shall be reported at fair value with gains or losses recognized as unrealized gains or losses.

11. The term "highly effective" describes a fair value hedging relationship where the change in fair value of the derivative instrument is within 80% to 125% of the opposite change in fair value of the hedged item attributed to the hedged risk. It shall also apply when an R-squared of .80 or higher is achieved when using a regression analysis technique.

Measurement/Recognition of Gains and Losses of Outstanding (Open) Instruments

12. All designated hedging instruments (all derivatives, including those reflected in portfolios) shall be reported in the financial statements at fair value.

13. Fair value fluctuations in the measurement of outstanding (non-expired) derivatives within a highly effective hedging strategy shall be reflected as follows:

[6] For situations in which there has been a change in hedging strategy pursuant to paragraph 8, when conducting retrospective hedge effectiveness assessments, reporting entities shall assess effectiveness based on the hedge target that was actually in effect during the retrospective time periods.

a. Fair value fluctuations in the hedging instruments attributable to the hedged risk that offset the current period change in the designated portion of the VM-21 reserve liability[7] shall be recognized as a realized[8] gain or loss.

b. Fair value fluctuations in the hedging instruments attributable to the hedged risk[9] that do not offset the current period change in the designated portion of the VM-21 reserve liability shall be recognized as deferred assets (admitted) and deferred liabilities. The ability to recognize a deferred asset and deferred liability is limited to only the portion of the fair value fluctuation in the hedging instruments that is attributed to the hedged risk and does not immediately offset changes in the designated portion of the VM-21 reserve liability.

c. An amount equal to the net deferred asset and deferred liability (net amount from all hedging strategies/programs captured within this guidance) shall be allocated from unassigned funds to special surplus. Upon domestic regulator request, reporting entities shall provide estimations of RBC as if the special accounting provisions had not been applied. This estimation shall reflect the removal of deferred assets or deferred liabilities and reflect the impact to unassigned funds as if the derivative gains and losses had been recognized.

d. As detailed in paragraph 10, fair value fluctuations in the hedging instruments that are not attributable to the hedged risk, shall be recognized as unrealized gains or unrealized losses.

e. Reporting entities shall utilize the following calculation for establishing the deferred asset (also illustrated in Exhibit A) unless a different method has been approved by the domiciliary state commissioner:

   i. Calculate the fair value gain or loss in the hedged item attributable to the hedged risk.

   ii. Express the quantity calculated in paragraph 13.e.i. as a percentage of the change in the full-contract fair value (i.e., with all product cash flows) attributed to interest rate movements[10].

   iii. Calculate the VM-21 liability change attributed to the hedged risk as the quantity calculated in paragraph 13.e.ii. multiplied by the VM-21 liability change attributable to interest rate.

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[7] Hedge effectiveness is determined by comparing fair value fluctuations between the hedging instruments and the hedged item. However, in determining recognition in the financial statements, the fair value fluctuation of the hedging instruments is compared to the change in the reported value of the designated portion of the VM-21 liability. The designated portion of the VM-21 liability is not reported at fair value in the statutory financial statements, as such, the offset reported as realized gains and losses is the portion of the fair value change in hedging instruments offset by the change in the reported value of the designated portion of the VM-21 reserve. In accordance with the documented hedging strategy, reporting entities shall compare the fair value fluctuations to the change in the designated portion of the reserve liability, after considering recognized derivative returns (including recognized derivative income), when determining the recognition of fair value fluctuations.

[8] Recognizing the fair value change for open derivative positions that offset the VM-21 change as a realized gain/loss (instead of an unrealized gain or loss) directly offsets the VM-21 reserve change in the income statement.

[9] The change in fair value of the hedging instruments and hedged item is limited to changes driven by market factors. For example, periodic recognition of a cost owed to acquire the derivative from a counterparty (financing cost) shall not be captured as a change in the derivative instrument's fair value. The fair value of the instrument shall be determined based on the underlying derivative without inclusion of acquisition costs (or other such contractual elements that may exist with the counterparty) that do not change based on the underlying derivative interests or market factors.

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

iv. Establish the deferred asset or deferred liability in the amount of the fair value loss or (gain) of the designated hedging instruments attributed to the hedged risk less the VM-21 liability decrease or (increase) attributed to the hedged risk as calculated in paragraph 13.e.iii.

v. Allocate an amount equal to the net deferred asset and deferred liability (net amount from all hedging strategies/programs captured within this guidance) to special surplus.

14. Deferred assets and deferred liabilities recognized under paragraph 13.b. shall be amortized using a straight-line method into realized gains or realized losses over a finite amortization period. The amortization timeframe shall equal the Macaulay duration of the guarantee benefit cash flows based on the VM-21 Standard Projection[11], but shall not exceed a period of 10 years.

a. Future recognition of deferred assets or liabilities (fair value fluctuations attributed to the hedged risk that are not offset by the reserve liability change) do not extend the amortization timeframe for previously recognized deferred assets or deferred liabilities. Reporting entities are required to separately track, with a schedule to show the initial deferred amount and amortization schedule, of the deferred assets and deferred liabilities recognized and outstanding at each reporting date.

b. The amount reported on the financial statement at each reporting date shall reflect the net amount (net as either a deferred asset or deferred liability) for each hedging strategy captured within scope of this guidance. (Reporting entities that have more than one hedging strategy could have both deferred assets and deferred liabilities in the financial statements based on the net position of the separate hedging strategies.)

c. Reporting entities are permitted to amortize a greater portion of the deferred assets and/or deferred liabilities into realized gains or realized losses at any time in advance of the scheduled amortization period.

i. If electing to accelerate amortization, reporting entities are required to accelerate amortization equally between deferred assets and deferred liabilities within a single hedging strategy. For example, a reporting entity is not permitted to accelerate amortization of the deferred liabilities (recognizing the gains from fair value changes) and not accelerate amortization of the deferred assets (continuing to defer losses from fair value changes). If a reporting entity only has a single hedging strategy which only reflects deferred assets or deferred liabilities, the reporting entity is permitted to accelerate amortization without restrictions.

ii. If a reporting entity has more than one hedging strategy, and the strategies have offsetting net positions (both deferred assets and deferred liabilities are recognized in the financial statements), a reporting entity's election to accelerate amortization must be applied equally to programs with offsetting net positions. (For example, a

[11] The VM-21 Standard Projection benefit cash flows shall be based on the prescribed assumptions run for the scenario that produces the scenario reserve closest to conditional tail expectation (CTE) 70 (adjusted). The VM-21 Standard Projection with prescribed assumptions run is determined using the method (company specific market path (CSMP) or conditional tail expectations with prescribed assumptions (CTEPA)) applied by the reporting entity to calculate the prescribed projections amount. For the CSMP method, the economic scenario is Path A, with the guarantee benefit cash flows from the run to calculate Prescribed Amount A. For the CTEPA method, the economic scenario is the scenario that produces the scenario reserve closest to the CTE70 (adjusted) from the stochastic reserve calculation, with the guarantee benefit cash flows from the VM-21 Standard Projection with prescribed assumptions run for this economic scenario. The discount rate for the Macaulay duration calculation shall be equal to the valuation interest rate specified by the Standard Valuation Law for annuities valued on an issue year basis, using Plan Type A and a Guarantee Duration greater than 10 years but not more than 20 years.

decision to accelerate amortization of a program with a net deferred liability must be applied equally to a program with a deferred asset that best corresponds to the deferred liability[12].) In these situations, the guidance in paragraph 14.c.i. is also applicable, whereas, the accelerated amortization must also apply equally to the deferred assets and deferred liabilities within each individual hedging program. If a reporting entity with more than one hedging strategy only has net deferred assets or net deferred liabilities recognized, the reporting entity is permitted to accelerate amortization to a single program in a manner consistent with the guidelines in paragraphs 14.c.i.

15. For outstanding (non-expired) derivative instruments that were removed from a highly effective hedging strategy (rebalanced), subsequent gains and losses from fair value fluctuations shall not impact the previously recognized deferred assets or deferred liabilities. The deferred assets and deferred liabilities for these derivative instruments shall be "locked" and amortized under the remaining schedule unless the reporting entity elects to terminate or accelerate amortization. Subsequent to the removal from a highly effective strategy, all fair value fluctuations from the outstanding derivative instruments would be subject to the guidance in SSAP No. 86 and recognized as unrealized gains and/or unrealized losses. If the derivative is re-designated as part of a highly effective hedging strategy qualifying under this standard, subsequent fair value fluctuations (after the re-designation) may be accounted for under the special accounting provision detailed in this statement.

16. For outstanding (non-expired) derivative instruments in a hedging strategy that no longer qualifies within scope of this standard (e.g., VM-21 requirements are not met) or is no longer a highly effective hedge, any non-amortized deferred assets or deferred liabilities shall be amortized to unrealized gains or unrealized losses over the remaining amortization timeframe, not to exceed five-years. If the deferred assets/deferred liabilities have a remaining amortization period that is less than the shortened timeframe, amortization shall continue over the remaining period. If the remaining amortization period is greater than 5-years at the time of the program no longer qualifies, or is no longer highly effective, the amortization schedule shall be revised to require full amortization within the shortened 5-year timeframe. If elected by the reporting entity, deferred assets and deferred liabilities may be immediately recognized as unrealized gains and/or unrealized losses or have accelerated amortization (less than 5-years) as unrealized gains and/or unrealized losses. (An election to immediate eliminate or accelerate amortization must follow the provisions in paragraph 14.c.) All future fair value fluctuations for these derivative instruments would be subject to the guidance in SSAP No. 86, and shall be recognized as unrealized gains or unrealized losses unless the instrument is subsequently designated as part of a highly effective hedging strategy within scope of this statement. If the derivative is re-designated as part of a highly effective hedging strategy qualifying under this standard, subsequent fair value fluctuations (after the re-designation) may be accounted for under the special accounting provision detailed in this statement.

17. Reporting entities may elect to terminate use of this special accounting provision at any time. In those instances, if the derivative instruments are outstanding, all deferred assets and deferred liabilities shall be amortized to unrealized gains or unrealized losses over the remaining amortization timeframe, not to exceed five-years. If the deferred assets/deferred liabilities have an amortization period that is less than the shortened 5-year timeframe, amortization shall continue over the established period. If the remaining amortization period is greater than 5-years at the time of termination, the amortization schedule shall be revised to require full amortization within the shortened 5-year timeframe. If elected by the reporting entity, deferred assets and deferred liabilities may be immediately eliminated or have accelerated amortization (less than 5-years) with recognition as unrealized gains and/or unrealized losses. (An election to immediate eliminate or accelerate amortization must follow the provisions in paragraph 14.c.) Once the special accounting provision is terminated, unless re-designated by the reporting entity, subsequent accounting of

[12] The intent of this guidance is to ensure that the ability to accelerate amortization does not result with elections that simply result in favorable financial statement presentation.

the derivatives in a hedging strategy that would be captured within this statement shall follow the fair value accounting approach in SSAP No. 86[13].

Measurement/Recognition of Realized Gains or Losses of Expired Derivatives

18. With the ability to rebalance the hedging instrument, this guidance allows for individual derivative instruments to expire and/or be removed from the portfolio of the hedging instrument, and not immediately trigger an assessment that the overall hedging strategy is no longer highly effective. Furthermore, special allowances are included to consider the tenure differences between a hedging instrument and VM-21 liability duration. These allowances permit expired[14] derivative instruments that were part of a highly effective hedging strategy at the time of expiration to continue amortizing the deferred gains and deferred losses over the previously established amortization timeframe even if the overall hedging strategy is subsequently terminated or subsequently identified as no longer qualifying as a highly effective hedge.

19. Pursuant to the provisions in paragraph 14.c., reporting entities are permitted to amortize a greater portion of the deferred assets and/or deferred liabilities from expired derivatives into realized gains or realized losses in advance of the scheduled amortization period.

20. Consistent with the guidance in paragraph 17, reporting entities may elect to terminate use of this special accounting provision at any time. In those instances, if the derivative instruments have expired, all deferred assets and deferred liabilities shall be amortized to realized gains or realized losses over the remaining amortization timeframe, not to exceed 5-years. If the deferred assets/deferred liabilities had an amortization period that was less than the shortened timeframe, amortization shall continue over the established period. If the amortization period was greater than 5-years at the time of termination, the amortization schedule would be revised to require full amortization within the shortened timeframe. If elected by the reporting entity, the deferred assets and deferred liabilities may be immediately eliminated, or have accelerated amortization, with recognition as realized gains and/or realized losses. An election to immediate eliminate or accelerate amortization (less than 5 years) must follow the provisions in paragraph 14.c.)

Derivative Income

21. Derivative income shall be recognized when earned.

22. Pursuant to the documented hedging strategy as a fair value hedge, derivative income shall be considered as part of the overall hedging strategy and included in the assessments on whether the strategy is highly effective.

Disclosures

23. A reporting entity that has any outstanding derivatives accounted for under this special accounting provision, or that has unamortized deferred assets and/or deferred liabilities (representing previously unrecognized qualifying fair value fluctuations) from expired derivatives under the special accounting provision shall disclose the following within the financial statements:

a. Discussion of hedged item, including information on the guarantees sensitive to interest rate risk, along with information on the designated hedging instruments being used to hedge the risk. Discussion of the hedging instruments shall identify whether a hedging instrument is a single instrument or portfolio, as well as information on the hedging strategy

[13] Macro-hedges and the ability to rebalance hedging instruments are not provisions permitted within "effective" hedges in scope of SSAP No. 86. As such, hedging strategies with these components accounted for under SSAP No. 86 shall follow the fair value accounting approach detailed in that standard.

[14] Throughout this standard the use of the word "expire" is intended to capture all instances in which the derivative is no longer outstanding. It includes maturities, terminations, sales, and/or other closing transactions of a derivative.

(including whether there have been changes in strategy from the prior reporting period, along with detailed information on the changes), and assessment of hedging effectiveness and compliance with the "Clearly Defined Hedging Strategy" of ~~VM-21~~VM-01. Identification shall occur on whether the hedged item is intended to be fully hedged under the hedging strategy, or if the strategy is only focused on a portion of the liability characteristics or a portion of the interest rate sensitivity. Hedging strategies shall be identified as highly effective or not highly effective. If the strategy for a particular hedging relationship excludes a specific component of the gain or loss, or related cash flows, from the assessment of hedge effectiveness, details on the excluded components shall be disclosed.

b. Aggregate disclosure of the original cost and fair value of hedging instruments (including all instruments within a portfolio), including any net investment income, realized and unrealized gains and losses during the reporting period. Additionally, disclose the fair value of the hedged item, the change in fair value from the prior reporting period, and the portion of the fair value change attributed to the hedged risk.

c. Schedule showing the aggregate fair value change from the prior reporting period for the designated components for all hedging instruments, with identification of the fair value change reflected in realized gains, realized losses, deferred assets, and deferred liabilities. This schedule shall also show the current period amortization, including any accelerated amortization elected by the reporting entity, and the future scheduled amortization of the deferred assets and deferred liabilities. This schedule shall identify the fair value of the excluded components of the hedging instruments, and the fair value change for those components reflected in unrealized gain and unrealized loss.

d. For hedging strategies no longer identified as highly effective previously captured within scope of this standard, information on the determination of ineffectiveness, including variations from prior assessments resulting in the change from classification as a highly effective hedge. This disclosure shall also include:

i. Identification of outstanding hedging instruments previously captured within scope of this standard and subsequently identified as no longer part of a highly effective hedging strategy. This disclosure shall identify the date in which the domiciliary state was notified that the hedging strategy had been identified by the reporting entity as no longer highly effective.

ii. Deferred assets and deferred liabilities previously recognized when the program was highly effective, with a schedule that shows the amortization that would have occurred if the program had remained highly effective, the amount of original amortization as well as a schedule that details the amortization that will occur as the program is no longer highly effective (maximum five-year timeframe).

iii. Disclosure on whether the reporting entity is electing to accelerate amortization (in advance of the remaining scheduled amortization or the maximum five-year timeframe), along with amounts immediately recognized to unrealized gains/losses, and how the election impacts the scheduled amortization.

e. For situations in which the reporting entity has elected to terminate the hedging strategy and/or discontinue the special accounting provisions permitted within this SSAP, the reporting entity shall disclose the key elements in the reporting's entity' decision to terminate, identifying changes in the reporting entity's objectives or perspectives from initial application. This disclosure shall also include:

i. Identification of outstanding hedging instruments previously captured within scope of this standard and the accounting impact as a result of the termination/discontinuation. (Open derivative transactions no longer captured within the special accounting provision would be subject to the accounting and reporting guidance within SSAP No. 86.) This disclosure shall identify the date in which the domiciliary state was notified that the hedging strategy or the election to use the special accounting provision in this SSAP had been terminated.

ii. Deferred assets and deferred liabilities previously recognized under the hedging strategy and/or program, with a schedule that shows the amortization that would have occurred if the strategy and/or program had remained highly effective, as well as a schedule that details the amortization that will occur with the termination of the strategy and/or program (maximum five-year timeframe).

iii. Disclosure on whether the reporting entity is electing to accelerate amortization (in advance of the remaining scheduled amortization or the maximum five-year timeframe), along with amounts immediately recognized to unrealized gains/losses, and the resulting impact to the scheduled amortization.

Effective Date and Transition

24. This statement is effective January 1, 2020, with early adoption permitted January 1, 2019. The guidance in this SSAP is required to be applied on a prospective basis for qualifying hedge programs in place on or after the effective date. This prospective application prohibits deferred asset and deferred liability recognition from fair value fluctuations previously recognized as unrealized gains or losses that occurred prior to the effective date of the guidance.

25. Reporting entities that have previously received permitted or prescribed practices for qualifying hedge programs, resulting with the recognition of deferred assets/deferred liabilities from unrecognized fair value fluctuations, shall work with their domiciliary state regulator to determine the appropriate method in transitioning from previously approved permitted practices. The reporting entity shall include disclosure of the transition approach approved by the domiciliary state in their financial statements in the first year of application. The approved transition approach is not considered a permitted practice as long as the reporting entity is fully compliant with the provisions of this statement after implementation. After the effective date of this statement, domiciliary state provisions that differ from this statement must be disclosed as a permitted or prescribed practice pursuant to *SSAP No. 1—Accounting Policies, Risks & Uncertainties and Other Disclosures*.

REFERENCES

RELEVANT ISSUE PAPERS

- *Issue Paper No. 159—Special Accounting Treatment for Limited Derivatives*

EXHIBIT A – CALCULATION OF DEFERRED ASSET OR DEFERRED LIABILITY

Under the special accounting provisions within this issue paper, as detailed in paragraph 13.e., fair value fluctuations in the hedging instruments attributable to the hedged risk that do not offset the current period change in the hedged item (the change in the VM-21 reserve liability) can be recognized as deferred assets (admitted) and deferred liabilities.

The ability to recognize a deferred asset and deferred liability is limited to only the portion of the fair value fluctuation in the hedging instruments that is attributed to the hedged risk and does not immediately offset changes in the hedged item. As detailed in the standard, the hedged risk may be designated as a specific component of the hedged item. For example, if the variable annuity reserve benefits are matched to bonds, the hedged risk could only be the portion of interest rate risk remaining after the natural hedge based on the asset-liability matching.

Unless a different method has been approved by the domiciliary state commissioner, reporting entities shall utilize the following calculation (detailed in paragraph 13) for establishing the deferred asset:

13.e.i. Calculate the fair value gain or loss in the hedged item attributable to the hedged risk (Step 1);

13.e.ii. Express the fair value gain or loss calculated (Step 1) as a percentage of the change in the full-contract fair value (i.e., with all product cash flows) attributed to interest rate movements (Step 2)[15].

13.e.iii. Calculate the VM-21 liability change attributed to the hedged risk as the quantity calculated in Step 2 multiplied by the VM-21 liability change attributable to interest rate (Step 3).

13.e.iv. Establish the deferred asset or deferred liability in the amount of the fair value loss or (gain) of the designated hedging instruments attributed to the hedged risk less the VM-21 liability decrease or (increase) attributed to the hedged risk as calculated in Step 3.

13.e.v. Allocate an amount equal to the net deferred asset and deferred liability (net amount from all hedging strategies/programs captured within this guidance) to special surplus.

To illustrate the above calculation:

<u>Clearly Defined Hedging Strategy (CDHS) characteristics</u>

Hedged item	Rider claims less rider fees
Hedged risk	50% of the rho (first-order IR level sensitivity)

<u>Calculation of the deferred asset or liability</u>

Note: positive values = increase in liability

Fair value gain (loss) in hedged item attributable to interest rate movement	(500)
13.e.i. – Fair value gain (loss) in hedged item attributable to hedged risk	(250)

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

Hence, if the insurer were hedging per the CDHS perfectly, then the insurer should see a 250 fair value loss in the designated IR hedge instruments. To determine how much of that loss should be deferred:

Fair value gain (loss) in full-contract cash flows attributable to IR movement	(700)
13.e.ii. – Quantity calculated in 13.b.i. as a % of the (700) above	36%

VM-21 liability increase (decrease) from beginning of period to end of period	400
VM-21 liability increase (decrease) attributable to interest rate movements	(100)
13.e.iii. – VM-21 liability increase (decrease) attributable to the hedged risk	(36)

In this example, even though the VM-21 liability increased by 400 during the reporting period, interest rate movements actually contributed to a 100 *decrease*. The hedged risk (50% of the interest rate sensitivity of rider cash flows) accounts for 36% of this, or $36 of the liability decrease. As such, $36 of the fair value loss on the interest rate hedge instruments should be reflected immediately and the remainder deferred via a deferred asset equal in amount to 250 – 36 = 214.

13.e.iv. – Deferred asset (13.b.i less 13.b.iii) attributable to hedged risk	**(214)**

(This is shown as a negative – to be consistent with the decrease in VM-21 liability – but represents a deferred asset. Deferred assets reflect fair value losses.)

INDEX to the Statements of Statutory Accounting Principles

This index is a compilation of topics listed in the table of contents found at the beginning of each statement of statutory accounting principle (SSAP). Refer to the referenced SSAP table of contents for specific page location. Also included in this index are topics and terms deemed significant that are not specifically listed in a SSAP table of contents but are referenced within the content of the statement(s).

GLOSSARY to the Statements of Statutory Accounting Principles

The terms in this Glossary are common in most SSAPs. Some SSAPs may have terminology that is topic-specific and not intended to be applied to other topics.

Adjusted Carrying Value – Carrying value amount adjusted to remove any accrued interest and to add back any of the following amounts: individual nonadmitted amounts, individual valuation allowances (if applicable), and aggregate valuation allowance (if applicable). In effect, this is equivalent to the SAP Book Value. (Not to be confused with the old “book value” reported in the annual statement blanks for data years 2000 and prior.)

Amortized Cost – See SAP Book Value.

Call Provision – Option to buy an asset at a specified price within a specified period. (Also applicable to Call and Call Option.)

Capitation Arrangement – A compensation plan used in connection with some managed care contracts in which a physician or other medical provider is paid a flat amount, usually on a monthly basis, for each subscriber who has elected to use that physician or medical provider.

Credit Rating Provider – CRP stands for Credit Rating Provider and refers to the nationally recognized statistical rating organizations (NRSROs) on the NAIC Credit Rating Provider List discussed in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*.

Deferred Tax Asset – The deferred tax consequences attributable to deductible temporary differences and carryforwards. A deferred tax asset is measured using the applicable enacted tax rate and provisions of the enacted tax law. Deferred tax assets are subject to the admissibility criteria as outlined in *SSAP No. 101—Income Taxes*, paragraph 11.

Deferred Tax Liability – The deferred tax consequences attributable to taxable temporary differences. A deferred tax liability is measured using the applicable enacted tax rate and provisions of the enacted tax law.

Equity Method – Accounting valuation approach used in which the initial investment is adjusted in accordance with the ownership of another entity. Guidance for using the equity method, and for determining adjustments to the investment under the equity method is detailed in *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.

Fair Value – Fair value is defined in *SSAP No. 100~~R~~—Fair Value.*

Guaranteed Investment Contract or Guaranteed Interest Contract (GIC) – An insurer-issued funding vehicle, typically issued to retirement plans, under which the insurer accepts a deposit (or, less frequently, a series of deposits) from the purchaser and guarantees to pay a specified interest rate of return on the funds deposited during a specified period of time.

Morbidity Risk – The potential for a person to experience illness, injury, or other physical or psychological impairment, whether temporary or permanent. Morbidity risk excludes the potential for an individual’s death, but includes the potential for an illness or injury that results in death.

Mortality Risk – The potential for loss of life, with respect to a specified person or group of people. For reverse mortgages (*SSAP No. 39—Reverse Mortgages*), mortality risk is defined as the risk of loan payments extending beyond the borrower’s original projected life expectancy.

Nonforfeiture – The principle that some types of insurance contract have an economic value to which the contract owner is entitled even upon lapsation or surrender of the contract. A *nonforfeiture value* is the economic value that must be provided to the contract owner upon lapsation or surrender; it can take various forms, such as a lump-sum cash payment, an amount of paid-up insurance, an amount of term insurance, etc.

Nonoperating System Software – Application systems software such as language processors, library routines and debugging aides and other computer software are not considered operating system software.

Operating System Software – The operating system is a program or a series of programs controlling the data job and task management operations of a computer or a computer network through executive scheduling and monitoring. It increases the productivity of a computer installation by managing the allocation of all available computer resources including the control processing unit, main storage and input/output devices.

Original Cost – See SAP Book Value.

Par Value – The nominal (or face value) of a stock or bond.

Recorded Investment – The SAP Book Value (Adjusted Carrying Value) plus Accrued Interest.

SAP Book Value – Original cost, including capitalized acquisition costs and accumulated depreciation, unamortized premium and discount, deferred origination and commitment fees, direct write-downs, and increase/decrease by adjustment.

SAP Carrying Value (Amount) – The SAP book value plus accrued interest and reduced by any valuation allowance (if applicable) and any nonadmitted adjustment applied to the individual investment. Carrying value is used in the determination of impairment.

Statement Value – The SAP book value reduced by any valuation allowance and nonadmitted adjustment applied to an individual investment or a similar group of investments, e.g., bonds, mortgage loans, common stock.