JANUARY 2022

Insurance Investment Management

Statement and Statutory Accounting Changes

Stacy Crook | Director of Investment Accounting

Quarterly and Annual Filings

SSAP 26R – Bonds – Accounting for Perpetual Bonds (2020-22)

Based on the material similarities of the accounting for perpetual preferred stock, the working group agreed that revisions were necessary to contain specific reporting guidance for Perpetual Bonds. The revisions clarify that perpetual bonds are within the scope of SSAP 26R. Those with an effective call option, any applicable premium shall be amortized under the yield to worst concept. Perpetual Bonds that do not possess or no longer possess a call feature shall be reported at fair value regardless of NAIC designation. Effective March 15, 2021.

SSAP 26R – Bonds - Disclosure Update (2020-32)

Through agenda item #2020-02: Accounting for Bond Tender Offers, the working group clarified that the accounting and reporting of investment income and capital gains/losses, due to early liquidation either through call or a tender offer should be similarly applied. The effective date January 1, 2021. This agenda item addresses revisions to expand current called bond disclosures to include bonds terminated through a tender offer. Effective March 15, 2021.

SSAP 32R -Publicly Traded Preferred Stock Warrants (2020-33)

Stock warrants generally fall into the scope of *SSAP No. 86 -Derivatives* although there was already a carveout for publicly traded common stock. With the only difference between publicly traded common stock and publicly traded preferred stock is the type of stock received. The working group determined that publicly traded preferred stock warrants should receive the same carveout as common stocks. Revisions capture publicly traded preferred stock warrants in scope of SSAP 32R and require the warrants to be reported at fair value. Effective March 15, 2021.

SSAP 43 R – Loan Backed and Structured Securities - Government Sponsored Enterprises – Credit Risk Transfer Program (2020-34)

It is anticipated that future Freddie Mac STACR and Fannie Mae CAS issuances will be solely conducted through a Real Estate Mortgage Investment Conduit (REMIC) trust. SAPWG support staff has confirmed that the anticipated use of a REMIC trust remains functionally equivalent and retains the same material risk structure as the original STACR and CAS programs. Additionally, investment in securities issued by a GSE REMIC trust remains within the review scope of the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual). Per part 4 of the P&P Manual, Mortgage Referenced Securities are not eligible for filing exemption and are subject to assessment by the Structures Securities Group. The revisions incorporate minor scope modifications to reflect recent changes to the Freddie Mac Structured Agency Credit Risk (STACR) and Fannie Mae Connecticut Avenue Securities (CAS) programs and will allow these credit risk transfer securities to remain in scope of SSAP 43R when issued through a real estate mortgage investment conduit (REMIC) trust structure.

INT 20-03: Troubled Restructuring Due to COVID-19

On March 27, 2020, President Donald Trump signed into law the Coronavirus Aid, Relief and Economic Security Act (CARES Act). The provisions in Section 4013 specifically address temporary relief from troubled debt restructurings. On December 27, 2020, President Trump signed into law the Consolidated Appropriations Act, 2021, which slightly modified and extended the original CARES Act January 1, 2022 or the date that is 60 days after the date on which the national emergency concerning the novel coronavirus disease (COVID–19) outbreak declared by the President on March 13, 2020 under the National Emergencies Act (50 U.S.C. 1601 et seq.) terminates.

Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) to Update the Financial Modeling Instructions for RMBS/CMBS Securities and Direct IAO Staff to Produce NAIC Designation and NAIC Designations Categories for Non-Legacy Securities

Each financially modeled Non-Legacy Security (RMBS and CMBS that closed on or after January 1, 2013*) will receive a single NAIC Designation and NAIC Designation category rather than Price Grids (breakpoints). Price Grids will continue to be provided for financially modelled RMBS and CMBS Legacy Securities (RMBS and CMBS that closed prior to January 1, 2013). Adopted March 22, 2021.

Proposed Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) to Private Rating Letter Rationale Report Only

The SVO proposes the following amendments to Parts One and Three of the Purposes and Procedures Manual of the Investment Analysis Office to permit the SVO to review all PL securities whether processed through a feed or submitted directly to the SVO and would require insurance company filers to provide private rating letter rationale reports for each security. Adopted May 24, 2021.

SSAP No. 43R – Residual Tranches (2021-15)

This agenda item provides updates to SSAP No. 43R—Loan-Backed and Structured Securities to clarify that securitization residual tranches shall be reported on Schedule BA: Other Long-Term Invested Assets and valued at the lower of cost or fair value. Effective December 31, 2022. In addition, the residual tranches are permitted to remain on Schedule D -1 for year-end 2021, with an NAIC 6 designation.

GAAP Updates

Credit Losses/Impairments

In June 2016, the FASB issued Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (ASU 2016-13). This standard includes the current expected credit loss (CECL) method, which requires reporting entities to establish an allowance for credit losses that are expected to be incurred over the lifetime of the assets. At each reporting period, the allowance should represent Management's current estimate of the expected credit losses. The estimate should be calculated after grouping the financial assets into pools based on their risk characteristics. If a financial asset cannot be grouped into a pool, it can be evaluated individually. The movement in this allowance would be recognized in income. Therefore, this model allows for an immediate reversal of credit losses recognized on assets that have an improvement in expected cash flows.

Although this standard includes most debt instruments, securities classified as available-for-sale (AFS) are not included in the CECL model. However, the credit loss guidance for AFS securities will be moved from Topic 320 to Topic 326-30, along with some targeted changes:

- An allowance for credit losses would be calculated at the individual security level each reporting period. The allowance would be equal to the amount that amortized cost exceeds the present value of expected future cash flows. However, the valuation allowance for credit losses shall not exceed the unrealized holding loss.
- This approach allows for impairment losses to be reversed as credit losses or the impaired status evaporates.
- The requirement to consider the length of time a security has been underwater to determine if a credit loss exists would be removed.
- The requirement to consider additional declines in fair value or recoveries subsequent to the balance sheet date would no longer be required when estimating if a credit loss exists.
- An allowance for credit losses roll-forward disclosure will be required each reporting period

In addition to AFS securities, the FASB decided to remove the following financial assets from the proposal's scope:

- Loans made to participants by defined contribution employee benefit plans
- Policy loan receivables of an insurance entity
- Pledge receivables of a not-for-profit entity
- Related party loans and receivables

ASU 2016-13 will be effective for public, SEC filing entities, excluding entities eligible to be Smaller Reporting Companies as defined by the SEC, for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. For all other entities, it will be effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years.

Over the past few years the FASB has focused efforts on implementation and adoption of ASU 2016-13. In response to feedback received the FASB has amended certain aspects of the ASU and added a project on the account for purchased credit-deteriorated (PCD) assets.

References

Statutory Accounting Principles (E) Working Group (SAPWG)

Accounting Practices and Procedures (E) Task Force

Financial Condition Committee

Valuation of Securities (E) Task Force

Financial Accounting Standards Board Accounting Standards Update

Stacy Crook *is is the Director of Investment Accounting at AAM with 26 years of investment experience. Stacy is responsible for the Investment Accounting Group which provides accounting and statutory reporting services. Stacy has held several roles with increasing responsibilities at AAM, most recently as Vice President of Investment Accounting. Prior to joining AAM, Stacy worked at Jackson National Life Insurance Company in several different roles, as well as at the Northern Trust Company as a Senior Accountant. Stacy is a Lifetime member and the president of the Chicago Chapter of the National Black MBA Association. She is also a member of the Women's Board of the Chicago Urban League in addition to her ongoing membership in the National Association of Black Accountants, Inc. Stacy earned a BS in Business Administration from the University of Tennessee at Knoxville, MBA in Finance from Roosevelt University and MS in Accounting from Governors State University.*

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