Emerging Accounting Issues Working Group
Meeting Agenda
Fall 2009

Roll Call

<table>
<tr><td colspan="2">Iowa,
Chair</td><td colspan="2">New York,
Vice Chair</td></tr>
<tr><td>Alabama</td><td colspan="2">Louisiana</td><td>Texas</td></tr>
<tr><td>California</td><td colspan="2">Michigan</td><td>Virginia</td></tr>
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1. REVIEW and ADOPTION of NON-CONTESTED TENTATIVE POSITIONS:
(Page 2 of Status of Issues, Attachment A)

- ***INT 09-05T— EITF 08-3: Accounting by Lessees for Maintenance Deposits* (INT 09-05T)** (Attachment B) – Adopts, with modification, EITF 08-3. This INT clarifies that maintenance deposits are nonadmitted assets. Also clarifies that costs incurred by the lessee for maintenance on the leased item that do not increase the value and enhance the usefulness of the leased asset shall continue to be expensed when incurred pursuant to SSAP No. 19.

- ***INT 09-06T— EITF 08-8: Accounting for an Instrument (or an embedded feature) with a Settlement Amount That is Based on the Stock of an Entity's Consolidated Subsidiary (INT 09-6T))*** (Attachment C) – Rejects EITF 08-08 as not applicable to statutory accounting. The definition of a derivative under SSAP No. 86 does not encompass the FAS 133 exclusion addressed within this EITF.

  Interested Parties' Comments:
  Interested parties have no comment on these tentative consensuses

2. REVIEW and DISCUSSION of OTHER TENTATIVE POSITIONS:
(Page 2 of Status of Issues, Attachment A)

- ***INT 09-07T—Accounting for Re-Securitization of Loan-Backed and Structured Securities (e.g., ReREMICs) (INT 09-07T)***
  (Attachment D)

  Summary:
  During the Spring 2009 National Meeting, the Emerging Accounting Issues Working Group discussed the concept of ReREMIC transactions and whether an interpretation should be issued. During that meeting, the Working Group was under the impression that such transactions had yet to transpire, and agreed to postpone issuing an interpretation until knowledge that such transactions were occurring. Immediately following the meeting, the chair of the Emerging Accounting Issues Working Group received notice that ReREMIC transactions are occurring and are likely more prevalent than originally anticipated. As such, the chair directed NAIC staff to prepare an interpretation regarding ReREMIC transactions for exposure.

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In accordance with the existing guidance within SSAP No. 91 and SSAP No. 25, the Working Group agreed to expose a tentative consensus as follows:

- Under SSAP No. 91R, paragraph 5, a transfer of a group of financial assets, or a portion of a financial asset in which the transferor surrenders control over those financial assets shall be accounted for as a sale to the extent that consideration other than beneficial interests in the transferred assets is received in exchange. Therefore, to the extent that the consideration received in the exchange, is beneficial interests in the transferred assets, the transfer does not qualify for sale treatment. If the transaction does not qualify for sale treatment, it is accounted for as a secured borrowing in accordance with SSAP No. 91R.

- A transfer of a structured security to a related party, as described in the interpretation, and any variation thereof shall be accounted for under SSAP No. 25 for the portion of beneficial interests retained by the reporting entity. The portion of beneficial interests that are sold to unrelated and unaffiliated investors shall be accounted for under SSAP No. 91R. The Working Group tentatively concluded that the accounting and reporting guidance included in SSAP No. 25 shall overlay other statutory accounting guidance when the transfer or transaction involves a related or affiliated party. As a result, transfers of structured securities to a related party that qualify for sale treatment under paragraph 5 of SSAP No. 91R shall be transferred at fair value in accordance with SSAP No. 25.

- If a reporting entity intends to re-securitize structured securities for which an other-than-temporary impairment has not been recorded due to the decline in value that was determined to be interest related, the reporting entity should record an other-than-temporary impairment as of the date of the change in intent, prior to the date of re-securitization (ReREMIC).

- Fair value determinations for either accounting or impairment shall be in accordance with *INT 09-04: Application of the Fair Value Definition* and fair value shall not be based on the re-securitization transfer price.

During the exposure period, comments were received from the following:

- Interested Parties
- Barclays Capital
- Jackson National Life

The comments received have been grouped by topic within this agenda. Please refer to the comment letter compilation for the full comment letters provided by each responder.

1. Address Perceived Intent of Re-REMIC Transactions – Manipulate Statutory Guidance

Interested Parties:

We are concerned that there may be some views that a Re-REMIC is a transaction intended to manipulate statutory accounting guidance. To the contrary, we believe that a Re-REMIC structure is an accurate and logical way to correct an unanticipated anomaly arising out of the unprecedented economic situation. More importantly, we believe that a Re-REMIC structure is the most accurate means, albeit a costly and time consuming means, to reflect correctly the underlying risks of collecting cash flows of any particular RMBS. *Thus the Re-REMIC structure*

promotes transparency and strengthens appropriate regulation. (We note that, due to the costs incurred and the time required to effectuate a Re-REMIC, we have proposed a "notching" approach, but that proposal is not intended to replace the appropriate use of Re-REMICs for those insurance companies that choose to pursue them.)

Jackson National Life

In discussions with others in the industry, there seems to be a view that Re-REMIC transactions are merely a tool being used to manipulate statutory accounting guidance to avoid additional RBC charges on downgraded securities. We believe this view is incorrect, as there are numerous benefits to be derived from a Re-REMIC and, depending on a company's individual circumstances, these benefits can be quite substantial. In many cases, an immediate benefit is that a significant portion of the restructured securities are more liquid and, therefore, more marketable at higher values, with a higher rating for the upper tranches due to the expanded subordination support. This improved liquidity and marketability not only makes the securities easier to sell if the company so chooses, but also makes them eligible to be pledged as collateral for short-term borrowing or hedging strategies. Additionally, more favorable tax treatment can also be obtained through a Re-REMIC as opposed to outright selling of the downgraded securities.

2. Proposed Accounting Guidance for Re-REMICS

Interested Parties:

Since there has been no change in the underlying cash flows, there should be no gain or loss recognized at the time of the re-ratings. The newly created CUSIPs, being what is legally owned and more indicative of risk, should be reflected in Annual Statement Schedule D with the corresponding rating assigned by the rating agency. The NAIC classification and corresponding RBC charge should reflect the new ratings of the instrument. Book values of the existing security(ies) will be allocated to the new securities based on the relative fair values of the new securities for the purpose of the presentation in the Annual Statement Schedule D. The company, though, will be required to continue to track and monitor the cash flows to determine asset impairment write-downs in accordance with existing statutory guidance. The result of the re-ratings will be to record no gain or loss in earnings; to reflect a new RBC charge consistent with the underlying risk of collectability of cash flows based on the current ratings; and to continue to analyze the cash flows for impairment. We believe this accounting reflects the essence of the transaction and falls within the interpretations of existing statutory guidance.

As such, we believe that a Re-REMIC should be treated as a re-rating of an existing security with no corresponding accounting for the security as a sale or a related party transaction. This produces an accounting result that is consistent with the economics of the transaction and provides a capital charge commensurate with underlying risk of the security as reflected by the current and more accurate ratings.

In the event that a portion of the beneficial interests of a Re-REMIC is sold outside the insurance company, we believe the same general principles apply. We note that in those situations the loss related to the portion sold should be recognized pursuant to SSAP 91R, however it would be inappropriate (in accordance with SSAP 91R) to recognize the unrealized loss on the portion of the security retained.

A Re-REMIC is, in substance, a re-rating of an existing security. For 100% retained Re-REMICs, the change in the RMBS security form and re-rating should not be accounted for as a sale or a

related party transaction. The process of **creating** a Re-REMIC has no economic impact on the entity – the cash flows remain the same since the underlying security cash flows have not been affected by the re-tranching of the security. In the event that a portion of the 100% retained Re-REMIC is concurrently or subsequently sold, the accounting required by SSAP No. 91R would be required and appropriate.

Barclay's Capital:

Our opinion is that the appropriate statutory accounting treatment for all Re-REMIC transactions is already fully encompassed in SSAP 91R. Assuming the transaction meets the criteria for transfer or sale of the assets, we believe paragraphs 6 and 7 of SSAP 91R provide the appropriate statutory accounting treatment for the transaction. To the extent beneficial interests are sold to third parties, the insurer would recognize a gain or loss on the sale of those interests, depending upon the difference between the market value and allocated statutory basis of those interests. To the extent the insurer retains beneficial interests, we believe it is appropriate for the insurer to carry these interests at their allocated statutory basis and account for them as appropriate in accordance with the statutory accounting principles for the specific asset type.

Implicit in our reasoning for relying on SSAP 91R and rejecting the introduction of SSAP 25 and forced OTTI are several views:

1) We do not believe that a transaction where the insurer has conclusively surrendered control of the underlying assets (such as in a QSPE or similar passive structure) has the issues of potential accounting manipulation that the related party transactions envisioned in SSAP 25 were meant to encompass. Therefore, we see no reason to force fair-value accounting per SSAP 25 on Re-REMIC transactions.

2) We do not believe the "intent to securitize" should be equated with "intent to sell" and therefore trigger other-than-temporary impairment on the underlying securities placed in a REMIC. Quite to the contrary, we believe insurers are using Re-REMICs *precisely because they would like to retain exposure to the underlying MBS*. They are simply using the Re-REMIC as a means to obtain what are more economically justifiable RBC charges based on revised ratings. If anything, the types of securities placed in Re-REMICs have market prices that most insurers believe is far below their assessment of fundamental value. This is the reason insurers have not taken OTTI and also why they would not consider selling at current market levels.

3) Short-term Re-REMIC transactions that are clearly designed from the outset to be secured financings should never result in gain or loss realization on the underlying securities, just as a decision to "repo" securities would not trigger a statutory sale. Where the insurer has not surrendered control of the assets in the accounting sense, it should not be forced to take OTTI based on a false presumption that a decision to sell has occurred.

Insurers are focused on mortgage restructurings such as Re-REMICs for sound economic reasons related to ratings, capital charges, non-recourse financing and taxes. We believe the current statutory guidelines, primarily as delineated in SSAP 91R adequately address the appropriate statutory accounting for these transactions. We further believe that the potential changes introduced by INT 09-07 would force unnecessary full loss realization on otherwise highly beneficial transactions. This would lead many if not most insurers to do nothing to restructure their MBS exposure for fear of triggering onerous statutory accounting consequences. We view that likely outcome as very unfortunate, since restructuring transactions can be of significant economic benefit to the insurer in the current precarious financial environment.

Jackson National Life:

A Re-REMIC is often, in substance, a re-rating of existing securities. Therefore, beneficial interests retained in a Re-REMIC, should not be accounted for as a sale or a related party transaction. Other than the costs involved, the process of creating a Re-REMIC has no economic impact on the entity – the cash flows remain the same since the underlying securities' cash flows have not been affected by the re-tranching of the newly issued securities. For transactions qualifying for sale accounting under SSAP 91R, the reallocation of book value to beneficial interests retained and recognition of any loss for beneficial interests sold, as outlined in SSAP 91R would be required and appropriate. While securities should always be reviewed for impairment, intent to re-securitize is not equivalent to intent to sell and, accordingly, an OTTI write-down to fair value should not be required merely because of the Re-REMIC. We believe the accounting treatment outlined here is a fair and reasonable treatment based on the economics of the transaction and is consistent with the Statutory amortized cost basis of accounting.

We believe the proposed accounting treatment described in this letter is a fair and reasonable interpretation reflective of the economics of the transaction. We believe that the intent of the regulations and the accounting literature is not to penalize a company for entering into a transaction with clear economic benefits, but should be reasonably consistent with those economics.

3. Technical Comments by Paragraph

Proposed INT – Paragraph 2 – Interested Parties

The Re-REMIC itself is simply the legal structure for effecting the granular re-rating discussed above. Paragraph 2 of the Proposed INT states that "by re-securitizing the investments and reclaiming all or a portion of such securities, an entity might improve its financial position without any material change to the securities held and/or the cash flows of the underlying securities." In the case of a Re-REMIC in which the insurer retains 100% of the beneficial interests, the insurer receives new securities that represent the exact same cash flows as it previously owned. Since there has not been a transaction (and therefore there is no de-recognition event), no accounting is required. In the event that a portion of the beneficial interests are sold, the insurer continues to retain a proportional interest in the assets it held. The RBC relief provided by the Re-REMIC is not due to the accounting for the Re-REMIC, but is the result of a security's rating change, which is consistent with the purpose of RBC as it more accurately reflects the economic risk in the investment. RBC is often impacted by security rating changes (e.g. a corporate bond) even though there is no transaction recorded for accounting purposes.

Proposed INT – Paragraph 3 – Interested Parties

The securities received in a Re-REMIC are beneficial interests in the securitized assets. There are no additional assets received or liabilities assumed in a Re-REMIC. Consequently, we do not believe that the reference to paragraph 7(e) of SSAP 91R applies to Re-REMICs.

Proposed INT – Paragraph 6 – Interested Parties

We are uncertain as to the meaning of the last sentence in paragraph 6 of the Proposed INT. It appears to be a conclusion based upon paragraph 10 of SSAP 91R. However, we believe that paragraph 10 of SSAP 91R would apply in a situation where the insurer (a) sells a portion of the Re-REMIC tranches, but not enough to qualify for sale accounting under paragraph 5 or (b) is a sale with recourse. In that case, only the proceeds received (other than beneficial interests) in the

non-qualifying "sale" would be accounted for as a secured borrowing. As a result, we recommend that the last sentence of Paragraph 6 be omitted from the document since paragraph 10 of SSAP 91R would not apply to a situation in which 100% of the beneficial interests were retained. Alternatively the sentence should be modified to read "If the transaction does not qualify for sale treatment, it should be evaluated under Paragraph 10 of SSAP 91R to determine whether or not secured borrowing accounting would apply."

Proposed INT – Paragraph 6 – Jackson National Life

We believe that paragraph 5 of SSAP 91R clearly defines when sale treatment is appropriate for transactions in which consideration other than beneficial interests is received. However, the last sentence of paragraph 6 of the Proposed INT seems to expand on paragraph 10 of SSAP 91R and implies that any transaction that does not qualify as a sale would be accounted for as a secured borrowing. Paragraph 10 of SSAP 91R does not apply to transactions in which 100% beneficial interests are received. We believe the last sentence should be deleted or further clarified by replacing it with the sentence "If the transaction does not qualify for sale treatment, it should be evaluated under Paragraph 10 of SSAP 91R to determine whether or not secured borrowing accounting would apply."

Proposed INT – Paragraph 7 – Jackson National Life

In those situations in which a portion of the beneficial interests are sold outside the insurance company, we believe that the guidance provided in paragraphs 25 – 27 of SSAP 91R and paragraph 3 of SSAP 25 should be applied to determine whether or not SSAP 25 applies. As a practical matter, we believe that most securitization SPEs would be considered qualifying SPEs and not meet the control criteria delineated in paragraph 3 since these are passive entities, and should therefore not be considered an affiliate of the insurer. Accordingly, the mere use of an SPE should not automatically require that the transaction be accounted for as an affiliated transaction under SSAP 25. For securitizations using a qualifying SPE and qualifying for sale treatment under SSAP 91R, paragraph 5, the beneficial interests should be recorded as outlined in SSAP 91R, paragraphs 6 and 7, without reference to SSAP 25. The only reason a separate legal entity – the SPE – is used in these transactions is by legal necessity. For the portion of the beneficial interests retained in a securitization that qualifies as a sale, there is no intent to permanently transfer those cash flows to another entity. Therefore, we believe the INT should be changed as follows:

> "A transfer of a structured security qualifying as a sale under SSAP 91R, paragraph 5, using a qualifying SPE, as defined in SSAP 91R, paragraphs 25 - 27, shall be accounted for under SSAP 91R, which would allocate the statutory book values of the underlying securities to the new beneficial interests created, with any gain or loss being realized by the insurer only to the extent of any beneficial interests sold. Transfers of structured securities to an affiliate shall be accounted for in accordance with SSAP 25."

Proposed INT – Paragraph 7 – Interested Parties

- *100% of beneficial interests retained by insurance company*

As stated in our comments on paragraph 2 of the Proposed INT, we do not believe that this type of Re-REMIC is a de-recognition event – no accounting should be required for what in substance is the re-rating of a security. Accordingly, we do not believe that this is a transaction to which SSAP 25 would apply. The accounting consequences of any subsequent decision to sell a portion of the re-rated investments would be the result of the decision to sell, not the re-rating process.

- *Some beneficial interests sold outside the insurance company*

We believe the focus of paragraph 7 should be on those situations in which a portion of the beneficial interests are sold outside the insurance company. In those cases, we believe that the guidance provided in paragraph 3 of SSAP 25 should be applied to determine whether or not SSAP 25 applies. As a practical matter, we believe that most securitization SPV's would not meet the control criteria delineated in this paragraph since these are passive entities.

- *Reference to Risk-based Capital*

We do not believe that the INT should provide guidance on the application of risk-based capital charges. The guidance should apply to the accounting for the re-rating only. SSAP 25 guidance on transactions with related parties explicitly applies to "statutory accounting practices." Clouding the distinction between statutory accounting practices and the RBC calculation could have many unintended consequences. We also respectfully object to the reference in paragraph 7 regarding the authority of domestic state legislation. It is obvious that the ultimate authority for permitted transactions and for the associated accounting resides with the state of domicile. The role of the EAIWG, though, should be limited to the interpretation of existing SSAP's without consideration of specific state laws and actions.

Proposed INT – Paragraph 8 – Interested Parties

As stated in our comments on paragraph 2 of the Proposed INT, we do not believe that a Re-REMIC is a de-recognition event – no accounting should be required for what in substance is the re-rating of a security. To the extent that the insurer retains the beneficial interests received in the Re-REMIC, there has not been a change in intent with regards to the underlying securities. To the contrary, the re-rating enhances the insurer's ability to continue to hold the investment. Should an insurer intend to sell a portion of the beneficial interests, we agree that the insurer should record any other-than-temporary impairment ("OTTI") on the portion being disposed as of the date of the change in intent.

Proposed INT – Paragraph 8- Jackson National Life

We believe the intent to securitize existing securities should not be equated with an intent to sell those securities. A valid reason for forming a Re-REMIC is to re-securitize existing securities where individual ratings no longer accurately reflect the economic risk in a security. As a consequence, the amount of risk-based capital held based on the rating of that security may be significantly overstated relative to the economic risk. The reason Jackson and other insurers are considering these transactions is because we believe the investments are good long-term investments that are not properly rated under the current system. We do not have an intent to sell the securities but, rather, seek to achieve a fair rating. To the extent that an insurer retains the beneficial interests received in the Re-REMIC, there has not been a change in intent with regard to the underlying securities. To the contrary, a re-rating enhances the insurer's ability to continue to hold the investment. If an insurer has not taken an OTTI charge on specific assets because they do not expect a permanent economic loss due to impaired cash flows, we do not believe that a securitization transaction should force them to do so. Should an insurer intend to sell a portion of the beneficial interests, it is clear that the insurer should record any loss on the interests sold to a third party. This is consistent with GAAP (GAAP codification topic 860-10-35 paragraph 5), which permits an entity to recognize a loss on only the portion of a securitization that it plans to sell. Given that SSAP 98, and the recently proposed SSAP 43R, attempt to align statutory OTTI

rules for RMBS with GAAP, we do not believe that the Proposed INT should require accounting that is inconsistent with GAAP, including OTTI write-downs to fair value prior to transfer to the SPE for the portion of the beneficial interests retained after the re-securitization.

Comment letters received also included educational guidance and background information on Re-REMIC Transactions. Please see the comment letters for this information.

4. Review of OUTSTANDING ISSUES:
(Page 1 of Status of Issues, Attachment A)

- ***Electronic Prescribing Transaction Service Fees***
(Attachment E)

Summary:
This Agenda Submission Form was provided by Millennium Consulting Services, LLC, and requests an interpretation to *SSAP No. 55—Unpaid Claims, Losses, and Loss Adjustment Expenses* (SSAP No. 55) to indicate that third-party e-prescription service fees shall be accounted for as a hospital/medical claims expense. In addition to providing information to support the position that these fees shall be considered medical claims costs, this request indicates that such accounting treatment is necessary to ensure consistent accounting with the way that pharmacy benefit managers are able to allocate comparable cost as part of their 'service fees' agreement.

- ***Statutory Accounting for Loans Received Under the Federal TALF Program***
(Attachment F)

Summary:
This agenda submission form was prepared to address questions received on the reporting of loans received, and provided collateral, under the Federal Term Asset-Backed Securities Lending Facility (TALF). Under the TALF program, the Federal Reserve Bank of New York will make non-recourse loans (three to five year terms for ABS based on asset class, and ten-year terms for CMBS), prepayable at the option of the borrower, secured by eligible collateral. All U.S. companies that own eligible collateral may borrow from the TALF, provided they maintain an account relationship with a primary dealer in US Treasury Securities. Foreign-owned US entities are also eligible, with certain restrictions. This agenda item addresses the issue of whether TALF loans received and the corresponding collateral provided by the reporting entity shall be reported net within the statutory financial statements.

5. Review of OUTSTANDING ISSUES PREVIOUSLY ADDRESSED:
(Page 2 of Status of Issues; Attachment A)

There are no items planned for discussion under this agenda item.

6. Other items to consider for discussion at open meeting:

- **Approve Interim Minutes**

  - June 13, 2009 – Email vote to expose interpretation on re-securitizations (Attachment G)

Comment deadline for items exposed for comment is October 28, 2009.

NOTE: The comment letters (34 pages) are included as Attachment H.

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Emerging Accounting Issues Working Group
Summary of Outstanding Issues
August 10, 2009

Title	Description	SSAP	Raised by	Form B Date	Status	Discussion Planned
Line of Credit Issued to Parent Entity; Guaranteed by Reporting Entity	Reporting Entity Guarantees LOC of SCA	5	Industry Question	8/22/02	Issue deferred pending SAPWG assessment of FIN 45.	Not scheduled
EITF 03-12	Impact of FASB Interpretation No. 45 on Issue No. 95-1	5	GAAP Level C	Pending	Issue deferred pending SAPWG assessment of FIN 45.	Not scheduled
EITF 06-2	Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43	11	GAAP Level C	5/2007	June 2007 - Action on this item was deferred, pending conclusion by the SAPWG on issue 2006-30 regarding FAS 158, pensions, and nonvested employee benefits.	Not scheduled
EITF 06-5	Accounting for Purchases of Life Insurance-Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin 85-4	21	GAAP Level C	7/2007	Fall 2007 - Working Group referred this issue to the Statutory Accounting Principles Working Group to determine if an interpretation of the existing guidance is sufficient, or if additional detail should be included in SSAP No. 21 to provide clarity.	Not Scheduled
Clarification of SSAP No. 85	Requests interpretation indicating that disease and case management services provided by a license clinical professional shall be treated as a medical expense.	85	DMAA: The Care Continuum Alliance	2/4/09	Spring 2009 - Working Group referred this item to the Accident and Health Working Group. On 6/5/09, the DMAA requested that this be deferred as they are rediscussing the matter. The AHWG has postponed discussion until advised by the DMAA.	Not Scheduled
FSP EITF 99-20-1: Amendments to the Impairment Guidance of EITF Issue 99-20	In Spring 2009, the SAPWG requested the EAIWG to consider revising INT 06-07 to include guidance from paragraphs 9 and 10 of FSP EITF 99-20-1	INT 06-07	SAPWG	TBD	Spring 2009 - Referred by SAPWG. EAIWG to discuss during a future meeting	Not Scheduled
Electronic Prescribing Transaction Service Fees	*Requests clarification of SSAP No. 55 to clarify that third party e-prescription services "transactions service fees" are accounted for as a hospital/medical claims expense.*	*55*	*Millennium Consulting Services, LLC*	*8/10/2009*	*Fall 2009 - Initial Discussion Planned*	*Fall 2009*
Statutory Accounting for Loans Received Under the Federal TALF Program	*Proposes tentative consensus indicating that loans received, and collateral provided, under the TALF program do not meet the SSAP No. 64 criteria for offset. Furthermore, recommends that no specific provisions be established within statutory accounting principles that permit a net reporting presentation for transactions under the TALF program.*	*64*	*NAIC Staff*	*9/1/2009*	*Fall 2009 - Initial Discussion Planned*	*Fall 2009*

Italics indicates that item was added since last National Meeting

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Emerging Accounting Issues Working Group
Summary of Tentative Issues
August 10, 2009

INT	Date of Tentative	SSAP	Raised by	Description	Status	Discussion Planned
INT 00-09	3/13/2000	10	EITF 98-11	Accounting for Acquired Temporary Differences in Certain Purchase Transactions That Are Not Accounted for as Business Combinations	Rejected EITF consensus - Form B being redrafted to include certain provisions of EITF consensus	Deferred pending staff revision of Form B
INT 01-30	10/16/2001	61/62	NAIC Staff	SSAP No. 61/62 Nonadmission and the Ninety Day Rule	Tentative - 90 day nonadmission criteria applies to all reinsurance balances	Issue referred to SAPWG for study of consistency among P/C, life and health insurers.
INT 02-12	6/9/2002	61	NAIC Staff	Determining Policies to be Included in the Existing Block of Business for Purposes of Applying the Accounting Specified in Appendix A-791	Tentative – Policies issued prior to the beginning of the quarter in which the binding letter of intent or reinsurance agreement is executed shall be considered to be part of the existing block of business for purposes of applying the accounting guidance in A-791, paragraph 3.	Deferred pending revision clarification of tentative position by NAIC staff
INT 06-06	6/11/2006	Various	NAIC Staff	EITF 00-12: Accounting by an Investor for Stock-Based Compensation Granted to Employees of an Equity Method Investee	June 2006 Exposed a tentative consensus to adopt EITF 00-12 with modification. In September 2006, this issue was deferred pending development of guidance on FAS 123 (R) .	Deferred
INT 07-04	9/29/2007	14	GAAP Level C	EITF 06-4: Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements	Fall 2007 - Issued tentative consensus to adopt EITF 06-04 with modifications to the transition guidance to reference appropriate statutory accounting for a change in accounting principle. Winter 2007 - Issue was deferred pending the SAPWG review of FAS 158.	Deferred
INT 07-05	9/29/2007	14	GAAP Level C	EITF 06-10: Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements	Fall 2007 - Working Group issued a tentative consensus to adopt EITF 06-10 with modifications to the transition guidance to reference statutory accounting for a change in accounting principle. Winter 2007 Issue was deferred and interested parties agreed to provide further information. Spring 2008 - Issue was referred to the SAPWG for consideration, recommending that SSAP 21, paragraph 6, be modified to provide additional details on the elements to be considered in determining admissibility of assets related to ownership and control of life insurance arrangements.	Referred to SAPWG on 3/29/08
INT 09-5	6/13/2009	22	GAAP Level C	EITF 08-3: Accounting by Lessees for Maintenance Deposits	Summer 2009 - Issued tentative consensus adopting, with modification, EITF 08-3. Tentative consensu clarifies that refundable maintenance deposits shall be accounted for as a nonadmitted asset. Costs that do not increase the value or usefulness of the asset shall be expensed when incurred under SSAP No. 19.	**Fall 2009**
INT 09-06	6/13/2009	86	GAAP Level C	EITF 08-8: Accounting for an Instrument (or an embedded feature) with a Settlement Amount That is Based on the Stock of an Entity's Consolidated Subsidiary	Summer 2009 - Issued tentative consensus rejecting EITF 08-8 as not applicable to statutory accounting. (Item is not considered applicable as SSAP No. 86 did not adopt the FAS 133 exceptions for the definition of a derivative.)	**Fall 2009**
INT 09-07	6/13/2009	91 & 25	NAIC Staff	Accounting for Re-Securitizations of Loan-Backed and Structured Securities (e.g., ReREMICs)	Summer 2009 - Issued tentative consensus on the basis of existing guidance in SSAP No. 91R and SSAP No. 25.	**Fall 2009**

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Interpretation of the Emerging Accounting Issues Working Group

INT 09-05: EITF 08-3: Accounting by Lessees for Maintenance Deposits

INT 09-05 Dates Discussed

June 13, 2009;

INT 09-05 References

SSAP No. 20—Nonadmitted Assets

SSAP No. 22—Leases

SSAP No. 29—Prepaid Expenses

SSAP No. 19—Furniture, Fixtures, and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee, Depreciation of Property and Amortization of Leasehold Improvements

INT 09-05 Issue

1. EITF 08-3 clarifies how a lessee shall account for a maintenance deposit under an arrangement accounted for as a lease. Particularly, this guidance addresses the issue when maintenance deposits paid by a lessee under an arrangement accounted for a lease are refunded only if the lessee performs specified maintenance activities. Guidance included within paragraphs 2 and 4 of EITF 08-3 identifies such maintenance arrangements and the accounting issue as follows:

> 2. Under certain equipment lease agreements, a lessee is legally or contractually responsible for repair and maintenance of the leased asset throughout the lease term. Additionally, certain lease agreements include provisions requiring the lessee to make deposits to the lessor in order to financially protect the lessor in the event the lessee does not properly maintain the leased asset.
>
> 4. In some cases, the total cost of cumulative maintenance events over the term of the lease is less than the cumulative deposits, resulting in excess amounts on deposit at the expiration of the lease. In those cases, some lease agreements provide that the lessor is entitled to retain such excess amounts; whereas other agreements specifically provide that, at the expiration of the lease agreement, such excess amounts are returned to the lessee (refundable maintenance deposit). Refundable maintenance deposits are accounted for as a deposit but diversity has developed on the accounting for maintenance deposits that may not be refunded (if the lessee does not perform the specified maintenance activities).

INT 09-05 Discussion

2. Guidance in paragraphs 8 and 9 of EITF 08-3 identifies that maintenance deposits shall be accounted for as a deposit asset. Furthermore, lessees shall continue to evaluate whether it is probable that an amount on deposit will be returned to reimburse the costs of the maintenance activities incurred by the lessee. When an amount on deposit is less than probable of being returned, it shall be recognized as additional expense. When the underlying maintenance is performed, the maintenance costs shall be expensed or capitalized in accordance with the lessee's maintenance accounting policy.

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3. Guidance is included within *SSAP No. 20—Nonadmitted Assets* (SSAP No. 20), pursuant to the Statement of Concepts, that specifically defines nonadmitted assets. Pursuant to that guidance, assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or third party interests should not be recognized on the balance sheet. Guidance is also included within *SSAP No. 29—Prepaid Expenses* (SSAP No. 29) that specifies that prepaid expenses shall be reported as nonadmitted assets and charged against unassigned funds. In accordance with the premise established by existing SSAPs and the Statement of Concepts, the Working Group reached a tentative consensus to adopt EITF 08-3 with modification to require reimbursable deposits to be reflected as nonadmitted assets. As such, deposits paid to the lessor, reimbursable when the lessee incurs costs for lease maintenance activities, shall be recorded as nonadmitted assets. When the amount on deposit is less than probable of being returned, the deposit shall be recognized as an additional lease expense.

4. In issuing this tentative consensus, the Working Group confirmed that costs incurred by the lessee for maintenance on the leased item that do not increase the value and enhance the usefulness of the leased asset shall continue to be expensed when incurred pursuant to *SSAP No. 19—Furniture, Fixtures, and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements* (SSAP No. 19).

INT 09-05 Status

5. Further discussion is planned.

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Interpretation of the Emerging Accounting Issues Working Group

INT 09-06: EITF 08-8: Accounting for an Instrument (or an embedded feature) with a Settlement Amount That is Based on the Stock of an Entity's Consolidated Subsidiary

INT 09-06 Dates Discussed

June 13, 2009;

INT 09-06 References

SSAP No. 86—Accounting for Derivative Instruments and Hedging, Income Generation, and Replication (Synthetic Asset) Transactions

INT 09-06 Issue

1. EITF 08-8 clarifies whether a financial instrument for which the payoff to the counterparty is based, in whole or in part, on the stock of an entity's consolidated subsidiary is indexed to the reporting entity's own stock and therefore should not be precluded from qualifying for the first part of the scope exclusion in paragraph 11(a) of *FAS 133, Accounting for Derivative Instruments and Hedging Activities* (FAS 133) or from being within the scope of *EITF Issue 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock* (EITF 00-19).

2. EITF 08-8 applies to freestanding financial instruments (and embedded features) for which the payoff to the counterparty is based, in whole or in part, on the stock of a consolidated subsidiary. EITF 08-8 also applies to those instruments (and embedded features) in the consolidated financial statements of the parent, whether the instrument was entered into by the parent or the subsidiary

INT 09-06 Discussion

3. Pursuant to the guidance in EITF 08-8, freestanding financial instruments (and embedded features) for which the payoff to the counterparty is based, in whole or in part, on the stock of a consolidated subsidiary are not precluded from being considered indexed to the entity's own stock in the consolidated financial statements of the parent if the subsidiary is a substantive entity. If the subsidiary is not a substantive entity, the instrument or embedded feature would not be considered indexed to the entity's own stock.

4. Statutory Accounting guidance for derivative instruments is included within *SSAP No. 86—Accounting for Derivative Instruments and Hedging Activities* (SSAP No. 86). This SSAP adopted the framework established by *FASB Statement 133, Accounting for Derivative Instruments and Hedging Activities* (FAS 133) for fair value and cash flow hedges. Technical guidance included within FAS 133 is adopted for statutory accounting to the extent such guidance is consistent with the statutory accounting approach included within SSAP No. 86

5. The guidance within SSAP No. 86 provides the definition of a derivative instrument. Although this statement adopts the 'framework' of FAS 133, the statutory definition of a derivative in SSAP No. 86 does not encompass the FAS 133 exclusion for items issued or held by the reporting entity that are both (a) indexed to its own stock and (b) classified in stockholders' equity in its statement of financial position. As such, instruments that have these characteristics are considered derivatives in accordance with the guidance in SSAP No. 86.

6. In addition to the variation of the definition of a derivative between GAAP and statutory accounting, the GAAP concept of consolidation has previously been rejected for statutory accounting. The guidance within *AICPA Accounting Research Bulletin 51, Consolidated Financial Statements* (ARB 51) was rejected within *SSAP No. 3—Accounting Changes and Corrections of Errors* (SSAP No. 3).

7. As the definition of a derivative in SSAP No. 86 does not encompass the FAS 133 exclusion for items issued or held by the reporting entity that are both (a) indexed to its own stock and (b) classified in stockholders' equity in its statement of financial position, and as the concept of consolidation has previously been rejected for statutory accounting, the Working Group reached a tentative consensus to reject EITF 08-8 as not applicable for statutory accounting.

INT 09-06 Status

8. Further discussion is planned.

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Interpretation of the Emerging Accounting Issues Working Group

INT 09-07: Accounting for Re-Securitizations of Loan-Backed and Structured Securities (e.g., ReREMICs)

INT 09-07 Dates Discussed

June 13, 2009

INT 09-07 References

SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties (SSAP No. 25)
SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 91R)
SSAP No. 43—Loan-backed and Structured Securities (SSAP No. 43)
SSAP No. 98—Treatment of Cash Flows When Quantifying Changes in Valuation and Impairments, an Amendment of SSAP No. 43—Loan-backed and Structured Securities (SSAP No. 98)
INT 06-07: Definition of Phrase "Other Than Temporary" (INT 06-07)

INT 09-07 Issue

1. Insurance reporting entities are active investors in various loan-backed and structured securities, such as residential mortgage backed securities (RMBSs). A significant decrease in the volume and level of market activity for these securities, coupled with large rating downgrades, have recently resulted in severe downward pressure on valuation. Valuation has also been impacted by changes in fair value determination for GAAP financial statements that increased transparency, which added further to the downward pressure on valuation. In addition, *SSAP No. 98—Treatment of Cash Flows When Quantifying Changes in Valuation and Impairments, an Amendment of SSAP No. 43—Loan-backed and Structured Securities* (SSAP No. 98) has also been adopted effective September 30, 2009 and is related to impairment of these securities. Holders of RMBS are experiencing many risks, three of which are related to accounting, reporting and solvency; risk of impairment, risk of greater regulatory capital requirements and the risk of future ratings downgrades by the rating agencies.

2. A basic description of the re-securitization (ReREMIC – re-securitization of real estate mortgage investment conduit) of a RMBS or other securities takes place when a reporting entity transfers ownership of the structured security to a special-purpose entity, which in turn transfers to a newly formed trust created specifically for the transfer/transaction. The trust issues new structured securities with differing pay classes (distributions of risk and/or cash flows) derived from the cash flows from the underlying structured securities. The newly created structured securities receive new CUSIPs and are intended to be individually rated by one or more rating agencies. Although re-securitizations may be designed to be sold to an outside, unrelated or unaffiliated entity, this interpretation addresses situations when some or all of the structured securities are taken back by the reporting entity. By re-securitizing the investments and reclaiming all or a portion of such securities, an entity might improve its financial position without any material change to the securities held and/or the cash flows of the underlying securities.

3. *SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SSAP No. 91R) provides the following guidance related to transfers within the scope of the SSAP **(bolding added for emphasis)**:

2. See SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties (SSAP No. 25) **for additional accounting and disclosure guidance concerning related party transactions**.

5. Except as discussed in paragraphs 55 and 87, a transfer of a group of financial assets, or a portion of a financial asset in which the transferor surrenders control over those financial assets shall be accounted for as a sale to the extent that consideration **other than beneficial interests in the transferred assets is received in exchange**. The transferor has surrendered control over transferred assets if, and only if, all of the following conditions are met:

a. The transferred assets have been isolated from the transferor—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership (see paragraphs 16 and 17);

b. Either (i) each transferee obtains the right, free of conditions that constrain it from taking advantage of that right (see paragraphs 18-22), to pledge or exchange the transferred assets or (ii) the transferee is a qualifying special-purpose entity as defined in paragraph 24 and the holders of beneficial interests in that entity have the right, free of conditions that constrain them from taking advantage of that right (see paragraph 23), to pledge or exchange those interests and no condition both constrains the transferee (or holder) from taking advantage of its right to pledge or exchange and provide more than a trivial benefit to the transferor; and

c. The transferor does not maintain effective control over the transferred assets through (i) an agreement that both entitles and obligates the transferor to repurchase or redeem them before their maturity (see paragraphs 37-39) or (ii) the ability to unilaterally cause the holder to return specific assets, other than through a cleanup call (see paragraphs 21 and 22 and 40-44).

6. Upon completion of any transfer of financial assets, the transferor shall:

a. Initially recognize and measure at fair value, if practicable, servicing assets and servicing liabilities assumed under a separate contractual obligation to service financial assets (see paragraph 50)

b. Allocate the previous carrying amount between the assets sold, if any, and the interests that continue to be held by a transferor, if any, based on their relative fair values at the date of transfer (see paragraphs 48 and 49).

c. Continue to carry in its balance any interests it continues to hold in the transferred assets, including, if applicable, beneficial interests in assets transferred to a qualifying special-purpose entity in a securitization, and undivided interests continued to be held by the transferor (see paragraphs 7c., 48 and 49; and

7. Upon completion of a transfer of financial assets that satisfies the conditions to be accounted for as a **sale** (see paragraph 5), the transferor (seller) shall:

a. Eliminate the transferred assets from the balance sheet;

b. Allocate the previous carrying amount of the transferred assets to the securities representing beneficial interests continued to be held by the reporting entity, if any, and the securities representing beneficial interests not continued to be held, if any, based on the relative fair values of the transferred assets at the date of transfer;

c. Record in its balance sheet, the allocated carrying value of the securities representing beneficial interests continued to be held interests in the assets (e.g., loan-backed securities). Subsequent to the transfer of assets:

i. Retained residuals are to be carried at fair value with the difference between fair value and the allocated cost basis recognized as an unrealized gain or loss;

ii. Beneficial interests continued to be held shall be accounted for in accordance with the statutory accounting principles for the specific asset type (e.g., bonds shall be accounted for in accordance with SSAP No. 26—Bonds, excluding Loan–backed and Structured Securities, loan-backed securities shall be accounted for in accordance with SSAP No. 43—Loan-backed and Structured Securities, preferred stock in accordance with SSAP No. 32—Investments in Preferred Stock (excluding investments in preferred stock of subsidiary, controlled, or affiliated entities).

d. Recognize all additional assets obtained (i.e., other than the securities representing beneficial interests continued to be held which are recorded in accordance with 7 c.) and liabilities incurred in consideration as proceeds of the sale;

e. **Initially measure such additional assets obtained and liabilities incurred in the sale at fair value** (see Glossary to the Statements of Statutory Accounting Principles), or if it is not practicable to estimate the fair value of an asset or a liability, apply alternative measures (paragraph 49); and

f. For reporting entities required to maintain an Interest Maintenance Reserve (IMR), the accounting for realized and unrealized capital gains and losses shall be in accordance with SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve (SSAP No. 7). 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).

10. If a transfer of financial assets in exchange for cash or other consideration **(other than beneficial interests in the transferred assets)** (a) does not meet the criteria for a sale in paragraph 5, or (b) is a sale of receivables with recourse (see paragraph 87); the transferor and transferee shall account for the transfer as a secured borrowing with pledge of collateral (see paragraph 12).

37. Reporting entities that have qualifying special-purpose entities as affiliates shall carry their investment in such entity at its underlying statutory book value in accordance with SSAP No. 97. **Additionally, transactions entered involving affiliated qualifying special-purpose entities are subject to the provisions of SSAP No. 25**.

SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties (SSAP No. 25) provides the following guidance and reasons for such requirements **(bolding added for emphasis)**:

1. Related party transactions are subject to abuse because reporting entities may be induced to enter transactions that may not reflect economic realities or may not be fair and reasonable to the reporting entity or its policyholders. As such, **related party transactions require specialized accounting rules and increased regulatory scrutiny**. This statement

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establishes statutory accounting principles and disclosure requirements for related party transactions.

3. 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 (SSAP No. 48). Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity method for all such investments. An affiliate is any person that is directly or indirectly, owned or controlled by the same person or by the same group of persons, that, directly or indirectly, own or control the reporting entity.

11. An arm's-length transaction is defined as a transaction in which willing parties, each being reasonably aware of all relevant facts and neither under compulsion to buy, sell, or loan, would be willing to participate. A transaction between related parties involving the exchange of assets or liabilities shall be designated as either an economic transaction or non-economic transaction. An economic transaction is defined as an arm's-length transaction which results in the transfer of the risks and rewards of ownership and represents a consummated act thereof, i.e., "permanence." The appearance of permanence is also an important criterion in assessing the economic substance of a transaction. In order for a transaction to have economic substance and thus warrant revenue (loss) recognition, it must appear unlikely to be reversed. If subsequent events or transactions reverse the effect of an earlier transaction prior to the issuance of the financial statements, the reversal shall be considered in determining whether economic substance existed in the case of the original transaction. Subsequent events are addressed in SSAP No. 9—Subsequent Events. An economic transaction must represent a bonafide business purpose demonstrable in measurable terms. A transaction which results in the mere inflation of surplus without any other demonstrable and measurable betterment is not an economic transaction. The statutory accounting shall follow the substance, not the form of the transaction.

13. A transaction between related parties may meet the criteria for treatment as an economic transaction at one level of financial reporting, but may not meet such criteria at another level of financial reporting. An example of such a transaction is a reporting entity purchasing securities at fair value from an affiliated reporting entity that carried the securities at amortized cost. This transaction meets the criteria of an economic transaction at this level of financial reporting, and therefore, the selling reporting entity would record a gain and the acquiring reporting entity would record the securities at their cost (fair value on the transaction date). At the common parent level of reporting, this transaction has resulted in the mere inflation of surplus, and therefore, is a non-economic transaction. The parent reporting entity shall defer the net effects of any gain or increase in surplus resulting from such transactions by recording a deferred gain and an unrealized loss. The deferred gain shall not be recognized by the parent reporting entity unless and until arms-length transaction(s) with independent third parties give rise to appropriate recognition of the gain.

14. A non-economic transaction is defined as any transaction that does not meet the criteria of an economic transaction. Similar to the situation described in paragraph 13, transfers of assets from a parent reporting entity to a subsidiary, controlled or affiliated entity shall be treated as non-economic transactions at the parent reporting level because the parent has continuing indirect involvement in the assets.

15. When accounting for a specific transaction, reporting entities shall use the following valuation methods:

a. Economic transactions between related parties shall be recorded at **fair value** at the date of the transaction. To the extent that the related parties are affiliates

under common control, the controlling reporting entity shall defer the effects of such transactions that result in gains or increases in surplus (see paragraph 13);

b. Non-economic transactions between reporting entities, which meet the definition of related parties above, shall be recorded at the **lower of existing book values or fair values** at the date of the transaction;

c. Non-economic transactions between a reporting entity and an entity that has no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or it's affiliates, shall be recorded at the **fair value** at the date of the transaction; however, to the extent that the transaction results in a gain, that gain shall be deferred until such time as permanence can be verified;

d. **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**.

Examples of transactions deemed to be non-economic include security swaps of similar issues between or among affiliated companies, and swaps of dissimilar issues accompanied by exchanges of liabilities between or among affiliates.

4. *INT 06-07: Definition of Phrase "Other Than Temporary"* provides the following guidance related to determination of whether an other-than-temporary impairment has occurred **(bolding added for emphasis)**:

5. An interest related impairment should be deemed other-than-temporary when an investor has the **intent to sell** an investment, at the reporting date, before recovery of the cost of the investment…

5. The Accounting Issues are as follows:

Issue 1 – If the consideration received is beneficial interests in the transferred assets, is sale accounting treatment permitted?

Issue 2 – Is the transfer of the original structured security to a related party SPE, accounted for at fair value in accordance with SSAP No. 25? If the transaction were structured to qualify for sale treatment under SSAP No. 91R, is it appropriate to follow the guidance in paragraph 6 and 7?

Issue 3 – If a structured security was not considered other-than-temporarily impaired because the impairment was considered interest related, what impact does the intent to re-securitize have on impairment analysis?

INT 09-07 Discussion

6. The Working Group tentatively notes that under SSAP No. 91R, paragraph 5, that to the extent that the transfer of a group of financial assets, or a portion of a financial asset in which the transferor surrenders control over those financial assets shall be accounted for as a sale **to the extent that consideration other than beneficial interests in the transferred assets is received in exchange**. Therefore, to the extent that the consideration received in the exchange, is beneficial interests in the transferred assets, the transfer **does not** qualify for sale treatment. If the transaction does not qualify for sale treatment, it is accounted for as a secured borrowing in accordance with SSAP No. 91R.

7. The Working Group reached a tentative consensus on Issue 2 that a transfer of a structured security to a related party as described above and any variation shall be accounted for under SSAP No. 25 for the portion of beneficial interests retained by the reporting entity. The portion of beneficial interests that are sold to unrelated and unaffiliated investors shall be accounted for under SSAP No. 91Rs. The Working Group concluded that the accounting and reporting guidance included in SSAP No. 25 shall overlay other statutory accounting guidance when the transfer or transaction involves a related or affiliated party. As a result, transfers of structured securities to a related party that qualify for sale treatment under paragraph 5 of SSAP No. 91R shall be transferred at fair value in accordance with SSAP No. 25. Care should be taken in constructing these transactions. Based upon the facts and circumstances for the transaction, if the regulator determines that sale treatment was obtained merely to avoid statutory accounting practices, related to the determination of risk-based capital levels, the transaction shall be accounted for under SSAP No. 25, paragraph 15d. (Domestic state legislation for transactions within an insurance holding company system – commonly defined as two or more affiliated persons, one or more of which is an insurer – may require commissioner notification or approval, as well as prohibit transactions designed to circumvent statutory thresholds and the resulting domestic commissioner review.)

8. The Working Group reached a tentative consensus on Issue 3 that if the reporting entity intends to re-securitize structured securities for which an other-than-temporary impairment has not been recorded due to the decline in value was determined to be interest related, the reporting entity should record an other-than-temporary impairment as of the date of the change in intent, prior to the date of re-securitization (ReREMIC).

9. The Working Group also expressed fair value determinations for either accounting or impairment shall be in accordance with *INT 09-04: Application of the Fair Value Definition* and that fair value shall not be based on the re-securitization transfer price.

INT 09-07 Status

10. Further discussion is planned.

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Emerging Accounting Issues Working Group
Agenda Submission Form
Form B

Issue: Electronic Prescribing Transaction Service Fees.

Clarification of SSAP No. 55 - *Unpaid Claims, Losses and Loss Adjustment Expenses,* and *SSAP No. 85 - Claim Adjustment Expenses, Amendments to SSAP No. 55 - Unpaid Claims, Losses and Loss Adjustment Expenses* (SSAP No. 85) as they relate to electronic prescribing transaction service fees.

Description of Transaction/Event/Issue:

Electronic prescribing or "e-prescribing" is defined as "the transmission, using electronic media, of prescription or prescription-related information, between a prescriber, dispenser, PBM, or health plan in either direction or through an intermediary, including an e-prescribing network. It includes, but is not limited to, two-way transmission between the point of care and the dispenser."[1]

E-prescribing utilizes an electronic hand-held "e-prescribing device or electronic portal" and "support software" that provides the end-to-end electronic connectivity between a physician practice and one or more pharmacies. The functionality offered by an e-prescribing device comes in various degrees of sophistication, ranging from simple devices that serve only as stand-alone electronic prescription writers to more sophisticated devices offering greater functionality that include clinical decision support to aid providers in safer, more informed prescribing such as access to information on drug-drug interactions, drug-allergy interactions, patient medication history, pharmacy eligibility, formulary (which specifies a patient's drug coverage), and benefits information. "By replacing handwritten prescriptions, e-prescribing saves lives by improving patient safety and saves money by eliminating the inefficiencies of manual processes. It achieves this through clinical decision support at the point of care and automating the transmission of data."[2]

Currently there are three primary ways in which e-prescription services are introduced to a provider. Irrespective of the manner of introduction, the cost of implementation, utilization, and maintenance is ultimately born by the health insurer (the "plan sponsor or payor") either directly or indirectly, and consequently must be accounted for or recorded in its financial statement based on the substance of those costs:

i) <u>Introduction by Provider</u> - Likely the least used method of introduction of e-prescription services, is the direct acquisition of the device and software by the provider. This is due primarily to the expense of buying and installing the system and the training involved.

   When this service is paid for by the provider, it is included as part of the provider's overall cost structure, and is covered in the negotiated rates for services rendered to the health insurer's subscribers as part of the fee for service or capitation payments (hospital/medical claim).

   In other situations, the plan sponsor may provide medical incentive payments to their network providers to offset or support the provider's installation and monthly maintenance of e-prescribing services. These incentive payments are typically based on utilization of the providers e-prescribing services (much like the CMS Incentive Plan discussed later) to the providers and are commonly reported as medical incentive (hospital/medical claim) benefits.

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[1] *42 CFR Part 423 Medicare Program; E-Prescribing and the Prescription Drug Program; Final Rule Federal Register" (CMS Final Rule)*

[2] *Center for Health Information "Electronic Prescribing: Deploying and Using E-prescribing to Save Lives and Save Money, Page 7*

ii) Introduction by Pharmacy Benefit Manager – PBMs are specialized third-party administrators responsible for funding and administering the pharmaceutical portion of patient care on behalf of health insurers and employers. PBMs also provide providers with e-prescription services for a number of reasons, including, but not limited to:

- Verifying patient-enrollee eligibility;
- Directly dispensing drugs via their mail-order pharmacy operations; and
- Providing operational efficiencies.

PBMs are directly contracted by plan sponsors and paid directly by plan sponsors. Health reporting entities generally account for and report their PBM costs as "prescription drug costs" a component of their hospital/medical expense.

iii) Introduction by Plan Sponsor/Payor – Payors are now increasingly introducing e-prescription services into their provider networks. Most often, this is accomplished by purchasing these services through a third-party vendor such as a PBM or Information Technology Vendor (ITV). When the plan sponsor utilizes a PBM, the e-prescription service costs are imbedded in the PBM contract fees via transaction service fees and accounted for as prescription drug costs, a claims expense. This "service fee" model is similar to a PBM's prescription drug contract which is accounted for as prescription drug costs.

When the plan sponsor utilizes a third party Information Technology Vendor, it commonly pays a "transaction service fee" to the vendor based on usage by its network providers. The Information Technology Vendor provides the plan sponsor's network providers with the e-prescription service. They then charge the plan sponsor a transaction service fee based on the utilization of the services by the plan sponsor's network providers. The transaction service fee is based on the number of "sponsored transaction" ordered through the device by the provider.

The Information Technology Vendor bills the health insurer for these services in the same manner, as would a PBM. In both the ITV and PBM transactions, this payment mechanism is often referred to as a "service fee model."

This last scenario (Scenario iii) is the subject of this Form B. Substantively, the costs of the e-prescription services paid directly by a plan sponsor to an ITV are not any different from costs for those services embedded in a provider's contracted rates or a PBM's transaction contract fees.

Based upon an analysis of relevant accounting guidance, it is our belief that it is entirely appropriate and justified to classify, record, and report the e-prescription service "transaction service fee" as a hospital/medical (prescription drugs) benefit expense in accordance with the requirements of Statutory Accounting Principles. Furthermore, given the lack of any more specific guidance within Generally Accepted Accounting Principles ("GAAP"), it likewise is appropriate and justified to treat e-prescription service "transaction service fee" as claims expense under GAAP. The following analysis supports the conclusion that E-Prescription Service "transaction service fees" are hospital/medical claims expense:

i) Current statutory accounting and reporting require health entities to report prescription drug costs as a component of "hospital/medical" claim benefits. The instructions for this line item state that the reporting entity should report "expenses for prescription drugs and other pharmacy benefits covered by the reporting entity."

Health reporting entities generally report the following items as part of their incurred prescription drug costs – provider/prescriber costs; pharmacy/dispenser costs; and PBM costs. PBMs, like

Information Technology Vendors, operate on a service fee model and provide a similar prescription drug service to health reporting entities.

As stated in the NAIC *Accounting Practices and Procedures Manual*, "Statutory Accounting Principles Statement of Concepts" paragraph 31, "*the regulators' need for meaningful, comparable financial information to determine an insurer's financial condition requires consistency in the development and application of statutory accounting principles. Because the marketplace, the economic and business environment, and the insurance industry products and practices are constantly changing, regulatory concerns are also changing. An effective statutory accounting model must be responsive to these changes and address emerging accounting issues*."

As stated in *FASB SFAC No. 2 Qualitative Characteristics of Accounting Information*, paragraph 111 "*the significance of information, especially quantitative information, depends to a great extent on the user's ability to relate it to some benchmark*." We believe such a benchmark for e-prescribing transaction service fees is currently established within statutory accounting and reporting.

ii) Current statutory accounting guidance addresses hospital/medical benefits in SSAP Nos. 73, 84 and 85. However, SSAP Nos. 73 and 84 provide very different accounting guidance than that found in SSAP No. 85 regarding how certain costs impact hospital/medical claims expense.

a. *SSAP No. 73 – Health Care Delivery Assets* (SSAP No. 73) addresses accounting for health care delivery assets, including durable medical equipment, pharmaceuticals, and medical equipment for staff model HMOs. The SSAP permits staff model HMOs to book such assets as admitted. Although not specifically stated in the SSAP, the NAIC *Health Annual Statement Instructions* state that such assets are included as a component of hospital/medical benefits. Consequently, to the extent a staff model HMO acquires e-prescription service devices for use in the provision of health care services to its subscribers, the devices would be accorded admitted asset status under SSAP No. 73 and included as a component of hospital medical benefit costs.

   For a network based health entity also providing such services to its network provider, the accounting and reporting guidance should be the same.

b. *SSAP No. 84 – Certain Health Care Receivables and Receivables Under Government Insured Plans* (SSAP No. 84) also addresses the accounting for hospital/medical benefit costs. Paragraph 2 of SSAP No. 84 provides a description of arrangements between PBMs and health reporting entities. Paragraph 12 goes on to state that income that arises from these pharmaceutical arrangements is reported as a "reduction to claims expenses." The accounting for the transaction service fees between a health reporting entity and an ITV, like rebates between a health reporting entity and a PBM, should be accounted for as hospital/medical benefit claim expense for consistency and comparability.

   Both SSAP No. 84 and SSAP No. 73 address accounting for certain health related issues that are accounted for as a component of hospital/medical claims expense. In both SSAPs, statutory accounting has codified that such expenses and contra-expenses are accounted for as a component of hospital/medical claims expense. We believe these SSAPs serve as a benchmark for the accounting for e-prescribing transaction service fees within statutory accounting.

c. *SSAP No. 85 - Claims Adjustment Expenses, Amendments to SSAP No. 55* (SSAP No. 85) differs from SSAP Nos. 73 and 84 in that while it also addresses an issue unique to health reporting entities, it takes a different approach and directs a reporting entity to account for certain expenses, deemed "cost containment expenses," as claim adjustment expense rather than as a component of hospital/medical claims expense. However, the transaction service fees between a health reporting entity and an ITV do not fall within the definition of cost containment expenses per SSAP No. 85.

The definition of cost containment expenses found in paragraph 4.a. states that these claim adjustment expenses are “expenses that serve to reduce the number of health services provided or the cost of such services.” The transaction service fees incurred by a health reporting entity to an ITV do neither. The transaction service fees do not reduce the number of prescriptions being filled (same prescriptions, different prescribing methodology) nor do they affect the cost of these prescriptions.

Careful analysis of the intent of the meaning of the cost containment expense elements listed in SSAP No. 85, particularly “case management activities” and “network access fees” also leads to the conclusion that e-prescription service “transaction service fees” do not fall within the definition or intent of cost containment expenses.

The following table provides an analytical comparison of the functionality of e-prescription services between that of a hospital/medical claim expense and a cost containment expense. As noted in the table, the attributes of e-prescription services are clearly aligned as a hospital/medical claim expense rather than as a cost containment expense. While the table almost exclusively aligns the functionality of e-prescribing services with hospital/medical claims expense, it is not by accident or design, rather that the functionality of e-prescribing services is more clearly aligned as a hospital/medical expense.

Functionality of E-Prescription Services as a Medical or Cost Containment Expense				
Prescription Process Phase	**Key Function**	**Description**	**Medical Expense**	**Cost Contain-ment Expense**
Prescribe	Patient Identification	The prescription is linked to detailed patient demographic information including birth date, gender, zip code	**X**	
	Current medication list based on history	The prescriber can have access to medication history across providers from PBM claims data, retail pharmacy transaction data, a health information exchange (HIE) initiative, or a combination of these	**X**	
	Medication selection	Medication can be selected from a list; options may be driven by diagnosis; accurate dosing; favorites lists	**X**	
	Safety alerts, clinical decision support	Can alert the prescriber when a medication is selected that is contraindicated or has a significant precaution based on the patient's allergies, current medications, medical conditions, body size, and/or laboratory test results	**X**	
	Formulary and benefit information at the point of care	Can alert the prescriber when medication is selected that is contraindicated by the patient's pharmacy benefit, e.g., nonpreferred, prior authorization, step therapy, higher co-pay	**X**	
	Renewal authorizations	Can alert the prescriber that a refill authorization is required and allows for generation of the renewal	**X**	
Transmit	Bi-directional electronic data interchange	Can communicate medication information among prescribers, dispensers and payers including: new scripts, renewal authorizations, change requests, pharmacy benefit information, medication history, counseling results, etc.	**X**	

Functionality of E-Prescription Services as a Medical or Cost Containment Expense				
Prescription Process Phase	**Key Function**	**Description**	**Medical Expense**	**Cost Contain-ment Expense**
Dispense	Pharmacist assessment and counseling	Assessment tools can identify patients likely to become non-adherent and encourage pharmacist counseling; makes a personal medication profile available to the patient	**X**	
	Patient education materials	Education materials can be made available about the condition, the therapy and potential side effects	**X**	**X**
Administer	Administration aids	Can provide graphical medication administration support for complex dosing schedules involving multiple medications	**X**	
	Collaborative medication management	Can connect physicians, other prescribers, pharmacists, health plan care coordinators and individual care managers to support collaboration for management of medication therapy	**X**	
Monitor	Linkage to lab testing	Can remind prescribers and patients to obtain lab tests associated with monitoring certain medications	**X**	
	Medication adherence alerts	Can use medication history to alert prescribers, pharmacists and others that a patient is non-adherent	**X**	
	Patient outreach	Can query patients regarding their experience with therapy, e.g., side effects, via interactive voice, email or text messaging	**X**	
	Refill reminders	Can remind patients that medications need to be refilled	**X**	
	Remote adherence monitoring	Can alert the patient, caregiver or care monitor when administration of doses is late or missed	**X**	

iii) Prescribing of medication by a provider clearly falls under the classification of medical claims costs as defined in SSAP No. 55. As such, the costs associated with managing and monitoring that prescription service should fall within that accounting classification. The background information to SSAP No. 55 found in the NAIC Manual Issue Paper No. 55 ("IP 55") reference to Chapter 8 of the previous *HMO Accounting Practices and Procedures Manual* supports that conclusion as well. ***NAIC Staff Note – The guidance within Issue Paper No. 55 is not authoritative for statutory accounting. The reference to paragraph 25 of Issue Paper No. 55 points to information included within the prior HMO Accounting Practices and Procedures Manual, which was superseded upon codification and the issuance of SSAP No. 55.***

iv) The inclusion of electronic prescribing in the Medicare Modernization Act (MMA) of 2003, which created the Part D prescription drug benefit in Medicare, gave momentum to the e-prescribing movement. The MMA required drug plans participating in the new prescription benefit to support electronic prescribing and laid out the steps CMS must take to develop the standards that will facilitate e-prescribing. The first step was to finalize foundational standards that apply to all electronic prescribing done under Part D. Although prescribers were not required to write prescriptions electronically, if they do, they must adhere any standards finalized by CMS. Medicare Advantage plans offering prescription drug benefits and other Part D sponsors were required to comply with any standards to accommodate those providers using e-prescribing.

The Medicare Improvements for Patients and Providers Act of 2008 (MIPPA) authorized the Medicare E-prescribing Incentive Program beginning in 2009 to promote adoption and promote the use of e-prescribing systems. For 2009, physicians and other eligible professionals who meet the e-prescribing criteria will be able to receive a bonus equal to 2% of the total estimated allowed medical charges for professional services covered by Medicare Part B and furnished during that calendar year.

In order to be eligible for the incentive in 2009, the provider must be an eligible professional whose estimated allowed Medicare Part B charges for the e-prescribing measure codes are at least 10% of your total Medicare Part B allowed charges. The e-prescribing medical codes are part of the Healthcare Common Procedure Coding System codes (HCPCS).

Medical codes are used to describe diagnoses and treatments, determine costs and reimbursements, and relate one disease or drug to another. All health care providers use Current Procedural Terminology Codes (CPT). These codes, developed by the American Medical Association, describe every type of service a healthcare provider may provide to a patient. They are used to make a list of those services, then to submit to insurance or Medicare or another payer for reimbursement of medical expenses. HCPCS codes are used by Medicare and in some cases are identical to CPT codes.

CMS is one of the primary proponents of e-prescribing. The MMA's requirement for Part D prescription drugs and the MIPPA incentive program are key examples of the implementation of e-prescribing in the health care area. In addition, the introduction of medical codes for e-prescribing services have clearly stated that such expenses are considered medical expenses subject to reimbursement under Medicare Part B and Part D.

CMS has clearly defined the prescribing of medication by a provider under the classification of claims expense as defined in SSAP No. 55 – *Unpaid Claims, Losses, and Loss Adjustment Expenses* for purposes of Medicare reimbursements.

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As discussed earlier, the introduction and use of e-prescription services to providers is accomplished in three primary methods: by the provider, a PBM, or by the Plan Sponsor. Irrespective of the manner of introduction, the cost of implementation, utilization, and maintenance is ultimately born by the plan sponsor or payor, and consequently should be accounted for and recorded in its financial statement based on the substance of those costs. In each of the scenarios, the plan sponsor is the one constant. In the first two scenarios, the accounting and reporting of the e-prescription service "transaction service fees" are unambiguously accounted for as claims expense. The substitution of a third-party vendor into the equation does not substantially change the characteristic of the expense nor should it change the nature of the accounting and reporting of the expense.

More importantly, e-prescription services, which entail clinical and diagnostic services from the provider at the beginning of the prescription chain, provide potentially extensive medical benefits, more effective and efficient dispensing of medication, and overall better pharmaceutical services than that provided by PBMs. To require e-prescription service costs to be accounted and reported as something other than claims expense (e.g. administrative costs) while requiring PBM service costs to be reported as claims expense (based upon the technicality of whom is the payee for the services) would clearly be classifying expenses on a form over substance basis. The overriding accounting conceptual framework and accounting principles emphasize accounting and reporting for the substance and not the form of transactions.

Accounting Issues:

Clarify the proper classification and reporting for the e-prescription services "transaction service fees" charged by an ITV. Should such fees be classified as a "prescription drug claim cost" (part of medical claims expense) or as a "cost containment expense" (part of administrative expense)? This accounting issue is generic to all e-prescription services and associated costs that fit the model discussed above. Current statutory accounting guidance does not clearly address the classification of transaction fees resulting from e-prescription services, and we are aware that there is currently diverse accounting by reporting entities for these fees.

Authoritative Literature (excerpt applicable references):

Statutory Accounting Principles Preamble, III. Statutory Accounting Principles Statements of Concept:

Consistency

31. The regulators' need for meaningful, comparable financial information to determine an insurer's financial condition requires consistency in the development and application of statutory accounting principles. Because the marketplace, the economic and business environment, and insurance industry products and practices are constantly changing, regulatory concerns are also changing.

Statement of Statutory Accounting Principle No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses (SSAP No. 55)*:*

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

    a. Claims unpaid for Managed Care Reporting Entities:

        i. Unpaid amounts for costs incurred in providing care to a subscriber, member or policyholder including inpatient claims, physician claims, referral claims, other medical claims, resisted claims in the course of settlement and other claims in the course of settlement;

SSAP No. 84—Certain Health Care Receivables and Receivables Under Government Insured Plans (SSAP No. 84):

12. Income from pharmaceutical rebates of insured plans shall be reported as a reduction to claims expense on the summary of operations.

SSAP No. 85—Claim Adjustment Expenses, Amendments to SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses (SSAP No. 85):

3. Claim Adjustment Expenses for Accident and Health Reporting Entities are those costs expected to be incurred in connection with the adjustment and recording of accident and health claims defined in subparagraphs 6 a. and 6 b. of SSAP No. 55. Further, Claim Adjustment Expenses for Managed Care Reporting Entities are those costs expected to be incurred in connection with the adjustment and recording of managed care claims defined in subparagraph 7 a. of SSAP No. 55. Certain claim adjustment expenses reduce the number or cost of health services thereby resulting in lower premiums or lower premium increases. These claim adjustment expenses shall be classified as cost containment expenses.

4. Claim adjustment expenses, including legal expenses, can be subdivided into cost containment expenses and other claim adjustment expenses:

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

      i. Case management activities;

      ii. Utilization review;

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

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

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

      vi. Expenses for internal and external appeals processes.

   b. Other claim adjustment expenses: Claim adjustment expenses as defined in paragraph 3 that are not cost containment expenses. Examples of other claim adjustment expenses are:

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

      ii. Maintaining records, general clerical, and secretarial;

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

      iv. Supervisory and executive duties; and

      v. Supplies and postage.

FASB Statement of Financial Accounting Concept No. 2 Qualitative Characteristics of Accounting Information provides the following guidance:

Comparability

111. Information about an enterprise gains greatly in usefulness if it can be compared with similar information about other enterprises and with similar information about the same enterprise for some other period or some other point in time. The significance Accounting for Electronic Prescribing Transaction Service Fees Page 22 of 25 of information, especially quantitative information, depends to a great extent on the user's ability to relate it to some benchmark.

115. Defined in the broadest terms, comparability is the quality or state of having certain characteristics in common, and comparison is normally a quantitative assessment of the common characteristic. Clearly, valid comparison is possible only if the measurements used—the quantities or ratios—reliably represent the characteristic that is the subject of comparison.

FASB Statement of Financial Accounting Concept No. 5, Recognition and Measurement in Financial Statements of Business Enterprises provides the following guidance:

Classification and Aggregation in Financial Statements

20. Classification in financial statements facilitates analysis by grouping items with essentially similar characteristics and separating items with essentially different characteristics. Analysis aimed at objectives such as predicting amounts, timing, and uncertainty of future cash flows requires financial information segregated into reasonably homogeneous groups. For example, components of financial statements that consist of items that have similar characteristics in one or more respects, such as continuity or recurrence, stability, risk, and reliability, are likely to have more predictive value than if their characteristics are dissimilar.

Expenses and Losses

85. Further guidance for recognition of expenses and losses is intended to recognize consumption (using up) of economic benefits or occurrence or discovery of loss of future economic benefits during a period. Expenses and losses are generally recognized when an entity's economic benefits are used up in delivering or producing goods, rendering services, or other activities that constitute its ongoing major or central operations or when previously recognized assets are expected to provide reduced or no further benefits.

Activity to Date (issues previously addressed by Statutory Accounting Principles WG, Emerging Accounting Issues WG, SEC, FASB, other State Departments of Insurance or other NAIC groups):
No activity to date specific to this issue.

Recommending Party's Proposed Conclusion or Future Action on Issue:
Issue a consensus interpretation of SSAP No. 55 - *Unpaid Claims, Losses, and Loss Adjustment* Expenses, that third-party e-prescription services "transactions service fees" are accounted for as hospital/medical claims expense. The accounting treatment is consistent and comparable to the accounting treatment for third-party PBM claims expense.

NAIC Staff Recommendation:
NAIC staff agrees that statutory accounting principles shall be established in a manner that supports the substance of the transaction, rather than the form. This is evidenced in several Statements of Statutory Accounting Principles and Interpretations.

While e-prescribing may be a new technology change in the way that prescriptions are dispensed, in some cases it could simply be a provider infrastructure cost. An insurance reporting entity may or may not choose to reimburse for the costs of e-prescribing transaction costs. To the extent it facilitates the tracking of prescription drug costs, some insurers might find it advantageous to reimburse providers for part of the costs. Staff notes that if an insurer purchased and owned e-prescribing devices, it would be electronic data processing equipment. The nonoperating system software (application software) associated with the devices would be a nonadmitted asset pursuant to *SSAP No. 16—Electronic Data Processing Equipment and Software.*

NAIC staff does not believe that 'transaction service fees' for e-prescribing transactions would be appropriately classified as a 'medical claim cost'. E-prescribing, providing the prescription in an electronic format instead of a hard copy, is not an insured event, but rather part of those costs expected to be incurred in connection with the adjustment and recording of the claim. E-prescribing transaction fees are consistent with the definition of an adjusting expense. If the reporting entity insurer chooses to reimburse providers or other vendors such as Pharmacy Benefits Managers or Information Technology Vendors for e-prescribing transaction costs, it would be an adjusting expense. The sponsor clearly notes that "The transaction service fees do not reduce the number of prescriptions being filled (same prescriptions, different prescribing methodology) nor do they affect the cost of these prescriptions." NAIC staff agrees that these expenses would not meet the definition of cost containment expenses as they would not serve to reduce the number of health services provided or the cost of such services. Rather, such expenses seem more appropriately classified as 'adjusting and other' claims adjusting expenses. As noted within SSAP No. 85, 'adjusting and other' claims adjustment expenses are expenses expected to be incurred in connection with the adjustment and recording of accident and health claims that are not cost containment expenses. Per the examples of 'adjusting and other' expenses within SSAP No. 85, such expenses include maintaining records, general clerical, office maintenance, computer maintenance, supervisory duties and even supplies and postage. (For reporting within Part 3 of the Underwriting and Investment Exhibit, it is proposed that e-prescribing transaction costs would be appropriately included within the 'outsourced services, including EDP, claims and other services' category under the adjusting and other expenses column.)

NAIC staff notes that the sponsor of this Form B indicates that all services administered under a pharmacy benefit manager (PBM) are allocated as prescription drug costs, and thus are considered medical claims expenses. Therefore, if a conclusion is made that e-prescribing transaction costs are not 'medical claims costs' for healthcare professionals that incorporate such services into their provider networks using an information technology vendor (ITV), rather than a PBM, this Form B ascertains that there would be a discrepancy in accounting treatment simply due to the nature of how the e-prescribing transaction services are provided. In reviewing this statement, NAIC staff does not agree that all 'service fees' from PBMs should be fully allocated as medical claim costs as prescription drug costs. Staff notes that in accordance with paragraph 12 or *SSAP No. 84—Certain Health Care Receivables and Receivables Under Government Insured Plans* (SSAP No. 84):

> 12. Income from pharmaceutical rebates of insured plans shall be reported as a reduction to claims expense on the summary of operations.

The guidance in SSAP No. 84 is indicating that pharmaceutical rebates reduce prescription drug costs. It is not indicating that all fees charged by the pharmacy benefits manager (PBM) are an increase in prescription drug costs. In most cases, fees from Pharmacy Benefits Managers would be a loss adjusting expense, not a medical claims expense. Thus, PBM service fees should be divided from actual prescription drug costs (including pharmacy rebates for insured plans as permitted under SSAP No. 84) and claims adjusting expenses (allocated between cost containment and adjusting and other under SSAP No. 85).

Additionally, in reviewing this Form B, NAIC staff notes that the provisions of the Medicare Modernization Act (MMA) of 2003 have not been adopted by statutory accounting. Thus, a conclusion by the MMA that e-prescribing services are medical expenses subject to reimbursement under Medicare Part B and Part D does not provide sufficient justification for classifying such expenses as 'medical claim costs' for statutory accounting.

Pursuant to the discussion above, NAIC staff recommends that the Emerging Accounting Issues Working Group issue a tentative consensus indicating that e-prescribing transaction service costs shall be classified as 'adjusting and other' claims adjustment expenses. This interpretation should provide guidance for all situations in which fees are charged for such services, regardless of the provider, meaning if the service is provided by a PBM, and incorporated as a component of their entire 'service fee' or if the distinct service is provided by another third-party vendor.

Recommending Party:
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NAIC Staff Review Completed by:
Julie Gann – NAIC
August 2009

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Emerging Accounting Issues Working Group
Agenda Submission Form
Form B

Issue: Statutory Accounting for Loans Received Under the Federal TALF Program

Description of Transaction/Event/Issue:

In November 2008, the Federal Reserve announced the "Term Asset-Backed Securities Lending Facility" (TALF) Program as a means to make credit available to consumers and small businesses on more favorable terms by facilitating the issuance of asset-backed securities (ABS) and improving the market conditions for eligible ABS. (Newly issued ABS backed by commercial mortgage loans (CMBS) are TALF eligible as of June 2009. Legacy CMBS, or securities created prior to January 2009 are eligible as of July 2009.)

Under the TALF program, the Federal Reserve Bank of New York will make non-recourse loans (three to five year terms for ABS based on asset class, and ten-year terms for CMBS), prepayable at the option of the borrower, secured by eligible collateral. All U.S. companies that own eligible collateral may borrow from the TALF, provided they maintain an account relationship with a primary dealer in US Treasury Securities. Foreign-owned US entities are also eligible, with certain restrictions.

Under the TALF program, loan proceeds will be disbursed to the borrower, contingent on receipt by the New York Federal Reserve's custodian bank (custodian) of the eligible collateral, an administrative fee, and margin, if applicable. As the loan is non-recourse, if the borrower does not repay the loan, the New York Federal Reserve Bank will enforce its rights in the collateral and sell the collateral to a special purpose vehicle (SPV) established specifically for the purpose of managing such assets.

Issuance of new TALF loans will cease in March 2010, except for CMBS which end in June 2010. (This is an extension from the original end date of December 31, 2009.)

Accounting Issue:
The accounting issue is whether TALF loans received and the corresponding collateral provided by the reporting entity shall be reported net within the statutory financial statements.

Authoritative Literature (excerpt applicable references):

Guidance is included within *SSAP No. 64—Offsetting and Netting Assets and Liabilities* (SSAP No. 64). This guidance indicates that assets and liabilities shall be reported net only when a valid right of setoff exists. Under paragraph 2, a valid right of setoff exists only when all of the following conditions are met:

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

b) The reporting party has the right to setoff the amount owed with the amount owed by the other party;

c) The reporting party intends to setoff; and

d) The right of setoff is enforceable by law

Guidance in SSAP No. 64, paragraph 3 indicates that assets and liabilities that meet the criteria for offset shall not be netted when prohibited by specific statements of statutory accounting principles. Paragraph 4 of SSAP No. 64 specifies that the netting of assets and liability for reporting purposes when no valid right of setoff exists shall be allowed only when provided for by specific statements of statutory accounting principles.

In reviewing the criteria for setoff within SSAP No. 64, it would appear that the criteria within paragraph 2a is clearly met, as after the receipt of a TALF loan, the borrower and the New York Federal Reserve Bank would owe the other determinable amounts. Further, it would seem that the criteria in paragraph 2d is also met, as if the reporting entity did not repay the loan, the New York Federal Reserve Bank has the ability to enforce its rights in the collateral and sell the collateral to a special purpose vehicle (SPV) established specifically for the purpose of managing such assets.

However, the conditions in paragraph 2b and 2c are not considered to be met, and prohibit a net presentation under SSAP No. 64. Paragraph 2b requires the reporting entity to have a right to setoff the amount owed. Although a default on the loan repayment will trigger an eventual setoff of the collateral and TALF loan, the ability to default on the loan is not considered a "right to setoff" by the reporting entity. Additionally, it is presumed that a reporting entity enters into these loans with the intention of repaying the loan and recapturing collateral. Thus, the provision of paragraph 2c, which requires an intent of the reporting party to setoff, is also not met.

In considering whether a provision should be incorporated within a specific statutory accounting principle to permit netting, although no valid right of setoff exists, it is noted that guidance for collateral is included within *SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SSAP No. 91R). Pursuant to guidance within paragraphs 12-13 of this SSAP, unless the transferor defaults on the secured contract, the transferor shall continue to carry the collateral as an asset. It is only after default that the reporting entity would remove the collateral as an asset, with a corresponding reduction to the liability. It is noted that a provision for TALF loans would be inconsistent with existing statutory guidance for the reporting of loans and collateral.

Activity to Date (issues previously addressed by Statutory Accounting Principles WG, Emerging Accounting Issues WG, SEC, FASB, other State Departments of Insurance or other NAIC groups):
None specific

NAIC Staff Recommendation:
Staff recommends that the Working Group issue a tentative consensus indicating that loans received, and collateral provided, under the TALF program do not meet the SSAP No. 64 criteria for offset. Furthermore, no specific provisions shall be established within statutory accounting principles that permit a net reporting presentation for transactions under the TALF program. Loans received and collateral provided under the TALF program shall be reported separately, on a gross basis, until time of default on the received loan. At time of default, the collateral claimed by the New York Federal Reserve Bank shall be removed from the reporting entity's balance sheet, with a corresponding reduction of the liability established for the TALF loan. For annual statement reporting, asset-backed securities provided as collateral under the TALF program shall continue to be reported in the same category as previously reported and would not be moved to the U.S. Government category. For example, Industrial and Misc. securities would continue to be reported in the industrial and miscellaneous category and not as government securities.

NAIC Staff Review Completed by:
Julie Gann – September 2009

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Emerging Accounting Issues (E) Working Group
Business conducted via e-mail
June 13, 2009

The Emerging Accounting Issues (E) Working Group of the Accounting Practices and Procedures (E) Task Force met in via e-mail on June 29, 2009. A quorum was present; Jim Armstrong (IA) chaired the meeting. The following Working Group members participated: Joseph Fritsch, Vice Chair (NY); Richard Ford (AL); Kim Hudson (CA); Jim Hanson (IL); Caroline Brock (LA); Judy Weaver (MI); Dale Bruggeman (OH); Steve Johnson (PA); Danny Saenz (TX); Doug Stolte (VA); and Peter Medley (WI).

1. Vote to Expose interpretation on Re-Securitizations

At the Summer National Meeting, the Working Group discussed ReREMIC transactions and Mr. Armstrong noted that if the transactions were occurring, the Working Group would consider drafting an interpretation. Subsequent to the Emerging meeting, Mr. Armstrong became aware of ReREMIC transactions that have been completed. At the direction of Mr. Armstrong, staff drafted an interpretation on re-securitizations, which was distributed by e-mail for Working Group review. The Working Group was asked to vote to expose the INT for comment. Upon a motion, by Mr. Saenz and seconded by Mr. Hudson, the Working Group voted to expose the INT 09-07: Accounting for Re-Securitizations of Loan-Backed and Structured Securities (e.g., ReREMICs) for public comment. Comments are due August 7, 2009.

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August 7, 2009

Mr. James Armstrong, Chairman
Emerging Accounting Issues Working Group
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108-2604

RE: Comments on Various Agenda Items on the NAIC Emerging Accounting Issues Working Group

Dear Mr. Armstrong,

We appreciate the opportunity to provide comments on the items that were exposed for comment during the NAIC Summer meeting in Minneapolis, Minnesota. We offer the following comments:

EITF 08-3: ***Accounting by Lessees for Maintenance Deposits*** **(EITF 08-3)**

The objective of EITF 08-3 is to clarify how a lessee should account for a maintenance deposit under an arrangement that is accounted for as a lease. Current GAAP guidance clarifies that refundable maintenance deposits shall be accounted for as a deposit asset, and the lessee shall continue to evaluate whether it is probable that an amount on deposit will be returned to reimburse the costs of the maintenance activities incurred by the lessee. In instances where an amount on deposit is less than probable of being returned, it shall be recognized as an additional expense. When the underlying maintenance is performed, the maintenance costs shall be expensed or capitalized in accordance with the maintenance accounting policy.

The Working Group exposed its tentative consensus to adopt the GAAP guidance, with modification to non-admit the maintenance deposits. This modification, which is consistent with the Statement of Concepts and the definition of non-admitted assets, will be accounted for in accordance with SSAP No. 19, *Furniture, Fixtures, and Equipment; Leasehold Improvements Paid by the Reporting Entity as a Lessee; Depreciation of Property and Amortization of Leasehold Improvements* (SSAP No. 19).

Interested parties have no comment on the tentative consensus.

EITF 08-8: ***Accounting for an Instrument (or an embedded feature) with a Settlement Amount That is Based on the Stock of an Entity's Consolidated Subsidiary*** **(EITF 08-8)**

The objective of EITF 08-8 is to clarify whether a financial instrument for which a payoff to a counterparty is based, in whole or in part, on the stock of an entity's consolidated subsidiary is indexed to the reporting entity's own stock, and therefore should not be precluded from qualifying for the first part of the scope exclusion in paragraph 11(a) of FAS 133, or from being within the scope of EITF Issue 00-19.

This GAAP interpretation clarifies that items within its scope are not precluded from being considered indexed to the entity's own stock in the consolidated financial statements of the parent if the subsidiary is a substantive entity. If the subsidiary is not a substantive entity, the instrument or embedded feature would not be considered indexed to the entity's own stock.

The Working Group reached a tentative consensus to reject EITF 08-8 as not applicable to statutory accounting. This position is consistent with previous actions taken by the Working Group, where the concept of consolidation has been rejected for statutory accounting.

Interested parties have no comment on the tentative consensus.

* * * * *

Thank you for considering our comments. We look forward to working with you, Mr. Fritsch, and the Working Group at the NAIC Fall meeting in Washington, D.C. If you have any questions in the interim, please do not hesitate to contact either one of us.

Sincerely, Sincerely,

D. Keith Bell Rose Albrizio

cc: Mr. Joe Fritsch, New York DOI
Robin Marcotte, NAIC staff
Interested Parties

The Interested Parties, as noted below, for the NAIC Emerging Accounting Issues Working Group agree with the comments contained in this letter:

Organization	**Name**	**Phone Number**	**E-Mail Address**
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July 29, 2009

Mr. Jim Armstrong, Chair
Emerging Accounting Issues Working Group
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108-2662

Re: Proposed Interpretation of the Emerging Accounting Issues Working Group INT 09-07: Accounting for Re-Securitizations of Loan-Backed and Structured Securities (e.g., ReREMICs)

Dear Mr. Armstrong:

We appreciate the opportunity to comment on Proposed Interpretation of the Emerging Accounting Issues Working Group INT 09-07: "Accounting for Re-Securitizations of Loan-Backed and Structured Securities (e.g., Re-REMICs)" ("Proposed INT"). We support the Working Group's efforts to provide statutory accounting guidance to insurers that may be considering resecuritizations. In reviewing the Proposed INT, we have the following comments for the Working Group's consideration. Our comments focus primarily on situations where the insurer retains 100% of the new securities issued in a Re-REMIC, though we offer some limited comments on other scenarios as well.

General Comments

We are concerned that there may be some views that a Re-REMIC is a transaction intended to manipulate statutory accounting guidance. To the contrary, we believe that a Re-REMIC structure is an accurate and logical way to correct an unanticipated anomaly arising out of the unprecedented economic situation. More importantly, we believe that a Re-REMIC structure is the most accurate means, albeit a costly and time consuming means, to reflect correctly the underlying risks of collecting cash flows of any particular RMBS. *Thus the Re-REMIC structure promotes transparency and strengthens appropriate regulation*. (We note that, due to the costs incurred and the time required to effectuate a Re-REMIC, we have proposed a "notching" approach, but that proposal is not intended to replace the appropriate use of Re-REMICs for those insurance companies that choose to pursue them.)

Background

Existing RMBS structures were created based on historical data that is very different from the current experience. Based on the historical data, the subordinate tranches of the RMBS structures were believed to be sufficiently large that they could accommodate anticipated losses, and thus the AAA tranches were believed to be sufficiently protected from downgrade risk. In other words, no rating agency and no model, including the NAIC rating system, anticipated that the AAA tranches would be at risk. Had the current economic environment been anticipated, many structures would have required larger subordinate tranches, thus providing sufficient protection to the AAA tranches. A Re-REMIC merely seeks to allocate the cash flows within a RMBS to accomplish that result, i.e. increasing the size of subordinate tranches that would be subject to more risk of loss and thus more risk of downgrade (and thus higher NAIC capital charges), and decreasing the size of senior tranches that would be more protected from loss and thus more protected from downgrade risk.

The anomaly in the current system arises from the fact that corporate bonds and mortgage backed securities are very different in terms of risk profile. If a corporate bond defaults, it is likely that a significant loss will be realized, and rating agencies reflect this likelihood. In the corporate bond context, it is appropriate to take an "all or nothing" approach to rating each security based on the probability of loss without considering the magnitude (economic impact) of projected losses.

On the other hand, a RMBS is very different from a corporate bond. By its very nature, a RMBS is an aggregation of multiple (usually thousands) of credits. A number of those credits could default without materially altering cash flows. Thus, the “all or nothing” approach to rating, when applied to a RMBS that was designed based on historical default rates, distorts the underlying strengths and weaknesses of the RMBS.

In assigning ratings, rating agencies typically focus on the probability of loss rather than the severity of loss. This focus on rating to the probability of loss rather than severity of loss produces unintended and misleading outcomes when utilizing such ratings for RBC purposes. Historically, over 40% of "B"-rated corporate bonds have gone in default with an average loss of approximately 60% (per *Moody's Global Credit Policy - Corporate Default and Recovery Rates, 1920-2008* (released February 2009). Thus, a portfolio of “B”-rated corporate bonds have an expected loss of approximately 24% over its lifetime.. In comparison , *Moody's Updates Loss Projections for '05, '06, '07 and '08 Jumbo RMBS* (published March 19, 2009), states: "Moody's rates securities B2 or higher if they are likely to be paid off under an expected scenario" (i.e. no loss is expected). Although, some percentage of these “B2”-rated RMBS will not be paid off in full as expected, the severity of loss will be significantly lower than the severity of loss on the default on a corporate bond. This is the result of the differing nature of a RMBS and a corporate bond, a RMBS being an aggregation of typically thousands of loans, versus the single obligation nature of a corporate bond. The loss on the typical “B2” rated RMBS that could go into default is likely to be less than 10% rather than a 60% loss on the defaulted

corporate bond. However, a "B"- rated RMBS carries the same RBC charge as a "B"-rated corporate bond, despite vastly different loss expectations. In other words, under the current NAIC rating structure, the anomaly results in a portfolio of "B"- rated corporate bonds whose anticipated loss over a 10-year period is approximately 24% being treated the exact same way as a portfolio of "B"- rated RMBS whose anticipated loss is less than 4% (40% probability of loss combined with a less than 10% severity). Clearly, this result does not make sense. Similarly, when these ratings are then input into the NAIC capital model, it does not translate into good regulation.

The NAIC rating system is designed for "all or nothing" approaches to rating securities, based on the underlying assumption that securitized structures would provide sufficient protection for the senior tranches. For the NAIC rating system to work as designed, it is imperative that securitizations be structured such that the senior tranches are adequately protected from downgrade risk. Again, we now know that the original underlying assumptions were not sufficiently conservative for today's environment and today's rating agency stress testing. A Re-REMIC merely corrects the problem by stratifying the cash flows of a RMBS into multiple layers (tranches) allowing the assignment of ratings to more accurately reflect the risks embedded in the RMBS. Thus structured, the NAIC rating system works as intended. Clearly, this aids and promotes appropriate regulation.

We think it important to acknowledge that, when interpreting technical accounting language, it is frequently the case that reasonable persons acting in good faith could disagree as to the correct technical interpretation, and that may be the case with the technical language at issue. But when more than one interpretation of technical language is possible, it is important to ask which interpretation best advances the overall regulatory goals. It cannot be disputed that appropriately reflecting the risk of loss is an overall regulatory goal. Similarly, the goal of consistency relating to amortized cost accounting is an overall regulatory goal. In this case, it seems clear that the overall regulatory goals are best advanced by recognizing that a Re-REMIC is simply a structure that allows the risk of loss to be appropriately reflected in the NAIC rating system. This common-sense interpretation is consistent with good regulatory objectives and in fact aids and promotes appropriate regulation.

The Re-REMIC Structure: A re-ratings event

A Re-REMIC is essentially a granular re-rating of a currently-held RMBS. The RMBS involved in the Re-REMIC are typically senior tranches that have been downgraded from "AAA" or are subject to potential downgrade due to the risk of losing as little as $1. In a Re-REMIC where the insurer continues to hold 100% of the tranches, there is no change in cash flows to the insurer. Bifurcating (re-tranching) the cash flows of an existing RMBS simply allows the insurer to obtain ratings that more appropriately reflect the layers of risk in the investment. It should be noted that the ratings agencies evaluate the current performance expectations of Re-REMIC RMBS with a high degree of scrutiny.

A Re-REMIC is the most accurate process to appropriately reflect the risk of loss on RMBS and the corresponding risk-based capital charges due to the granular analysis of the cash flows by the rating agencies using current default and loss projections. But it is clear there is no sale or change in cash flows when 100% of the beneficial interests are retained. The same cash flows held by an insurer continue to be held by the insurer, and the insurer continues to control the investment.

The Proposed Accounting for a re-rating

Since there has been no change in the underlying cash flows, there should be no gain or loss recognized at the time of the re-ratings. The newly created CUSIPs, being what is legally owned and more indicative of risk, should be reflected in Annual Statement Schedule D with the corresponding rating assigned by the rating agency. The NAIC classification and corresponding RBC charge should reflect the new ratings of the instrument. Book values of the existing security(ies) will be allocated to the new securities based on the relative fair values of the new securities for the purpose of the presentation in the Annual Statement Schedule D. The company, though, will be required to continue to track and monitor the cash flows to determine asset impairment write-downs in accordance with existing statutory guidance. The result of the re-ratings will be to record no gain or loss in earnings; to reflect a new RBC charge consistent with the underlying risk of collectability of cash flows based on the current ratings; and to continue to analyze the cash flows for impairment. We believe this accounting reflects the essence of the transaction and falls within the interpretations of existing statutory guidance.

As such, we believe that a Re-REMIC should be treated as a re-rating of an existing security with no corresponding accounting for the security as a sale or a related party transaction. This produces an accounting result that is consistent with the economics of the transaction and provides a capital charge commensurate with underlying risk of the security as reflected by the current and more accurate ratings.

In the event that a portion of the beneficial interests of a Re-REMIC is sold outside the insurance company, we believe the same general principles apply. We note that in those situations the loss related to the portion sold should be recognized pursuant to SSAP 91R, however it would be inappropriate (in accordance with SSAP 91R) to recognize the unrealized loss on the portion of the security retained.

Technical Comments

Proposed INT – Paragraph 2

The Re-REMIC itself is simply the legal structure for effecting the granular re-rating discussed above. Paragraph 2 of the Proposed INT states that "by re-securitizing the investments and reclaiming all or a portion of such securities, an entity might improve its

financial position without any material change to the securities held and/or the cash flows of the underlying securities." In the case of a Re-REMIC in which the insurer retains 100% of the beneficial interests, the insurer receives new securities that represent the exact same cash flows as it previously owned. Since there has not been a transaction (and therefore there is no de-recognition event), no accounting is required. In the event that a portion of the beneficial interests are sold, the insurer continues to retain a proportional interest in the assets it held. The RBC relief provided by the Re-REMIC is not due to the accounting for the Re-REMIC, but is the result of a security's rating change, which is consistent with the purpose of RBC as it more accurately reflects the economic risk in the investment. RBC is often impacted by security rating changes (e.g. a corporate bond) even though there is no transaction recorded for accounting purposes.

Proposed INT – Paragraph 3

The securities received in a Re-REMIC are beneficial interests in the securitized assets. There are no additional assets received or liabilities assumed in a Re-REMIC. Consequently, we do not believe that the reference to paragraph 7(e) of SSAP 91R applies to Re-REMICs.

Proposed INT – Paragraph 6

We are uncertain as to the meaning of the last sentence in paragraph 6 of the Proposed INT. It appears to be a conclusion based upon paragraph 10 of SSAP 91R. However, we believe that paragraph 10 of SSAP 91R would apply in a situation where the insurer (a) sells a portion of the Re-REMIC tranches, but not enough to qualify for sale accounting under paragraph 5 or (b) is a sale with recourse. In that case, only the proceeds received (other than beneficial interests) in the non-qualifying "sale" would be accounted for as a secured borrowing. As a result, we recommend that the last sentence of Paragraph 6 be omitted from the document since paragraph 10 of SSAP 91R would not apply to a situation in which 100% of the beneficial interests were retained. Alternatively the sentence should be modified to read “If the transaction does not qualify for sale treatment, it should be evaluated under Paragraph 10 of SSAP 91R to determine whether or not secured borrowing accounting would apply.”

Proposed INT – Paragraph 7

100% of beneficial interests retained by insurance company

As stated in our comments on paragraph 2 of the Proposed INT, we do not believe that this type of Re-REMIC is a de-recognition event – no accounting should be required for what in substance is the re-rating of a security. Accordingly, we do not believe that this is a transaction to which SSAP 25 would apply. The accounting consequences of any subsequent decision to sell a portion of the re-rated investments would be the result of the decision to sell, not the re-rating process.

Some beneficial interests sold outside the insurance company

We believe the focus of paragraph 7 should be on those situations in which a portion of the beneficial interests are sold outside the insurance company. In those cases, we believe that the guidance provided in paragraph 3 of SSAP 25 should be applied to determine whether or not SSAP 25 applies. As a practical matter, we believe that most securitization SPV's would not meet the control criteria delineated in this paragraph since these are passive entities.

Reference to Risk-based Capital

We do not believe that the INT should provide guidance on the application of risk-based capital charges. The guidance should apply to the accounting for the re-rating only. SSAP 25 guidance on transactions with related parties explicitly applies to "statutory accounting practices". Clouding the distinction between statutory accounting practices and the RBC calculation could have many unintended consequences.We also respectfully object to the reference in paragraph 7 regarding the authority of domestic state legislation. It is obvious that the ultimate authority for permitted transactions and for the associated accounting resides with the state of domicile. The role of the EAIWG, though, should be limited to the interpretation of existing SSAP's without consideration of specific state laws and actions.

Proposed INT – Paragraph 8

As stated in our comments on paragraph 2 of the Proposed INT, we do not believe that a Re-REMIC is a de-recognition event – no accounting should be required for what in substance is the re-rating of a security. To the extent that the insurer retains the beneficial interests received in the Re-REMIC, there has not been a change in intent with regards to the underlying securities. To the contrary, the re-rating enhances the insurer's ability to continue to hold the investment. Should an insurer intend to sell a portion of the beneficial interests, we agree that the insurer should record any other-than-temporary impairment ("OTTI") on the portion being disposed as of the date of the change in intent.

Summary

A Re-REMIC is, in substance, a re-rating of an existing security. For 100% retained Re-REMICs, the change in the RMBS security form and re-rating should not be accounted for as a sale or a related party transaction. The process of **creating** a Re-REMIC has no economic impact on the entity – the cash flows remain the same since the underlying security cash flows have not been affected by the re-tranching of the security. In the event that a portion of the 100% retained Re-REMIC is concurrently or subsequently sold, the accounting required by SSAP No. 91R would be required and appropriate.

Thank you for considering our comments. We welcome the opportunity to further explain the Re-REMIC structure, the effects on RBC of ratings changes related thereto, and our comments on the Proposed INT at your earliest convenience.

Sincerely,

D. Keith Bell

Sincerely,

Rose Albrizio

cc: Mr. Joseph Fritsch, NY DOI
Robin Marcotte, NAIC staff
Interested Parties

The Interested Parties, as noted below, for the Emerging Accounting Issues Working Group agree with the comments contained in this letter:

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July 31, 2009

Mr. Jim Armstrong, Chair
Emerging Accounting Issues Working Group
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108-2662

Re: Proposed INT 09-07: Accounting for Re-Securitizations of Loan-Backed and Structured Securities (e.g., Re-REMICs)

Dear Mr. Armstrong:

As a major investment bank which conducts significant business with US insurance companies, Barclays Capital is very much involved in helping its insurance clients restructure their mortgage portfolios. Over the past year or so, we have had dozens of meetings with US insurers to discuss the state of the market for both residential and commercial MBS, and ideas about how to restructure their MBS holdings to be more economically efficient. Given our active dialogue with insurers on mortgage restructurings, we naturally read the proposed INT 09-07 with great interest. The purpose of this letter is to offer our comments on the NAIC's proposed changes to Re-REMIC accounting.

Background – Why Are Insurers Motivated To Re-REMIC Their MBS?

Re-REMICs are a tool used to restructure existing REMIC securities, either individually, or on a portfolio basis. The focal point of most REMIC transactions is the rating of the new securities to be issued from the REMIC. Re-REMIC technology "carves up" the cash flows of the underlying MBS to create new securities in a capital structure where senior classes are protected through subordination of more junior classes. As a result of this subordination, more senior tranches are capable of obtaining very high credit ratings, usually AAA, even when the underlying collateral is not investment grade (as is the case in recent re-REMICs of downgraded MBS). In ordinary times, it would not be possible to achieve a substantial ratings upgrade by taking a portfolio of REMIC securities, putting them in a new REMIC, and issuing newly rated beneficial interests – i.e., the expectation would be that the new securities created would, on average, have the same ratings as the securities that went in.

However, the unprecedented events of the past year, including substantial levels of defaults on residential mortgages and rising defaults on commercial mortgages, have created a situation where re-REMICs can arguably achieve a significant improvement in average ratings for MBS. *Barclays Capital believes these higher ratings are justified when applying current rating agency criteria to updated and more realistic default assumptions on the underlying mortgage pools.* In particular, we think re-REMICs address a recent and particularly serious

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impact of ratings downgrades in MBS: rating agency ratings mostly reflect probability of default, largely to the exclusion of loss severity. It is consequently the situation that many insurers own MBS which may have an increased probability of loss, but where the severity of loss, as estimated using the best predictive models currently available, may be quite low relative to the RBC that would be required for insurers to hold if and when a security is downgraded by the rating agencies.

In light of the preceding, it is our opinion that the primary motivation for insurers to engage in Re-REMIC transactions is a desire to restructure their MBS portfolios so that they hold the appropriate level of RBC given the most recent rating agency criteria and economic loss estimates. As it stands, following recent downgrades insurers will hold RBC that is well in excess of conservatively estimated future losses on many MBS. The Re-REMIC transaction allows insurers to address this situation by effectively re-rating the underlying MBS.

From a statutory accounting perspective, one thing is obvious from the preceding: in order to obtain the benefit of the new ratings achieved from a Re-REMIC, the insurer must recognize the new securities created from the Re-REMIC and derecognize the old securities currently on balance sheet. This exchange of old MBS securities for new needs to occur at the cusip level.

Another distinct motivation for some Re-REMICs has nothing to do with improving the credit ratings of the underlying collateral and more to do with enhancing economic value. These REMIC transactions are appropriately structured from the outset as secured financings and not as a sale of any of the underlying collateral. Typically, these “short-term” REMICs have a maturity that is significantly shorter than the tenor of the underlying collateral. In most cases the planned maturity of the REMIC is shorter than two years even if the underlying collateral has a much longer weighted average life. The insurer’s objective may be tax related, or the transaction is simply a way of borrowing money via sale of a very senior interest to a third party investor. It is the intent from the outset of these transactions that the insurer will get back all of the underlying collateral when the REMIC unwinds in one to two years. Therefore, from both a GAAP and statutory perspective, these “short-term” REMICs are most appropriately accounted for as financings.

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To summarize, from Barclays' perspective we see three types of Re-REMIC securitizations that can be useful to insurers in the current environment:

1) Re-REMICs motivated by a desire to achieve revised ratings (hence revised RBC charges) on the underlying collateral pool. This transaction focuses only on statutory accounting and the insurer does not intend to sell any interest to a third party.
2) Re-REMICs motivated by a desire to achieve revised RBC charges on the underlying collateral pool and also to enact a sale for GAAP purposes. This type of Re-REMIC transaction necessarily involves sale of some beneficial interests to third parties in order to achieve sale treatment under GAAP. In addition, the insurer may also have a desire to raise funds from the transaction that makes the sale of interests to a third party attractive from an economic perspective as well.
3) Re-REMICs motivated by economic funding or tax objectives where the tenor of the REMIC is substantially shorter than the life of the underlying collateral and the insurer intends to get back all the underlying collateral when the REMIC unwinds.

Statutory Accounting for Re-REMIC Transactions and INT 09-07

Our opinion is that the appropriate statutory accounting treatment for all Re-REMIC transactions is already fully encompassed in SSAP 91R. Assuming the transaction meets the criteria for transfer or sale of the assets, we believe paragraphs 6 and 7 of SSAP 91R provide the appropriate statutory accounting treatment for the transaction. To the extent beneficial interests are sold to third parties, the insurer would recognize a gain or loss on the sale of those interests, depending upon the difference between the market value and allocated statutory basis of those interests. To the extent the insurer retains beneficial interests, we believe it is appropriate for the insurer to carry these interests at their allocated statutory basis and account for them as appropriate in accordance with the statutory accounting principles for the specific asset type.

Implicit in our reasoning for relying on SSAP 91R and rejecting the introduction of SSAP 25 and forced OTTI are several views:

1) We do not believe that a transaction where the insurer has conclusively surrendered control of the underlying assets (such as in a QSPE or similar passive structure) has the issues of potential accounting manipulation that the related party transactions envisioned in SSAP 25 were meant to encompass. Therefore, we see no reason to force fair-value accounting per SSAP 25 on Re-REMIC transactions.
2) We do not believe the "intent to securitize" should be equated with "intent to sell" and therefore trigger other-than-temporary impairment on the underlying securities placed in a REMIC. Quite to the contrary, we believe insurers are using Re-REMICs *precisely because they would like to retain exposure to the underlying MBS*. They are simply using the Re-REMIC as

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a means to obtain what are more economically justifiable RBC charges based on revised ratings. If anything, the types of securities placed in Re-REMICs have market prices that most insurers believe is far below their assessment of fundamental value. This is the reason insurers have not taken OTTI and also why they would not consider selling at current market levels.

3) Short-term Re-REMIC transactions that are clearly designed from the outset to be secured financings should never result in gain or loss realization on the underlying securities, just as a decision to "repo" securities would not trigger a statutory sale. Where the insurer has not surrendered control of the assets in the accounting sense, it should not be forced to take OTTI based on a false presumption that a decision to sell has occurred.

Regulatory Implications of Re-REMICs

In the current economic environment, it appears to us that both regulators and insurers are somewhat uncertain as to what the appropriate RBC charges should be on many MBS holdings. Clearly, many senior RMBS and CMBS securities have been downgraded by the rating agencies, some to levels that are below investment grade. These lower ratings will result in a potentially significant increase in required RBC. Yet, there is a strong case to be made that economic losses and required RBC are both overstated at these new lower ratings due to the "severity of loss versus probability of loss" issue mentioned earlier. The industry, through the ACLI, has proposed a "notching" alternative to the NAIC to address this issue which would mitigate the required RBC charges. Our understanding is that the SVO has recommended that the NAIC reject the notching solution because they view it to "lack a clear and verifiable analytical justification."

We would suggest that the process of undertaking a Re-REMIC is a rigorous form of "re-underwriting" the underlying MBS in the REMIC. The process of structuring an entirely new REMIC from existing MBS requires significant input from rating agencies, and a "bottoms-up" re-projection of cash flows for the underlying pools of mortgages. This process would provide the NAIC and the SVO with a clear and verifiable analytical justification for any improvement in the overall average ratings of any securities placed into a new REMIC. In short, it would provide regulators and the insurance industry with a more current "mark-to-market" on the ratings of the underlying MBS. We think this should be very desirable to both parties.

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Conclusion

Insurers are focused on mortgage restructurings such as Re-REMICs for sound economic reasons related to ratings, capital charges, non-recourse financing and taxes. We believe the current statutory guidelines, primarily as delineated in SSAP 91R adequately address the appropriate statutory accounting for these transactions. We further believe that the potential changes introduced by INT 09-07 would force unnecessary full loss realization on otherwise highly beneficial transactions. This would lead many if not most insurers to do nothing to restructure their MBS exposure for fear of triggering onerous statutory accounting consequences. We view that likely outcome as very unfortunate, since restructuring transactions can be of significant economic benefit to the insurer in the current precarious financial environment.

We appreciate your consideration of our comments. We would welcome the opportunity to further explain our thoughts on the appropriate statutory accounting treatment for Re-REMICs, and on mortgage restructuring transactions in general at your convenience.

Sincerely,

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August 5, 2009

Mr. Jim Armstrong, Chair
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Dear Mr. Armstrong:

Re: Proposed Interpretation of the Emerging Accounting Issues Working Group INT 09-07: Accounting for Re-Securitizations of Loan-Backed and Structured Securities (e.g., Re-REMICs)

Jackson National Life Insurance Company ("Jackson") appreciates the opportunity to comment on the Proposed Interpretation of the Emerging Accounting Issues Working Group INT 09-07: "Accounting for Re-Securitizations of Loan-Backed and Structured Securities (e.g., Re-REMICs)" ("Proposed INT"). We are considering a re-securitization and support the Working Group's efforts to provide statutory accounting guidance on this topic. We agree with the Interested Parties comment letter dated July 29, 2009, that focuses primarily on situations where the insurer retains 100% of the new securities issued in a Re-REMIC. The comments in this letter focus on re-securitizations that qualify as a sale under SSAP No. 91R – *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* ("SSAP 91R").

In discussions with others in the industry, there seems to be a view that Re-REMIC transactions are merely a tool being used to manipulate statutory accounting guidance to avoid additional RBC charges on downgraded securities. We believe this view is incorrect, as there are numerous benefits to be derived from a Re-REMIC and, depending on a company's individual circumstances, these benefits can be quite substantial. In many cases, an immediate benefit is that a significant portion of the restructured securities are more liquid and, therefore, more marketable at higher values, with a higher rating for the upper tranches due to the expanded subordination support. This improved liquidity and marketability not only makes the securities easier to sell if the company so chooses, but also makes them eligible to be pledged as collateral for short-term borrowing or hedging strategies. Additionally, more favorable tax treatment can also be obtained through a Re-REMIC as opposed to outright selling of the downgraded securities.

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We believe the proposed accounting treatment described in this letter is a fair and reasonable interpretation reflective of the economics of the transaction. We believe that the intent of the regulations and the accounting literature is not to penalize a company for entering into a transaction with clear economic benefits, but should be reasonably consistent with those economics.

Proposed INT – Paragraph 6

We believe that paragraph 5 of SSAP 91R clearly defines when sale treatment is appropriate for transactions in which consideration other than beneficial interests is received. However, the last sentence of paragraph 6 of the Proposed INT seems to expand on paragraph 10 of SSAP 91R and implies that any transaction that does not qualify as a sale would be accounted for as a secured borrowing. Paragraph 10 of SSAP 91R does not apply to transactions in which 100% beneficial interests are received. We believe the last sentence should be deleted or further clarified by replacing it with the sentence "If the transaction does not qualify for sale treatment, it should be evaluated under Paragraph 10 of SSAP 91R to determine whether or not secured borrowing accounting would apply."

Proposed INT – Paragraph 7

In those situations in which a portion of the beneficial interests are sold outside the insurance company, we believe that the guidance provided in paragraphs 25 – 27 of SSAP 91R and paragraph 3 of SSAP 25 should be applied to determine whether or not SSAP 25 applies. As a practical matter, we believe that most securitization SPEs would be considered qualifying SPEs and not meet the control criteria delineated in paragraph 3 since these are passive entities, and should therefore not be considered an affiliate of the insurer. Accordingly, the mere use of an SPE should not automatically require that the transaction be accounted for as an affiliated transaction under SSAP 25. For securitizations using a qualifying SPE and qualifying for sale treatment under SSAP 91R, paragraph 5, the beneficial interests should be recorded as outlined in SSAP 91R, paragraphs 6 and 7, without reference to SSAP 25. The only reason a separate legal entity – the SPE – is used in these transactions is by legal necessity. For the portion of the beneficial interests retained in a securitization that qualifies as a sale, there is no intent to permanently transfer those cash flows to another entity. Therefore, we believe the INT should be changed as follows:

> "A transfer of a structured security qualifying as a sale under SSAP 91R, paragraph 5, using a qualifying SPE, as defined in SSAP 91R, paragraphs 25 - 27, shall be accounted for under SSAP 91R, which would allocate the statutory book values of the underlying securities to the new beneficial interests created, with any gain or loss being realized by the insurer only to the extent of any beneficial interests sold. Transfers of structured securities to an affiliate shall be accounted for in accordance with SSAP 25."

Proposed INT – Paragraph 8

We believe the intent to securitize existing securities should not be equated with an intent to sell those securities. A valid reason for forming a Re-REMIC is to re-securitize existing securities where individual ratings no longer accurately reflect the economic risk in a security. As a consequence, the amount of risk-based capital held based on the rating of that security may be significantly overstated relative to the economic risk. The reason Jackson and other insurers are considering these transactions

is because we believe the investments are good long-term investments that are not properly rated under the current system. We do not have an intent to sell the securities but, rather, seek to achieve a fair rating. To the extent that an insurer retains the beneficial interests received in the Re-REMIC, there has not been a change in intent with regard to the underlying securities. To the contrary, a re-rating enhances the insurer's ability to continue to hold the investment. If an insurer has not taken an OTTI charge on specific assets because they do not expect a permanent economic loss due to impaired cash flows, we do not believe that a securitization transaction should force them to do so. Should an insurer intend to sell a portion of the beneficial interests, it is clear that the insurer should record any loss on the interests sold to a third party. This is consistent with GAAP (GAAP codification topic 860-10-35 paragraph 5), which permits an entity to recognize a loss on only the portion of a securitization that it plans to sell. Given that SSAP 98, and the recently proposed SSAP 43R, attempt to align statutory OTTI rules for RMBS with GAAP, we do not believe that the Proposed INT should require accounting that is inconsistent with GAAP, including OTTI write-downs to fair value prior to transfer to the SPE for the portion of the beneficial interests retained after the re-securitization.

Summary

A Re-REMIC is often, in substance, a re-rating of existing securities. Therefore, beneficial interests retained in a Re-REMIC, should not be accounted for as a sale or a related party transaction. Other than the costs involved, the process of creating a Re-REMIC has no economic impact on the entity – the cash flows remain the same since the underlying securities' cash flows have not been affected by the re-tranching of the newly issued securities. For transactions qualifying for sale accounting under SSAP 91R, the reallocation of book value to beneficial interests retained and recognition of any loss for beneficial interests sold, as outlined in SSAP 91R would be required and appropriate. While securities should always be reviewed for impairment, intent to re-securitize is not equivalent to intent to sell and, accordingly, an OTTI write-down to fair value should not be required merely because of the Re-REMIC. We believe the accounting treatment outlined here is a fair and reasonable treatment based on the economics of the transaction and is consistent with the Statutory amortized cost basis of accounting.

Thank you for considering our comments. We welcome the opportunity to address any questions or further explain our comments on the Proposed INT.

Sincerely,

Andrew B. Hopping
Executive Vice President & Chief Financial Officer
Jackson National Life Insurance Company

c: NAIC Staff
Mr. Ken Ross, Commissioner, State of Michigan
Mr. Joseph Fritsch, NY DOI

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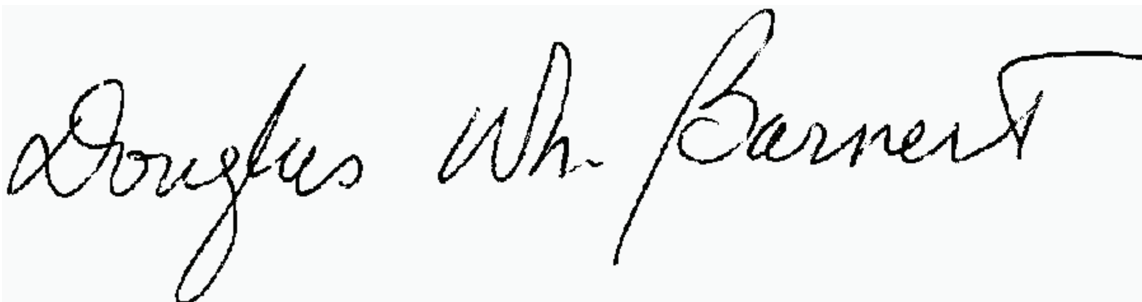
From: Doug Barnert [mailto:doug@barnert.com]
Sent: Thursday, September 03, 2009 4:48 PM
Subject: Comment on INT 09-07

We are writing in our capacity as representing Jackson National Life Insurance Company in discussions on proposed INT 09-07.

Based on our conversations with interested persons and regulators, we have prepared a marked version of proposed INT 09-07 as an additional comment on the exposure. Due to the time deadlines of the submission, we have not been able to circulate this draft for the "signing" process, but based on several conference calls of interested persons reviewing the draft, we are comfortable that most, if not all, would agree that this markup represents their current views and recommendations to the NAIC.

We understand that NAIC staff plans to circulate meeting materials for the Fall 2008 Emerging Accounting Issues Working Group imminently. We would appreciate it if you could include this in your documents.

Thank you,



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Interpretation of the Emerging Accounting Issues Working Group

INT 09-07: Accounting for Re-Securitizations of Loan-Backed and Structured Securities (e.g., ReREMICs)

INT 09-07 Dates Discussed

June 13, 2009

INT 09-07 References

SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties (SSAP No. 25)
SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 91R)
SSAP No. 43R—Loan-backed and Structured Securities – Revised (SSAP No. 43R)
~~*SSAP No. 98—Treatment of Cash Flows When Quantifying Changes in Valuation and Impairments, an Amendment of SSAP No. 43—Loan-backed and Structured Securities* (SSAP No. 98)~~
INT 06-07: Definition of Phrase "Other Than Temporary" (INT 06-07)

INT 09-07 Issue

1. Insurance reporting entities are active investors in various loan-backed and structured securities, such as residential mortgage backed securities (RMBSs). A significant decrease in the volume and level of market activity for these securities, coupled with large rating downgrades, have recently resulted in severe downward pressure on valuation. Valuation has also been impacted by changes in fair value determination for GAAP financial statements that increased transparency, which added further to the downward pressure on valuation. In addition, *SSAP No. ~~98—Treatment of Cash Flows When QuantifyingChanges in Valuation and Impairments,~~43R an Amendment of SSAP No. 43—Loan-backed and Structured Securities* (SSAP No. ~~98~~43R) has also been exposed for comment and is expected to be adopted effective September 30, 2009 and is related to impairment of these securities. Holders of RMBS are experiencing many risks, three of which are related to accounting, reporting and solvency; risk of impairment, risk of greater regulatory capital requirements and the risk of future ratings downgrades by the rating agencies.

2. A ~~basic description of the re-securitization~~ (ReREMIC – re-securitization of real estate mortgage investment conduit) of a RMBS or other securities takes place when a reporting entity transfers ownership of the structured security to a special-purpose entity, which in turn transfers to a newly formed trust created specifically for the transfer/transaction. The trust issues new structured securities with differing pay classes (distributions of risk and/or cash flows) derived from the cash flows from the underlying structured securities. The newly created structured securities receive new CUSIPs and are intended to be individually rated by one or more rating agencies. Although re-securitizations may be designed to be sold to an outside, unrelated or unaffiliated entity, this interpretation addresses situations when some or all of the restructured securities are taken back by the reporting entity. By re-securitizing the investments and reclaiming all or a portion of such securities, an entity might improve its financial position, or restore it to where it was prior to the ratings downgrades, without any material change to the securities held and/or the cash flows of the underlying securities.

3. *SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SSAP No. 91R) provides the following guidance related to transfers within the scope of the SSAP **(bolding added for emphasis)**:

> 2. See SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties (SSAP No. 25) **for additional accounting and disclosure guidance concerning related party transactions**.
>
> 5. Except as discussed in paragraphs 55 and 87, a transfer of a group of financial assets, or a portion of a financial asset in which the transferor surrenders control over those financial assets shall be accounted for as a sale to the extent that consideration **other than beneficial interests in the transferred assets is received in exchange**. The transferor has surrendered control over transferred assets if, and only if, all of the following conditions are met:
>
> a. The transferred assets have been isolated from the transferor—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership (see paragraphs 16 and 17);
>
> b. Either (i) each transferee obtains the right, free of conditions that constrain it from taking advantage of that right (see paragraphs 18-22), to pledge or exchange the transferred assets or (ii) the transferee is a qualifying special-purpose entity as defined in paragraph 24 and the holders of beneficial interests in that entity have the right, free of conditions that constrain them from taking advantage of that right (see paragraph 23), to pledge or exchange those interests and no condition both constrains the transferee (or holder) from taking advantage of its right to pledge or exchange and provide more than a trivial benefit to the transferor; and
>
> c. The transferor does not maintain effective control over the transferred assets through (i) an agreement that both entitles and obligates the transferor to repurchase or redeem them before their maturity (see paragraphs 37-39) or (ii) the ability to unilaterally cause the holder to return specific assets, other than through a cleanup call (see paragraphs 21 and 22 and 40-44).
>
> 6. Upon completion of any transfer of financial assets, the transferor shall:
>
> a. Initially recognize and measure at fair value, if practicable, servicing assets and servicing liabilities assumed under a separate contractual obligation to service financial assets (see paragraph 50)
>
> b. Allocate the previous carrying amount between the assets sold, if any, and the interests that continue to be held by a transferor, if any, based on their relative fair values at the date of transfer (see paragraphs 48 and 49).
>
> c. Continue to carry in its balance any interests it continues to hold in the transferred assets, including, if applicable, beneficial interests in assets transferred to a qualifying special-purpose entity in a securitization, and undivided interests continued to be held by the transferor (see paragraphs 7c., 48 and 49; and
>
> 7. Upon completion of a transfer of financial assets that satisfies the conditions to be accounted for as a **sale** (see paragraph 5), the transferor (seller) shall:
>
> a. Eliminate the transferred assets from the balance sheet;

b. Allocate the previous carrying amount of the transferred assets to the securities
representing beneficial interests continued to be held by the reporting entity, if any, and
the securities representing beneficial interests not continued to be held, if any, based on
the relative fair values of the transferred assets at the date of transfer;
c. Record in its balance sheet, the allocated carrying value of the securities representing beneficial interests continued to be held interests in the assets (e.g., loan backed securities). Subsequent to the transfer of assets:

i. Retained residuals are to be carried at fair value with the difference between fair value and the allocated cost basis recognized as an unrealized gain or loss;

ii. Beneficial interests continued to be held shall be accounted for in accordance with the statutory accounting principles for the specific asset type (e.g., bonds shall be accounted for in accordance with SSAP No. 26—Bonds, excluding Loan–backed and Structured Securities, loan-backed securities shall be accounted for in accordance with SSAP No. 43—Loan-backed and Structured Securities, preferred stock in accordance with SSAP No. 32—Investments in Preferred Stock (excluding investments in preferred stock of subsidiary, controlled, or affiliated entities).

d. Recognize all additional assets obtained (i.e., other than the securities representing beneficial interests continued to be held which are recorded in accordance with 7 c.) and liabilities incurred in consideration as proceeds of the sale;

e. **Initially measure such additional assets obtained and liabilities incurred in the sale at fair value** (see Glossary to the Statements of Statutory Accounting Principles), or if it is not practicable to estimate the fair value of an asset or a liability, apply alternative measures (paragraph 49); and

f. For reporting entities required to maintain an Interest Maintenance Reserve (IMR), the accounting for realized and unrealized capital gains and losses shall be in accordance with SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve (SSAP No. 7). 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).

10. If a transfer of financial assets in exchange for cash or other consideration **(other than beneficial interests in the transferred assets)** (a) does not meet the criteria for a sale in paragraph 5, or (b) is a sale of receivables with recourse (see paragraph 87); the transferor and transferee shall account for the transfer as a secured borrowing with pledge of collateral (see paragraph 12).

Qualifying SPE
25. A qualifying SPE is a trust or other legal vehicle that meets all of the following conditions:
a. It is demonstrably distinct from the transferor (paragraphs 25 and 26);
b. Its permitted activities:
i. Are significantly limited;
ii. Were entirely specified in the legal documents that established the SPE or created the beneficial interests in the transferred assets that it holds; and
iii. May be significantly changed only with the approval of the holders of at least a majority of the beneficial interests held by entities other than any transferor, its affiliates, and its agents (paragraphs 27 and 28).
c. It shall hold only:
i. Financial assets transferred to it that are passive in nature (paragraph 29);
ii. Passive derivative financial instruments that pertain to beneficial interests (other than another derivative financial instrument) issued or sold to parties other than the transferor, its affiliates, or its agents (paragraphs 29 and 30);

iii. Financial assets (for example, guarantees or rights to collateral) that would reimburse it if others were to fail to adequately service financial assets transferred to it or to timely pay obligations due to it and that it entered into when it was established, when assets were transferred to it, or when beneficial interests (other than derivative financial instruments) were issued by the SPE;
iv. Servicing rights related to financial assets that it holds;
v. Temporarily, nonfinancial assets obtained in connection with the collection of financial assets that it holds (paragraph 31);
vi. Cash collected from assets that it holds and investments purchased with that cash pending distribution to holders of beneficial interests that are appropriate for that purpose (that is, money-market or other relatively risk-free instruments without options and with maturities no later than the expected distribution date).
d. If it can sell or otherwise dispose of noncash financial assets, it can do so only in automatic response to one of the following conditions:
i. Occurrence of an event or circumstance that:
(a) Is specified in the legal documents that established the SPE or created the beneficial interests in the transferred assets that it holds;
(b) Is outside the control of the transferor, its affiliates, or its agents; and
(c) Causes, or is expected at the date of transfer to cause, the fair value of those financial assets to decline by a specified degree below the fair value of those assets when the SPE obtained them (paragraphs 32 and 33.)
ii. Exercise by a BIH (other than the transferor, its affiliates, or its agents) of a right to put that holder's beneficial interest back to the SPE (paragraph 34);
iii. Exercise by the transferor of a call specified in the legal documents that established the SPE, transferred assets to the SPE, or created the beneficial interests in the transferred assets that it holds (paragraphs 40-44);
iv. Termination of the SPE or maturity of the beneficial interests in those financial assets on a fixed or determinable date that is specified at inception (paragraph 35).
Need to Be Demonstrably Distinct from the Transferor
26. A qualifying SPE is demonstrably distinct from the transferor only if it cannot be unilaterally dissolved by any transferor, its affiliates, or its agents and either:
a. At least 10 percent of the fair value of its beneficial interests is held by parties other than any transferor, its affiliates, or its agents; or
b. The transfer is a guaranteed mortgage securitization.
27. An ability to unilaterally dissolve an SPE can take many forms, including but not limited to holding sufficient beneficial interests to demand that the trustee dissolve the SPE, the right to call all the assets transferred to the SPE, and a right to call or a prepayment privilege on the beneficial interests held by other parties.

37. Reporting entities that have qualifying special-purpose entities as affiliates shall carry their investment in such entity at its underlying statutory book value in accordance with SSAP No. 97. **Additionally, transactions entered involving affiliated qualifying special-purpose entities are subject to the provisions of SSAP No. 25**.

SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other RelatedParties (SSAP No. 25) provides the following guidance and reasons for such requirements **(bolding added for emphasis)**:

1. Related party transactions are subject to abuse because reporting entities may be induced to enter transactions that may not reflect economic realities or may not be fair and reasonable to the reporting entity or its policyholders. As such, **related party transactions require specialized accounting rules and increased regulatory scrutiny**. This statement establishes statutory accounting principles and disclosure requirements for related party transactions.

3. 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 (SSAP No. 48). Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity

method for all such investments. An affiliate is any person that is directly or indirectly, owned or controlled by the same person or by the same group of persons, that, directly or indirectly, own or control the reporting entity.

4. 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 contract for goods or nonmanagement services where the volume of activity results in a reliance relationship (d) by common management, or (e) 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.

5. Control as defined in paragraph 4 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 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. 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 participation rights1 as a shareholder to the investee.

11. An arm's-length transaction is defined as a transaction in which willing parties, each being reasonably aware of all relevant facts and neither under compulsion to buy, sell, or loan, would be willing to participate. A transaction between related parties involving the exchange of assets or liabilities shall be designated as either an economic transaction or non-economic transaction. An economic transaction is defined as an arm's-length transaction which results in the transfer of the risks and rewards of ownership and represents a consummated act thereof, i.e., "permanence." The appearance of permanence is also an important criterion in assessing the economic substance of a transaction. In order for a transaction to have economic substance and thus warrant revenue (loss) recognition, it must appear unlikely to be reversed. If subsequent events or transactions reverse the effect of an earlier transaction prior to the issuance of the financial statements, the reversal shall be considered in determining whether economic substance existed in the case of the original transaction. Subsequent events are addressed in SSAP No. 9—Subsequent Events. An economic transaction must represent a bonafide business purpose demonstrable in measurable terms. A transaction which results in the mere inflation of surplus without any other demonstrable and measurable betterment is not an economic transaction. The statutory accounting shall follow the substance, not the form of the transaction.

13. A transaction between related parties may meet the criteria for treatment as an economic transaction at one level of financial reporting, but may not meet such criteria at another level of financial reporting. An example of such a transaction is a reporting entity purchasing securities at fair value from an affiliated reporting entity that carried the securities at amortized cost. This transaction meets the criteria of an economic transaction at this level of financial reporting, and therefore, the selling reporting entity would record a gain and the acquiring reporting entity would record the securities at their cost (fair value on the transaction date). At the common parent level of reporting, this transaction has resulted in the mere inflation of surplus, and therefore, is a noneconomic transaction. The parent reporting entity shall defer the net effects of any gain or increase in surplus resulting from such transactions by recording a deferred gain and an unrealized loss. The deferred gain shall not be recognized by the parent reporting entity unless and until arms-length transaction(s) with independent third parties give rise to appropriate recognition of the gain.

14. A non-economic transaction is defined as any transaction that does not meet the criteria

of an economic transaction. Similar to the situation described in paragraph 13, transfers of assets from a parent reporting entity to a subsidiary, controlled or affiliated entity shall be treated as noneconomic transactions at the parent reporting level because the parent has continuing indirect involvement in the assets.

15. When accounting for a specific transaction, reporting entities shall use the following valuation methods:

a. Economic transactions between related parties shall be recorded at **fair value** at the date of the transaction. To the extent that the related parties are affiliates under common control, the controlling reporting entity shall defer the effects of such transactions that result in gains or increases in surplus (see paragraph 13);

b. Non-economic transactions between reporting entities, which meet the definition of related parties above, shall be recorded at the **lower of existing book values or fair values** at the date of the transaction;

c. Non-economic transactions between a reporting entity and an entity that has no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or it's affiliates, shall be recorded at the **fair value** at the date of the transaction; however, to the extent that the transaction results in a gain, that gain shall be deferred until such time as permanence can be verified;

d. **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**.

Examples of transactions deemed to be non-economic include security swaps of similar issues between or among affiliated companies, and swaps of dissimilar issues accompanied by exchanges of liabilities between or among affiliates.

4. *INT 06-07: Definition of Phrase "Other Than Temporary"* provides the following guidance related to determination of whether an other-than-temporary impairment has occurred **(bolding added for emphasis)**:

> 5. An interest related impairment should be deemed other-than-temporary when an investor has the **intent to sell** an investment, at the reporting date, before recovery of the cost of the investment…

5. The Accounting Issues are as follows:

Issue 1 – If the consideration received is beneficial interests in the transferred assets, is sale accounting treatment permitted?

Issue 2 – Is the transfer of the original structured security to a related party SPE, accounted for at fair value in accordance with SSAP No. 25? If the transaction were structured to qualify for sale treatment under SSAP No. 91R, is it appropriate to follow the guidance in paragraph 6 and 7?

Issue 3 – If a structured security was not considered other-than-temporarily impaired because the impairment was considered interest related, what impact does the intent to re-securitize have on impairment analysis?

INT 09-07 Discussion

6. The Working Group reached a consensus ~~tentatively notes~~ that under SSAP No. 91R, paragraph 5, that to the extent that the transfer of a group of financial assets, or a portion of a financial asset in which the transferor surrenders control over those financial assets shall be accounted for as a sale **to the extent that consideration other than beneficial interests in the transferred assets is received in exchange**. Therefore, to the extent that the consideration received in the exchange, is solely beneficial interests in the transferred assets, the transfer **does not** qualify for sale treatment. If the transaction does not qualify for sale treatment, it should be evaluated under paragraph 10 of SSAP 91R to determine whether or not ~~is accounted for as a~~ secured borrowing accounting would apply.~~in accordance with SSAP No. 91R.~~

7. The Working Group reached a ~~tentative~~ consensus on Issue 2 that a transfer of a structured security qualifying as a sale under SSAP 91R, paragraph 5 would allocate the statutory book values of the underlying securities to the new beneficial interests created, with any gain or loss being realized by the insurer only to the extent of any beneficial interests not retained. Transfers of structured securities to an affiliate (not including a trust that is beyond the control of the insurer or its subsidiaries) shall be accounted for in accordance with SSAP 25. Additionally, to the extent that the underlying securities are transferred to a trust that is beyond the contol of the insurer or its subsidiaries and 100% of the beneficial interests are retained by the insurer, no sale has occurred and the statutory book values of the underlying securities are transferred to the new beneficial interests created, with no gain or loss recognized. ~~to a related party as described above and any variation shall be accounted for under SSAP No. 25 for the portion of beneficial interests retained by the reporting entity. The portion of beneficial interests that are sold to unrelated and unaffiliated investors shall be accounted for under SSAP No. 91Rs. The Working Group concluded that the accounting and reporting guidance included in SSAP No. 25 shall overlay other statutory accounting guidance when the transfer or transaction involves a related or affiliated party. As a result, transfers of structured securities to a related party that qualify for sale treatment under paragraph 5 of SSAP No. 91R shall be transferred at fair value in accordance with SSAP No. 25. Care should be taken in constructing these transactions. Based upon the facts and circumstances for the transaction, if the regulator determines that sale treatment was obtained merely to avoid statutory accounting practices, related to the determination of risk-based capital levels, the transaction shall be accounted for under SSAP No. 25, paragraph 15d. (Domestic state legislation for transactions within an insurance holding company system – commonly defined as two or more affiliated persons, one or more of which is an insurer – may require commissioner notification or approval, as well as prohibit transactions designed to circumvent statutory thresholds and the resulting domestic commissioner review.)~~

Existing authoritative GAAP guidance relating to transfers of financial assets includes FAS 140 *Accounting for Transfers and Servicing of Financial Assets and extinguishments of Financial Liabilities*. FAS 140 provides for the carryover of the basis of the structured security to the extent that the beneficial interests created are retained by the transferor.

8. The Working Group reached a consensus on Issue 3 that re-securitization transactions where an insurer's intent is to obtain a re-rating of asset backed securities and to continue to hold a portion of the underlying cash flows, the re-securitization is not an intent to sell those securities for which the insurer retains the beneficial interests. Once re-securitized, the beneficial interests retained shall be reviewed for impairment in accordance with existing statutory accounting principles. This interpretation is not intended to limit transfers undertaken for other reasons or with other asset classes.~~The Working Group reached a tentative consensus on Issue 3 that if the reporting entity intends to re-securitize structured securities for which an other-than-temporary~~

~~impairment has not been recorded due to the decline in value was determined to be interest related, the reporting entity should record another-than-temporary impairment as of the date of the change in intent, prior to the date of resecuritization (ReREMIC).~~

9. The Working Group also expressed fair value determinations for either accounting or impairment shall be in accordance with *INT 09-04: Application of the Fair Value Definition* and that fair value shall not be based on the re-securitization transfer price.

INT 09-07 Status

10. Further discussion is planned.

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EMERGING ACCOUNTING ISSUES WORKING GROUP

Additional Handouts

1) Compilation of Rejected GAAP

STATUTORY ACCOUNTING PRINCIPLES WORKING GROUP

Additional Handouts

1) Ref # 2008-28: Property/Casualty Reinsurance – Memo and Proposed Journal Entries
2) Ref # 2009-06: Increase in Admission of Deferred Tax Assets – CNA Presentation
3) Interim Minutes – August 20, 2009
4) Interim Minutes – September 14, 2009
5) Issue Paper No. 140, Substantive Revisions to SSAP No. 43 (Historical Reference)
6) Ref # 2009-13: FASB Standards Codification – Modifications to Proposed Revisions

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Emerging Accounting Issues Working Group
Agenda Submission Form
Form B

Issue:
Compilation of Rejected Interpretations

Description of Transaction/Event/Issue:
The current practice for establishing statutory interpretations for all reviewed Consensus Positions of the FASB Emerging Issues Task Force (EITFs) has resulted with a significant number of interpretations included within Appendix B of the Accounting Practices and Procedures Manual (AP&P Manual) that reject U.S. GAAP guidance without providing additional statutory guidance, reject guidance on the basis of issues already rejected in a SSAP or that identify the GAAP guidance as not applicable to statutory accounting. The inclusion of these interpretations, as they summarize the GAAP standard and are similar to the structure and form of interpretations that adopt GAAP guidance, have been identified as potentially impairing the usefulness of information provided within Appendix B. It has been noted that the number of such interpretations hinders searches for applicable interpretations.

To illustrate, *SSAP No. 86—Accounting for Derivative Instruments and Hedging, Income Generation and Replication (Synthetic Asset) Transactions* (SSAP No. 86) includes references to eight interpretations on the face of the SSAP. In reviewing these interpretations, seven of these interpretations reject a GAAP EITF position on the basis of the guidance being non-applicable to statutory accounting, or reject the EITF in accordance with a position previously stated in the SSAP. Thus, for a user reviewing the interpretations as part of applying the SSAP, it would appear that the inclusion of these items as separate interpretations hinders the search to identify guidance that actually clarifies or interprets the SSAP No. 86 statutory guidance. It would seem that only including references on the face of the SSAP to INTs that adopt GAAP EITFS, that interpret the SSAP guidance, or that clearly reject the GAAP EITFs (i.e., referencing a compiled document of rejected GAAP), would be beneficial for users. Also, a listing that identifies rejected EITFs would provide assistance for users who are quickly trying to determine if a GAAP EITF is applicable for statutory accounting.

In accordance with paragraph 50 of the Preamble:

> As expressed in the Statement of Concepts, SAP utilizes the framework established by GAAP. This Manual integrates that framework with objectives exclusive to statutory accounting. The NAIC's guidance on SAP is comprehensive for those principles that differ from GAAP based on the concepts of statutory accounting outlined herein. **Those GAAP pronouncements that are not applicable to insurance companies will not be adopted by the NAIC**. For those principles that do not differ from GAAP, the NAIC may specifically adopt those GAAP Pronouncements to be included in statutory accounting. **GAAP Pronouncements do not become part of SAP until and unless adopted by the NAIC.** GAAP pronouncements that have been considered in the development of SAP include all issued pronouncements in categories a, b and c of the GAAP Hierarchy. **Future SAP pronouncements will specifically identify any GAAP pronouncements that are to be included in SAP whether in whole, in part, or with modification as well as any GAAP pronouncements that are rejected**. Future GAAP pronouncements which SAP has not yet addressed shall not be considered as providing authoritative statutory guidance.

GAAP EITFs are included within the lowest-level of the GAAP hierarchy considered for statutory accounting. For other GAAP pronouncements higher in the GAAP hierarchy (i.e., FASB Statements, Financial Accounting Interpretations, FASB Staff Positions, APB Opinions, AICPA Accounting Research Bulletins, FASB Technical Bulletins, AICPA Industry Audit and Accounting Guides, and AICPA Statement of Positions) the documentation of "non-applicable" GAAP from these sources continues to be

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included within Issue Paper No. 99. GAAP pronouncements that are "rejected", but pertain to a specific SSAP are not included within Issue Paper No. 99, but are listed in the 'Relevant GAAP Guidance' within the relevant SSAP.

Accounting Issues:

Issue 1: Should the interpretations included within Appendix B that either reject GAAP guidance without providing additional statutory accounting guidance or indicate that GAAP guidance is not applicable to statutory accounting be removed from Appendix B and simply included within a listing?

Issue 2: If the answer to the above Issue is yes, where should the rejected and "non-applicable" GAAP EITF listing be included within the AP&P Manual?

a. *Issue Paper No. 99—Nonapplicable GAAP Pronouncements* (Issue Paper No. 99) - Issue Paper No. 99 already includes reference to several "non-applicable" GAAP EITFS, as these items were previously included in this listing during the codification process. Emerging Accounting Issues Working Group began issuing separate INTs for the reviewed GAAP EITFS issued after 1996 and other issues to provide interpretations on SSAPs . If this option is selected, a change in policy would likely be required to allow the EAIWG the ability to include reference of rejected GAAP EITFs that pertain to specific SSAPs within the 'Relevant GAAP guidance' section of the relevant SSAP. GAAP EITFs that are clearly non-applicable to any specific SSAP would be included within Issue Paper No. 99.

b. A new INT that lists "rejected" EITFs captured within a new INT number (i.e., INT 99-00) could be listed on the front of the relevant SSAPs. To illustrate, SSAP No. 86 currently lists eight INTs, seven of which reject EITFs, and one which adopts part of an EITF. Under this proposal, SSAP No. 86, would then list two EITFs – 1) The INT number for the listing of rejected EITFS (i.e., 99-00), and 2) the INT which adopts part of an GAAP EITF. This would maintain a cross-reference on the face of the SSAP for rejected EITFs.

Authoritative Literature (excerpt applicable references):

Preamble –

III. Statutory Accounting Principles Statement of Concepts

24. SAP utilizes the framework established by GAAP. This document integrates that framework with objectives exclusive to statutory accounting. The NAIC's guidance on SAP is comprehensive for those principles that differ from GAAP based on the concepts of statutory accounting outlined herein. Those GAAP pronouncements that are not applicable to insurance companies will not be adopted by the NAIC. For those principles that do not differ from GAAP, the NAIC may specifically adopt those GAAP Pronouncements to be included in statutory accounting. **GAAP Pronouncements do not become part of SAP until and unless adopted by the NAIC**

VII. Relationship to GAAP

50. As expressed in the Statement of Concepts, SAP utilizes the framework established by GAAP. This Manual integrates that framework with objectives exclusive to statutory accounting. The NAIC's guidance on SAP is comprehensive for those principles that differ from GAAP based on the concepts of statutory accounting outlined herein. **Those**

> **GAAP pronouncements that are not applicable to insurance companies will not be adopted by the NAIC.** For those principles that do not differ from GAAP, the NAIC may specifically adopt those **GAAP Pronouncements to be included in statutory accounting. GAAP Pronouncements do not become part of SAP until and unless adopted by the NAIC.** GAAP pronouncements that have been considered in the development of SAP include all issued pronouncements in categories a, b and c of the GAAP Hierarchy. **Future SAP pronouncements will specifically identify any GAAP pronouncements that are to be included in SAP whether in whole, in part, or with modification as well as any GAAP pronouncements that are rejected.** Future GAAP pronouncements which SAP has not yet addressed shall not be considered as providing authoritative statutory guidance.

Issue Paper No. 99—Nonapplicable GAAP Pronouncements

1. This statement addresses Generally Accepted Accounting Principles (GAAP) pronouncements that are nonapplicable due to one of the following reasons:

    a. The pronouncement does not relate to the insurance industry;

    b. The pronouncement is not within the objectives of statutory accounting;

    c. The pronouncement would not add a substantive amount of guidance to statutory accounting due to the narrow scope of the topic;

    d. The pronouncement relates to transition of a previously issued GAAP pronouncement.

Activity to Date (issues previously addressed by Statutory Accounting Principles WG, Emerging Accounting Issues WG, SEC, FASB, other State Departments of Insurance or other NAIC groups):
None

NAIC Staff Recommendation:
Due to the number of Interpretations that reject GAAP without providing additional statutory guidance, or are not applicable to statutory accounting, the identification of interpretations that provide statutory guidance has become overshadowed by the amount of documentation included for rejected or nonapplicable GAAP guidance.

Issue 1 - While the Working Group does have the duty to document rejected GAAP guidance, staff believes that the current format is not user-friendly and results with a significant number of INTs that hinder the identification of relevant interpretations. I**t is recommended that the Emerging Accounting Issues Working Group adopt a process to incorporate “rejected” or “non-applicable” EITFs that do not provide additional statutory accounting guidance in a specific listing. In order to accomplish this change for the 2010 Manual, it is recommended that the Working Group expose an intent to remove all interpretations that reject GAAP guidance as “not applicable to statutory accounting” or that “reject” GAAP guidance without providing statutory accounting guidance from the AP&P Manual publications and document these GAAP pronouncements within a more user friendly listing.** Detail of the interpretations that would be removed pursuant to this recommendation has been included as an appendix.

Issue 2 - **On Issue 2, staff provides the following comments:**

1) Incorporate a new INT listing of rejected EITFs. This would incorporate a new document in Appendix B with the specific focus to record “rejected” GAAP. Although this would serve to retain the cross-reference on the face of the SSAP, it mirrors the function of Issue Paper No. 99,

which already includes several EITF references from pre-1996. If this is selected, the existing references within Issue Paper No. 99 could be moved to the new listing.

2) Utilize Issue Paper No. 99 to document the "non-applicable" GAAP EITFs, reviewed by Emerging. Although this would eliminate the cross-reference on the face of the SSAP, this Issue Paper already includes reference to several non-applicable GAAP EITFS. Under this proposal, a change in policy would likely be necessary to provide the EAIWG the ability to include reference of rejected GAAP EITFs within the 'Relevant GAAP guidance' section of each impacted SSAP.

Staff recommends that the process be changed so that future items reviewed by the EAIWG as part of the GAAP hierarchy that are initially recommended as 'not applicable for statutory accounting' would not be exposed as a tentative interpretation. Instead, such items would be exposed in the 'agenda submission form' (Form B) format, similar to the Statutory Accounting Principles Working Group process for a Form A, and if concluded as not applicable, simply be added to the location of the designated 'non-applicable GAAP EITF' listing.

Recommending Party:
NAIC Staff

NAIC Staff Review Completed by:
Julie Gann and Robin Marcotte
September 2009

G:\DATA\Stat Acctg\2. Emerging\A. Issues\a. Form Bs\1. Active Form B's\Compilation of Rejected INTs - 9-15-09.doc

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	Interpretation	Title / EITF	Statutory Status
1	INT 99-05	*EITF 97-1: Implementation Issues in Accounting for Lease Transactions, Including Those Involving Special-Purpose Entities*	Not Applicable
2	INT 99-06	*EITF 97-2: Application of FASB Statement No. 94 and APB Opinion No. 16 to Physician Practice Management Entities and Certain Other Entities with Contractual Management Arrangements*	Not Applicable
3	INT 99-07	*EITF 97-3: Accounting for Fees and Costs Associated with Loan Syndications and Loan Participations after the Issuance of FASB Statement No. 25*	Rejected – Guidance in SSAP No. 91
4	INT 99-08	*EITF 97-6: Application of Issue No. 96-20 to Qualifying Special-Purpose Entities Receiving Transferred Financial Assets Prior to the Effective Date of FASB Statement No. 125*	Not Applicable
5	INT 99-09	*EITF 97-7: Accounting for Hedges of the Foreign Currency Risk Inherent in an Available-for-Sale Marketable Equity Security*	Not Applicable
6	INT 99-11	*EITF 95-22: Balance Sheet Classification of Borrowings Outstanding under Revolving Credit Agreements That Include both a Subjective Acceleration Clause and a Lock-Box Arrangement*	Not Applicable
7	INT 99-12	*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*	Rejected – Consolidation
8	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*	Rejected – FAS 132 and EITF 96-18 was initially rejected in SSAP No. 13
9	INT 99-15	*EITF 97-10: The Effect of Lessee Involvement in Asset Construction*	Rejected – Guidance is in SSAP No. 22
10	INT 99-19	*EITF 97-9: Effect on Pooling-of-Interests Accounting of Certain Contingently Exercisable Options or Other Equity Instruments*	Not Applicable
11	INT 99-20	*EITF 98-1: Valuation of Debt Assumed in a Purchase Business Combination*	Not Applicable
12	INT 00-07	*EITF 97-15: Accounting for Contingency Arrangements Based on Security Prices in a Purchase Business Combinations*	Not Applicable
13	INT 00-13	*EITF 99-5: Accounting for Pre-Production Costs Related to Long-Term Supply Arrangements*	Not Applicable
14	INT 00-14	*EITF 99-6: Impact of Acceleration Provisions in Grants Made between Initiation and Consummation of a Pooling-of-Interests Business Combination*	Not Applicable
15	INT 00-15	*EITF 99-7: Accounting for an Accelerated Share Repurchase Program*	Not Applicable
16	INT 00-16	*EITF 99-11: Subsequent Events Caused by Year 2000*	Not Applicable

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17	INT 00-17	*EITF 99-13: Application of Issue No. 97-10 and FASB Interpretation No. 23 to Entities that Enter into Leases with Governmental Entities*	Not Applicable
18	INT 00-18	*EITF 99-15: Accounting for Decreases in Deferred Tax Asset Valuation Allowances Established in a Purchase Business Combination as a Result of a Change in Tax Regulations*	Not Applicable
19	INT 00-19	*EITF 99-18: Effect on Pooling-of-Interests Accounting on Contracts Indexed to a Company's Own Stock*	Not Applicable
20	INT 00-25	*EITF 97-4: Deregulation of the Pricing of Electricity*	Not Applicable
21	INT 01-08	*EITF 99-6: Accounting for Transactions with Elements of Research and Development Arrangements*	Not Applicable
22	INT 01-09	*EITF 99-19: Reporting Revenue Gross as a Principal versus Net as an Agent*	Not Applicable
23	INT 01-13	*EITF 00-15: Classification in the Statement of Cash Flows of the Income Tax Benefit Received by a Company upon Exercise of a Nonqualified Employee Stock Option*	Not Applicable
24	INT 01-15	*EITF 00-17: Measuring the Fair Value of Energy-Related Contracts in Applying Issue No. 98-10*	Not Applicable
25	INT 02-13	*EITF 00-4: Majority Owner's Accounting for a Transaction in the Shares of a Consolidated Subsidiary and a Derivative Indexed to the Minority Interest in That Subsidiary*	Not Applicable
26	INT 02-14	*EITF 00-6: Accounting for Freestanding Derivative Financial Instruments Indexed to, and Potentially Settled in, the Stock of a Consolidated Subsidiary*	Not Applicable
27	INT 02-16	*EITF 01-9: Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)*	Not Applicable
28	INT 03-04	*EITF 01-3: Accounting in a Business Combination for Deferred Revenue of an Acquiree*	Not Applicable
29	INT 03-06	*EITF 01-12: The Impact of the Requirements of FASB Statement No. 133 on Residual Value Guarantees in Connection with a Lease*	Not Applicable
30	INT 03-07	*EITF 00-19: Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, A Company's Own Stock*	Not Applicable
31	INT 03-08	*EITF 01-6: The Meaning of "Indexed to a Company's Own Stock"*	Not Applicable
32	INT 03-10	*EITF 01-14: Income Statement Characterization of Reimbursements Received for "Out-of-Pocket" Expenses Incurred*	Not Applicable
33	INT 03-11	*EITF 02-3: Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities*	Rejected – Inconsistent with guidance in SSAP No. 86
34	INT 03-13	*EITF 02-6: Classification in the Statement of Cash Flows of Payments Made to Settle an Asset Retirement Obligation within the Scope of FASB Statement No. 143*	Not Applicable
35	INT 03-14	*EITF 02-7: Unit of Accounting for Testing Impairment*	Rejected – FAS

		of Indefinite-Lived Intangible Assets	142 rejected in SSAP No. 68
36	INT 03-15	*EITF 02-8: Accounting for Options Granted to Employees in Unrestricted, Publicly Traded Shares of an Unrelated Entity*	Not Applicable
37	INT 04-04	*EITF 01-5: Application of FASB Statement No. 52 to an Investment Being Evaluated for Impairment That Will Be Disposed Of*	Rejected – FAS 52 is rejected in SSAP No. 23 and SSAP No. 31
38	INT 04-06	*EITF 02-13: Deferred Income Tax Considerations in Applying the Goodwill Impairment Test in FASB Statement No. 142*	Rejected – FAS 141 and FAS 142 rejected in SSAP No. 68
39	INT 04-08	*EITF 02-17: Recognition of Customer Relationship Intangible Assets Acquired in a Business Combination*	Rejected – FAS 141 and FAS 142 rejected in SSAP No. 68
40	INT 04-09	*Sales Incentives Offered to Resellers of Merchandise by Vendors as Discussed in EITF 02-16 and EITF 03-10*	Not Applicable
41	INT 04-11	*EITF 03-2: Accounting for the Transfer to the Japanese Government of the Substantial Portion of Employee Pension Fund Liabilities*	Not Applicable
42	INT 04-14	*EITF 03-6: Participating Securities and the Two-class Method under FASB Statement No. 128*	Rejected – Concept of EPS "not recognized or required" in SAP
43	INT 04-19	*EITF 00-22: Accounting for "Points" and Certain Other Time-Based or Volume-Based Sales Incentive Offers, and Offers for Free Products or Services to be Delivered in the Future*	Not Applicable
44	INT 04-22	*EITF 02-14: Whether the Equity Method of Accounting Applies When an Investor Does Not Have an Investment in Voting Stock of an Investee but Exercises Significant Influence through Other Means*	Rejected – Not consistent with guidance in SSAP No. 48 and 88
45	INT 04-23	*EITF 03-11: Reporting Realized Gains and Losses on Derivative Instruments That Are Subject to FASB Statement No. 133 and Not "Held for Trading Purposes" as Defined in Issue No. 02-3*	Rejected – Not consistent with guidance in SSAP No. 86
46	INT 04-24	*EITF 03-16: Accounting for Investments in Limited Liability Companies*	Rejected – Not consistent with guidance in SSAP No. 48
47	INT 04-25	*EITF Positions Related to Mining Activities: EITF 04-2, Whether Mineral Rights are Tangible or Intangible Assets, EITF 04-3, Mining Assets: Impairment and Business Combinations and EITF 04-4, Allocation of Goodwill to Reporting Units for a Mining Enterprise*	Not Applicable
48	INT 05-01	*EITF 04-8: The Effect of Contingently Convertible Instruments on Diluted Earnings per Share*	Not Applicable

49	INT 05-02	*EITF 04-1: Accounting for Preexisting Relationships between the Parties to a Business Combination*	Not Applicable
50	INT 05-03	*EITF 03-13: Applying the Conditions in Paragraph 42 of FASB Statement No. 144 in Determining Whether to Report Discontinued Operations*	Not Applicable
51	INT 06-03	*EITF 04-6: Accounting for Stripping Costs Incurred During Production in the Mining Industry*	Not Applicable
52	INT 06-04	*EITF 04-13: Accounting for Purchases and Sales of Inventory with the Same Counterparty*	Not Applicable
53	INT 06-05	*EITF 04-7: Determining Whether an Interest is a Variable Interest in a Potential Variable Interest Entity*	Not Applicable
54	INT 06-08	*EITF 04-5: Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights*	Not Applicable
55	INT 06-09	*EITF 05-5: Accounting for Early Retirement or Postemployment Programs with Specified Features (Such as Term Specified in Altersteilzeit Early Retirement Arrangements)*	Not Applicable
56	INT 06-11	*EITF 05-8: Income Tax Consequences of Issuing Convertible Debt with a Beneficial Conversion Feature*	Not Applicable
57	INT 07-02	*EITF 06-1: Accounting for Consideration Given by a Specific Provider to Manufacturers or Resellers of Equipment Necessary for an End-Customer to Receive Service from the Service Provider*	Not Applicable
58	INT 07-06	*FSP EITF 85-24-1: Application of EITF Issue No. 85-24 When Cash for the Right to Future Distribution Fees for Shares Previously Sold is Received from Third Parties*	Not Applicable
59	INT 08-01	*EITF 06-07: Issuer's Accounting for a Previously Bifurcated Conversion Option in a Convertible Debt Instrument When the Conversion Option No Longer Meets the Bifurcation Criteria in FASB Statement No. 133*	Not Applicable
60	INT 08-09	*EITF 04-10: Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds*	Not Applicable

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To: Statutory Accounting Principles Working Group
From: Ryan Couch and Robin Marcotte, NAIC staff
Date: September 18, 2009
Re: Property and Casualty Run-off Agreements

The Statutory Accounting Principles Working Group exposed and referred review of *Issue Paper No. 137 —Transfer of Property and Casualty Reinsurance Agreements in Run-off* and the related revisions to SSAP No. 62, to the Property and Casualty Reinsurance Study Group. The Study Group held a public call on September 15, 2009 to discuss the referral. Included in the materials for the Study Group discussion was alternative language prepared by the Reinsurance Association of America (RAA) for a proposed new paragraph 70 that provides more detail on the accounting treatment, as well as example journal entries for illustration. This language was also included in the Fall National Meeting public materials for the Statutory Accounting Principles Working Group consideration.

The Study Group discussed concerns expressed by regulators with respect to the Issue Paper and discussed the proposed accounting treatment with the RAA. Although the original Issue Paper indicated that agreements which met the criteria would receive prospective accounting treatment, the proposed treatment is actually not prospective accounting, but a hybrid accounting treatment that is more similar to loss portfolio accounting. The journal entries included and the language indicate that the ceding entity would record the consideration paid by the ceding entity as a paid loss. This keeps the gross reserves on the books of the ceding entity, but also allows a reinsurance credit. As one of the criteria for the contracts is that the losses be transferred without limitation and cannot be recaptured, this treatment avoids the loss development distortion that would occur in schedule P, if the ceding treated this as ceded reserves etc. The ceding entity does not show loss development after the day of cession, because while the ceding entity retains a credit risk with respect to the assuming entity, future development, either positive or negative, will only impact the assuming entity.

The Study Group voted to refer the item back to the SAPWG in support of adopting the Issue Paper and the new proposed accounting with a few minor technical clarifications provided below. Two members were opposed, one abstained. The Study Group recommended the following clarifications:

- That the last sentence be deleted from paragraph 9.

- The Study Group discussed that additional clarification to paragraph 69 was needed to make it clear that the commissioner approval discussed in paragraph 69 was to obtain the accounting treatment which varies from retroactive accounting. NAIC staff was directed to work with the RAA to further refine the intent of the wording in paragraph 69.

- While the Study Group agreed with the general description of the accounting in paragraph 70, they thought that additional minor clarifications were needed. NAIC staff was directed to work with the RAA to further refine the intent of the wording in paragraph 70.

- The Study Group agreed that the proposed accounting approach, was not intuitive, and recommends that the Working Group consider including journal entries (shown in the attached) as a possible exhibit to the SSAP and Issue paper. SSAP No. 62 currently includes an Exhibit A implementation guide. The journal entries could be Exhibit B or possibly folded into the end of Exhibit A.

RAA worked with NAIC staff to develop the language for paragraphs 69 and 70 shown in the attached. This language is consistent with the direction of the Study Group, but has not been re-reviewed by the Study Group. In the course of the discussions, a few more minor consistency items were noted. The list of changes is shown on the following pages.

List of recommended changes:

1. Paragraphs 9 – Discussion section, delete the last sentence- per P&C Reinsurance Study Group.

   9. It is contemplated that insurers and reinsurers would primarily use this option to exit unprofitable lines or products or as a way to cede off business the company is no longer writing. As it is possible that circumstances that might have made the product unattractive can change, this guidance is not intended to permanently prevent a company from reentering a line that was previously ceded in run-off. If questioned, the reporting entity shall be able to explain to the satisfaction of the affected states the change in circumstances regarding why a product that was previously considered a run-off product is now actively marketed. ~~A partial list of examples of reasonable explanations might include a material change in policy form, legal reforms in the geographic area, material changes in underwriting standards and or pricing etc.~~

2. Paragraph 31- consistency change noted by staff as not all of the exceptions to retroactive accounting are receiving prospective accounting.

   31. The accounting principles for retroactive reinsurance agreements in paragraph 29 shall not apply to the following types of agreements (which shall be accounted for as prospective reinsurance agreements unless otherwise provided in this statement):

3. Paragraph 69- with clarifications developed by RAA and NAIC staff:

   69. The accounting treatment for p~~P~~roperty and casualty run-off agreements must be approved by the domiciliary regulators of the transferring entity (either the original direct insurer in the case of a reinsurance agreement or the original assuming reinsurer in the case of a retrocession agreement) and the assuming entity. If the transferring entity and assuming entity are domiciled in the same state, then the regulator of the state where the majority of the transferred liabilities is located shall be asked to approve the ~~agreement~~accounting treatment. In determining whether to approve an agreement for this accounting treatment, the regulators shall require the following:

4. New paragraph 70 to describe the accounting in text and reference the exhibit with journal entries with clarifications developed by RAA and NAIC staff. Note the entire text below, has not been reviewed by the Working Group, but is tracked to show additional language, not reviewed by the Study Group. Make the existing Paragraph 70 number 71 and renumber following paragraphs.

   70. At the inception of the transaction, the transferring entity shall record the consideration paid to the assuming entity as a Paid Loss. If the consideration paid by the transferring entity is less than the loss reserves transferred, the difference shall be recorded as ~~is~~ a decrease in losses incurred. The assuming entity shall record the consideration received as a Negative Paid Loss. In addition, the transferring entity shall record an increase to Ceded Reinsurance Recoverable for the amount of the transferred reserve. Journal entries illustrating these transactions, including situations in which the transaction includes an unearned premium reserve, are included in Exhibit B of this Statement.

5. Staff will recheck paragraph numbering and cross referencing in the final document.

6. Journal entries, proposed by the RAA, and generally discussed by the Study Group-see attached.

Accounting & Blank Reporting for P&C Runoff Reinsurance Transactions
09/11/09

The following provides illustrative journal entries for P&C Runoff Reinsurance Transactions.

Example 1: Transfer of existing block of runoff business with no residual UPR on books of Transferor

Cedent/Transferor		**DR**	**CR**
Day 1 - Cedent transfers 50,000 in reserves for 50,000			
Ceded Reinsurance Recoverable (U/W Part 2A & Sched F)	Contra Liab ↑	50,000	
Cash	Asset ↓		50,000
Losses Paid (U/W Part 2 & Sched P)	I/S ↓	50,000	
Change in Reserves - Incurred Losses (U/W Part 2.)	I/S ↑		50,000
Unlike novation –gross reserves stay on books of transferor			
Day 360 - Negative Development on Transferred Business -3,000:			
Reinsurance Recoverable on Unpaid Losses (Sched. F)	Contra Liab ↑	3,000	
Reserves for Unpaid Losses (U/W Part 2A & Sched P)	Liab ↑		3,000
Day 540 – Reinsurer Pays the Loss @ Reported Reserve			
Reserves for Unpaid Losses (U/W Part 2A & Sched P)	Liab ↓	53,000	
Ceded Reinsurance Recoverable (U/W Part 2A & Sched F)	Contra Liab ↓		53,000
Reinsurer/ Transferee			
Day 1 - Cedent transfers 50,000 in reserves for 50,000			
Cash	Asset ↑	50,000	
Reported Losses on Reins. Assumed (U/W Part 2A & Sched P)	Liab ↑		50,000
Change In Reserves – Incurred Losses (U/W Part 2.)	I/S ↓	50,000	
Losses Paid or Incurred (negative) (U/W Part 2 &Sched P)	I/S ↑		50,000
Day 360 - Negative Development on Transferred Business -3,000:			
Change in Reserves – Incurred Losses (U/W Part 2.)	I/S↓	3,000	
Reserves for Unpaid Losses (U/W Part 2A & Sched P)	Liab ↑		3,000
Day 540 – Reinsurer Pays the Loss			
Reserves for Unpaid Losses (U/W Part 2A & Sched P)	Liab ↓	53,000	
Cash	Asset ↓		53,000

Comments:
The above is the same as prospective accounting for an Assumption Reinsurance transaction or LPT (when there is no surplus gain). Since the Transferor is ceding incurred losses neither party should have premium impacted. To do that would distort many financial ratios.

Example 2: Transfer of existing block of runoff business with some residual UPR of 10,000 on books of Transferor (this should be less common)

Cedent/Transferor		**DR**	**CR**
Day 1 - Cedent transfers 50k in reserves & 10k UPR for 60,000			
Ceded Reinsurance Recoverable (U/W Part 2A & Sched F)	Contra Liab ↑	50,000	
Unearned Premium Reserve (U/W Part 1& 1A)	Liab ↓	10,000	
Cash	Asset ↓		60,000
Ceded Premium Written (U/W Part 1B)	I/S ↓	10,000	
Losses Paid (U/W Part 2 & Sched P)	I/S ↓	50,000	
Change in Reserves - Incurred Losses (U/W Part 2.)	I/S ↑		50,000
Change in UPR (U/W Part 1& 1A)	I/S ↑		10,000
Unlike novation –gross reserves stay on books of transferor			
Day 180 – Premium is Fully Earned (Assumes 80% Loss Ratio)			
Ceded Reinsurance Recoverable (U/W Part 2A & Sched F)	Contra Liab ↑	8,000	
Reserves for Unpaid Losses (U/W Part 2A & Sched P)	Liab ↑		8,000
To mirror the increase in unpaid losses by the transferee			
Day 360 - Negative Development on Transferred Business -3,000:			
Reinsurance Recoverable on Unpaid Losses (Sched. F)	Contra Liab ↑	3,000	
Reserves for Unpaid Losses (U/W Part 2A & Sched P)	Liab ↑		3,000
Day 540 – Reinsurer Pays the Loss @ Reported Reserves (50+8+3)			
Reserves for Unpaid Losses (U/W Part 2A & Sched P)	Liab ↓	61,000	
Ceded Reinsurance Recoverable (U/W Part 2A & Sched F)	Contra Liab ↓		61,000
Reinsurer/ Transferee			
Day 1 - Cedent transfers 50k in reserves & 10k UPR for 60,000			
Cash	Asset ↑	60,000	
Reported Losses on Reins. Assumed (U/W Part 2A & Sched P)	Liab ↑		50,000
Unearned Premium Reserve (U/W Part 1& 1A)	Liab ↑		10,000
Assumed Premium Written (U/W Part 1B)	I/S ↑		10,000
Change In Reserves – Incurred Losses (U/W Part 2.)	I/S ↓	50,000	
Change in UPR (U/W Part 1& 1A)	I/S ↓	10,000	
Losses Paid or Incurred (negative) (U/W Part 2 &Sched P)	I/S ↑		50,000
Day 180 – Premium is Fully Earned (Assumes 80% Loss Ratio)			
Unearned Premium Reserve (U/W Part 1& 1A)	Liab ↓	10,000	
Reserves for Unpaid Losses (U/W Part 2A & Sched P)	Liab ↑		8,000
Change In Reserves – Incurred Losses (U/W Part 2.)	I/S↓	8,000	
Change in UPR (U/W Part 1& 1A)	I/S ↑		10,000
To record the increase in unpaid losses by the transferee			
Day 360 - Negative Development on Transferred Business -3,000:			
Change In Reserves – Incurred Losses (U/W Part 2.)	I/S↓	3,000	
Reserves for Unpaid Losses (U/W Part 2A & Sched P)	Liab ↑		3,000
Day 540 – Reinsurer Pays the Loss @ Reported Reserves (50+8+3)			
Reserves for Unpaid Losses (U/W Part 2A & Sched P)	Liab ↓	61,000	
Cash	Asset ↓		61,000

Comments:
In this second example, the portion of the runoff business that has an UPR associated with it is essentially booked as prospective reinsurance. Other elements of the example are the same except that we assumed an 80% loss ratio on the unearned portion of the business.

Initial Transaction
Paid Loss or Ceded Premium?

Illustration of the rationale for treating the initial transaction as a Paid Loss by the Cedent/Transferor and a negative paid loss by the Reinsurer/Transferee.

Rationale:

1. This is a transfer of an existing block of business in which typically all premiums have been earned. The cedent is essentially transferring the reserves on an existing block of runoff business for a final negotiated premium.
2. Treating the initial transaction as ceded premium would distort the I/S and standard ratios of the cedent.
3. Additionally, Schedule P for the Cedent/Transferor would be distorted since existing loss reserves would never be paid, resulting in favorable reserve development in Schedule P.
4. Treating the initial transaction as a paid loss is consistent with similar transactions like assumption reinsurance and LPTs(when there is no surplus gain) and better presents the true economics of the transaction.
5. Treating the initial transaction as a Paid Loss preserves the logical data flow in all of the U/W and investment exhibits, Schedule P and Schedule F.

Illustration: Assume $110,000 of earned premiums and the transfer of a runoff block of business representing $50,000 in reserves for $50,000 cash

Cedent I/S	Before Transaction	Recorded As Paid Loss	Recorded As Ceded Premium
Premiums Earned	110,000	110,000	**60,000**
Losses Incurred	85,000	85,000	**35,000**
Other U/W Expenses	30,000	30,000	30,000
Net U/W Gain (Loss)	(5,000)	(5,000)	(5,000)
Investment Income	7,000	7,000	7,000
Other Income	1,000	1,000	1,000
Net income	3,000	3,000	3,000
Loss Ratio	77%	77%	**58%**
Expense Ratio	27%	27%	**50%**
Combined Ratio	104%	104%	**108%**
Cedent B/S	Before Transaction	Recorded As Paid Loss	Recorded As Ceded Premium
Cash & Invested Assets	445,000	**395,000**	**395,000**
Reinsurance Recoverable on Unpaid Losses	45,000	45,000	45,000
EDP Equipment	1,000	1,000	1,000
Other Assets	9,000	9,000	9,000
Total Assets	500,000	450,000	450,000
Unpaid Losses and LAE	175,000	**125,000**	**125,000**
Unearned Premium	45,000	45,000	45,000
A/P and Accrued Expenses	3,000	3,000	3,000
Other Liabilities	2,000	2,000	2,000

Total Liabilities	225,000	175,000	175,000
Common Stock	10,000	10,000	10,000
PIC	90,000	90,000	90,000
Unassigned Surplus	175,000	175,000	175,000
Total Capital & Surplus	275,000	275,000	275,000
Total Liab. Capital & Surplus	500,000	450,000	450,000

Conclusion:

1. If you report the consideration paid by the Cedent/Transferor as a Paid Loss, there is no net effect on the B/S or I/S or key underwriting ratios.
2. If you report the consideration paid by the Cedent/Transferor as a Ceded Premium the effect on the I/S and underwriting ratios is dramatic.
3. Additionally, Schedule P for the Cedent/Transferor would be distorted since existing loss reserves would never be paid, resulting in favorable reserve development in Schedule P.

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Reinsurer I/S	Before Transaction	Recorded As Paid Loss	Recorded As Ceded Premium
Premiums Earned	110,000	110,000	**160,000**
Losses Incurred	85,000	85,000	**135,000**
Other U/W Expenses	30,000	30,000	30,000
Net U/W Gain (Loss)	(5,000)	(5,000)	(5,000)
Investment Income	7,000	7,000	7,000
Other Income	1,000	1,000	1,000
Net income	3,000	3,000	3,000
Loss Ratio	77%	77%	**85%**
Expense Ratio	27%	27%	**19%**
Combined Ratio	104%	104%	**104%**
Reinsurer B/S	Before Transaction	As Paid Loss	As Ceded Premium
Cash & Invested Assets	445,000	**495,000**	**495,000**
Reinsurance Recoverable on paid Losses	45,000	45,000	45,000
EDP Equipment	1,000	1,000	1,000
Other Assets	9,000	9,000	9,000
Total Assets	500,000	550,000	550,000
Unpaid Losses and LAE	175,000	**225,000**	**225,000**
Unearned Premium	45,000	45,000	45,000
A/P and Accrued Expenses	3,000	3,000	3,000
Other Liabilities	2,000	2,000	2,000
Total Liabilities	225,000	275,000	275,000
Common Stock	10,000	10,000	10,000
PIC	90,000	90,000	90,000
Unassigned Surplus	175,000	175,000	175,000
Total Capital & Surplus	275,000	275,000	275,000
Total Liab. Capital & Surplus	500,000	550,000	550,000

Conclusion:

1. If you report the consideration received by the Reinsurer/ Transferee as a negative Paid Loss, there is no net effect on the B/S or I/S or key underwriting ratios.
2. If you report the consideration paid by the Reinsurer/ Transferee as a Ceded Premium the effect on the I/S and underwriting ratios is dramatic.

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Executive Summary

- Issue: Existing deferred tax guidance arbitrarily limits admitted asset recognition, resulting in inconsistent and inappropriate statutory results
- Impediment to Change: Concern regarding realizability of asset, especially for marginally capitalized companies
- Recommended Resolution: Enhance RBC formula to isolate and evaluate risk of non-realizability while allowing GAAP-like recognition of future tax consequences in statutory financial statements
- Benefits: Accounting model consistently accounts for both the transactional activity and resulting tax consequences on an accrual basis while effectively monitoring solvency through RBC

Statutory Perspective

- During the last decade statutory accounting has evolved from a liquidation focused regime to a more GAAP-like accrual based framework focusing on economic impacts to insurers
- The following SSAPs are a few examples that demonstrate this trend:
  - SSAP No. 35 – Guarantee Fund and Other Assessments
  - SSAP No. 100 – Accounting for Pensions, A Replacement of SSAP No. 89
  - SSAP No. 92 – Accounting for Postretirement Benefits Other Than Pensions, A Replacement of SSAP No. 14

Statutory Perspective (cont.)

- During this same period, statutory guidance on tax consequences evolved only marginally resulting in inconsistent financial results:
  - Transactions reported on accrual basis
  - Tax consequences reported on modified cash basis
- This inconsistent view of the economics of transactions is misleading to the various users of the financial statements including regulators, policyholders, financial institutions, investors and rating agencies

U.S. GAAP Perspective

- FAS 109 was adopted in 1992 permitting full recognition of deferred tax consequences of all events, reduced by a valuation allowance where necessary
  - Valuation allowance is a "more likely than not" standard that some portion or all of the asset will not be realized
  - Valuation allowance and tax planning strategy reviewed by independent public accountants
  - Valuation allowance approach and judgments are well established in practice across all industries
  - During FAS 109 deliberations, FASB concluded accounting for a transaction on an accrual basis and the related tax consequences on a cash basis would be "inconsistent and inappropriate"

Solvency Metrics

- NAIC developed RBC as dynamic solvency tool to evaluate insurer's risk profile and determine minimum capital requirements
- Deferred taxes currently receive minimal risk consideration in RBC since the admitted balance is significantly and arbitrarily haircutted in the financial statements
- Other financial regulatory regimes such as the FSA and U.S. Banking Regulation allow full deferred tax asset (DTA) recognition in financial statements and limit recognition in its capital model

Proposed Resolution

- Adopt a FAS 109 approach for statutory accounting, full deferred tax recognition, non-admitting the portion deemed not be realizable using the “more likely than not” standard
- Monitor and adjust net deferred tax asset within RBC calculation on a sliding scale based on insurer’s capital adequacy, excluding benefit of net deferred tax asset
- Develop parameters limiting distribution of any favorable surplus impact of proposal

RBC Proposal

- Initially, insurer computes RBC excluding DTA balance
- Based on initial computation outcome, sliding scale haircut is applied to DTA to be included in final formula
- An initial RBC result closer to Authorized Control Level receives larger haircut
- Rationale is insurers with higher RBC result excluding DTA have a greater likelihood of realizing DTA
- Approach eliminates marginally capitalized companies relying on DTAs in capital metrics

CNA FINANCIAL CORPORATION

Accounting for Deferred Taxes | September 2009

RBC Example ($m)

Step #1 - RBC Calculation Excluding DTA Benefit (ACL)

RBC After Covariance (Authorized Control Level)	$250
2008 Surplus with FAS 109 Deferred Tax Assets	1,000
Deferred Tax Asset	(275)
Total Adjusted Capital excluding DTA	$725
RBC Ratio (Authorized Control Level)	290%

Step #2 - Deferred Tax Asset Haircut (ACL)	Haircut %
325% or greater	0%
300% - 324%	20%
275% - 299%	40%
250% - 274%	60%
225% - 249%	80%
224% or lower	100%

Step #3 - RBC Calculation With Deferred Tax Asset Haircut

RBC After Covariance (Authorized Control Level)	$250
Deferred Tax Assets	275
Total Adjusted Capital Excluding Deferred Tax Impact	725
Deferred Tax Asset With Haircut (60% pickup)	165
Total Adjusted Capital with Deferred Tax Impact	$890
RBC Ratio (Authorized Control Level)	356%

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CNA FINANCIAL CORPORATION

Accounting for Deferred Taxes | September 2009

Benefits of Proposal

- Results in consistently accounting for both transactional and resulting tax activity in the statutory accounting framework
- Effectively isolates, monitors and evaluates deferred taxes through RBC, the ultimate solvency tool
- Financial statement presentation and capital model evaluation similar to FSA and U.S. Banking models

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Draft: 8/25/09

Statutory Accounting Principles (E) Working Group
Conference Call
August 20, 2009

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met via conference call on Aug 20, 2009. The following Working Group members participated: Joseph Fritsch (NY), Chair; Jim Armstrong, (IA) Vice Chair; Ann Tang (CA); Linda Sizemore (DE); Tom Ratsch (IL); Stewart Guerin (LA); Judith A. Weaver (MI); Thomas Burke (NH); Matti Peltonen (NY); Dale Bruggeman and Barry Ankrom (OH); Steve Johnson (PA); Jaime Walker (TX); Doug Stolte and David Smith (VA); and Peter Medley (WI). Kirk Regner (AZ) and Kathy Belfi (CT) also participated.

1. Presentation of Deferred Tax Asset Proposals

The Working Group held a conference call to receive a presentation from the American Council of Life Insurers (ACLI) on an alternative approach for admitting deferred tax assets (DTAs) within *SSAP No. 10—Income Taxes* (SSAP No. 10).

a. Presentation from the American Council of Life Insurers (ACLI)

Frank Svoboda (Torchmark Corporation – representing the ACLI) presented the ACLI proposal for admitting DTAs within the statutory financial statements (Attachment A). Pursuant to the ACLI presentation, the ACLI proposes to modify SSAP No. 10, paragraph 10, to: 1) allow the admittance of DTAs that are expected to be reversed within three years of the balance sheet date; 2) continue to admit eligible DTAs to the extent of taxes previously paid and recoverable; and 3) for the remaining eligible DTAs, increase the current surplus limitation of 10% to 15% of adjusted capital and surplus.

In response to a question from Ms. Belfi, Mr. Svoboda advised that the proposed revisions would be applicable to both life and property and casualty companies. Mr. Bruggeman inquired how companies would apply the proposal to capital gains and losses and operating income. Mr. Svoboda advised that SSAP No. 10 requires the character of income to be considered. Thus, the company would have to differentiate and identify capital gains to offset capital losses, and would not be apply to match-up capital losses with operating results. Mr. Svoboda discussed the tax-strategy planning provisions currently allowed within SSAP No. 10, which requires entities to illustrate that the strategy is prudent and feasible, but that the entity is not required to implement the tax-planning strategy. Mr. Svoboda noted that the guidance does not allow projection of future capital gains. In response to a question from Mr. Regner regarding how the RBC haircut would apply for entities that do not utilize RBC, i.e., mortgage guaranty insurers, Mr. Svoboda advised that he would research this issue. Mr. Fritsch noted that entities that fall below RBC would experience an increasing detrimental effect, as under the proposal they would no longer be able to admit the DTA. Mr. Svoboda agreed that this would occur. Mr. Svoboda advised that property and casualty companies have a two-year carry-back limitation under tax law. Therefore, as these entities are limited by the tax-law, they would not be allowed to admit anything that was not recoverable within two-years, even if the statutory guidance permitted up to three-years.

Mr. Fritsch noted that the current guidance within SSAP No. 10, paragraph 10a, was not originally established with a surplus cap as the items would be realizable within one-year, and it was determined that it would be relatively easy to verify whether the DTA was recoverable. He advised that such verification will be difficult if the provision was extended to a three-year period. Mr. Svoboda advised that since this paragraph addresses loss carrybacks, there is certainty that the amounts will be recovered. He explained that in 2010, if a life company had a reversing taxable difference and there was no taxable income, then the entity would be able to receive an additional tax refund. If there was taxable income, then the carryback would reduce the taxes payable. In either scenario, the entity receives a benefit from the carryback. Mr. Bruggeman clarified that under the application of paragraph 10a, the entity does not have to project taxable income. Regardless of the income, the reversal will occur to the extent there was taxes-paid in the carryback period. If there was no taxable income in the prior period, no admittance would occur under paragraph 10a, and then income would need to be projected in order to admit DTAs under paragraph 10b. Mr. Fritsch stated that in order for the DTA to captured within 10a, it would have to be based on taxes paid. Mr. Svoboda agreed and noted that in order to move to paragraph 10b, the entity would have to illustrate anticipated future taxable income. If an entity has not paid taxes in recent years, it would be difficult for an entity to illustrate that they anticipate future taxable income. For an entity that has continuously had taxable income, it would be reasonable to expect future taxable income.

In response to the ACLI presentation, Birny Birnbaum (Center for Economic Justice—CEJ) presented their view and the view of the Consumer Federation of America (CFA). Mr. Birnbaum stated that the CEJ and CFA strongly oppose the ACLI

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proposed changes to the accounting treatment for DTAs. He advised that statutory accounting is different, and more conservative, from tax accounting to ensure that insurers have sufficient liquid assets and resources to weather unexpected economic conditions and events to protect policyholders. Contrary to comments of the ACLI, statutory accounting is not designed to reflect the economic condition of the insurer to investors.

Mr. Birnbaum advised that the effect of the ACLI proposal is to include a greater amount of non-liquid assets in surplus and to create risky and unreliable projections about DTAs. Contrary to the ACLI claims, the proposed change harms consumers by reducing the amount of true liquid resources available to the insurer. By counting more DTAs in surplus, less cash is needed to meet regulatory capital standards. The ACLI argues that DTAs are due to timing differences between statutory and tax accounting for certain expenses and that the differences reverse over time. Both of these statements are true. But what ACLI fails to point out is that over time aggregate DTAs maintain or grow because the insurer is continually adding new DTAs while retiring old DTAs. While the creation of DTAs is due to accounting timing differences, the fact remains that DTAs continue and are not available as cash for the insurer. The proposal to increase DTA from 10% to 15% of surplus means that cash-type assets will become a smaller portion of surplus.

Mr. Birnbaum stated that the proposal to extend the projection period to three years is particularly ill-advised. While an insurer could reasonably estimate DTAs a year ahead in a stable environment and market -- no great changes in expenses or net income -- a reasonable projection cannot be made during an unusual economic period and clearly cannot be made reasonably three years into the future. He stated that it is specifically the purpose of surplus to provide the insurer with a cushion during unexpected times. As an example, an insurer makes a large profit in year one, in part, because of significant increases in sales. Substantial DTAs are generated because the insurer has more income on a tax basis than on a statutory basis. But in year two, there is a financial crisis resulting in lower sales and net losses. The DTAs disappear. The DTAs were "good" assets as they offset the negative DTAs of year two, but the DTAs were never available to the insurer to protect policyholders.

Mr. Birnbaum advised that they are particularly concerned that the ACLI proposal reflects an effort to carry the massive 2008 losses forward via DTAs for two years more than currently allowed. He noted that there is no basis for ACLI claims that the proposed change will more accurately reflect the true financial condition of the company. Rather, this would certainly reflect a less accurate condition of the meaningful surplus available to the company.

Mr. Birnbaum stated that there is no evidence that the current treatment of DTAs reflect over-conservatism, as claimed by ACLI and certainly no basis for the claim that the current rule harms consumers. If the current rule was overly conservative, Mr. Birnbaum questioned why a number of insurers experienced financial stress in the past year, including some seeking federal assistance and many seeking capital and surplus relief. Mr. Birnbaum recommended that the regulators not rely on the unsubstantiated assertions by ACLI that fill its presentation.

Mr. Birnbaum advised that the ACLI proposal, if enacted, would increase the speed of decline for financially stressed insurers. As an insurer moves into financial distress, the insurer would lose the DTAs with a resulting reduction in surplus – thereby speeding the insurer's decline in financial condition. He also advised that the proposed limitation on DTAs for distressed insurers is based on the fact that the DTAs are not useful assets – not useful for protecting consumers and, therefore, not counted. Mr. Birnbaum then inquired why DTAs should be counted if a company is not in financial peril, and if the accounting for an asset should change based on the financial condition of the company.

Mr. Birnbaum stated that the proposed ACLI change is profoundly anti-consumer and should be rejected. He stated that the CEJ and CFA are stunned that the NAIC continues to spend time considering these give-aways to insurers while not addressing the problems faced by consumers in the aftermath of the financial market crisis and recession from insurers' use of consumer credit information.

Mr. Svoboda responded to Mr. Birnbaum comments noting that not all other assets admitted within financial statements are currently liquid and readily convertible to cash. The requirement under *SSAP No. 4—Assets and Nonadmitted Assets* (SSAP No. 4) requires the assets to be convertible to pay claims as they are anticipated to come due and payable. With the proposed guidance for DTAs scheduled to reverse within three-years, such DTAs will create real cash-flow to assist with policyholder obligations, in the reduction of tax obligation, as these items relate to an event that has already occurred within the financial statements. Mr. Birnbaum responded by providing a situation where a company was profitable in one-year and received a large DTA. If the company then lost money, and had tax losses, the 'funds' that were going to be available to pay claims do not materialize. Such a situation is troublesome if predicting out income or losses over three-years, particularly as the current market has illustrated how the solvency of life insurers could quickly change in the course of one year. Such predictions could occur in periods of stable markets, but the premise of surplus is to protect policyholders during unstable times.

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Mr. Stolte stated concerns with the three-year recoverable period as the projections are based on unaudited forecasts and budgeted numbers, and if such numbers are not available, would be based on industry trends. Mr. Stolte stated that Mr. Birnbaum provided some very strong points regarding the volatility of surplus. Mr. Stolte noted that the statutory statement of concepts of conservatism, consistency and recognition need to be considered. Mr. Svoboda noted that auditors would need to be 'comfortable' with company projections if the DTA was based on the company's forecasts and projections. It was noted, however, that such forecast or budget numbers would otherwise not be audited as a matter of course.

Keith Bell (Travelers) noted that the ACLI proposal also brings RBC into the equation for DTAs. He inquired whether auditors would also be required to audit the RBC calculation in order to admit the DTA. Mr. Svoboda noted that this issue has not yet been discussed, and would need further research, but suggested that the auditors would not need to audit the calculations per se, but just on how the RBC factor was being applied in the DTA calculation. Mr. Bell inquired how often the RBC calculation would be required, and if the prior year calculation would be applied for the subsequent year's quarters. Mr. Fritsch stated that this needs to be clarified, but that he assumes that the year-end RBC calculation would be utilized for the subsequent quarters, with no update needed for the quarters. Mr. Bell noted that recalculating the RBC quarterly would be problematic for property and casualty companies. Mr. Svoboda noted that it is intended for the RBC calculation to be based on the prior year-end.

Mr. Ratsch inquired whether the DTA would be buried if included as a write-in amount, and the rationale about splitting the DTA from a write-in and a regular item when it is also disclosed in the notes. Mr. Svoboda noted that the idea of having the item as a write-in would result with a greater amount of visibility and it would be easier to separately identify as needed to figure out restrictions, such as for dividend calculations. Mr. Tittle noted that in the pdf submission of the financial statements, the individual write-ins can be separately identified. The main line item is aggregated, but the items are separately noted within the pdf version.

Mr. Fritsch noted concerns with incorporating guidance within the statutory accounting rules regarding dividend restrictions as these sort of restrictions are governed by state statutes or law. Mr. Tittle noted that NAIC staff would look into this question. Mr. Bell inquired whether any surveys were completed to identify the magnitude of the proposed ACLI changes. Mr. Svoboda advised that he is unaware of any surveys or analyses completed to quantify the impact, but that he would follow-up with the representatives of the ACLI. Mr. Bell noted that entities would have to complete this calculation, as additional detail is necessary from what is provided in the data within the filed financial statements. Ms. Marcotte noted that the proposed ACLI change does not simply increase the admitted DTA from 10% to 15% to surplus, as the proposed change would effectively move more items from paragraph 10b into paragraph 10a, and paragraph 10a does not have a surplus limit. Mr. Smith stated that when the ACLI performs an analysis of the impact, he would like to request identification of the amounts that are classified within paragraph 10a and paragraph 10b under the proposed guidance, and comparison of those amounts to what is reported under the current statutory guidance.

Jeff Alton (CNA) advised that CNA has a proposal for DTAs that differs from the ACLI proposal and requested time at the 2009 Fall National Meeting to present their proposal. Mr. Bell stated support for the CNA proposal as it is not as complex as the ACLI approach. Joseph Sieverling (Reinsurance Association of America—RAA) also stated support for hearing the CNA proposal. Mr. Fritsch advised that Working Group would hear the CNA proposal during the upcoming National Meeting.

Having no further business, the Statutory Accounting Principles (E) Working Group adjourned.

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Draft: 9/15/09

Statutory Accounting Principles (E) Working Group
Conference Call
September 14, 2009

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met via conference call on Sept. 14, 2009. The following Working Group members participated: Joseph Fritsch (NY), Chair; Jim Armstrong, (IA) Vice Chair; Kim Hudson (CA); Linda Sizemore (DE); Tom Ratsch (IL); Stewart Guerin (LA); Judith Weaver and Kristen Hynes (MI); Thomas Burke (NH); Matti Peltonen (NY); Dale Bruggeman (OH); Steve Johnson and Dave Delbindo (PA); Jaime Walker (TX); Doug Stolte and David Smith (VA); and Peter Medley (WI).

1. Public Hearing

The Working Group held a public hearing to review comments (Attachment One-A) on the exposed *SSAP No. 43—Loan-backed and Structured Securities - Revised* (SSAP No. 43R).

a. Agenda Item 2004-11 (Exposed SSAP No. 43R)

Mr. Fritsch identified that comments had been received from the exposure of SSAP No. 43R. Mr. Fritsch advised that the interested parties had submitted marked-draft changes on the exposed SSAP No. 43R addressing several technical items. Mr. Fritsch requested John Tittle (NAIC) to first present the proposed technical revisions. In response to a request from Mr. Fritsch, Mr. Tittle presented each technical revision proposed by the interested parties' on a paragraph-by-paragraph basis. (The interested parties' proposed revisions were included as a supplement to their comment letter and are included within Attachment A.) The Working Group agreed that several of the proposed changes improved the readability or clarity of the guidance and agreed to incorporate technical changes into SSAP No. 43R as identified below:

- Proposed change in paragraph 4, modified to reflect "or other securities."
- Proposed changes in paragraph 6, only to revise all references of "Loaned-backed" to "Loan-backed."
- Proposed changes in paragraph 12, modified to reflect, "The following guidance applies to loan-backed and structured securities for which it is probable that the investors will be able to collect all contractually required payments receivable. (Paragraphs 17-19 provide guidance for securities in which collection of all contractual cash flows is not probable and paragraphs 20-24 provide guidance for beneficial interests.)"
- All proposed changes within paragraph 17.
- All proposed changes within paragraph 18.
- Proposed wording change in paragraph 19b.
- All proposed changes within paragraph 20, including footnote additions and changes.
- All proposed changes within paragraph 21.
- All proposed changes within paragraph 22.
- Proposed deletion of guidance within paragraph 27. The Working Group also agreed to modify this paragraph to incorporate new language and include clarifying paragraph references. The revised paragraph reads as follows: "The application of this reporting requirement resulting from NAIC designation (i.e., lower of cost or fair value) is not a substitute for other-than-temporary impairment recognition (paragraphs 32-36). For securities reported at fair value where an other-than-temporary impairment has been determined to have occurred, the realized loss recognized from the other-than-temporary impairment shall first be applied towards the realization of any unrealized losses previously recorded as a result of fluctuations in the security's fair value due to the reporting requirements. After the recognition of the other-than-temporary impairment, the security shall continue to report unrealized gains and losses as a result of fluctuations in fair value."
- All proposed changes within paragraph 36.

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Julie Gann (NAIC) then presented the comments submitted by Sungard iWorks Financials (Sungard) on the exposed SSAP No. 43R regarding bifurcation of AVR/IMR. She noted that Sungard's comments indicated that the rules for AVR/IMR classification currently provide for a simple determination based upon NAIC designation. The comments suggest that it is inconsistent to carve-out the losses resulting from other-than-temporary impairment recognition per SSAP No. 43R using different standards and analysis. The comments propose a new project to revisit the rules for IMR/AVR classification as a larger project. Ms. Gann advised that the existing rules that detail the AVR/IMR determination based upon NAIC designation are intended to address the classification of AVR and IMR when the security is sold. The proposed guidance within SSAP No. 43R is intended to only provide guidance when the security has a recognized loss for an other-than-temporary impairment. Sunguard is suggesting a larger project to reassess the classification of AVR and IMR. Ms. Gann also noted that historically there have been different treatment of impairment losses for loan-backed securities in the AVR and IMR. To address previous concerns with recording other-than-temporary impairments completely through the AVR, staff proposes that the Working Group retain the AVR/IMR bifurcation as exposed within SSAP No. 43R. Dennis Lebar (Sungard) advised that their concerns primarily focus on inconsistencies, as the same security could have different treatment among entities between AVR and IMR depending on recognition of other-than-temporary impairments. He advised that all securities will have a component of "credit-related" impairment and stressed that a larger project would be more appropriate. After considering the comments, the Working Group did not support incorporating revisions into SSAP No. 43R and agreed to retained the exposed language.

Mr. Tittle then presented proposed revisions to the SSAP No. 43R disclosures submitted by interested parties. Mr. Tittle noted that interested parties proposed retaining an existing disclosure from SSAP No. 43, which requires disclosure of the adjustment methodology for each type of securities (i.e., whether it is prospective or retrospective). Mr. Tittle advised that NAIC staff is supportive of this proposed revision. The Working Group agreed to incorporate this disclosure. Mr. Tittle then advised that the interested parties are proposing aggregate disclosure presentation of the securities recognized as other-than-temporarily impaired based on the present value of cash flows expected to be collected. Mr. Smith advised that they strongly believe individual security disclosure for these items is necessary in order to allow appropriate regulator analysis of the cash-flow assessments. Mr. Smith advised that although some information is included within Schedule D, the proposed disclosure information is desired on an individual basis within a note to the financial statements in order to assist regulators in identifying this information. Rose Albrizio (AXA Equitable) advised that interested parties are proposing aggregation due to the extent of information that will be required in a quarterly financials, as well as the fact that the information is already available within Schedule D. Mr. Medley advised that the information will likely be presented in the year-end Schedule D information, but that the Schedule D submitted with the quarterly financial statement may not include this information. In response to an inquiry from Mr. Fritsch, Ms. Albrizio advised that the extent of disclosures will depend on the type of portfolio for each specific insurance company, and could result in a significant amount of disclosures. Ms. Albrizio stated that from a reporting standpoint, the extent of disclosures required on a "per security basis" continues to grow. Rob Axel (Prudential) estimated that the number of securities reported may be 50 to 100 or more based on the reporting entity's portfolio. He advised that requiring this level of detail in a financial statement disclosure is not consistent with previous reporting decisions. Mr. Stolte stated that for consistency and comparability as well as the ability to identify outliers on the valuation, this information is necessary within the financial statements. He advised that with the allowances given to the industry from SSAP No. 43R, the industry should provide the desired disclosure information.

Alan Close (ACLI) stated that the required aggregate summary disclosure will inform regulators of the magnitude of these other-than-temporary impairments. This aggregate disclosure could then point to Schedule D, and as Schedule D provides the information on a "per security basis," the regulator could review this information if further scrutiny were desired. Mr. Medley advised that the Schedule D provided in the quarterly financial statements does not provide the detail necessary, and the disclosures within SSAP No. 43R are requested quarterly. Mr. Medley requested the inclusion of an electronic template to assist reporting entities in completing this disclosure uniformly, potentially in an additional schedule within the blanks. Mr. Close advised that column 14 of Schedule D - Part 1 provides information on other-than-temporary impairments. Mr. Armstrong reiterated that the concern is with the quarterly financial statements, especially with the September 2009 transition period as regulators are going to want to see the impact on a CUSIP-by-CUSIP basis. Mr. Armstrong stated support for the individual disclosures as suggested by Virginia and Wisconsin. Mr. Stolte advised that if the information is readily and easily available, the industry should include this information within the specific note to the financial statements.

Leigh Wilson (KPMG) inquired whether the detailed information included within the notes would also be included within the audited financial statements. Mr. Stolte advised that this information is included within the footnotes, and therefore should be audited. Mr. Medley advised that these footnotes will assist regulators in identifying significant deviations among companies. Mr. Fritsch stated that it appears the will of the group is to include the detail within the financial statements. He requested the creation of a template to assist with consistent disclosures. He stated that after year-end 2009, the Working Group could reevaluate and amend this disclosure requirement if they believe an aggregate disclosure would be sufficient. Mr. Smith reminded that this individual detail is only required for those securities that are considered other-than-temporarily impaired

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due to cash flow assessments, and not securities recognized as other-than-temporarily impaired because the entity intends to sell, or because the entity does not have the intent and ability to hold.

Mr. Fritsch directed interested parties to present their comments on the topic of "intent and ability to hold securities until the recovery of the cost basis" and their proposed alternative language for paragraph 30. Jay Muska (Travelers) stated that their proposed revisions were trying to clarify what it means for "intent and ability" at a point in time. The proposed revisions try to point to circumstances that could occur in the market that would justify changing a reporting entity's initial assertion. Mr. Fritsch inquired whether a reference to *SSAP No. 9—Subsequent Events* (SSAP No. 9) could be added, without adding the additional language proposed by the interested parties. Mr. Stolte stated significant concerns with the interested parties proposed language "shall not call into question" as this language seems to codify the ability for reporting entities to change assertions and block regulators and auditors from questioning situations in which securities are sold after the company makes an assertion on the intent and ability to hold. Mr. Stolte stated support for the original language, without revisions. Mr. Medley stated amazement when reading the interested parties proposal, as the language seems to imply that the interested parties want a safe harbor from applying this accounting guidance. Mr. Medley stated that this approach is inconsistent with any other SSAP. Mr. Smith stated that the audit guidance should not be incorporated within the accounting standards.

Lily Hu (Sunlife) stated that if there is an intent to sell the security, then an other-than-temporary impairment recognition is necessary. Thus, if there is no intent to sell, than an other-than-temporary impairment is not required. Robin Marcotte (NAIC) advised that if there is no intent to sell, then the entity must assess whether they have the intent and ability to hold the security until recovery of the cost basis. Also, if a non-interest related decline exists - when the present value of cash flows is less than the amortized cost of the security - the entity must also recognize an other-than-temporary impairment. Ms. Hu inquired what proof is necessary to verify a reporting entity's intent and ability to hold a security. Mr. Tittle stated that this would depend on the facts and circumstances on the situation. He advised that this issue would be more related to audit and examination requirements. Mr. Muska inquired whether the "intent and ability" would be interpreted consistently. Ms. Hu inquired whether these assertions would be made by management assessments. Mr. Fritsch stated that the intent and ability assertions would be made by management assessments. Mr. Muska inquired whether the phrase "generally not call into question" would be considered as a modification from the interested parties proposed guidance to replace the previously proposed "shall not call into question" language. Mr. Stolte and Mr. Medley both stated that even with this revision they would not support the proposed interested parties' language. Mr. Fritsch stated that it is difficult to put a bright-line test on this guidance.

Mr. Axel advised that paragraph 29 addresses the intent of sell, and paragraph 30 addresses the intent and ability to hold. He advised that experience has shown that there are operational challenges in applying and interpreting the guidance included within paragraph 30 of the exposed guidance. Without clarifying guidance, the interested parties foresee challenges with the actual application of this guidance. Mr. Stolte stated that they cannot support the "shall not call into question" language proposed by the interested parties. Mr. Fritsch noted that with the safe harbor guidance proposed by the interested parties, it would seem that everyone would have the intent and ability to hold a security until the security was actually sold. Ms.Hu inquired whether the reporting entity would be required to provide their assessment of how long it would take before the security would recover the amortized cost basis. Mr. Axel advised that the language proposed by interested parties' is not intended to create a safe harbor, but is intended to identify specific events that would support changes from an original assertion on the intent and ability to hold. Mr. Medley stated that supporting documentation held by the reporting entity would likely be considered by auditors if actions occurred that were contrary to the original assertion, but the language proposed seems to incorporate a safe harbor for all circumstances. Mr. Stolte stated that an alternative to the requirement in paragraph 30 would be to retain SSAP No. 98. Mr. Fritsch stated that the subsequent event guidance in SSAP No. 9 would address situations in which events subsequent to the balance sheet date occurred. Mr. Fritsch inquired whether any of the Working Group members were interested in making changes to paragraph 30. As no Working Group members indicated interest in modifying this guidance, Mr. Fritsch stated that no changes would occur and the language exposed would be retained.

Ms. Gann presented the comments submitted by Sungard on the exposed SSAP No. 43R guidance regarding the proposed Sept. 30, 2009 effective date. Ms. Gann noted that Sungard's comments indicated that several issues make the proposed Sept. 30, 2009 effective date impractical. These issues include system considerations, educational and internal procedures, and that the exposed SSAP No. 43R guidance differs from GAAP. Ms. Gann noted that Sungard's comment letter was the only comment received on the effective date from the current exposure draft. She noted that from the prior exposure period, comment had been received from interested parties noting that they believe the Sept. 30, 2009 application of SSAP No. 43R is feasible. Ms. Gann reminded that SSAP No. 98 was previously adopted with a Sept. 30, 2009 effective date. Dave Zdechlik (Sungard) stated that pushing back the effective date would be beneficial. Mr. Fritsch stated that the companies who have difficulty applying the guidance should approach their state for an extension in their third quarter financials. Mr. Fritsch

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advised that he would not support delaying the effective date of SSAP No. 43R past Sept. 30, 2009, and if it was delayed, he would support with having SSAP No. 98 come into effect.

Wally Givler (Northwestern Mutual) presented the interested parties comments on the transition guidance. He advised that the current draft does not allow those companies that early-adopted SSAP No. 98 in 2008, or those companies that had a prior policy to impair to fair value to adjust the cost-basis of securities or make cumulative adjustments. Many interested parties believe this is punitive as these companies had originally followed more conservative accounting. Mr. Givler advised that the interested parties have proposed two different proposals to revise the transition guidance, noting that either would eliminate this punitive impact. Mr. Fritsch stated that he was sympathetic to those companies that had early-adopted SSAP No. 98 in 2008 and would be fine with allowing those companies to apply the proposed transition guidance. Mr. Fritsch stated that he was uncomfortable with expanding the transition guidance to companies that had previously adopted a policy to write-down securities down to fair value as this was a specific decision previously made by a company. Mr. Smith inquired whether the cumulative effective adjusted would be made as of July 1, 2009. Mr. Fritsch agreed as this would prevent reporting entities from having to amend their prior statements. Ms. Hu inquired whether the Sept. 30, 2009 effective date would require a transition to an earlier date. Mr. Tittle confirmed that that under the transition guidance, the proposed guidance allows some reporting entities to have a cumulative effect adjustment.

Mr. Givler confirmed that the interested parties proposal would encompass both reporting entities that had early-adopted SSAP No. 98 in 2008, as well as companies that had an a company policy to write other-than-temporary impaired securities to fair value. Mr. Givler advised that the interested parties had previously interpreted the transition guidance within the previous exposed version, dated July 15, 2009, to also include companies making write-downs to fair value in accordance with company policy. Mr. Givler advised that the proposed language included within the current interested parties comment letter was developed with collaboration with members of the AICPA. Mr. Fritsch reiterated that he is fine with modifying the transition guidance to include companies that had early-adopted SSAP No. 98 in 2008, but was concerned with including all companies that had previously written down other-than-temporarily impaired securities as part of company policy. In response to a request on the will of the Working Group on this issue, Mr. Hudson advised that the intent of the previously exposed guidance was to allow adjustment for the early SSAP No. 98 adopters only.

Marty Carus (AIG) informed the Working Group that the proposed transition guidance would result with different treatments for different companies based on whether they early-adopted SSAP No. 98, when they early-adopted the SSAP No. 98 guidance, and if the company did not early adopt as they already had a more conservative approach based on company policy. He stated that the accounting requirements should not result with this different treatment. Mr. Carus stated that the interested party's proposal is not an attempt to game the system, but to allow consistent accounting treatment when SSAP No. 43R is effective, regardless of the prior treatment. Mr. Fritsch stated that if desired, the Working Group could consider going back to SSAP No. 98 as this SSAP would allow consistent treatment, and this topic would be eliminated as an issue. Mr. Carus noted that SSAP No. 98, and the requirement to write down to fair value, when the company is going to generate cash flows that exceed fair value is not appropriate.

Dan Ross (Scottish Re) advised that their comments mirror those presented by the interested parties, and the disparities that would result among companies. Mr. Smith stated that valuations between companies, as a result of insurers adopting company policies that differ from statutory, have previously resulted with different measurements of the securities. Mr. Carus noted that his company did not previously see the need to make a formal declaration that they were early-adopting SSAP No. 98, as they were already following a more conservative approach to write securities down to fair value. Mr. Carus noted that if the transition guidance is revised as desired by interested parties, as of Sept. 30, 2009, the companies will be following the same guidance as they are afforded the same accounting treatment. Deborah Whitmore (Ernst & Young) advised that under GAAP all companies, once they adopted the GAAP guidance, were placed on the same basis. Thus, different companies with similar securities would be accounting for such securities on similar basis. She advised that GAAP is a bifurcated model, and is consistent with what is proposed under SSAP No. 43R. Mr. Tittle confirmed that these statements are accurate, but only for "credit-related" impairments under GAAP. Mr. Tittle confirmed that under statutory, the security will have a much-higher reported value on the balance sheet then it will have under GAAP, as GAAP requires other-than-temporarily impaired securities to be written down to fair value. Under GAAP, the bifurcation of impairment is reflected within the income statement. Mr. Fritsch reiterated the accounting treatment for situations in which an entity has an intent to sell, when the entity does not have the intent and ability to hold, and for situations of when a "non-interest" impairment is present in response to an inquiry from Ms. Hu.

In response to a request from Mr. Fritsch, Mr. Hudson, Mr. Smith and Mr. Medley stated that they were supportive of allowing the transition guidance only for the early-adopters of SSAP No. 98 and not for reporting entities with company policies that resulted with previous impairment write-downs to fair value. In response to a request from Mr. Fritsch, none of the Working Group members indicated a desire to further expand the transition guidance. As a result of these inquiries, Mr.

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Fritsch stated that the transition guidance would be modified to incorporate all of the SSAP No. 98 early-adopters, regardless of the date for which early-adoption was elected, but continue to exclude from the transition guidance reporting entities with company policies that resulted in previous impairment write-downs to fair value. Mr. Tittle advised that the original exposure draft incorporated language that was similar to the Working Group's decision. He advised that this language would be incorporated, with modification as necessary for clarity and to clearly exclude those companies that had company policies, but that did not early-adopt SSAP No. 98. Mr. Tittle advised that the exclusion language was included within the recent exposure draft. As such, all of the language that will be incorporated within the transition has previously been exposed.

Ms. Wilson clarified that companies that early-adopted prior to Jan. 1, 2009 would have a cumulative effective adjustment as of July 1, 2009 for the prior-year impact, and the current year impact would be reflected within the third-quarter income statement, so the year-to-date income statement is comparable with the companies that did not early adopt. Mr. Tittle stated that this is intended and proposed minor modifications to clarify this within SSAP No. 43R. After additional discussion, Mr. Bell suggested following GAAP so that the cumulative effect adjustment is taken at the start of the quarter in which the guidance was adopted, and the income statement effect was only for the current quarter. Mr. Fritsch stated that this is how SSAP No. 43R is currently written and would be retained.

On a motion from Mr. Hudson, seconded by Mr. Johnson, the Working Group agreed to conduct a roll-call vote to adopt SSAP No. 43R, with the modifications incorporated during the conference call. Mr. Ross provided additional comments regarding the transition guidance, stating that if companies that did not see the need to declare early adoption of SSAP No. 98, as they already had a more conservative accounting policy, they are being adversely impacted. Mr. Carus stated similar comments, noting that he does not understand the rationale for requiring different accounting for companies with similar securities. Mr. Carus advised that a company's past accounting decisions should not drive different accounting treatment under a new accounting standard. Mr. Carus noted that it is those companies that had taken a better, more conservative approach that are being penalized with the transition guidance. In response to a request from Mr. Fritsch, none of the Working Group members vocalized a desire to make changes to the accounting guidance in response to these comments received.

Mr. Tittle then conducted the roll call vote with Iowa, California, Delaware, Illinois, Louisiana, Michigan, New Hampshire, Ohio, Pennsylvania, and Texas voting affirmatively to adopt SSAP No. 43R, and with Virginia and Wisconsin abstaining. Mr. Fritsch declared that the motion carried.

Mr. Tittle advised that SSAP No. 43R will be forwarded to the parent committees. A joint conference call of the Accounting Practices and Procedures Task Force and the Financial Condition (E) Committee has been scheduled for Sept. 17, 2009 to consider adoption of SSAP No. 43R. If the item is adopted during that joint conference call, it will be presented to Executive and Plenary for adoption at the 2009 Fall National Meeting.

Ms. Marcotte advised that an Issue Paper would be created for historical reference on the adoption of SSAP No. 43R.

Having no further business, the Statutory Accounting Principles (E) Working Group adjourned.

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Statutory Issue Paper No. 140

Substantive Revisions to SSAP No. 43—Loan-Backed and Structured Securities (SSAP No. 43R)

STATUS:
September 2009 Exposure Draft

Type of Issue:
Common Area

SUMMARY OF ISSUE

1. The purpose of this issue paper is to retain for historical purposes the statutory guidance superseded with the issuance of *SSAP No. 43R—Loan-backed and Structured Securities – Revised* (SSAP No. 43R):

a. *SSAP No. 43—Loan-backed and Structured Securities* (SSAP No. 43);

b. *SSAP No. 98—Treatment of Cash Flows When Quantifying Changes in Valuation and Impairments, an Amendment of SSAP No. 43—Loan-backed and Structured Securities* (SSAP No. 98);

c. Paragraph 13 of *SSAP No. 99—Accounting for Certain Securities to an Other-Than-Temporary Impairment* (SSAP No. 99)

2. This Issue Paper also details SSAP No. 43R as initially adopted in September 2009. The substantive revisions adopted within SSAP No. 43R include accounting guidance for securities acquired in a transfer, beneficial interests, recognition of impairment and disclosures.

3. SSAP No. 43R supersedes SSAP No. 98 (impairment to fair value) and revises valuation and impairment requirements based on the cash flows expected to be collected for the securities, rather than fair value. Since the impairment requirements are based upon expected cash flows, most impairment charges recognized will be based upon cash flows that the reporting entity does NOT expect to collect (credit related). Reporting entities would only impair to fair value if there is intent to sell the security, or the reporting entity cannot assert that they have the intent and ability to retain the investment for a period of time sufficient to recover the amortized cost basis. No. 43R provides differences in impairment recognition for situations when: 1) there is an intent to sell; 2) the entity does not have the intent and ability to hold the security; and 3) there is a non-interest related decline, when there is no intent to sell and when the entity has the intent and ability to hold the security.

4. For historical record, the guidance within SSAP No. 43, SSAP No. 98, and paragraph 13 of SSAP No. 99, which has been superseded by SSAP No. 43R, has been included as the 'Relevant Statutory Accounting' guidance within paragraphs 7, 8 and 9.

5. The adopted guidance within SSAP No. 43R has been included below:

SSAP No. 43R

SCOPE OF STATEMENT

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1. This statement establishes statutory accounting principles for investments in loan-backed securities and structured securities. In accordance with *SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SSAP No. 91R), retained beneficial interests from the sale of loan-backed securities and structured securities are accounted for in accordance with this statement. In this statement loan-backed securities and structured securities are collectively referred to as loan-backed securities.

SUMMARY CONCLUSION

2. Loan-backed securities are defined as pass-through certificates, collateralized mortgage obligations (CMOs), and other securitized loans not included in structured securities, as defined below, for which the payment of interest and/or principal is directly proportional to the interest and/or principal received by the issuer from the mortgage pool or other underlying securities.

3. Structured securities are defined as loan-backed securities which have been divided into two or more classes for which the payment of interest and/or principal of any class of securities has been allocated in a manner which is not proportional to interest and/or principal received by the issuer from the mortgage pool or other underlying securities.

4. Loan-backed securities are issued by special-purpose corporations or trusts (issuer) established by a sponsoring parent organization. Mortgage loans or other securities securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee until the issuer's obligation has been fully satisfied. The investor can look only to the issuer's assets (primarily the trusteed assets or third parties such as insurers or guarantors) for repayment of the obligation. As a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the responsibility for servicing the underlying mortgage loans or other securities. Some sponsors do guarantee the performance of the underlying loans.

5. Loan-backed securities 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.

6. The scope of this statement encompasses all types of loan-backed and structured securities, including, but not limited to, the following:

a. Loan-backed and structured securities acquired at origination,

b. Loan-backed and structured securities acquired subsequent to origination for which it is probable, at acquisition, that the reporting entity will be **able** to collect all contractually required payments receivable, and are accounted for at acquisition under SSAP No. 91R,

c. Loan-backed and structured securities for which it is probable, either known at acquisition or identified during the holding period[1], that the reporting entity will be **unable** to collect all contractually required payments receivable, and

d. Beneficial interests that continue to be held by a reporting entity (transferor) in securitization transactions that are accounted for as sales under SSAP No. 91R and purchased beneficial interests in securitized financial assets[2].

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[1] Securities classified within the type of paragraph 6.a. or 6.b. may be required to change classification to type 6.c. when it becomes probable that the reporting entity will be unable to collect all contractually required payments receivable.

7. At acquisition, loan-backed securities, except for loan-backed or structured securities that are beneficial interests that are not of high credit quality or can contractually be prepaid or otherwise settled in such a way that the reporting entity would not recover substantially all of its recorded amount[3] (see paragraphs 20 through 24), shall be reported at cost, including brokerage and related fees. Cost shall not exceed fair value. Acquisitions and dispositions shall be recorded on the trade date, not the settlement date, except for the acquisition of private placement loan-backed securities which shall be recorded on the funding date. For securities where all information is not known as of the trade date (e.g., actual payment factors and specific pools), a reporting entity shall make its best estimate based on known facts.

8. Amortization of premium or discount shall be calculated using the scientific (constant yield) interest method and shall be recorded as an adjustment to investment income. The interest method results in a constant effective yield equal to the prevailing rate at the time of purchase or at the time of subsequent adjustments to book value. The amortization period shall reflect estimates of the period over which repayment of principal of the loan-backed securities is expected to occur, not the stated maturity period.

9. Interest shall be accrued using the effective-yield method using the redemption prices and redemption dates used for amortizing premiums and discounts. Interest income consists of interest collected during the period, the change in the due and accrued interest between the beginning and end of the period as well as reductions for premium amortization and interest paid on acquisition of loan-backed securities, and the addition of discount accrual. Contingent interest may be accrued if the applicable provisions of the underlying contract and the prerequisite conditions have been met.

10. For reporting entities required to maintain an IMR, the accounting for realized capital gains and losses on sales of loan-backed securities 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 on sales of loan-backed securities shall be recorded on the trade date and shall be reported as net realized capital gains or losses in the Statement of Income.

11. A loan-backed security may provide for a prepayment penalty or acceleration fee in the event the investment is liquidated prior to its scheduled termination date. These fees shall be reported as investment income when received.

Collection of All Contractual Cashflows is Probable

12. The following guidance applies to loan-backed and structured securities for which it is probable that the investor will be able to collect all contractually required payments receivable. (Paragraphs 17-19 provide guidance for securities in which collection of all contractual cash flows is not probable and paragraphs 20-24 provide guidance for beneficial interests.) Prepayments are a significant variable element in the cash flow of loan-backed securities because they affect the yield and determine the expected maturity against which the yield is evaluated. Falling interest rates generate faster prepayment of the mortgages underlying the security, shortening its duration. This causes the reporting entity to reinvest assets sooner than expected at potentially less advantageous rates. This is called prepayment risk. Extension risk is created by rising interest rates which slow repayment and can significantly lengthen the duration of the security. Differences in cash flows can also result from other changes in the cash flows from the underlying assets. If assets are delinquent or otherwise not generating cash flow, which should be reflected

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[2] The accounting requirements related to these type of securities included in paragraphs 20 through 24 shall be determined at acquisition or initial transfer.

[3] As referenced in the Relevant Literature section, this Statement adopts EITF 99-20, including the scope requirements of that guidance.

in the cash flow analysis through diminishing security cash flows, even if assets have not been liquidated and gain/losses have not been booked.

13. Changes in currently estimated cash flows, including the effect of prepayment assumptions, on loan-backed securities shall be reviewed periodically, at least quarterly. The prepayment rates of the underlying loans shall be used to determine prepayment assumptions. Prepayment assumptions shall be applied consistently across portfolios to all securities backed by similar collateral (similar with respect to coupon, issuer, and age of collateral). Reporting entities shall use consistent assumptions across portfolios for similar collateral within controlled affiliated groups. Since each reporting entity may have a unique method for determining the prepayment assumptions, it is impractical to set standard assumptions for the industry. Relevant sources and rationale used to determine each prepayment assumption shall be documented by the reporting entity.

14. Loan-backed securities shall be revalued using the currently estimated cash flows, including new prepayment assumptions, using either the prospective or retrospective adjustment methodologies, consistently applied by type of securities. However, if at anytime during the holding period, the reporting entity determines it is no longer probable that they will collect all contractual cashflows, the reporting entity shall apply the accounting requirements in paragraphs 17 through 19.

15. The prospective approach recognizes, through the recalculation of the effective yield to be applied to future periods, the effects of all cash flows whose amounts differ from those estimated earlier and the effects and changes in projected cash flows. Under the prospective method, the recalculated effective yield will equate the carrying amount of the investment to the present value of the anticipated future cash flows. The recalculated yield is then used to accrue income on the investment balance for subsequent accounting periods. There are no accounting changes in the current period unless the security is determined to be other than temporarily impaired.

16. The retrospective methodology changes both the yield and the asset balance so that expected future cash flows produce a return on the investment equal to the return now expected over the life of the investment as measured from the date of acquisition. Under the retrospective method, the recalculated effective yield will equate the present value of the actual and anticipated cash flows with the original cost of the investment. The current balance is then increased or decreased to the amount that would have resulted had the revised yield been applied since inception, and investment income is correspondingly decreased or increased.

Collection of All Contractual Cashflows is Not Probable

17. The following guidance applies to loan-backed and structured securities with evidence of deterioration of credit quality since origination for which it is probable, either known at acquisition or identified during the holding period, that the investor will be unable to collect all contractually required payments receivable, except for those beneficial interests that are not of high credit quality or can contractually be prepaid or otherwise settled in such a way that the reporting entity would not recover substantially all of its recorded amount determined at acquisition (see paragraphs 20 through 24).

18. The reporting entity shall recognize the excess of all cash flows expected at acquisition over the investor's initial investment in the loan-backed or structured security as interest income on an effective-yield basis over the life of the loan-backed or structured security (accretable

yield).[4] Any excess of contractually required cash flows over the cash flows expected to be collected is the nonaccretable difference. Expected prepayments shall be treated consistently for determining cash flows expected to be collected and projections of contractual cash flows such that the nonaccretable difference is not affected. Similarly, the difference between actual prepayments and expected prepayments shall not affect the nonaccretable difference.

19. An investor shall continue to estimate cash flows expected to be collected over the life of the loan-backed or structured security. If, upon subsequent evaluation:

a. The fair value of the loan-backed or structured security has declined below its amortized cost basis, an entity shall determine whether the decline is other than temporary. For example, if, based on current information and events, there is a decrease in cash flows expected to be collected (that is, the investor is unable to collect all cash flows expected at acquisition plus any additional cash flows expected to be collected arising from changes in estimate after acquisition (in accordance with paragraph 19.b.), an other-than-temporary impairment shall be considered to have occurred. The investor shall consider both the timing and amount of cash flows expected to be collected in making a determination about whether there has been a decrease in cash flows expected to be collected.

b. Based on current information and events, if there is a significant increase in cash flows previously expected to be collected or if actual cash flows are significantly greater than cash flows previously expected, the investor shall recalculate the amount of accretable yield for the loan-backed or structured security as the excess of the revised cash flows expected to be collected over the sum of (1) the initial investment less (2) cash collected less (3) other-than-temporary impairments plus (4) amount of yield accreted to date. The investor shall adjust the amount of accretable yield by reclassification from nonaccretable difference. The adjustment shall be accounted for as a change in estimate in conformity with SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3), with the amount of periodic accretion adjusted over the remaining life of the loan-backed or structured security (prospective method).

Beneficial Interests

20. The following paragraphs provide statutory accounting guidance for interest income and impairment for a reporting entity that continues to hold an interest in securitized financial assets accounted for as sales under SSAP No. 91R, or that purchases a beneficial interest in securitized financial assets that are not of high credit quality or can contractually be prepaid or otherwise settled in such a way that the reporting entity would not recover substantially all of its recorded amount, determined at acquisition or the date of transfer[5]. Beneficial interests that are of high credit quality and cannot contractually be prepaid or otherwise settled in such a way that the reporting entity would not recover substantially all of its recorded investment, shall be accounted for in accordance with paragraphs 12 through 16.

21. The reporting entity shall recognize the excess of all cash flows attributable to the beneficial interest estimated at the acquisition/transaction date (referred to herein as the

[4] A loan-backed or structured security may be acquired at a discount because of a change in credit quality or rate or both. When a loan-backed or structured security is acquired at a discount that relates, at least in part, to the security's credit quality, the effective interest rate is the discount rate that equates the present value of the investor's estimate of the security's future cash flows with the purchase price of the loan-backed or structured security.

[5] The accounting requirements related to these type of securities included in paragraphs 20 through 24 shall be determined at acquisition or initial transfer. As referenced in the Relevant Literature section, this Statement adopts EITF 99-20, including the scope requirements of that guidance.

transaction date) over the initial investment (the accretable yield) as interest income over the life of the beneficial interest using the effective yield method. If the holder of the beneficial interest is the reporting entity that transferred the financial assets for securitization, the initial investment would be the allocated carrying amount after application of the relative fair value allocation method required by SSAP No. 91R. The amount of accretable yield shall not be displayed in the balance sheet.

22. The reporting entity that holds a beneficial interest shall continue to update the estimate of cash flows over the life of the beneficial interest. If upon evaluation:

a. Based on current information and events it is probable that there is a favorable (or an adverse) change in estimated cash flows from the cash flows previously projected, then the investor shall recalculate the amount of accretable yield for the beneficial interest on the date of evaluation as the excess of estimated cash flows over the beneficial interest's reference amount (the reference amount is equal to (1) the initial investment less (2) cash received to date less (3) other-than-temporary impairments recognized to date [as described in paragraph 22(b)] plus (4) the yield accreted to date. The adjustment shall be accounted for prospectively as a change in estimate in conformity with SSAP No. 3, with the amount of periodic accretion adjusted over the remaining life of the beneficial interest. Based on estimated cash flows, interest income may be recognized on a beneficial interest even if the net investment in the beneficial interest is accreted to an amount greater than the amount at which the beneficial interest could be settled if prepaid immediately in its entirety.

b. The fair value of the beneficial interest has declined below its reference amount; a reporting entity shall determine whether the decline is other-than-temporary. If, based on current information and events it is probable that there has been an adverse change in estimated cash flows (in accordance with paragraph 22(a) above), then (1) an other-than-temporary impairment shall be considered to have occurred and (2) the beneficial interest shall be written down to the current estimate of cash flows at the financial reporting date discounted at a rate equal to the current yield used to accrete the beneficial interest with the resulting change being recognized as a realized loss. Determining whether there has been a favorable (or an adverse) change in estimated cash flows from the cash flows previously projected (taking into consideration both the timing and amount of the estimated cash flows) involves comparing the present value of the remaining cash flows as estimated at the initial transaction date (or at the last date previously revised) against the present value of the cash flows estimated at the current financial reporting date. The cash flows shall be discounted at a rate equal to the current yield used to accrete the beneficial interest. If the present value of the original cash flows estimated at the initial transaction date (or the last date previously revised) is less than the present value of the current estimate of cash flows expected to be collected, the change is considered favorable (that is, an other-than-temporary impairment shall be considered to have not occurred). If the present value of the original cash flows estimated at the initial transaction date (or the last date previously revised) is greater than the present value of the current estimated cash flows, the change is considered adverse (that is, an other-than-temporary impairment shall be considered to have occurred). However, absent any other factors that indicate an other-than-temporary impairment has occurred, changes in the interest rate of a "plain-vanilla," variable-rate beneficial interest generally shall not result in the recognition of an other-than-temporary impairment[6] (a plain-vanilla, variable-rate beneficial interest

[6] Changes in the interest rate of a "plain-vanilla," variable-rate beneficial interest (a plain-vanilla, variable-rate beneficial interest does not include those variable-rate beneficial interests with interest rate reset

does not include those variable-rate beneficial interests with interest rate reset formulas that involve either leverage or an inverse floater).

23. All cash flows estimated at the transaction date are defined as the holder's estimate of the amount and timing of estimated future principal and interest cash flows used in determining the purchase price or the holder's fair value determination for purposes of determining a gain or loss under SSAP No. 91R. Subsequent to the transaction date, estimated cash flows are defined as the holder's estimate of the amount and timing of estimated principal and interest cash flows based on the holder's best estimate of current information and events. A change in estimated cash flows is considered in the context of both timing and amount of the estimated cash flows.

24. In situations in which it is not practicable for a transferor to estimate the fair value of the beneficial interest at the initial transfer date, interest income shall not be recognized using the interest method. For these beneficial interests (that is, those beneficial interests that continue to be held by a transferor that are recorded at $0 pursuant to SSAP No. 91R), the transferor shall use the cash basis for recognizing interest income because the beneficial interest will have an allocated carrying amount of zero.

Reporting and Impairment Guidance for All Loan-Backed and Structured Securities

25. Loan-backed securities shall be valued and reported in accordance with this statement, the *NAIC Purposes and Procedures of the Securities Valuation Office* manual, and the designation assigned in the NAIC Valuations of Securities product prepared by the NAIC Securities Valuation Office. For reporting entities that maintain an Asset Valuation Reserve (AVR), loan-backed securities shall be reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value. For reporting entities that do not maintain an AVR, loan-backed securities designated highest-quality and high-quality (NAIC designations 1 and 2, respectively) shall be reported at amortized cost; loan-backed securities that are designated medium quality, low quality, lowest quality and in or near default (NAIC designations 3 to 6, respectively) shall be reported at the lower of amortized cost or fair value.

26. For reporting entities required to maintain an AVR, the accounting for unrealized gains and losses shall be in accordance *with SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve* (SSAP No. 7). 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).

27. The application of this reporting requirement resulting from NAIC designation (i.e., lower of cost or fair value) is not a substitute for other-than-temporary impairment recognition (paragraphs 32-36). For securities reported at fair value where an other-than-temporary impairment has been determined to have occurred, the realized loss recognized from the other-than-temporary impairment shall first be applied towards the realization of any unrealized losses previously recorded as a result of fluctuations in the security's fair value due to the reporting requirements. After the recognition of the other-than-temporary impairment, the security shall continue to report unrealized gains and losses as a result of fluctuations in fair value.

28. If the fair value of a loan-backed or structured security is less than its amortized cost basis at the balance sheet date, an entity shall assess whether the impairment is other than

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formulas that involve either leverage or an inverse floater) generally should not result in the recognition of an other-than-temporary impairment. For plain-vanilla, variable-rate beneficial interests, the yield is changed to reflect the revised interest rate based on the contractual interest rate reset formula. For example, if a beneficial interest pays interest quarterly at a rate equal to LIBOR plus 2 percent, the yield of that beneficial interest is changed prospectively to reflect changes in LIBOR. However, changes in the fair value of a plain-vanilla, variable-rate beneficial interest due to credit events should be considered when evaluating whether there has been an other-than-temporary impairment.

temporary. Amortized cost basis includes adjustments made to the cost of an investment for accretion, amortization, collection of cash, previous other-than-temporary impairments recognized as a realized loss (including any cumulative-effect adjustments recognized in accordance with paragraphs 55 through 57 of this Statement).

29. If an entity intends to sell the loan-backed or structured security (that is, it has decided to sell the security), an other-than-temporary impairment shall be considered to have occurred.

30. If an entity does not intend to sell the loan-backed or structured security, the entity shall assess whether it has the intent and ability[7] to retain the investment in the security for a period of time sufficient to recover the amortized cost basis. If the entity does not have the intent and ability to retain the investment for the time sufficient to recover the amortized cost basis, an other-than-temporary impairment shall be considered to have occurred.

31. If the entity does not expect to recover the entire amortized cost basis of the security, the entity would be unable to assert that it will recover its amortized cost basis even if it does not intend to sell the security and the entity has the intent and ability to hold. Therefore, in those situations, an other-than temporary impairment shall be considered to have occurred. In assessing whether the entire amortized cost basis of the security will be recovered, an entity shall compare the present value of cash flows expected to be collected from the security with the amortized cost basis of the security. If present value of cash flows expected to be collected is less than the amortized cost basis of the security, the entire amortized cost basis of the security will not be recovered (that is, a non-interest related decline[8] exists), and an other-than-temporary impairment shall be considered to have occurred. A decrease in cashflows expected to be collected on a loaned-backed or structured security that results from an increase in prepayments on the underlying assets shall be considered in the estimate of the present value of cashflows expected to be collected.

32. In determining whether a non-interest related decline exists, an entity shall calculate the present value of cash flows expected to be collected based on an estimate of the expected future cash flows of the impaired loan-backed or structured security, discounted at the security's effective interest rate.

a. For securities accounted for under paragraphs 12 through 16 – the effective interest rate of the loan-backed or structured security is the rate of return implicit in the security (that is, the contractual interest rate adjusted for any net deferred fees or costs, premium, or discount existing at the origination or acquisition of the security).[9]

b. For securities accounted for under paragraphs 17 through 19 – the effective interest rate is the rate implicit immediately prior to the recognition of the other-than-temporary impairment.

c. For securities accounted for under paragraphs 20 through 24 – the reporting entity shall apply the guidance in paragraph 22.b.

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[7] This assessment shall be considered a high standard due to the accounting measurement method established for the securities within the scope of this Statement (amortized cost).

[8] A non-interest related decline is a decline in value due to fundamental credit problems of the issuer. Fundamental credit problems exist with the issuer when there is evidence of financial difficulty that may result in the issuer being unable to pay principal or interest when due. An interest related decline in value may be due to both increases in the risk-free interest rate and general credit spread widening.

[9] See Footnote 1.

33. When an other-than-temporary impairment has occurred because the entity intends to sell the security or has assessed that that they do not have the intent and ability to retain the investments in the security for a period of time sufficient to recover the amortized cost basis, the amount of the other-than-temporary impairment recognized in earnings as a realized loss shall equal the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. (This guidance includes loan-backed securities previously held at lower of cost or market. For these securities, upon recognition of an other-than-temporary impairment, unrealized losses would be considered realized.)

34. When an other-than-temporary impairment has occurred because the entity does not expect to recover the entire amortized cost basis of the security even if the entity has no intent to sell and the entity has the intent and ability to hold, the amount of the other-than-temporary impairment recognized as a realized loss shall equal the difference between the investment's amortized cost basis and the present value of cash flows expected to be collected, discounted at the loan-backed or structured security's effective interest rate in accordance with paragraph 32. (This guidance includes loan-backed securities previously held at lower of cost or market. For these securities, upon recognition of an other-than-temporary impairment, unrealized losses would be considered realized for the non-interest related decline. Hence, unrealized losses could continue to be reflected for these securities due to the reporting requirements.)

35. For reporting entities required to maintain an AVR or IMR, the accounting for the other-than-temporary impairment shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. Non-interest related other-than-temporary impairment losses shall be recorded through the AVR. If the reporting entity wrote the security down to fair value due to the intent to sell or does not have the intent and ability to retain the investment in the security for a period of time sufficient to recover the amortized cost basis, the non-interest related portion of the other-than-temporary impairment losses shall be recorded through the AVR; the interest related other-than-temporary impairment losses shall be recorded through the IMR.

36. For situations where an other-than-temporary impairment is recognized pursuant to paragraphs 33 and 34 of this Statement, the previous amortized cost basis less the other-than-temporary impairment recognized as a realized loss shall become the new amortized cost basis of the investment. That new amortized cost basis shall not be adjusted for subsequent recoveries in fair value. Therefore, the prospective adjustment method shall be used for periods subsequent to loss recognition.

37. In periods subsequent to the recognition of an other than temporary impairment loss for a loan-backed or structured security, the reporting entity shall account for the other-than-temporarily impaired security as if the security had been purchased on the measurement date of the other-than-temporary impairment at an amortized cost basis equal to the previous amortized cost basis less the other-than-temporary impairment recognized as a realized loss. The difference between the new amortized cost basis and the cash flows expected to be collected shall be accreted as interest income. A reporting entity shall continue to estimate the present value of cash flows expected to be collected over the life of the loan-backed or structured security.

a. For securities accounted for under paragraphs 12 through 19, if upon subsequent evaluation, there is a significant increase in the cash flows expected to be collected or if actual cash flows are significantly greater than cash flows previously expected, such changes shall be accounted for as a prospective adjustment to the accretable yield in accordance with paragraphs 17 through 19. The security shall continue to be subject to impairment analysis for each subsequent reporting period. The new amortized 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.

b. For beneficial interests accounted for under paragraphs 20 through 24, a reporting entity shall apply the guidance in paragraphs 21 through 22 to account for changes in cash flows expected to be collected.

38. It is inappropriate to automatically conclude that a security is not other-than-temporarily impaired because all of the scheduled payments to date have been received. However, it also is inappropriate to automatically conclude that every decline in fair value represents an other-than-temporary impairment. Further analysis and judgment are required to assess whether a decline in fair value indicates that it is probable that the holder will not collect all of the contractual or estimated cash flows from the security. In addition, the length of time and extent to which the fair value has been less than cost can indicate a decline is other than temporary. The longer and/or the more severe the decline in fair value, the more persuasive the evidence that is needed to overcome the premise that it is probable that the holder will not collect all of the contractual or estimated cash flows from the issuer of the security.

39. In making its other-than-temporary impairment assessment, the holder shall consider all available information relevant to the collectibility of the security, including information about past events, current conditions, and reasonable and supportable forecasts, when developing the estimate of future cash flows. Such information generally shall include the remaining payment terms of the security, prepayment speeds, the financial condition of the issuer(s), expected defaults, and the value of any underlying collateral. To achieve that objective, the holder shall consider, for example, industry analyst reports and forecasts, sector credit ratings, and other market data that are relevant to the collectibility of the security. The holder also shall consider how other credit enhancements affect the expected performance of the security, including consideration of the current financial condition of the guarantor of a security (if the guarantee is not a separate contract) and/or whether any subordinated interests are capable of absorbing estimated losses on the loans underlying the security. The remaining payment terms of the security could be significantly different from the payment terms in prior periods (such as for some securities backed by "nontraditional loans"[10]). Thus, the holder shall consider whether a security backed by currently performing loans will continue to perform when required payments increase in the future (including "balloon" payments). The holder also shall consider how the value of any collateral would affect the expected performance of the security. If the fair value of the collateral has declined, the holder needs to assess the effect of that decline on the ability of the holder to collect the balloon payment.

Origination Fees

40. Origination fees represent fees charged to the borrower in connection with the process of originating or restructuring a transaction. The fees include, but are not limited to, points, management, arrangement, placement, application, underwriting, and other fees pursuant to such a transaction. Origination fees shall not be recorded until received in cash. Origination fees intended to compensate the reporting entity for interest rate risks (e.g., points), shall be amortized into income over the term of the loan-backed security consistent with paragraph 8 of this statement. Other origination fees shall be recorded as income upon receipt.

[10] A nontraditional loan may have features such as (a) terms that permit principal payment deferral or payments smaller than interest accruals (negative amortization), (b) a high loan-to-value ratio, (c) multiple loans on the same collateral that when combined result in a high loan-to value ratio, (d) option adjustable-rate mortgages (option ARMs) or similar products that may expose the borrower to future increases in repayments in excess of increases that result solely from increases in the market interest rate (for example, once negative amortization results in the loan reaching a maximum principal accrual limit), (e) an initial interest rate that is below the market interest rate for the initial period of the loan term and that may increase significantly when that period ends, and (f) interest-only loans that should be considered in developing an estimate of future cash flows.

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Origination, Acquisition, and Commitment Costs

41. Costs related to origination when paid in the form of brokerage and other related fees shall be capitalized as part of the cost of the loan-backed security, consistent with paragraph 7 of this statement. All other costs, including internal costs or costs paid to an affiliated entity related to origination, purchase, or commitment to purchase loan-backed securities, shall be charged to expense when incurred.

Commitment Fees

42. Commitment fees are fees paid to the reporting entity that obligate the reporting entity to make available funds for future borrowing under a specified condition. A fee paid to the reporting entity to obtain a commitment to make funds available at some time in the future, generally, is refundable only if the loan-backed security is issued. If the loan-backed security is not issued, then the fees shall be recorded as investment income by the reporting entity when the commitment expires.

43. A fee paid to the reporting entity to obtain a commitment to borrow funds at a specified rate and with specified terms quoted in the commitment agreement, generally, is not refundable unless the commitment is refused by the reporting entity. This type of fee shall be deferred, and amortization shall depend on whether or not the commitment is exercised. If the commitment is exercised, then the fee shall be amortized in accordance with paragraph 8 of this statement over the life of the loan-backed security as an adjustment to the investment income on the loan-backed security. If the commitment expires unexercised, the commitment fee shall be recognized in income on the commitment expiration date.

Giantization/Megatization of FHLMC or FNMA Mortgage Backed Securities

44. Giantization/megatization of mortgage backed securities is defined as existing pools of FHLMC or FNMA mortgage-backed securities (MBS) with like coupon and prefix which are repooled together by the issuing agency creating a new larger security. The new Fannie Mae “Mega” or Freddie Mac “Giant” is a guaranteed MBS pass-through representing an undivided interest in the underlying pools of loans.

45. The benefits derived from giantization/megatization include:

a. Increased liquidity: Smaller MBS pools (particularly those with current face of less than $1 million) are less liquid than mortgage pools with current faces exceeding $5 million. Repooling smaller MBS pools into one larger pool improves the marketability for the aggregate package;

b. Geographic diversity: Regrouping of multiple pools generally will create greater geographic pool loan diversity resulting in less prepayment variation due to regional economic factors;

c. Reduced administrative expenses: The reduced number of pools lowers bank custodial fees, pricing/factor service fees, and increases efficiency for the accounting and investment departments.

46. Repooled FHLMC and FNMA securities meet the definition of substantially the same as defined in *SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The transaction shall not be considered a sale/purchase and no gain or loss shall be recognized. To properly document the repooling, the transaction shall be reported through Schedule D of the Annual Statement as a disposition and an acquisition.

47. Transaction fees charged by the issuing agencies shall be capitalized and amortized over the life of the repooled security.

Disclosures

48. In addition to the disclosures required for invested assets in general, the following disclosures regarding loan-backed securities shall be made in the financial statements. Regardless of the allowances within paragraph 59 of the Preamble, the disclosures in paragraph 48f, 48g and 48h are required in separate, distinct notes to the financial statements:

a. Fair values in accordance with *SSAP No. 27—Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk, Financial Instruments with Concentrations of Credit Risk and Disclosures about Fair Value of Financial Instruments* (SSAP No. 27);

b. Concentrations of credit risk in accordance with SSAP No. 27;

c. Basis at which the loan-backed securities are stated;

d. The adjustment methodology used for each type of security (prospective or retrospective);

e. Descriptions of sources used to determine prepayment assumptions.

f. All securities within the scope of this statement with a recognized other-than-temporary impairment, disclosed in the aggregate, classified on the basis for the other-than-temporary impairment: (1) intent to sell, (2) inability or lack of intent to retain the investment in the security for a period of time sufficient to recover the amortized cost basis, or (3) present value of cash flows expected to be collected is less than the amortized cost basis of the security.

g. For each security with a recognized other-than-temporary impairment, currently held by the reporting entity, as the present value of cash flows expected to be collected is less than the amortized cost basis of the securities:

    i. The amortized cost basis, prior to any current-period other-than-temporary impairment.

    ii. The other-than-temporary impairment recognized in earnings as a realized loss.

    iii. The fair value of the security.

    iv. The amortized cost basis after the current-period other-than-temporary impairment.

h. All impaired securities (fair value is less than cost or amortized cost) for which an other-than-temporary impairment has not been recognized in earnings as a realized loss (including securities with a recognized other-than-temporary impairment for non-interest related declines when a non-recognized interest related impairment remains):

    i. The aggregate amount of unrealized losses (that is, the amount by which cost or amortized cost exceeds fair value) and

    ii. The aggregate related fair value of securities with unrealized losses.

i. The disclosures in (i) and (ii) above should be segregated by those securities that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer using fair values determined in accordance with SSAP No. 27.

j. Additional information should be included describing the general categories of information that the investor considered in reaching the conclusion that the impairments are not other-than-temporary.

k. When it is not practicable to estimate fair value in accordance with SSAP No. 27, the investor should disclose the following additional information, if applicable:

i. The aggregate carrying value of the investments not evaluated for impairment, and

ii. The circumstances that may have a significant adverse effect on the fair value.

49. Refer to the preamble for further discussion regarding disclosure requirements. All disclosures within this Statement shall be included within the interim and annual statutory financial statements.

Relevant Literature

50. This statement adopts *FASB Emerging Issues Task Force No. 99-20*, *Exchange of Interest-Only and Principal-Only Securities for a Mortgage-Backed Security and FASB Staff Position EITF 99-20-1, Amendments to the Impairment Guidance of EITF Issue No. 99-20.* This statement adopts paragraphs 5, 7 and 9 of AICPA *Statement of Position 03-03, Accounting for Certain Loans or Debt Securities Acquired in a Transfer* (SOP 03-03) for loan-backed and structured securities only. With the exception of this specific adoption, consideration of SOP 03-03 is still pending consideration for statutory accounting.

51. This statement rejects *FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities* and *FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*.

52. This statement also rejects *FASB Emerging Issues Task Force No. 89-4, Accounting for a Purchased Investment in a Collateralized Mortgage Obligation Instrument or in a Mortgage-Backed Interest-Only Certificate, FASB Emerging Issues Task Force No. 90-2, Exchange of Interest-Only and Principal-Only Securities for a Mortgage-Backed Security, FASB Emerging Issues Task Force No. 93-18, Recognition of Impairment for an Investment in a Collateralized Mortgage Obligation Instrument or in a Mortgage-Backed Interest-Only Certificate*, and *FASB Emerging Issues Task Force No. 96-12, Recognition of Interest Income and Balance Sheet Classification of Structured Notes*.

Effective Date and Transition

53. This statement is effective for years beginning January 1, 2001. 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*.

54. For securities purchased prior to January 1, 1994, where historical cash flows are not readily available for applying the retrospective method, the reporting entity may use January 1, 1994 as the acquisition date and the then book value as the cost for purposes of determining yield adjustments in future periods.

55. This revised statement supersedes SSAP No. 98 and paragraph 13 of SSAP No. 99 effective September 30, 2009. For reporting entities that either early adopted the requirements of SSAP No. 98 or previously adopted a statutory accounting policy that was in accord with the prescriptions of SSAP No. 98, for which an other-than-temporary impairment was previously recognized, and if such reporting entities do not intend to sell the security, and have the intent

and ability to retain the investment in the security for a period of time sufficient to recover the amortized cost basis, those reporting entities shall recognize the cumulative effect of reversing the impact of the adoption of SSAP No. 98, or an equivalent statutory accounting policy, and paragraph 13 of SSAP No. 99 as an adjustment to the opening balance of unassigned funds (surplus) as of July 1, 2009, with a corresponding adjustment to applicable financial statement elements.

56. The accounting and reporting requirements of this revised statement shall be applied to existing and new investments held by a reporting entity on or after September 30, 2009. For loan-backed and structured securities held at the beginning of the interim period of adoption (July 1, 2009) and continue to be held as of September 30, 2009, for which an other-than-temporary impairment was previously recognized under SSAP No. 43, if a reporting entity does not intend to sell the security, and has the intent and ability to retain the investment in the security for a period of time sufficient to recover the amortized cost basis, the reporting entity shall recognize the cumulative effect of initially applying this revised statement as an adjustment to the opening balance of unassigned funds (surplus) as of July 1, 2009, with a corresponding adjustment to applicable financial statement elements. The cumulative effect on unassigned funds (surplus) shall be calculated by comparing the present value of the cash flows expected to be collected determined in accordance with the methodology in paragraph 32, as applicable, with the amortized cost basis of the loan-backed and structured security as of the beginning of the interim period in which this revised statement is adopted (July 1, 2009). The cumulative-effect adjustment shall include related tax effects. The discount rate used to calculate the present value of the cash flows expected to be collected shall be the rate in effect before recognizing any other-than-temporary impairments and not a rate that has been adjusted to reflect those impairments.

57. The amortized cost basis of a security for which an other-than-temporary impairment was previously recognized shall be adjusted by the amount of the cumulative-effect adjustment before taxes. The difference between the new amortized cost basis and the cash flows expected to be collected shall be accreted as interest income (see paragraph 37).

58. In the period of adoption, an entity shall provide the disclosures required by SSAP No. 3 for changes in accounting principles.

AUTHORITATIVE LITERATURE

Statutory Accounting

- NAIC *Purposes and Procedures of the Securities Valuation Office*
- NAIC *Valuations of Securities* manual prepared by the Securities Valuation Office

RELEVANT ISSUE PAPERS

- Issue Paper No. 43—Loan-backed and Structured Securities
- Issue Paper No. 140—Loan-backed and Structured Securities, Revised September, 2009

DISCUSSION

6. This Issue Paper is intended to provide a historical reference of SSAP No. 43, SSAP No. 98 and SSAP No. 99 prior to the adoption of SSAP No. 43R. SSAP No. 43R was adopted in September 2009 with an effective date of September 30, 2009.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

7. Statutory accounting principles for loan-backed and structured securities was included within *SSAP No. 43—Loan-backed and Structured Securities* (SSAP No. 43). This guidance has been superseded by SSAP No. 43R:

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for investments in loan-backed securities and structured securities. In accordance with SSAP No. 91R, retained beneficial interests from the sale of loan-backed securities and structured securities are accounted for in accordance with this statement. In this statement loan-backed securities and structured securities are collectively referred to as loan-backed securities.

SUMMARY CONCLUSION

2. Loan-backed securities are defined as pass-through certificates, collateralized mortgage obligations (CMOs), and other securitized loans not included in structured securities, as defined below, for which the payment of interest and/or principal is directly proportional to the interest and/or principal received by the issuer from the mortgage pool or other underlying securities.

3. Structured securities are defined as loan-backed securities which have been divided into two or more classes for which the payment of interest and/or principal of any class of securities has been allocated in a manner which is not proportional to interest and/or principal received by the issuer from the mortgage pool or other underlying securities.

4. Loan-backed securities are issued by special-purpose corporations or trusts (issuer) established by a sponsoring parent organization. Mortgage loans or other securities securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee until the issuer's obligation has been fully satisfied. The investor can look only to the issuer's assets (primarily the trusteed assets or third parties such as insurers or guarantors) for repayment of the obligation. As a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the responsibility for servicing the underlying mortgage loans. Some sponsors do guarantee the performance of the underlying loans.

5. Loan-backed securities 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.

Acquisitions and Sales

6. At acquisition, loan-backed securities shall be reported at cost, including brokerage and related fees. Cost shall not exceed fair value. Acquisitions and dispositions shall be recorded on the trade date, not the settlement date, except for the acquisition of private placement loan-backed securities which shall be recorded on the funding date. For securities where all information is not known as of the trade date (e.g., actual payment factors and specific pools), a reporting entity shall make its best estimate based on known facts.

Amortization

7. Amortization of premium or discount shall be calculated using the scientific (constant yield) interest method and shall be recorded as an adjustment to investment income. The interest method results in a constant effective yield equal to the prevailing rate at the time of purchase or at the time of subsequent adjustments to book value. The amortization period shall reflect

estimates of the period over which repayment of principal of the loan-backed securities is expected to occur, not the stated maturity period.

Balance Sheet Amount

8. Loan-backed securities shall be valued and reported in accordance with this statement, the NAIC *Purposes and Procedures of the Securities Valuation Office* manual, and the designation assigned in the NAIC *Valuations of Securities* product prepared by the NAIC Securities Valuation Office. For reporting entities that maintain an Asset Valuation Reserve (AVR), loan-backed securities shall be reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value. For reporting entities that do not maintain an AVR, loan-backed securities designated highest-quality and high-quality (NAIC designations 1 and 2, respectively) shall be reported at amortized cost; loan-backed securities that are designated medium quality, low quality, lowest quality and in or near default (NAIC designations 3 to 6, respectively) shall be reported at the lower of amortized cost or fair value.

9. For reporting entities required to maintain an AVR, the accounting for unrealized gains and losses shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve* (SSAP No. 7). 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).

Changes in Valuation

10. Prepayments are a significant variable element in the cash flow of loan-backed securities because they affect the yield and determine the expected maturity against which the yield is evaluated. Falling interest rates generate faster prepayment of the mortgages underlying the security, shortening its duration. This causes the reporting entity to reinvest assets sooner than expected at potentially less advantageous rates. This is called prepayment risk. Extension risk is created by rising interest rates which slow repayment and can significantly lengthen the duration of the security. Differences in cash flows can also result from other changes in the cash flows from the underlying assets. If assets are delinquent or otherwise not generating cash flow, that should be reflected in the cash flow analysis through diminishing security cash flows, even if assets have not been liquidated and gain/losses have not been booked.

11. Changes in currently estimated cash flows, including the effect of prepayment assumptions, on loan-backed securities shall be reviewed periodically. For securities that have the potential for loss of a portion of the original investment, the review shall be performed at least quarterly. For other securities, the review shall be performed at least annually. In addition to assets that are delinquent or otherwise not generating cash flows, other examples of securities that have the potential for loss of a portion of the original investment include CMO residuals and mortgage-backed interest-only certificates. For these securities, an effective yield or internal rate of return is calculated at acquisition based on the purchase price and anticipated future cash flows.

12. The prepayment rates of the underlying loans shall be used to determine prepayment assumptions. Prepayment assumptions shall be applied consistently across portfolios to all securities backed by similar collateral (similar with respect to coupon, issuer, and age of collateral). Reporting entities shall use consistent assumptions across portfolios for similar collateral within controlled affiliated groups. Since each reporting entity may have a unique method for determining the prepayment assumptions, it is impractical to set standard assumptions for the industry. Relevant sources and rationale used to determine each prepayment assumption shall be documented by the reporting entity.

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13. Loan-backed securities shall be revalued using the currently estimated cash flows, including new prepayment assumptions, using either the prospective or retrospective adjustment methodologies, consistently applied by type of securities.

14. The prospective approach recognizes, through the recalculation of the effective yield to be applied to future periods, the effects of all cash flows whose amounts differ from those estimated earlier and the effects and changes in projected cash flows. Under the prospective method, the recalculated effective yield will equate the carrying amount of the investment to the present value of the anticipated future cash flows. The recalculated yield is then used to accrue income on the investment balance for subsequent accounting periods. There are no accounting changes in the current period unless the undiscounted anticipated cash flow is less than the carrying amount of the investment.

15. The retrospective methodology changes both the yield and the asset balance so that expected future cash flows produce a return on the investment equal to the return now expected over the life of the investment as measured from the date of acquisition. Under the retrospective method, the recalculated effective yield will equate the present value of the actual and anticipated cash flows with the original cost of the investment. The current balance is then increased or decreased to the amount that would have resulted had the revised yield been applied since inception, and investment income is correspondingly decreased or increased.

Impairment

16. Regardless of whether a reporting entity is using a prospective or retrospective method, if the revaluation based on new currently estimated cash flows results in a negative yield (i.e., undiscounted estimated future cash flows are less than the current book value), an other than temporary impairment shall be considered to have occurred. If it is determined an other than temporary impairment has occurred, the cost basis of the security shall be written down to the undiscounted estimated future cash flows and the amount of the write down shall be accounted for as a realized loss. For reporting entities required to maintain an AVR/IMR, the accounting for the entire amount of the realized capital loss shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. The new cost basis shall not be changed for subsequent recoveries in fair value. Therefore, the prospective adjustment method must be utilized for periods subsequent to the loss recognition.

17. NOTE: This paragraph is added by *SSAP No. 99—Accounting for Certain Securities Subsequent to an Other-Then-Temporary Impairment.* Remaining paragraphs are renumbered.

In periods subsequent to the recognition of an other than temporary impairment loss for a loan-backed or structured security, the reporting entity shall account for the other-than-temporarily impaired security as if the security had been purchased on the measurement date of the other-than-temporary impairment. The fair value of the security on the measurement date shall become the new cost basis. The discount or reduced premium recorded for the security, based on the new cost basis, shall be amortized in the prospective manner over the remaining period in which repayment of principal is expected to occur. The security shall continue to be subject to impairment analysis for each subsequent reporting period. The new cost basis shall not be changed for subsequent recoveries in fair value. Therefore, the prospective adjustment method must be utilized for periods subsequent to the impairment loss recognition. Future declines in fair value which are determined to be other-than-temporary shall be recorded as realized losses.

Income

18. Interest shall be accrued using the interest method using the redemption prices and redemption dates used for amortizing premiums and discounts. Interest income consists of interest collected during the period, the change in the due and accrued interest between the beginning and end of the period as well as reductions for premium amortization and interest paid

on acquisition of loan-backed securities, and the addition of discount accrual. Contingent interest may be accrued if the applicable provisions of the underlying contract and the prerequisite conditions have been met.

19. For reporting entities required to maintain an IMR, the accounting for realized capital gains and losses on sales of loan-backed securities 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 on sales of loan-backed securities shall be recorded on the trade date and shall be reported as net realized capital gains or losses in the Statement of Income.

20. A loan-backed security may provide for a prepayment penalty or acceleration fee in the event the investment is liquidated prior to its scheduled termination date. These fees shall be reported as investment income when received.

Beneficial Interests

21. A holder of a beneficial interest in securitized financial assets should recognize the excess of all cash flows attributable to the beneficial interest estimated at the acquisition/transaction date over the initial investment as interest income over the life of the beneficial interest using the effective yield method.

22. The holder of a beneficial interest should continue to update the estimate of cash flows over the life of the beneficial interest. Based on current information and events, if a favorable or adverse change in estimated cash flows is projected, the holder should recalculate the amount of interest income for the beneficial interest on the date of evaluation. The recalculated yield should be used to recognize interest income as a prospective change over the remaining life of the beneficial interest. Impairment for beneficial interests shall be determined in accordance with paragraph 16.

Origination Fees

23. Origination fees represent fees charged to the borrower in connection with the process of originating or restructuring a transaction. The fees include, but are not limited to, points, management, arrangement, placement, application, underwriting, and other fees pursuant to such a transaction. Origination fees shall not be recorded until received in cash. Origination fees intended to compensate the reporting entity for interest rate risks (e.g., points), shall be amortized into income over the term of the loan-backed security consistent with paragraph 7 of this statement. Other origination fees shall be recorded as income upon receipt.

Origination, Acquisition, and Commitment Costs

24. Costs related to origination when paid in the form of brokerage and other related fees shall be capitalized as part of the cost of the loan-backed security, consistent with paragraph 6 of this statement. All other costs, including internal costs or costs paid to an affiliated entity related to origination, purchase, or commitment to purchase loan-backed securities, shall be charged to expense when incurred.

Commitment Fees

25. Commitment fees are fees paid to the reporting entity that obligate the reporting entity to make available funds for future borrowing under a specified condition. A fee paid to the reporting entity to obtain a commitment to make funds available at some time in the future, generally, is refundable only if the loan-backed security is issued. If the loan-backed security is not issued, then the fees shall be recorded as investment income by the reporting entity when the commitment expires.

26. A fee paid to the reporting entity to obtain a commitment to borrow funds at a specified rate and with specified terms quoted in the commitment agreement, generally, is not refundable unless the commitment is refused by the reporting entity. This type of fee shall be deferred, and amortization shall depend on whether or not the commitment is exercised. If the commitment is exercised, then the fee shall be amortized in accordance with paragraph 7 of this statement over the life of the loan-backed security as an adjustment to the investment income on the loan-backed security. If the commitment expires unexercised, the commitment fee shall be recognized in income on the commitment expiration date.

Giantization/Megatization of FHLMC or FNMA Mortgage Backed Securities

27. Giantization/megatization of mortgage backed securities is defined as existing pools of FHLMC or FNMA mortgage-backed securities (MBS) with like coupon and prefix which are repooled together by the issuing agency creating a new larger security. The new Fannie Mae “Mega” or Freddie Mac “Giant” is a guaranteed MBS pass-through representing an undivided interest in the underlying pools of loans.

28. The benefits derived from giantization/megatization include:

- d. Increased liquidity: Smaller MBS pools (particularly those with current face of less than $1 million) are less liquid than mortgage pools with current faces exceeding $5 million. Repooling smaller MBS pools into one larger pool improves the marketability for the aggregate package;

- e. Geographic diversity: Regrouping of multiple pools generally will create greater geographic pool loan diversity resulting in less prepayment variation due to regional economic factors;

- f. Reduced administrative expenses: The reduced number of pools lowers bank custodial fees, pricing/factor service fees, and increases efficiency for the accounting and investment departments.

29. Repooled FHLMC and FNMA securities meet the definition of substantially the same as defined in *SSAP No. 91—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The transaction shall not be considered a sale/purchase and no gain or loss shall be recognized. To properly document the repooling, the transaction shall be reported through Schedule D of the Annual Statement as a disposition and an acquisition.

30. Transaction fees charged by the issuing agencies shall be capitalized and amortized over the life of the repooled security.

Disclosures

31. In addition to the disclosures required for invested assets in general, the following disclosures regarding loan-backed securities shall be made in the financial statements:

- a. Fair values in accordance with SSAP No. 27—Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk, Financial Instruments with Concentrations of Credit Risk and Disclosures about Fair Value of Financial Instruments (SSAP No. 27);

- b. Concentrations of credit risk in accordance with SSAP No. 27;

- c. Basis at which the loan-backed securities are stated;

- d. The adjustment methodology used for each type of security (prospective or retrospective);

e. Changes from the retrospective to the prospective adjustment methodology due to negative yield on specific securities;
f. If, for applying the retrospective method, the reporting entity has elected to use book value as of January 1, 1994 as the cost for securities purchased prior to January 1, 1994 where historical cash flows are not readily available; and

g. Descriptions of sources used to determine prepayment assumptions.

h. For each balance sheet presented, all securities in an unrealized loss position for which other-than-temporary declines in value have not been recognized

l. The aggregate amount of unrealized losses (that is, the amount by which cost or amortized cost exceeds fair value) and

m. The aggregate related fair value of securities with unrealized losses.

i. The disclosures in (i) and (ii) above should be segregated by those securities that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer using fair values determined in accordance with SSAP No. 27.

j. As of the date of the most recent balance sheet presented, additional information should be included describing the general categories of information that the investor considered in reaching the conclusion that the impairments are not other-than-temporary.

k. When it is not practicable to estimate fair value in accordance with SSAP No. 27, the investor should disclose the following additional information, if applicable, as of each date for which a statement of financial position is presented in its annual financial statements:

a. The aggregate carrying value of the investments not evaluated for impairment, and

b. The circumstances that may have a significant adverse effect on the fair value.

32. Refer to the preamble for further discussion regarding disclosure requirements. The disclosures in paragraphs 31a., 31b., 31h., 31i., 31j., and 31k. above shall be included in the annual audited statutory financial reports only.

Relevant Literature

33. This statement rejects *FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities* and *FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*.

34. This statement also rejects FASB Emerging Issues Task Force No. 89-4, *Accounting for a Purchased Investment in a Collateralized Mortgage Obligation Instrument or in a Mortgage-Backed Interest-Only Certificate,* FASB Emerging Issues Task Force No. 90-2, *Exchange of Interest-Only and Principal-Only Securities for a Mortgage-Backed Security,* FASB Emerging Issues Task Force No. 93-18, *Recognition of Impairment for an Investment in a Collateralized Mortgage Obligation Instrument or in a Mortgage-Backed Interest-Only Certificate, and FASB Emerging Issues Task Force No. 96-12, Recognition of Interest Income and Balance Sheet Classification of Structured Notes, and FASB Emerging Issues Task Force No. 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets.*

Effective Date and Transition

35. This statement is effective for years beginning January 1, 2001. 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.*

36. For securities purchased prior to January 1, 1994, where historical cash flows are not readily available for applying the retrospective method, the reporting entity may use January 1, 1994 as the acquisition date and the then book value as the cost for purposes of determining yield adjustments in future periods.

8. *SSAP No. 98—Treatment of Cash Flows When Quantifying Changes in Valuation and Impairments, an Amendment of SSAP No. 43—Loan-backed and Structured Securities* (SSAP No. 98) amended paragraphs 14 through 16 of SSAP No. 43. This guidance was superseded with the issuance of SSAP No. 43R:

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for impairment analysis and subsequent valuation of loan-backed and structured securities.

SUMMARY CONCLUSION

2. This statement amends paragraphs 14 through 16 of SSAP No. 43—*Loan-backed and Structured Securities* to the following:

14. The prospective approach recognizes, through the recalculation of the effective yield to be applied to future periods, the effects of all cash flows whose amounts differ from those estimated earlier and the effects and changes in projected cash flows. Under the prospective method, the recalculated effective yield will equate the carrying amount of the investment to the present value of the anticipated future cash flows. The recalculated yield is then used to accrue income on the investment balance for subsequent accounting periods. There are no accounting changes in the current period unless the security is determined to be other than temporarily impaired.

15. The retrospective methodology changes both the yield and the asset balance so that expected future cash flows produce a return on the investment equal to the return now expected over the life of the investment as measured from the date of acquisition. Under the retrospective method, the recalculated effective yield will equate the present value of the actual and anticipated cash flows with the original cost of the investment. The current balance is then increased or decreased to the amount that would have resulted had the revised yield been applied since inception, and investment income is correspondingly decreased or increased.

Impairment

16. If it is determined that the decline in fair value of the security is other than temporary, then the cost basis of the security shall be written down to fair value. The amount of the write down shall be accounted for as a realized loss. An interest related decline in value shall be considered other than temporary only when a reporting entity has the intent to sell the investment, at the reporting date, before recovery of the cost of the investment. For reporting entities required to maintain an AVR/IMR, the accounting for the entire amount of the realized capital loss shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. Credit related other than temporary impairment losses shall be recorded through the AVR; interest related other than temporary impairment losses shall be recorded through the IMR. The new cost basis

shall not be changed for subsequent recoveries in fair value. Therefore, the prospective adjustment method must be utilized for periods subsequent to the loss recognition.

Disclosures

3. This statement requires no additional disclosures.

Effective Date and Transition

4. This statement is effective for quarterly and annual reporting periods beginning on or after January 1, 2009, with early adoption permitted and encouraged. A change resulting from the adoption of this statement shall be accounted for prospectively. No cumulative effect adjustments or application of the new guidance to prior events or periods are required, similar to a change in accounting estimate.

9. *SSAP No. 99—Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment* (SSAP No. 99) establishes statutory accounting principles for the treatment of premium or discount applicable to certain securities subsequent to the recognition of an other-than-temporary impairment. Paragraph 13 of SSAP No. 99 inserted a new paragraph into SSAP No. 43. Consistent with the superseding of SSAP No. 43 by SSAP No. 43R, paragraph 13 of SSAP No. 99 (and the new paragraph inserted within SSAP No. 43) have also been superseded:

Loan-backed and Structured Securities

13. This statement shall insert the following new paragraph 17 into SSAP No. 43, with subsequent paragraphs of SSAP No. 43 to be renumbered accordingly:

17. In periods subsequent to the recognition of an other than temporary impairment loss for a loan-backed or structured security, the reporting entity shall account for the other-than-temporarily impaired security as if the security had been purchased on the measurement date of the other-than-temporary impairment. The fair value of the security on the measurement date shall become the new cost basis. The discount or reduced premium recorded for the security, based on the new cost basis, shall be amortized in the prospective manner over the remaining period in which repayment of principal is expected to occur. The security shall continue to be subject to impairment analysis for each subsequent reporting period. The new cost basis shall not be changed for subsequent recoveries in fair value. Therefore, the prospective adjustment method must be utilized for periods subsequent to the impairment loss recognition. Future declines in fair value which are determined to be other-than-temporary shall be recorded as realized losses.

Disclosures

14. This statement requires no additional disclosures.

Generally Accepted Accounting Principles

10. The adoption of SSAP No. 43R did not adopt or reject any GAAP standards.

RELEVANT LITERATURE

Statutory Accounting

- *SSAP No. 43—Loan-backed and Structured Securities*

- *SSAP No. 98—Treatment of Cash Flows When Quantifying Changes in Valuation and Impairments, an Amendment of SSAP No. 43—Loan-backed and Structured Securities*

- *SSAP No. 99—Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment*

- *Issue Paper No. 43—Loan-backed and Structured Securities*

- *Issue Paper No. 124—Treatment of Cash Flows When Quantifying Changes in Valuation and Impairments: An Amendment to SSAP No. 43—Loan-backed and Structured Securities*

- *Issue Paper No. 131—Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment*

Generally Accepted Accounting Principles

- None

State Regulations

- No additional guidance obtained from state statutes or regulations.

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Statutory Accounting Principles Working Group
Maintenance Agenda Submission Form
Form A

Issue:
FAS 168, FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles

Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐

Description of Issue:
FASB Statement 168, FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles (FAS 168), issued June 2009 replaces *FAS 162, The Hierarchy of Generally Accepted Accounting Principles* (FAS 162). FAS 168, effective for interim and annual periods ending after Sept. 15, 2009, identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of the financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States.

Key Aspects of FAS 168:

- Establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities. (SEC guidance included within the codification is provided for convenience and relates only to SEC entities.)

- If guidance for a transaction or event is not specified within a source of authoritative GAAP, entity shall consider accounting principles for similar transactions or events within a source of authoritative GAAP and then consider nonauthoritative guidance from other sources. Sources of nonauthoritative GAAP include:

  - Practices that are widely recognized and prevalent either generally or in the industry,
  - FASB Concept Statements,
  - AICPA Issues Papers,
  - International Financial Reporting Standards of the IASB,
  - Pronouncements of professions associations or regulatory agencies,
  - Technical Information Service Inquiries and Replies Included in AICPA Technical Practice Aids,
  - Accounting textbooks, handbooks and articles

- Accounting Standards Updates issued after the effective date of FAS 168 will not be considered authoritative in their own right. Such standards will serve only to update the Codification, provide background information, and provide the bases of conclusions on the changes to the Codification.

- On the effective date, all non-SEC accounting and reporting standards are superseded. Additionally, all nongrandfathered, non-SEC accounting literature not included in the Codification is deemed nonauthoritative.

- Changes in applying FAS 168 shall be accounted for a change in accounting principle or correction or error, as applicable, in accordance with *FAS 154, Accounting Changes and Error Corrections* (Section 250-10-50 of the Codification).

Existing Authoritative Literature:

Preamble - IV. Statutory Hierarchy – The guidance within the Preamble adopts, with modification *FAS 162, The Hierarchy of Generally Accepted Accounting Principles* (FAS 162). Modifications from FAS 162 excluded FAS 133 Implementation Issues from the NAIC Hierarchy unless considered significant and relevant to statutory accounting

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and specifically requested for review as part of the maintenance process. Also, FASB Staff Positions adopted after May 9, 2009 were considered NAIC Level 1 – Category 'a'. FSPs adopted prior to May 9, 2008 were classified as NAIC Level 1 – Category 'b' and reviewed as part of the maintenance process if considered to be 'Board-directed'. FSPs not considered 'Board-directed' were classified as NAIC Level 5 and not reviewed as part of the statutory accounting maintenance review process.

INT 04-01: Applicability of New GAAP Disclosures Prior to NAIC Consideration (INT 04-01) provides guidance on when GAAP pronouncement disclosures are required for statutory accounting purposes. This interpretation includes reference to FAS 162.

INT 04-18: EITF 00-21: Revenue Arrangements with Multiple Deliverables (INT 04-18) provides guidance for arrangements in which the company will perform multiple revenue-generating activities. This interpretation includes reference to FAS 162 within a footnote.

Activity to Date (issues previously addressed by SAPWG, Emerging Accounting Issues WG, SEC, FASB, other State Departments of Insurance or other NAIC groups):

During the 2009 Summer National Meeting, the Statutory Accounting Principles Working Group formed a Subgroup to address changes necessitated by current projects, including the FASB Accounting Standards Codification.

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

None

Staff Recommended Conclusion or Future Action on Issue:

Staff recommends that the Statutory Accounting Principles Working Group move this item to the Nonsubstantive Active Listing and direct the AP&P Manual Subgroup to review the following proposed changes for incorporation within the *NAIC Accounting Practices and Procedures Manual*:

1) Revise guidance in the Preamble for the Statutory Hierarchy to reference the FASB Codification rather than the different categories of GAAP guidance.

2) Update all GAAP references throughout the AP&P manual to include reference the FASB Codification. Although GAAP filers are required to use the Codification reference for interim and annual periods ending after Sept. 15, 2009, it is Staff's recommendation that both the prior GAAP title and Codification reference continue to be retained in the *NAIC Accounting Practices and Procedures Manual*. (Review and reference of GAAP material adopted after the Codification effective date will simply include the Codification reference.)

3) Modify the GAAP to SAP Cross-Reference (Appendix D) to reflect the GAAP guidance within the FASB Codification. (Staff is looking for Subgroup member comments on whether the existing form of Appendix D should also be retained for a period of time to allow for adjustment to the new reference approach.)

Recommending Party:

Julie Gann – NAIC Staff
July 2009

Proposed Revisions to Preamble, INT 04-1 and INT 04-18:

(Staff Note: The revisions below only identify proposed revisions to the Preamble and other locations where FAS 162 was referenced. Pursuant to the staff recommendation, all references in the AP&P manual to "GAAP Pronouncements" will be revised to reflect "FASB Codification" or "GAAP Guidance".)

IV. Statutory Hierarchy

The following Hierarchy is not intended to preempt state legislative and regulatory authority.

Level 1:

- SSAPs, including GAAP reference material to the extent adopted by the NAIC from the FASB Accounting Standards Codification[1] (FASB Codification or GAAP guidance)[2] ~~GAAP reference material~~ to the extent adopted by the NAIC ~~from Categories a, b and c from the GAAP Hierarchy, as defined in FAS 162, The Hierarchy of Generally Accepted Accounting Principles (FAS 162) with modification to exclude FAS 133 Implementation Issues from the NAIC Hierarchy and statutory accounting standard review process3~~.

~~**Category a includes: FASB Statements and Interpretations, FASB Staff Positions4, APB Opinions, and AICPA Accounting Research Bulletins.**~~

~~**Category b includes: FASB Technical Bulletins, AICPA Industry Audit and Accounting Guides, and AICPA Statements of Position.**~~

~~**Category c includes: Consensus positions of the FASB Emerging Issues Task Force and AICPA Practice Bulletins.**~~

Level 2:

- Consensus positions of the Emerging Accounting Issues Working Group as adopted by the NAIC

Level 3:

- NAIC Annual Statement Instructions
- NAIC Purposes and Procedures of the Securities Valuation Office manual

Level 4:

- Statutory Accounting Principles Statement of Concepts[5]

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[1] Effective September 15, 2009, the FASB Codification is the source of authoritative U.S. generally accepted accounting principles. As of that date, the FASB Codification superseded all then-existing non-SEC accounting and reporting standards. All other nongrandfathered, non-SEC accounting literature not included in the FASB Codification is nonauthoritative.

[2] FAS 133 Implementation Issues~~, classified within FASB category 'a'~~ are excluded from the NAIC hierarchy and statutory accounting standard review process unless considered significant and relevant to statutory accounting and specifically requested for review as part of the maintenance process, or in accordance with future projects in which review of a specific FAS 133 Implementation Issue would be considered beneficial. (These items are excluded from the maintenance process as SSAP No. 86 only adopts the framework of the guidance included in FAS 133.)

[4] FASB Staff Positions (FSPs) adopted after May 9, 2008 ~~are considered within NAIC Level 1 – Category 'a' and~~ are reviewed as part of the statutory accounting maintenance review process. FSPs adopted prior to May 9, 2008 were ~~classified within NAIC Level 1 – Category 'b' and~~ reviewed as part of the maintenance process if considered to be 'Board-directed'. (Board-directed FSPs were issued to provide narrow and limited revisions to the FASB statements or FASB interpretations formerly provided in FASB Technical Bulletins.) FSPs that were not considered 'Board-directed' were considered to provide application guidance similar to that found in FASB Staff Implementation Guides and Staff Announcements and ~~were classified as NAIC Level 5 guidance. Due to this Level 5 classification, these FSPs~~ were not reviewed as part of the statutory accounting maintenance review process.

[5] The Statutory Accounting Principles Statement of Concepts incorporates by reference FASB Concepts Statements One, Two, Five and Six to the extent they do not conflict with the concepts outlined in the statement. However, for purposes of applying this hierarchy the FASB Concepts Statements shall be included in Level 5 and only those concepts unique to statutory accounting as stated in the statement are included in Level 4.

Level 5:

- Sources of nonauthoritative GAAP accounting guidance and literature, including: (a) practices that are widely recognized and prevalent either generally or in the industry, (b) FASB Concept Statements, (c) AICPA Issues Papers, (d) International Financial Reporting Standards, (e) Pronouncements of professional associations or regulatory agencies, (f) Technical Information Service Inquiries and Replies included in the AICPA Technical Practice Aids, and (g) ~~GAAP reference material below category c in the GAAP Hierarchy~~Accounting textbooks, handbooks and articles.

~~2.~~39. If the accounting treatment of a transaction or event is not specified by the SSAPs, preparers, regulators and auditors of statutory financial statements should consider whether the accounting treatment is specified by another source of established statutory accounting principles. If an established statutory accounting principle from one or more sources in Level 2 or 3 is relevant to the circumstances, the preparer, regulator or auditor should apply such principle. If there is a conflict between statutory accounting principles from one or more sources in Level 2 or 3, the preparer, regulator or auditor should follow the treatment specified by the source in the higher level—that is, follow Level 2 treatment over Level 3. Revisions to guidance in accordance with additions or revisions to the NAIC statutory hierarchy should be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

~~3.~~40. Because of developments such as new legislation or the evolution of a new type of business transaction, there sometimes are no established statutory accounting principles for reporting a specific transaction or event. In those instances, it might be possible to report the event or transaction on the basis of its substance by selecting a statutory accounting principle that appears appropriate when applied in a manner similar to the application of an established statutory principle to an analogous transaction or event. In the absence of a SSAP or another source of established statutory accounting principles, the preparer, regulator or auditor of statutory financial statements may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes the Statutory Accounting Principles Statement of Concepts and GAAP reference material and accounting literature ~~below category c in the GAAP hierarchy as defined in FAS 162~~identified in Level 5. The appropriateness of other accounting literature depends on its relevance to the particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, the Statutory Accounting Principles Statement of Concepts would be more authoritative than any other sources of accounting literature. Similarly, FASB Concepts Statements would normally be more influential than other sources ~~below category d in the GAAP hierarchy~~of nonauthoritative GAAP pronouncements[6].

VII. Relationship to GAAP

~~1.~~50. As expressed in the Statement of Concepts, SAP utilizes the framework established by GAAP. This Manual integrates that framework with objectives exclusive to statutory accounting. The NAIC's guidance on SAP is comprehensive for those principles that differ from GAAP based on the concepts of statutory accounting outlined herein. ~~Those~~ GAAP ~~pronouncements~~ guidance that ~~are~~is not applicable to insurance companies will not be adopted by the NAIC. For those principles that do not differ from GAAP, the NAIC may specifically adopt ~~those~~ GAAP ~~Pronouncements~~ guidance to be included in statutory accounting. Elements of the FASB Codification ~~GAAP Pronouncements~~ do not become part of SAP until and unless adopted by the NAIC. ~~GAAP pronouncements that have been considered in the development of SAP include all issued pronouncements in categories a, b and c of the GAAP Hierarchy.~~ Future SAP pronouncements will specifically identify any ~~GAAP pronouncements~~element of the FASB Codification that are to be included in SAP whether in whole, in part, or with modification as well as any rejected GAAP ~~pronouncements~~ guidance~~that are rejected~~. ~~Future~~ GAAP ~~pronouncements~~ guidance which SAP has not yet addressed shall not be considered as providing authoritative statutory guidance.

[6] ~~The Statutory Accounting Principles Statement of Concepts incorporates by reference FASB Concepts Statements One, Two, Five and Six to the extent they do not conflict with the concepts outlined in the statement. However, for purposes of applying this hierarchy the FASB Concepts Statements shall be included in Level 5 and only those concepts unique to statutory accounting as stated in the statement are included in Level 4.~~

INT 04-01: Applicability of New GAAP Disclosures Prior to NAIC Consideration

1. In accordance with the Preamble and the NAIC Policy Statement on Statutory Accounting Principles Maintenance Agenda Process, Generally Accepted Accounting Principles (GAAP) ~~reference material categories a, b and c from the GAAP Hierarchy, as defined in *FAS 162, The Hierarchy of Generally Accepted Accounting Principles*~~contained within the FASB Accounting Standards Codification, are automatically placed on the Statutory Accounting Principles Working Group maintenance agenda for review and discussion. (As noted in the Preamble, ~~FAS 162 has been adopted with modification to exclude~~ FAS 133 Implementation Issues are excluded from the statutory review process unless individually requested for review.)

INT 04-18: EITF 00-21: Revenue Arrangements with Multiple Deliverables

Footnote 1 - Whether a deliverable(s) is within the scope of higher-level authoritative literature is determined by the scope provisions of that literature, without regard to the order of delivery of that item in the arrangement. The term higher-level literature refers to items captured within the FASB Accounting Standards Codification. ~~categories (a) and (b) of the generally accepted accounting principles (GAAP) hierarchy as defined in *FAS 162, The Hierarchy of Generally Accepted Accounting Principles* in the Independent Auditor's Report. EITF consensuses represent category (c) of the hierarchy.~~

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