

## Chapter 1

# Nature, Conduct, and Regulation of the Business

## General Nature of the Business

**1.01** The primary purpose of the property and liability insurance business is the spreading of risks. The term *risk*<sup>1</sup> generally has two meanings in insurance — it can mean either a *peril insured against* (for example, fire is a risk to which most property is exposed) or a *person or property protected* (for example, a home or an automobile). For a payment known as a premium, insurance entities agree to relieve the policyholder of all or part of a risk and to spread the total cost of similar risks among large groups of policyholders.

**1.02** The functions of the property and liability insurance business include marketing, underwriting (that is, determining the acceptability of risks and the amount of the premiums), billing and collecting premiums, investing and managing assets, investigating and settling claims made under policies, and paying expenses associated with these functions.

**1.03** In conducting its business, an insurance entity accumulates a significant amount of investable assets. In addition to funds raised as equity and funds retained as undistributed earnings, funds accumulate from the following:

- Premiums collected
- Sums held for the payment of claims in the process of investigation, adjustment, or litigation
- Sums held for payment of future claims settlement expenses

The accumulation of these funds, their investment, and the generation of investment income are major activities of insurance entities.

## Kinds of Insurance

**1.04** Kinds of insurance, generally referred to as *lines of insurance*, represent the perils that are insured by property and liability insurance entities. Some of the more major lines of insurance offered by property and liability insurance entities include the following:

- *Accident and health* covers loss by sickness or accidental bodily injury. It also includes forms of insurance that provide lump-sum or periodic payments in the event of loss by sickness or accident, such as disability income insurance and accidental death and dismemberment insurance.

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<sup>1</sup> This definition differs from the definition of *insurance risk* stated in the FASB *Accounting Standards Codification* (ASC) Master Glossary, which describes insurance risk as the risk arising from uncertainties about both underwriting risk and timing risk. Actual or imputed investment returns are not an element of insurance risk. Insurance risk is fortuitous; the possibility of adverse events occurring is outside the control of the insured. It is the definition in the FASB ASC Master Glossary that determines the proper accounting when considering risk transfer. See chapter 6, "Reinsurance."

## Property and Liability Insurance Entities

- *Automobile* covers personal injury or automobile damage sustained by the insured and liability to third parties for losses caused by the insured.
- *Fidelity bonds* cover employers against dishonest acts by employees. Blanket fidelity bonds cover groups of employees.
- *Fire and allied lines* includes coverage for fire, windstorm, hail, and water damage (but not floods).
- *Home insurance* provides coverage for damage or destruction of the policyholder's home. In some geographical areas, the policy may exclude certain types of risks, such as flood or earthquake, and require additional coverage.
- *Inland marine* covers property being transported other than transocean. (It also includes floaters, which are policies that cover movable property, such as a tourist's personal property.)
- *Miscellaneous liability* covers most other physical and property damages not included under workers' compensation, automobile liability, and multiple peril policies. Damages include death, cost of care, and loss of services resulting from bodily injury, as well as loss of use of property.
- *Multiple peril*, a package coverage, includes most property and liability coverage except workers' compensation, automobile insurance, and surety bonds.
- *Ocean marine* includes coverage for ships and their equipment, cargo, freight, and liability to third parties for damages.
- *Professional liability* covers physicians, surgeons, dentists, hospitals, engineers, architects, accountants, attorneys, and other professionals from liability arising from error or misconduct in providing or failing to provide professional service.
- *Surety bonds* provide for monetary compensation to third parties for failure by the insured to perform specifically covered acts within a stated period. (Most surety bonds are issued for persons doing contract construction, persons connected with court actions, and persons seeking licenses and permits.)
- *Workers' compensation* compensates employees for injuries or illness sustained in the course of their employment.

**1.05** In addition to these lines, insurance is provided by excess and surplus lines:

- *Excess liability* covers the insured against loss in excess of a stated amount, but only for losses as covered and defined in an underlying policy. The underlying amount is usually insured by another policy but can be retained by the insured.
- *Surplus lines* include coverage for risks that do not fit normal underwriting patterns, risks that are not commensurate with standard rates, or risks that will not be written by standard carriers because of general market conditions. These kinds of policies may be written by carriers not licensed in the jurisdiction where the risk is located and generally are not subject to regulations governing premium rates or policy language.

**1.06** The lines and premium volume that may be written by an entity are generally restricted by state insurance regulations. States also use risk-based capital standards for regulating solvency and capacity and also monitor the amount of premium written as a ratio of the entity's surplus.

**1.07** Insurance written by property and liability insurance entities may be broadly classified as *personal lines*, which consist of insurance policies issued to individuals, and *commercial lines*, which consist of policies issued to business enterprises. Personal lines generally consist of large numbers of relatively standard policies with relatively small premiums per policy. Examples are homeowner and individual automobile policies. Commercial lines involve policies with relatively large premiums that may also be retroactively adjusted based on claims experience. The initial premium is often only an estimate because it may be related to payroll or other variables. Examples are workers' compensation and general liability. Many large insurance entities have separate accounting, underwriting, and claim-processing procedures for these two categories.

**1.08** Insurance is generally available to the individual as a means of protection against loss. There are instances, however, in which a person cannot obtain insurance in the voluntary insurance market. States have established programs to provide insurance to those with high risks who otherwise would be excluded from obtaining coverage. The following are some of the more common programs that provide the necessary coverage:

- *Involuntary automobile insurance.* States have a variety of methods for apportioning involuntary automobile insurance. The most widely used approach is the Automobile Insurance Plan (formerly called the Assigned Risk Plan). Under this plan, all entities writing automobile insurance in a state are allocated a share of the involuntary business on an equitable basis. Each automobile insurer operating in the state accepts a share of the undesirable drivers, based on the percent of the state's total auto insurance that it writes. For example, an entity that writes 5% of the voluntary business in a state may be assigned 5% of the involuntary applicants. It is then responsible for collecting the premiums and paying the claims on the policies issued to these applicants. Other states use a reinsurance plan under which each insurer accepts all applicants but may place high-risk drivers in a reinsurance pool, with premiums paid to and losses absorbed by the pool. Still another approach is a joint underwriting association, in which one or more servicing entities are designated to handle high-risk drivers. States may require insurers to participate in the underwriting results.
- *Fair Access to Insurance Requirements (FAIR) plans.* FAIR plans are state-supervised programs established to provide coverage for property in high-risk areas. Entities that operate in the state are required to participate in the premiums, losses, expenses, and other operations of the FAIR plan.
- *Medical malpractice pools.* These pools were established when healthcare professionals and institutions were experiencing difficulty in obtaining liability insurance in the voluntary insurance market. The pools were established by law and currently exist in the majority of states. All insurers writing related liability

insurance in such states are considered mandatory participants in the pools as a condition for their continuing authority to transact business in such states.

- *Workers' compensation pools.* These pools are similar to FAIR plans. As with FAIR plans, companies operating in a given state are assessed a proportionate share, based on direct writings, of the underwriting results of the pool.

## Legal Forms of Organization

**1.09** The principal kinds of property and liability insurance organizations are

- stock companies*, which are corporations organized for profit with ownership and control of operations vested in the stockholders. Generally, the stockholders are not liable in case of bankruptcy or impairment of capital.
- mutual companies*, which are organizations in which the ownership and control of operations are vested in the policyholders. On the expiration of their policies, policyholders lose their rights and interests in the entity. Many states require the net assets of a mutual insurance entity in liquidation to be distributed among the current policyholders of the entity, and the prior policyholders have no claim against the assets. Most major mutual entities issue nonassessable policies as provided under state laws. If a mutual entity is not qualified to issue such policies, however, each policyholder is liable for an assessment equal to at least one annual premium in the event of bankruptcy or impairment of minimum equity requirements. Many mutual insurance entities are seeking enhanced financial flexibility and access to capital to support long-term growth and other strategic initiatives. Because of many economic and regulatory factors, as well as increased competition, some mutual insurance entities have chosen to demutualize or to form mutual insurance holding entities.
- reciprocal or interinsurance exchanges*, which are composed of a group of persons, firms, or corporations, commonly termed *subscribers*, who exchange contracts of insurance through the medium of an attorney-in-fact. Each subscriber executes an identical agreement empowering the attorney-in-fact to assume, on the subscriber's behalf, an underwriting liability on policies covering the risks of the other subscribers. The subscriber assumes no liability as an underwriter on policies covering his or her own risk; the subscriber's liability is limited by the terms of the subscriber's agreement. Customarily, the attorney-in-fact is paid a percentage of premium income, from which he or she pays most operating expenses, but some exchanges pay his or her own operating expenses and compensate the attorney-in-fact at a lower percentage of premiums or by some other method.
- public entity risk pools*, which are cooperative groups of governmental entities joining together to finance exposures, liabilities, or risks. Risk may include property and liability, workers' compensation, employee health care, and so forth. A pool may be a stand-alone entity

or be included as part of a larger governmental entity that acts as the pool's sponsor. Stand-alone pools are sometimes organized or sponsored by municipal leagues, school associations, or other kinds of associations of governmental entities. A stand-alone pool is frequently operated by a board that has as its membership one member from each participating government. It typically has no publicly elected officials or power to tax. Public entity risk pools normally should be distinguished from private pools, which are organized under the Risk Retention Act of 1986. These private pools, or risk retention groups, can provide only liability coverage, whereas public entity risk pools organized under individual state statutes can provide several kinds of coverage. The four basic kinds of public entity risk pools are

- i. *risk-sharing pools*, which are arrangements by which governments pool risks and funds and share in the cost of losses.
- ii. *insurance-purchasing pools*, which are arrangements by which governments pool funds or resources to purchase commercial insurance products. These arrangements are also called *risk-purchasing groups*.
- iii. *banking pools*, which are arrangements by which money is made available for pool members in the event of loss on a loan basis.
- iv. *claims-servicing or account pools*, which are arrangements by which pools manage separate accounts for each pool member from which the losses of that member are paid.

A pool can serve one or several of those functions. Pools that act only as banking or claims-servicing pools do not represent transfer of risk. Those pools are not considered insurers and do not need to report as such.

- e. *private pools*. Because of the unavailability and unaffordability of commercial liability insurance, Congress enacted the Risk Retention Act of 1986. This act allows the organization of private pools for the purpose of obtaining general liability insurance coverage. Two basic types of private pools are allowed:
  - i. *Risk retention groups*. An insurance entity formed by the members of the private pool primarily to provide commercial liability insurance to the members.
  - ii. *Purchasing groups*. Members of a private pool purchase commercial liability insurance on a group basis.

## Methods of Producing Business

**1.10** The marketing department of an insurance entity is responsible for sales promotion, supervision of the agency or sales force, and sales training. Property and liability insurance entities may produce business through a network of agents (agency companies) or through an employee sales force (direct writing companies), or they may acquire business through insurance brokers or through direct solicitation. A combination of methods may also be used. The distinctions among an agent, a broker, and a salesperson are based on their relationships with the insurance entity.

**1.11 Agents.** Insurance agents act as independent contractors who represent one insurance entity (exclusive agents) or more than one entity (independent agents) with express authority to act for the entity in dealing with insureds.

**1.12 General agents** have exclusive territories in which to produce business. They agree to promote the entity's interest, pay their own expenses, maintain a satisfactory agency force, and secure subagents. They may perform a significant portion of the underwriting. They may also perform other services in connection with the issuance of policies and the adjustment of claims, including negotiating reinsurance on behalf of the insurer, which neither local agents nor brokers are authorized or expected to do.

**1.13 Local and regional agents** are authorized to underwrite and issue policies but are not usually given exclusive territories. They usually report either to entity branch offices or directly to the entity's home offices. Agents are generally compensated by commissions based on percentages of the premiums they produce. Because of their greater authority and duties, general agents usually receive higher percentages than local or regional agents.

**1.14 Agents** have the power to bind the entity, which means that the insurance is effective immediately, regardless of whether money is received or a policy is issued. Generally, agents are considered to have vested rights in the renewal of policies sold for insurance entities. The entity cannot, however, compel independent agents to renew policies, and the agents may place renewals with other entities.

**1.15 Brokers.** Insurance brokers represent the insured. As a result, brokers do not have the power to bind the entity. Brokers solicit business and submit it for acceptance or rejection with one or more insurance entities. Brokers may submit business directly to an entity, through general or local agents, or through other brokers. Brokers are compensated by commissions paid by insurance entities, normally percentages of the premiums on policies placed with the entities, or through fees paid by the insured. Some large brokers have fee agreements, wherein commissions are either not accepted from the respective insurer or commissions received from the insurer by the broker are offset against the fees to be paid by the insured.

**1.16 Direct writing.** Direct writing entities sell policies directly to the public, usually through salespeople or internet sales, thus bypassing agents and brokers. Direct writing may be done from the entity's home office or through branch sales offices. Underwriting and policy issuance may also be done from the home office or branches. The salespeople may be paid commissions, straight salaries, or a commission incentive with a base salary. Salespeople generally have the power to bind the entity; however, the entity retains the right to cancel the policy, generally for up to 60 days.

**1.17 Direct response advertising or mass marketing** is also used for producing business. This results in sales to many people simultaneously, with single programs to insure a number of people or businesses. Such methods use direct billing techniques that may also permit individuals to pay premiums by salary deductions, credit cards, or as a direct draft against a checking account.

## Major Transaction Cycles

### Underwriting of Risks

**1.18** Underwriting includes evaluating the acceptability of the risk, determining the premium, and evaluating the entity's capacity to assume the entire risk.

**1.19** *Evaluating risks.* Evaluating risks and their acceptance or rejection involves (a) a review of exposure and potential loss based on both the review of policies, past claims experience, and the endorsements to existing policies and (b) an investigation of risks in accordance with procedures established by entity policy and state statutes. For example, applicants for automobile insurance may be checked by reference to reports on driving records issued by a state department of motor vehicles. A commercial enterprise wanting to purchase property insurance coverage may need to provide certain types of information when applying for coverage, for example, claims history, an engineering survey, a fire hazard survey, or similar investigations. In addition, an entity's underwriting policy may establish certain predetermined criteria for accepting risks. Such criteria often specify the lines of insurance that will be written as well as prohibited exposures, the amount of coverage to be permitted on various kinds of exposure, the areas of the country in which each line will be written, and similar restrictions.

**1.20** *Setting premium rates.* Establishing prices for insurance coverage is known as the rate-making process, and the resultant rates that are applied to some measure of exposure (for example, payroll or number of cars) are referred to as *premiums*. Determining premiums is one of the most difficult tasks in the insurance business. The total amount of claims is not known at the time the insurance policies are issued and, for many liability policies, is not known until years later. Determining proper premium rates is further complicated by the fact that no two insurable risks are exactly alike. The intensity of competition among hundreds of property and liability insurance entities in the United States is also significant in setting premiums.

**1.21** Premium rates may be established by one of three methods:

- a. *Manual rating*, which results in standard rates for large groups of similar risks and is used, for example, in many personal lines such as automobile insurance
- b. *Judgment rating*, which depends on the skill and experience of the rate-maker and, generally, is used for large or unusual risks such as ocean marine insurance
- c. *Merit rating*, which begins with an assumed standard or "manual" rate that is adjusted based on an evaluation of the risk or the insured's experience in past or current periods and is used in many commercial lines such as workers' compensation

**1.22** The transaction cycle for premiums is described in detail in chapter 3, "Premiums."

**1.23** *Reinsurance.* Insurance entities collect amounts from many risks subject to insurable hazards; it is expected that these amounts will be sufficient in the aggregate to pay all losses sustained by the risks in the group. To do so,



the number of risks insured needs to be large enough for the law of averages to operate.<sup>2</sup> However, insurance entities are often offered, or may be compelled to accept, insurance of a class for which they do not have enough volume in the aggregate to permit the law of averages to operate. Further, entities often write policies on risks for amounts beyond their financial capacities to absorb. An entity also may write a heavy concentration of policies in one geographic area that exposes the entity to catastrophes beyond its financial capabilities. Ordinarily, all or part of such risks are passed on to other insurance or reinsurance entities.

**1.24** Spreading of risks among insurance entities is called *reinsurance*. The entity transferring the risk is called the *ceding entity* and the entity to which the risk is transferred is called the *assuming entity*, or the *reinsurer*. Although a ceding entity may transfer its risk to another entity through reinsurance, it does not discharge its primary liability to its policyholders. The ceding entity remains liable for claims under the policy; however, through reinsurance, the ceding entity reduces its maximum exposure in the event of loss by obtaining the right to reimbursement from the assuming entity for the reinsured portion of the loss. The ceding entity is also exposed to the possibility that the reinsurer will not be able to reimburse the ceding entity.

**1.25** The term *portfolio reinsurance* is applied to the sale of all or a block of an entity's insurance in force to another entity. This kind of reinsurance is frequently used when an entity wishes to withdraw from a particular line, territory, or agency. In portfolio reinsurance, the assuming entity generally undertakes responsibility for servicing the policies — collecting the premiums, settling the claims, and so on — and the policyholder subsequently deals directly with the assuming entity.

**1.26** *Fronting*. Fronting is a form of an indemnity reinsurance arrangement between two or more insurers whereby the fronting entity will issue contracts and then cede all or substantially all of the risk through a reinsurance agreement to the other insurer(s) (the fronted entity) for a ceding commission. Such arrangements must comply with any regulatory requirements applicable to fronting to ensure avoidance of any illegal acts. As with other reinsurance contracts, the fronting entity remains primarily liable on the insurance contract with the insured. Fronting arrangements usually are initiated by fronted companies that are not authorized to write insurance in particular states.

**1.27** The principal kinds of reinsurance agreements and the mechanics of reinsurance are discussed in detail in chapter 6, "Reinsurance."

## Pooling, Captives, and Syndicates

**1.28** *Pooling*. The term *pooling* is often used to describe the practice of sharing all, or portions of, business of an affiliated group of insurance entities among the members of the group. Each premium written by the affiliated companies is customarily ceded to one entity; after allowing for any business reinsured outside the group, the premiums are in turn ceded back in agreed-upon ratios. Claims, claim adjustment expenses, commissions, and other underwriting and operating expenses are similarly apportioned. Each member of the group shares pro rata in the total business of the group, and all achieve similar underwriting results. Another kind of pooling involving sharing of risks among governmental entities is discussed in paragraph 1.09d.

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<sup>2</sup> That is, the statistical tendency of expected losses over a large population of risks.



**1.29** *Underwriting pools, associations, and syndicates.* Underwriting pools, associations, or syndicates are formed by several independent entities or groups of entities in joint ventures to underwrite specialized kinds of insurance or to write in specialized areas. These groups are often operated as separate organizations having distinctive names and their own staff of employees. The pools, associations, or syndicates may issue individual or syndicate policies on behalf of the member entities, which share in all such policies in accordance with an agreement, or policies may be issued directly by the member entities and then reinsured among the members in accordance with the agreement. The agreement stipulates the group's manner of operation and the sharing of premiums, claims, and expenses. Such groups customarily handle all functions in connection with the specialized business that would otherwise have to be handled by specific departments in each of the member companies. This kind of arrangement usually is more economical in handling the business for the members.

**1.30** *Captives.* Noninsurance businesses<sup>3</sup> try to use various methods to minimize their cost of insurance. Other than retaining the risk (that is, self-insurance), perhaps the most conventional method is the use of captive insurers. Captive insurers may be wholly owned subsidiaries or organized by a group of entities created to provide insurance to those entities. Captives were originally formed because no tax deductions are allowed if risks are not transferred, whereas premiums paid to insurers are tax deductible. Captives domiciled in the United States continue to expand as states continue to pass legislation to facilitate the formation of domestic captives. The growth in the capital that captives control is also on the rise. Captives are discussed in detail in chapter 9, "Captive Insurance Entities."

## Processing and Payment of Claims

**1.31** An insurance entity's claim department accepts, investigates, adjusts, and settles claims. Although specific procedures vary from entity to entity, a common pattern exists to the flow of transactions through the claims cycle, which consists of the following major functions: claim acceptance and processing, claim adjustment and estimation, and claim settlement.

**1.32** The transaction cycle for claims, including a claims process flowchart, is discussed in more detail in chapter 4, "The Loss Reserving and Claims Cycle."

## Investments

**1.33** A property and liability insurance entity collects funds from those who desire protection from insured losses and disburses funds to those who incur such losses. During the time between receiving premiums and the payment of losses, the entity invests the funds. These investments consist primarily of debt and equity securities but may also include mortgage loans, real estate, repurchase agreements, and derivative instruments. They may also include investments in mutual funds, hedge funds, joint ventures, and partnerships. In addition to holding long-term investments, insurance companies generally maintain short-term portfolios consisting of assets with maturities of less than

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<sup>3</sup> Technical Questions and Answers (Q&A) sections 1200.06–.16 of section 1200, *Income Statement*, provide information on finite insurance products utilized by noninsurance enterprises. The nonauthoritative guidance provides information to assist insurance customers and practitioners in identifying the relevant literature to consider in addressing their specific facts and circumstances.

All Q&A sections can be found in *Technical Questions and Answers*.

one year to meet liquidity needs. Short-term investments of property and liability insurance entities typically consist of commercial paper, repurchase agreements, certificates of deposit, Treasury bills, and money market funds.

**1.34** Because insurance entities must be able to meet the claims of their policyholders, their investments generally should be both financially sound and sufficiently liquid. To ensure that entities will be able to meet their obligations, statutory restrictions have been placed on their investment activities. Although statutes and regulations vary from state to state, most states specify maximum percentages of an entity's assets, surplus, or both that may be placed in various kinds of investments. In addition, regulatory authorities may require that some investments be deposited with the state insurance departments as a condition for writing business in those states. Investment standards and restrictions for public entity risk pools differ significantly from standards for insurance entities. In some jurisdictions, public entity risk pools must follow regulations governing the investment of public funds.

**1.35** Many insurance entities have separate investment departments responsible for managing the entities' investable funds. However, they may also use outside advisers or portfolio managers. The evaluation for purchase and subsequent purchase or sale of investments is based on the judgment of the entity's investment and finance committees.

**1.36** The transaction cycle for investments is discussed in more detail in chapter 5, "Investments and Fair Value Considerations."

## Definition of Public Business Entity

**1.37** In accordance with FASB Accounting Standards Update (ASU) No. 2013-12, *Definition of a Public Business Entity—An Addition to the Master Glossary*, the FASB Accounting Standards Codification (ASC) Master Glossary was amended to include one definition of public business entity (PBE) in future use of accounting principles generally accepted in the United States of America (U.S. GAAP).

**1.38** As more fully described in the "Alternatives Within U.S. Generally Accepted Accounting Principles" section of the preface to this guide, the determination of whether or not an entity is a *public business entity* will determine whether the entity is subject to full U.S. GAAP accounting and reporting standards. Entities that are not public business entities will be within the scope of the Private Company Decision-Making Framework and may apply alternatives within U.S. GAAP to be proposed by the Private Company Council.

**1.39** As defined in the FASB ASC Master Glossary,

[a] *public business entity* is a business entity meeting any one of the criteria below. Neither a not-for-profit entity nor an employee benefit plan is a business entity.

- a. It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).
- b. It is required by the Securities Exchange Act of 1934 (the Act), as amended, or rules or regulations promulgated

- under the Act, to file or furnish financial statements with a regulatory agency other than the SEC.
- c. It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer.
  - d. It has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market.
  - e. It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including footnotes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.

An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

**1.40** Subsequent to the issuance of FASB ASU No. 2013-12, the term has been used to not only delineate between PBE and non-PBE accounting alternatives, but also to establish effective dates and to scale disclosure requirements for new ASUs.<sup>4</sup> This has directed attention to the definition of a PBE that had not previously existed. Technical Questions and Answers (Q&A) sections 7100.01–.16 are intended to address questions regarding the definition of a PBE. Q&A section 7100.15, "Insurance Companies and the Definition of Public Business Entity," is specific to insurance entities and provides nonauthoritative guidance in this circumstance.

**1.41** Q&A section 7100.15 states the following:

*Inquiry* — Is an insurance entity considered a PBE under the FASB ASC Master Glossary definition?

*Reply* — An insurance entity may or may not be considered a PBE based on its facts and circumstances and an analysis of each of the criteria in the definition of a PBE. The following are examples of common insurance arrangements and considerations for determining if an insurance entity is a PBE. It should be noted that the list of examples is not all inclusive.

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<sup>4</sup> In August 2019, FASB exposed proposed ASU *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842)—Effective Dates* and proposed ASU *Financial Services—Insurance (Topic 944): Effective Date*, in response to FASB developing a philosophy to extend and simplify how effective dates are staggered between larger public companies (bucket one) and all other entities (bucket two). Under this philosophy, a major update would first be effective for bucket-one entities — entities that are SEC filers (per the FASB ASC Master Glossary definition), excluding entities eligible to be smaller reporting companies (SRCs) under the SEC's definition. All other entities, including entities eligible to be SRCs, all other public business entities, and all non-public business entities (private companies, not-for-profit organizations, and employee benefit plans) would compose bucket two. For those entities, it is anticipated that the board will consider requiring an effective date staggered at least two years after bucket one for major updates.

The definition of a PBE excludes not-for-profit entities within the scope of FASB ASC 958. The FASB ASC Master Glossary definition of a not-for-profit entity explicitly excludes "entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance entities." Therefore, such entities that do not meet the FASB definition of a not-for-profit entity must be analyzed to determine PBE status.

*Insurance entity that is required to file statutory accounting financial statements with an insurance regulator.*

An insurance entity might be required to make statutory accounting financial statements publicly available. Such a requirement would not meet the second condition of criterion (e) to periodically prepare full U.S. GAAP financial statements and make them publicly available.

*Insurance entity that is required to file stand-alone U.S. GAAP financial statements with a regulator.*

Some insurance entities (such as captives, risk retention groups, and health plans) may file stand-alone U.S. GAAP financial statements with the applicable state regulator instead of statutory accounting financial statements.

The elements of criterion (e) under the FASB ASC Master Glossary definition of a PBE should be analyzed. Generally, the financial statement requirement and public availability of financial statements for insurance companies is a facts and circumstances analysis.

The insurance entity should determine if any securities are subject to contractual restriction on transfer and consider the discussion in section 7100.06. This includes both explicit and implicit restrictions as discussed in section 7100.06. Many wholly owned (100%) entities, such as captives, will not qualify as PBEs due to this analysis.

If it is determined that one or more securities are not subject to contractual restriction, an assessment of the remaining requirements of criterion (e) should be made. As a reminder, entities should determine if they have met all of the following requirements of criterion (e):

- a. Is required by law, contract, or regulation
- b. To prepare and make publicly available
- c. Full U.S. GAAP financial statements including footnotes
- d. On a periodic basis

If the financial statements are made publicly available on a voluntary basis (regardless of who makes them publicly available), the entity would not meet all of the previous requirements. Entities should refer to section 7100.07 and consider the discussion of the terms *prepare, publicly available, financial statements*, and *periodic basis* in their evaluation of criterion (e). As a reminder, it is inappropriate to combine the

ability to request financial statements under statutes such as the Freedom of Information Act (FOIA) with other requirements to prepare financial statements because FOIA does not qualify as a requirement (by law, contract, or regulation) to prepare and make financial statements publicly available on a periodic basis as FOIA does not include a requirement to prepare financial statements. This would also be applicable to state statute or regulation.

*Separate accounts registered under the 1940 Act that file U.S. GAAP financial statements with the SEC.*

Separate accounts of an insurance entity are used to support variable annuity contracts and variable life insurance policies (hereinafter referred to together as variable contracts). Separate accounts can be registered investment companies under the Investment Company Act of 1940 (1940 Act). A variable contract can be both a security registered under the Securities Act of 1933 and an insurance policy filed with, and approved and regulated by, state insurance departments.

Separate accounts that are registered under the 1940 Act and are required to file U.S. GAAP financial statements with the SEC in product filings for variable contracts (N-3, N-4, or N-6) would meet criterion (a).

*Separate accounts registered under the 1940 Act that are exempt from filing U.S. GAAP financial statements with the SEC.*

Separate accounts that are registered under the 1940 Act and that are exempt from submitting product filings (N-3, N-4, or N-6) for variable contracts (referred to as Great Wasted), but do file U.S. GAAP financial statements on the SEC's website (for example, under SEC Rule N-30D) where the financial statements are publicly available, would meet criterion (a).

*Insurance sponsor of a separate account filing.*

An insurance entity that sponsors a separate account and includes its U.S. GAAP financial statements in product filings for variable contracts (N-3, N-4, or N-6) with the SEC would meet criterion (a).

*Insurance entity subsidiary when the immediate or ultimate parent company is a PBE.*

Like the discussion in section 7100.08, if an insurance subsidiary is deemed to not be a PBE but its immediate or ultimate parent company is a PBE, the subsidiary's stand-alone financial statements would be able to use deferred effective dates and private company council alternatives not available to PBEs. Notwithstanding the subsidiary's stand-alone financial statements, the parent company must still obtain financial information of the subsidiary sufficient to comply with PBE based accounting standards and effective dates for the purposes of the parent company's consolidated financial statements.

Surplus notes.

The issuance of surplus notes by an insurance entity may or may not cause the insurance entity to be considered a PBE based on the facts and circumstances of the arrangement and analysis of each of the criteria in the definition of a PBE.

## Revenue Recognition

1.42 Paragraphs 14.7.01–14.7.16 of chapter 14, "Insurance Entities," of the AICPA Audit and Accounting Guide *Revenue Recognition* contain the following revenue recognition implementation issue for insurance entities applying FASB ASC 606, *Revenue with Contracts with Customers*:<sup>5</sup>

### Considerations for Applying the Scope Exception in FASB ASC 606-10-15-2 and 606-10-15-4 to Contracts Within the Scope of FASB ASC 944

#### 14.7.01 FASB ASC 606-10-15-2 states

An entity shall apply the guidance in this Topic to all contracts with customers, except the following:

(b) Contracts within the scope of Topic 944, *Financial Services—Insurance*.

#### 14.7.02 BC13 of FASB ASU No. 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*, states:

The amendment to paragraph 606-10-15-2(b) clarifies that all contracts (that is, not only insurance contracts) within the scope of Topic 944, *Financial Services—Insurance*, are excluded from the scope of Topic 606. This exclusion applies to contracts within the scope of Topic 944 such as life and health insurance, property and liability insurance, title insurance, and mortgage guarantee insurance. Topic 944 provides guidance on accounting and financial reporting for those contracts, including guidance that is applied to both insurance and investment contracts to determine the revenue recognition for fees. Investment contracts (defined in the FASB ASC Master Glossary as long-duration contracts that do not subject the insurance entity to risks arising from policyholder mortality or morbidity) are included within the scope of Topic 944. For example, Subtopic 944-825 provides guidance on the accounting for and the financial reporting of financial instruments, including guidance on investment contracts. Those contracts are accounted for under a deposit accounting model, similar to financial instrument contracts issued by entities

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<sup>5</sup> FASB ASU No. 2014-09, *Revenue from Contract with Customers (Topic 606)*, was issued in May 2014. The amendments are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2018, and interim periods beginning after December 15, 2019. Earlier application is permitted. Readers are encouraged to read the full text of the ASU, available at [www.fasb.org](http://www.fasb.org). Readers should apply the appropriate guidance based on their facts and circumstances.

other than insurance entities. As noted in paragraph 606-10-15-2(c), financial instruments issued by entities other than insurance entities also are excluded from the scope of Topic 606, and, therefore, this technical correction is consistent with the existing scope exceptions for insurance and financial instrument contracts.

**14.7.03** As explained in BC13 of FASB ASU No. 2016-20, the intent of the amendment to FASB ASC 606-10-15-2b is to clarify that all contracts within the scope of FASB ASC 944, such as investment contracts, life and health insurance, property and liability insurance, title insurance, and mortgage guarantee insurance, are excluded from the scope of FASB ASC 606.

### ***Contracts Provided by Insurance Entities***

**14.7.04** Insurance contracts typically have components, that consist of various types and varying degrees of activities (enrollment, claim adjudication, administration and payment, and customer service) embodied in them in order for the insurer to fulfill its insurance obligations. In some instances, especially in commercial lines of business such as general liability, contracts may have high deductibles, but the insurance entity adjudicates all claims, including those below the deductible level. In some cases, an insurance entity may provide high deductible coverage, and the policyholder will obtain claims adjudication and settlement services from a third party unrelated to the insurer.

**14.7.05** Insurance entities can also provide services, such as claims adjudication and settlement, to customers without providing insurance coverage.

### ***Applying Scope Exemption***

**14.7.06** BC14 of FASB ASU No. 2016-20, states

Contracts within the scope of Topic 944 are excluded from the scope of Topic 606. That scope exception applies to contracts within the scope of Topic 944 and does not apply to all contracts of insurance entities. An insurance entity might need to consider whether a contract with a customer is for goods or services that are not within the scope of Topic 944. For example, the Board understands that a contract for administrative services (such as claims processing) without any insurance element is at present accounted for as a revenue arrangement within the scope of Topic 605. The Board expects that those types of service arrangements would be accounted for under Topic 606.

**14.7.07** BC15 of FASB ASU No. 2016-20, states

The Board received questions about the interaction of the guidance in paragraph 606-10-15-2 and the guidance in paragraph 606-10-15-4. Some stakeholders questioned whether the guidance in paragraph 606-10-15-4 requires an insurance entity to bifurcate contracts (within the scope of Topic 944) into elements within the scope of Topic 944 and elements within the scope of Topic 606. The guidance in paragraph 606-10-15-4 is applied after applying the guidance in paragraph



606-10-15-2. For example, if an entity reaches an appropriate conclusion that it has a contract entirely within the scope of Topic 944, then the entity would not apply the guidance in paragraph 606-10-15-4. This is because there are no elements of the contract within the scope of Topic 606 based on the entity's conclusion that the entire contract is included within the scope of Topic 944. This assessment is similar to how an insurance entity determines whether elements of contracts are within the scope of Topic 944 or Topic 605 currently. There could be other activities in the contract, such as insurance risk mitigation or cost containment activities that relate to costs to fulfill the contract within the scope of Topic 944. Those fulfillment activities would not be within the scope of Topic 606 and, instead, similar to current practice, would be considered part of the contract within the scope of Topic 944. This assessment is similar to how an insurance entity determines whether elements of a contract are within the scope of Topic 944 or Topic 605 today.

**14.7.08** In accordance with BC15 of FASB ASU No. 2016-20, for contracts that are within the scope of FASB ASC 944, the insurance entity should determine if elements of the contract should be accounted for within FASB ASC 944 or FASB ASC 606. If it is determined that a contract is not entirely within the scope of FASB ASC 944 due to elements of the contract being within the scope of FASB ASC 606, the insurance entity should apply the guidance in FASB ASC 606-10-15-4.

**14.7.09** Also as explained in BC15 of FASB ASU No. 2016-20, there could be activities included in the contract, such as insurance risk mitigation or cost containment activities, that should be considered fulfillment activities, not within the scope of FASB ASC 606 but, similar to current practice, considered part of the contract within the scope of FASB ASC 944.

**14.7.10** The following are examples of activities performed by an insurance entity, included in contracts within the scope of FASB ASC 944, that FinREC believes generally should be considered fulfillment activities (that either mitigate risks to the insurer or contain costs related to services to fulfill the insurer's obligation) that are not within the scope of FASB ASC 606, but should be considered part of the contract within the scope of FASB ASC 944:

- a.* Claims adjudication and processing: These activities can be included with commercial property casualty insurance contracts, (for example, general liability, property, automobile, workers' compensation) offered as a high deductible policy, such that the policyholder is "self-insuring" numerous claims below the deductible, that specifies that the adjudication/processing of claims both above and below the deductible amount will be performed by the insurer.

These claim adjudication and processing activities are performed even if the high deductible is ultimately not reached. Compensation for claims adjudication and processing below and above the deductible is either (1) an explicit or implicit component of the policy premium or (2) separately billed to the policyholder based on a percentage

of paid or incurred losses, or as a flat charge per claim and referred to as a claims servicing charge.

For those claim activities below the deductible, although the activities are partially provided as a service to the customer, they also mitigate the insurer's risk of loss above the deductible. Generally from the insurer's perspective, a holistic view is taken in managing claims from the ground up (from below the deductible through the insurer's limit), whether the insurer performs the claims adjudication or if it is outsourced to a third party. The insurer is integral in developing the strategy and approach for settling a claim below or above the deductible, along with the insured or the third party administrator if one is involved (that is, whether a loss event is ultimately covered within the insurance protection provided or not).

- b. Health insurance contracts within the scope of FASB ASC 944 (for example, medical including high deductible health plans [HDHPs], dental, vision): Additional activities related to the fulfillment of the insurance contract may include enrollment (for group plans), provider network access, routine physicals and screenings, immunizations, preventative care and wellness benefits, transportation to facilities for treatment, and access to durable medical equipment (for example, wheelchairs and crutches), and wellness benefits that include biometric screening, tobacco cessation, personal health assessments and records, health coaching, and disease management provided with health insurance contracts within the scope of FASB ASC 944.
- c. Safety inspections: These activities are sometimes provided with a property and liability insurance contract and such activities can be viewed as mitigating the insurer's risk.
- d. Roadside assistance provided with an automobile insurance policy: Examples of activities provided are towing cars from an accident location or changing a flat tire, which both help mitigate the risk of a further accident or damage to the car.
- e. Cybersecurity activities: These activities are sometimes provided with a general liability insurance contract and such activities can be viewed as mitigating the insurer's risk.
- f. A title search provided with a title insurance policy: This activity is part of fulfilling the insurance contract and mitigating the insurer's risk.

**14.7.11** In some situations involving claim adjudication and processing activities, these activities may not be part of the fulfillment activities of an insurance contract. For example, structures may be offered in the marketplace in which a commercial customer will purchase a high-deductible property casualty insurance contract. Under this policy, insurance coverage may be provided only for claims above a specified

deductible amount, and the customer may obtain claims adjudication and processing services from a third party administrator (oftentimes a subsidiary of another insurance group) unrelated to the insurer providing the insurance coverage. That third party would be subject to FASB ASC 606 for its provision of claims processing services. In these cases the claims adjudication and processing services are not offered in conjunction with an insurance contract. As explained in BC14 of FASB ASU No. 2016-20, contracts offered by an insurance entity that are not within the scope of FASB ASC 944, such as administrative services only contracts without any insurance element, should be accounted for under FASB ASC 606.

### ***Administrative Services Only Contracts Offered With Stop Loss Insurance Contracts***

**14.7.12** An insurance entity, such as a health insurer, may enter into an administrative services only contract and an insurance contract at the same time with the same party. If either contract's price was discounted from the insurance entity's normal pricing practices for either contract, this may suggest a pricing interdependency under which these contracts may need to be treated as one arrangement. That is, although the combination of contracts guidance in FASB ASC 606-10-25-9 is not applicable to contracts outside the scope of FASB ASC 606 (for example, a contract in the scope of FASB ASC 944), FinREC believes that insurance entities should consider the economics and nature of the arrangements (including pricing interdependencies), when assessing whether contracts with the same customer (or related parties of the customer) should be combined for accounting purposes.

**14.7.13** If an insurer determines that the contracts should be combined for accounting purposes, FinREC believes that the entity should look to BC15 of FASB ASU No. 2016-20, to determine whether the activities in the combined contract, other than providing insurance coverage, are predominantly performed as part of fulfilling the insurance obligation or mitigating the insurer's insurance risk.

**14.7.14** If an insurer determines that the activities are predominantly performed as part of fulfilling the insurance obligation or mitigating the insurer's insurance risk, FinREC believes that the combined contracts should be accounted for as one contract under FASB ASC 944.

**14.7.15** If an insurer determines that certain of the activities of the combined contract are not predominantly performed as part of fulfilling the insurance obligation or mitigating the insurer's insurance risk, FinREC believes that the guidance in FASB ASC 606 should be applied to determine the allocation of the combined consideration between (a) those noninsurance performance obligations to be accounted for under FASB ASC 606 and (b) insurance coverage (assuming that it meets the criteria to be classified as an insurance contract under FASB ASC 944) to be accounted for under FASB ASC 944.

### ***Revenue Recognition for Fees***

**14.7.16** BC13 of FASB ASU No. 2016-20, also clarifies that FASB ASC 944 includes guidance that is applied to both insurance and investment contracts to determine the revenue recognition for fees. In accordance with BC13 of FASB ASU No. 2016-20, the revenue recognition

guidance in FASB ASC 944 should be applied to fees associated with insurance and investment contracts.

## Accounting Practices

### State Insurance Regulation

**1.43** The insurance industry is deemed to be a business vested with the public interest and is regulated by the states. Statutes in each state provide for the organization and maintenance of an insurance department responsible for supervising insurance entities and enforcing compliance with the law. Property and liability insurance entities are subject to formal regulation by the insurance department of the state in which they are domiciled and are also subject to the insurance regulations of the states in which they are licensed to do business.

**1.44** Although statutes vary from state to state, they have as their common principal objective the development and enforcement of measures designed to promote solvency, propriety of premium rates, fair dealings with policyholders, and uniform financial reporting. State statutes (a) restrict investments of insurance entities to certain kinds of assets, (b) prescribe methods of valuation of securities and other assets, (c) require maintenance of reserves, risk-based capital, and surplus, and (d) define those assets not permitted to be reported as admitted assets.

**1.45** The states regulate insurance premium rates to ensure that they are adequate, reasonable, and not discriminatory. In a 1944 decision, the U.S. Supreme Court held that insurance is interstate commerce and as such is subject to regulation by the federal government. However, in 1945 Congress passed the McCarran-Ferguson Act, which exempts the insurance business from antitrust laws. Although Congress insisted that the federal government has the right to regulate the insurance industry, it stated in the McCarran-Ferguson Act that the federal government would not regulate insurance as long as state legislation provided for the supervision of insurance entities, including rate making. The following practices are protected by the McCarran-Ferguson Act:

- Pooling of statistical data for rate making
- Standard policy forms and standardized coverage
- Joint underwriting and joint reinsurance (such as insurance pools for exceptional hazards)
- Tying of various lines of insurance, that is, making the purchase of lines of insurance that are unprofitable to the insurance entity conditional on the purchase of profitable lines (**Note:** Tying is not permitted in certain states)

**1.46** All states have passed legislation requiring insurance commissioners to review, with or without prior approval, most rates charged by insurance entities. An entity must file most rates with the insurance department of each state in which it is authorized to do business. A number of states also require formal or tacit approval of rates by respective state insurance departments.

**1.47** To promote fair dealing with policyholders, state statutes provide for certain standard provisions to be incorporated in policies and for the insurance departments to review and approve the forms of policies. State insurance

departments review and approve contract forms and perform market conduct examinations involving pricing policies and notifications to contract holders as required by law. Insurance agents, brokers, and salespeople must qualify for and obtain licenses granted by the insurance department of a state before they may conduct business in the state.

**1.48** To promote uniform financial reporting, as previously discussed, the statutes provide for annual or more frequent filings with the insurance departments in a prescribed form.

**1.49** In a majority of states, insurance entities may not be organized without the authorization of the insurance department and, in states in which such authorization is not necessary, approval by the insurance department is necessary for the completion of organization.

**1.50** An insurance department generally consists of an insurance commissioner or superintendent in charge, one or more deputies, and a staff of examiners, attorneys, and clerical assistants. Many larger insurance departments also employ actuaries to review rate filings and to assist in the monitoring of financial solvency, principally relating to loss reserves. The head of the state insurance department, generally referred to as the commissioner, is either appointed by the governor or elected. The state legislature is responsible for enacting laws and statutes; however, the commissioner usually holds many discretionary powers, including the authority to issue the rules and regulations necessary to ensure compliance with the state's statutes. A commissioner is not bound by precedent; that is, the commissioner may disregard his or her own previous decisions as well as the decisions made by predecessors. Formal acts of an insurance regulatory authority are set forth either as adjudications or rulings. *Adjudications* are a commissioner's decision in a particular situation, such as a denial of a provision in a certain contract form requested by an insurer. *Rulings*, or regulations, are regulatory decisions concerning situations that have widespread implications; they apply to all activities over which the state insurance department has jurisdiction. The insurance commissioner also has the power to take remedial action against any entity in noncompliance with the regulations of the affected state, including actions that would preclude the insurance entity from writing further business in a particular state.

**1.51** States generally conduct periodic financial examinations of property and liability insurance entities. These examinations are conducted under the supervision of the state insurance department of the entity's state of domicile with the participation of other zones on request from other states in which the entity is licensed to write business. Examinations generally are conducted every three to five years, at the discretion of the state department of insurance. At the conclusion of the examination, a detailed report, including any adjustments to statutory surplus required by the state examiners, is issued. Generally, such adjustments are not retroactively recognized in an entity's financial statement. Regulators may deem a property and liability insurance entity unable to continue doing business as a result of inadequate statutory surplus levels, and force the entity into receivership, rehabilitation, or liquidation.

## National Association of Insurance Commissioners

**1.52** To create greater uniformity both in the laws and their administration and to recommend desirable legislation in state legislatures, the state commissioners of insurance organized an association that is known today as the National Association of Insurance Commissioners (NAIC). The activities of

the NAIC include monitoring financial conditions and providing guidance on financial reporting and state regulatory examinations. The work of the NAIC over the years has helped to eliminate many conflicts of state law and to promote more uniform and efficient regulation of insurance entities. In June 1989, the Financial Regulation Standards were developed, which established baseline requirements for an effective regulatory system in each state. The NAIC Financial Regulation Standards and Accreditation Program was subsequently developed by the NAIC to provide states with guidance regarding these standards. The standards are divided into three categories: (a) laws and regulations, (b) regulatory practices and procedures, and (c) organizational and personnel practices. Accounting, financial reporting, and auditing requirements are included in the standards. Mandating certain requirements and certifying that the states are in compliance provides a degree of assurance that regulators have adequate authority to regulate insurers, have the resources to carry out that authority, and have in place administrative practices designed for effective regulation.

**1.53** *Insurance Regulatory Information System.*<sup>6</sup> The NAIC Insurance Regulatory Information System (IRIS) was developed to assist the state insurance departments in monitoring financial conditions of property and liability insurance entities. The system uses financial ratios to identify entities that may be having financial difficulties. Such priority entities can then be targeted for closer surveillance or perhaps for onsite examination. IRIS ratio results are kept confidential through the period when the ratios are calculated. They are made available only to the entity and to the state of domicile insurance department. After a period of review by the entity and the domiciliary state regulator, the ratio results are published by the NAIC.

#### *Financial Ratios*

Financial ratios can be categorized as overall ratios, profitability ratios, liquidity ratios, or reserve ratios. A brief description of each of the individual ratios and the acceptable results follows.

#### *Overall Ratios*

*Gross premiums written to policyholders' surplus.* An entity's policyholders' surplus provides a cushion for absorbing above-average losses. This ratio measures the adequacy of this cushion, net of the effects of premiums ceded to reinsurers. The higher the ratio, the more risk the entity bears in relation to the policyholders' surplus available to absorb loss variations. This ratio is calculated by dividing gross premiums written by policyholders' surplus. The results of this test should include results up to 900%.

*Net premiums written to policyholders' surplus.* An entity's surplus provides a cushion for absorbing above-average losses. This ratio measures the adequacy of this cushion. The higher the ratio, the more risk the entity bears in relation to the surplus available to absorb loss variations. This ratio is calculated by dividing net premiums written by policyholders' surplus. The results of this test should be less than 300%.

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<sup>6</sup> From the National Association of Insurance Commissioners Insurance Regulatory Information System, Kansas City, Kansas.

*Change in net writings.* Major increases or decreases in net premiums written indicate a lack of stability in the entity's operations. A large increase in premium may signal abrupt entry into new lines of business or sales territories. In addition, such an increase in writings may indicate that the entity is increasing cash inflow in order to meet loss payments. A large decrease in premiums may indicate the discontinuance of certain lines of business, scaled back writings due to large losses in certain lines, or loss of market share due to competition. The usual range for this ratio is from -33% to 33%.

*Surplus aid to policyholders' surplus.* The use of surplus aid reinsurance treaties may be taken as an indication that entity management believes policyholders' surplus to be inadequate. In addition, the continued solvency of entities with a large portion of policyholders' surplus deriving from surplus aid may depend upon the continuing cooperation of the reinsurer. The usual range for the test is less than 15%.

### *Profitability Ratios*

*Two-year overall operating ratio.* The overall operating ratio is a measure of the operating profitability of an insurance entity. Over the long run, the profitability of the business is a principal determinant of the entity's financial solidity and solvency. The usual range for this test is less than 100%.

*Investment yield.* In addition to measuring one important element in profitability, the investment yield also provides an indication of the general quality of the entity's investment portfolio. The usual range for this test is greater than 3% and less than 6.5%.

*Gross change in policyholders' surplus.* The Gross Change in Policyholders' Surplus ratio is the ultimate measure of improvement or deterioration in the insurer's financial condition during the year. The usual range for the ratio includes results less than 50% and greater than -10%.

*Change in policyholders' surplus.* The change in policyholders' surplus is, in a sense, the ultimate measure of the improvement or deterioration of the entity's financial condition during the year. The usual range for this test is from a decrease of 10% to an increase of 50%.

*Change in adjusted policyholders' surplus.* This ratio measures the improvement or deterioration in the insurer's financial condition during the year based on operational results. The usual range for the ratio includes results less than 25% and greater than -10%.

### *Liquidity Ratios*

*Liabilities to liquid assets.* The ratio of total liabilities to liquid assets is a measure of the entity's ability to meet the financial demands that may be placed upon it. It also provides a rough indication of the possible implications for policyholders if liquidation becomes necessary. The usual range for this test is less than 100%.

*Gross agents' balances to policyholders' surplus.* The ratio of agents' balances to policyholders' surplus measures the degree to which solvency depends on an asset that frequently cannot be realized in the event of liquidation. In addition, the ratio is reasonably effective



in distinguishing between troubled and solid entities. The usual range for this test is less than 40%.

#### *Reserve Ratios*

*One-year reserve development to policyholders' surplus.* This ratio measures the accuracy with which reserves were established one year ago. The usual range for this test is less than 20%.

*Two-year reserve development to policyholders' surplus.* The two-year reserve development to surplus ratio is calculated in a manner similar to the calculation in the one-year reserve development test. The two-year reserve development is the sum of the current reserve for losses incurred more than two years prior, plus payments on those losses during the past two years minus the reserves that had been established for those losses two years earlier. The usual range for this test is less than 20%.

*Estimated current reserve deficiency to policyholders' surplus.* This ratio provides an estimate of the adequacy of current reserves. The usual range for this test is less than 25%.

Unusual circumstances precluded, an entity would be considered a higher risk entity if it failed four or more ratios. As previously discussed, the results of the NAIC IRIS financial ratios should be reviewed and results outside the usual ranges investigated and explained.

## **Federal Regulation — Securities and Exchange Commission**

**1.54** Because property and liability insurance entities are subject to state insurance department supervision and regulations, the Securities Exchange Act of 1934 contains certain provisions exempting stock property and liability insurance entities from registration with the SEC. However, a large number of entities have registered under the act, either in connection with the listing of their shares on a national securities exchange or because they have formed holding companies that do not qualify for exemption under the act. Property and liability insurance entities registered under the act must comply with the SEC's periodic reporting requirement and are subject to the proxy solicitation and insider-trading rules. Insurance entities making public offerings are required to file under the Securities Act of 1933 and must thereafter comply with the annual and periodic reporting requirements of the Securities Exchange Act of 1934. However, these entities are not under the proxy solicitation or insider-trading rules of the Securities Exchange Act of 1934 as long as they meet the attendant provisions for exemption. Insurance entities that are SEC registrants should follow Article 7 of SEC Regulation S-X, SEC Industry Guide 6, and applicable Staff Accounting Bulletins, which prescribe the form and content of financial statements.

**1.55** Additionally, the aforementioned entities subject to SEC rules and regulations are required to follow the provisions of the Sarbanes-Oxley Act of 2002 and related SEC regulations that implement the act. Their outside auditors are also subject to the provisions of the act and to the rules and standards issued by the PCAOB, subject to SEC oversight. For further information on these rules and regulations, see chapter 2, "Audit Considerations."

**1.56** *Disclosure information — general recommendations.* SEC staff recommendations for improved disclosures include, but are not limited to the following:

- a. *Loss reserves.* The SEC staff desires improved explanations for changes in reserve estimates. More specifically, disclosure should show changes in estimates by line of business, discussion of the range of estimates by line of business, improved explanations of the facts involved in the reserve estimates, or new information since the last report date underlying the improved insight on estimates and a more robust discussion of the entity's remaining exposure to uncertainty. Additional disclosure for incurred, but not reported, reserves and case reserves and by line of business should also be considered. The staff has expressed concern that investors expect a higher degree of precision on loss reserve estimates than exists. Therefore, investors should be provided with more detailed information relating to uncertainties inherent in the estimates.

Note that disclosures for the liability for unpaid claims and claim adjustment expenses and reinsurance recoverables on paid and unpaid claims should enable the reader to understand (i) management's method for establishing the estimate for each material line of business and how the methodology is appropriate for the reporting, development, and payment patterns inherent in the business line; (ii) any changes to significant assumptions used to determine the current period estimate from the assumptions used in the immediately preceding period, the reason for the change, and the impact of the change; and (iii) the reasonably likely variability inherent in the current estimate and the impact that variability may have on future reported results, financial condition, and liquidity. Disclosure about the liability for unpaid claims and claim adjustment expenses should identify underlying causes, not just intermediate effects, and should include a quantitative as well as qualitative discussion. Disclosure should be concise and to the point and should avoid unnecessary repetition. Readers may find it helpful to refer to Section II R of the SEC's *Current Accounting and Disclosure Issues in the Division of Corporation Finance*, which can be accessed at [www.sec.gov/divisions/corpfin/cfacctdisclosureissues.pdf](http://www.sec.gov/divisions/corpfin/cfacctdisclosureissues.pdf).

Readers may also refer to minutes from the December 20, 2018, AICPA Insurance Expert Panel and SEC Staff meeting, that includes observations related to disclosures required by FASB ASU No. 2015-09, *Financial Services—Insurance (Topic 944): Disclosures about Short-Duration Contracts*. The minutes can be found on the Insurance Expert Panel webpage at <https://www.aicpa.org/content/dam/aicpa/interestareas/frc/industryinsights/downloadabledocuments/ins/ins-ep-meeting-highlights-201812.pdf>.

- b. *Other than temporary impairments of securities (general).*<sup>7</sup> Discussion should include the entity policy for evaluating other than temporary impairments, the amount of impairment, and whether those factors would affect other investments. The SEC staff expressed an

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<sup>7</sup> For the application of generally accepted accounting principles (GAAP), refer to FASB ASC 320, *Investments—Debt and Equity Securities*.

For statutory accounting practices, refer to the impairment sections of Statement of Statutory Accounting Principles (SSAP) No. 26R, *Bonds*; SSAP No. 32, *Preferred Stock*; and SSAP No. 34, *Investment Income Due and Accrued*. For additional specifics, see chapter 5, "Investments and Fair Value Considerations."

expectation for this level of disclosure for each quarter for all material impairments.

- c. *Realized losses on investments.* Discussion should include the amount of loss and the fair value at the date of sale as well as the reasons for sales if the entity previously asserted the ability and intent to hold the investment to maturity, in order to justify the lack of an impairment loss. The SEC expressed an expectation for this level of disclosure each quarter for all material losses.
- d. *Unrealized losses on investments.* Discussion should include concentrations of securities with a loss. Additionally, disclosure should include the length of time that securities have been recorded with an unrealized loss, in tabular format, by class of security, and broken out between investment and noninvestment grade investments. The SEC staff expressed an expectation for this level of disclosure each quarter for all material unrealized losses.
- e. *Accounting policy disclosures.* Registrants should provide more specific information regarding critical accounting policies, especially if the policies are in areas where there is known diversity in practice.
- f. *Contractual obligations.* The SEC staff recommended increased disclosures regarding insurance contracts in the contractual obligations table in Form 10-K. Disclosures include variables such as future lapse rates and interest crediting rates.
- g. *Loss contingencies.* The guidance in FASB ASC 450-20 should be followed when determining what information related to legal proceedings and loss contingencies should be disclosed.
- h. *Mortgage and foreclosure-related activities or exposures.* Discussion should include the impact of various representations and warranties regarding mortgages made to purchasers of the mortgages (or to purchasers of mortgage-backed securities) including to the government-sponsored entities (GSEs), private-label mortgage-backed security (MBS) investors, financial guarantors, and other whole loan purchasers.

**1.57 SEC disclosures — Sarbanes-Oxley Act of 2002 implementation.** In response to passage of the Sarbanes-Oxley Act of 2002, the SEC and PCAOB have issued (or are issuing) additional rules and regulations specifying compliance. Additionally, in June 2006, state regulators adopted changes to the Annual Financial Reporting Model Regulation effective in 2010 by considering certain provisions of the act. For additional information, see chapter 2. Sections of the act that contain disclosure requirements include Sections 302, 401(a), 401(b), 404, 406, and 407:

- a. Section 302 — Certification of disclosure in companies quarterly and annual reports CEOs and CFOs (or their equivalents) are now required to certify the financial and other information contained in quarterly and annual reports and make certain disclosures. Additionally, Department of Justice certifications (governed by Section 906 of the act) became effective upon enactment of the act.
- b. Section 401(a) — Disclosure in management's discussion and analysis about off-balance sheet arrangements and aggregate contractual obligations. This section of the act requires that each annual

and quarterly financial report disclose specific material transactions and relationships.

- c. Section 401(b) — Conditions for use of non-GAAP financial measures. This section discusses the disclosure of pro forma financial information in any report filed with the SEC, or in any public disclosures or press releases. The use of the phrase *non-GAAP financial measures* rather than *pro forma financial information* is used to eliminate confusion with pro forma disclosures that are required under existing SEC rules and regulations. As required by the act, whenever an entity presents a non-GAAP financial measure, Regulation G will require presentation of a numerical reconciliation to the most directly comparable measurement calculated using GAAP. Regulation G also explicitly prohibits the presentation of inaccurate or misleading non-GAAP financial measures. Rule 401(b) defines a *non-GAAP financial measure* as a numerical measure of an entity's historical or future financial performance, financial position, or cash flows that excludes (includes) amounts, or is subject to adjustments that have the effect of excluding (including) amounts, that are included (excluded) in the most directly comparable measure calculated in accordance with GAAP.

Readers may also refer to minutes from the December 7, 2017, AICPA Insurance Expert Panel and SEC staff meeting, that includes discussion on non-GAAP measures. The minutes can be found on the Insurance Expert Panel webpage at <https://www.aicpa.org/content/dam/aicpa/interestareas/frc/industryinsights/downloadabledocuments/ins/ins-ep-meeting-highlights-archive.pdf>.

- d. Section 404 — Management's reports on internal control over financial reporting and certification of disclosure in exchange act periodic reports. See chapter 2 of this guide for additional information about this section.
- e. Sections 406 and 407 — Disclosure required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002. These sections discuss code of ethics and audit committee financial expert disclosures, respectively.

**1.58** *Additional insurance industry information for non-GAAP financial measures.* The definition of non-GAAP financial measures specifically excludes measures that are required to be disclosed by generally accepted accounting principles (GAAP), SEC rules, or an applicable system of regulation imposed by a government, governmental authority, or self-regulatory organization. Therefore, ratios (for example, statutory) used by insurance registrants in SEC filings to describe the results of operations are considered outside the scope of the non-GAAP rules so long as those ratios are identical (in terms of both formula and result) to those presented in required filings with insurance regulators.

**1.59** In addition to Regulation G, the SEC also amended Regulation S-K Item 10(e) to impose additional requirements and restrictions on the disclosure of non-GAAP financial measures included in a filing with the SEC. Among other things, the amendments to Regulations S-K prohibit the presentation of performance measures that exclude charges or gains identified as *nonrecurring*, *infrequent*, or *unusual*, unless the excluded items meet certain conditions.

In the past, many insurance entities had used the term *operating earnings* (or similar non-GAAP terms) in discussing financial results included in a filing with the SEC. Operating earnings can be defined in a variety of different ways; however, the most common definition is net income excluding after-tax realized investment gains and losses. Under non-GAAP rules, insurance entities should be aware of restrictions around the use of the term *operating earnings* and refer to the SEC Compliance and Disclosure Interpretation *Non-GAAP Financial Measures*, that was updated in May 2016, for additional information.<sup>8</sup>

## Federal Regulation — The Dodd-Frank Wall Street Reform and Consumer Protection Act

**1.60** The Dodd-Frank Act created new regulations for companies that extend credit to customers, exempt small public companies from Section 404(b) of the Sarbanes-Oxley Act of 2002, make auditors of broker-dealers subject to PCAOB oversight, and change the registration requirements for investment advisers. Some of the highlights of the Dodd-Frank Act are summarized in the following paragraphs.

**1.61** The Dodd-Frank Act created the Federal Insurance Office of the Treasury Department that monitors all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the United States financial system. The office coordinates and develops federal policy on prudential aspects of international insurance matters, including representing the United States in the International Association of Insurance Supervisors. The office assists the secretary in negotiating (with the U.S. Trade Representative) certain international agreements. The office monitors access to affordable insurance by traditionally underserved communities and consumers, minorities, and low- and moderate-income persons. The office also assists the secretary in administering the Terrorism Risk Insurance Program. The Federal Insurance Office is not a regulator or supervisor.

**1.62** The Dodd-Frank Act created a new systemic risk regulator called the Financial Stability Oversight Council (FSOC). The FSOC identifies any company, product, or activity that could threaten the financial system. It is chaired by the Treasury secretary and members are heads of regulatory agencies, including the chairmen of the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and the SEC, among others. For those large entities deemed a threat to the U.S. financial system, the FSOC can, under the authority of a new orderly liquidation authority, authorize the FDIC to close such entities under the supervision of the Federal Reserve. The FSOC, through the Federal Reserve, has the power to break up large firms, require increased reserves, or veto rules created by another new regulator, the Bureau of Consumer Financial Protection, with a two-thirds vote.

**1.63** The new Bureau of Consumer Financial Protection (BCFP) consolidates most federal regulation of financial services offered to consumers. The director of the BCFP replaces the director of the Office of Thrift Supervision on the FDIC board. Almost all credit providers, including mortgage lenders,

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<sup>8</sup> Readers should be aware of the revised SEC Compliance and Disclosure Interpretation *Non-GAAP Financial Measures* (specifically question 102.03 that addresses adjusting a non-GAAP financial performance measures), issued in January 2010, updated in May 2016, that can be found on the SEC website at [www.sec.gov/divisions/corpfin/guidance/nongapinterp.htm](http://www.sec.gov/divisions/corpfin/guidance/nongapinterp.htm).

providers of payday loans, refund anticipation loan providers, other nonbank financial companies, and banks and credit unions with assets over \$10 billion, will be subject to the new regulations.

**1.64** The Dodd-Frank Act recognizes that CPAs providing customary and usual accounting activities (which include accounting, tax, advisory, or other services that are subject to the regulatory authority of a state board of accountancy) and other services incidental to such customary and usual accounting activities are already adequately regulated and, therefore, are not subject to the BCFP's authority.

**1.65** The Dodd-Frank Act amended the Sarbanes-Oxley Act to make permanent the exemption from its Section 404(b) requirement for nonaccelerated filers (those with less than \$75 million in market capitalization) that had temporarily been in effect by order of the SEC. Section 404(b) of the Sarbanes-Oxley Act requires companies to obtain an auditor's report on management's assessment of the effectiveness of the company's internal control over financial reporting. In September 2010, the SEC issued Final Rule Release Nos. 33-9142; 34-62914, *Internal Control Over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers*, to conform its rules to this resulting change from the Dodd-Frank Act.

**1.66** The Dodd-Frank Act gives the FSOC the duty to monitor domestic and international financial regulatory proposals and developments, including insurance and accounting issues, and to advise Congress to make recommendations in such areas that will enhance the integrity, efficiency, competitiveness, and stability of the U.S. financial markets. The FSOC may submit comments to the SEC and any standard setting body with respect to an existing or proposed accounting principle, standard, or procedure.

**1.67** Previously, the Investment Advisers Act of 1940 required investment advisers with more than \$30 million in assets under management to register with the SEC. Under the Dodd-Frank Act, this threshold for federal regulation has been raised to \$100 million, with certain exceptions. This change will increase the number of advisers under state supervision.

**1.68** Because it lowers the legal standard from "knowing" to "knowing or reckless," the Dodd-Frank Act may make it easier for the SEC to prosecute aiders and abettors of those who commit securities fraud under the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, and the Investment Advisers Act of 1940. Additionally, the Dodd-Frank Act authorizes two studies on these matters. One of the studies directs the Government Accountability Office to investigate the impact of authorizing private rights of action for aiding and abetting claims and to release its findings within 1 year. The second study directs the SEC to examine whether private rights of action should be authorized for transnational or extraterritorial claims, and that study is to be completed within 18 months.

**1.69** The Dodd-Frank Act requires a nonbinding shareholder vote on executive pay. Management must give shareholders the opportunity to vote on how frequently shareholders will have a "say on pay" (that is, annually, every two years, or every three years). Compensation based on financial statements that are restated must be returned for the three years preceding the restatement in an amount equal to the excess of what would have been paid under the restated results. Listing exchanges will enforce the compensation policies. The Dodd-Frank Act also requires directors of compensation committees to be



independent of the company and its management and requires new disclosures regarding compensation.

**1.70** In addition to the previously mentioned regulations, the Dodd-Frank Act also

- provides for the PCAOB to create a program for registering and inspecting the auditors of broker-dealers, including standard setting and enforcement.
- requires standardized swaps to be traded on an exchange, or in other centralized trading facilities, to better promote transparency in this complex market.
- eliminates the private adviser exemption under the Investment Advisers Act of 1940, which will consequently result in more advisers having to register with the SEC. Advisers to venture capital funds remain exempt from registration, as well as advisers to private funds if such an adviser acts solely as an adviser to private funds and has less than \$150 million in U.S. assets under management. The Dodd-Frank Act also amends the Investment Advisers Act of 1940 to specifically exclude family offices from registration as an investment adviser.

## Federal Regulation — Terrorism

**1.71** Property and liability entities must follow the Terrorism Risk Insurance Act of 2002 (TRIA) and its amendments, the Terrorism Risk Insurance Extension Act of 2005, the Terrorism Risk Insurance Program Reauthorization Act of 2007, and the Terrorism Risk Insurance Program Reauthorization Act of 2015. TRIA created a federal backstop for property and casualty insurance entities covering acts of terrorism in excess of \$5 million. Insurance entities would pay a deductible equal to 7%, 10%, and 15% of prior year premiums in 2003, 2004, and 2005, respectively. The government would then cover 90% of losses exceeding the deductible with insurance entities liable for the other 10%. Federal payments would be capped at \$90 billion, \$87.5 billion, and \$85 billion in 2003, 2004, and 2005, respectively. Among other matters, the updated TRIA also mandates that insurers should make terrorism insurance available under all of its property and casualty insurance policies on the same terms and conditions as the underlying policy.

**1.72** Effective January 1, 2006, the Terrorism Insurance Extension Act of 2005 added new program years 4 and 5 (2006 and 2007, respectively) to the definition of insurer deductible. The insurer deductible is set as the value of an insurer's direct earned premiums for (newly defined) commercial property and casualty insurance over the immediately preceding calendar year multiplied by 17.5% and 20% for 2006 and 2007, respectively. A program trigger prohibits payment of federal compensation unless the aggregate industry insured losses from an act of terrorism exceeds \$50 million and \$100 million for 2006 and 2007, respectively. Additionally, subject to the program trigger, the federal share is 90% and 85% of an amount that exceeds the applicable insurer's deductible in 2006 and 2007, respectively.

**1.73** On December 26, 2007, the Terrorism Risk Insurance Program Reauthorization Act of 2007 was signed into law. This act extends the provisions of the revised TRIA through December 31, 2014. In January 2015, the provisions of the revised TRIA were further extended through December 31, 2020, raised



the threshold for the program trigger from \$100 million in losses to \$200 million in \$20 million increments starting in January 2016, and increased the amount that insurers must cover as a whole through co-payments and a deductible.

**1.74** In January 2006, the NAIC adopted two model disclosure forms to assist insurers in complying with the Terrorism Risk Insurance Extension Act of 2005. The model disclosure forms may be used by insurers to meet their obligation under the rules and provide policyholders of the status of current coverage. Insurers must comply with state law and this act and are encouraged to review the disclosure forms in light of their current policy language, state legal requirements, and the provisions of this act.

**1.75** Additionally, the NAIC's Terrorism Insurance Implementation Working Group adopted a model bulletin intended to help state insurance regulators advise insurers about regulatory requirements related to the extension of the TRIA. The model bulletin provides guidance to insurers related to rate filings and policy language that state regulators would find acceptable to protect U.S. businesses from acts of terrorism. The model bulletin describes important changes that are contained in the Terrorism Insurance Extension Act of 2005 and informs insurers regarding whether rate and policy form filings might be needed.

## Industry Associations

**1.76** The property and liability insurance industry has many industry associations to help with the multitude of technical problems that arise in the course of business. These organizations also monitor regulatory developments and provide public relations for the industry. See appendix G, "List of Industry Trade and Professional Associations, Publications, and Information Resources," for a list.

## Statutory Accounting Practices

**1.77** *NAIC codified statutory accounting.* Statutory financial statements are prepared using accounting principles and practices prescribed or permitted by the insurance department of the state of domicile, referred to in this guide as statutory accounting practices (SAP). The insurance laws and regulations of the states generally require insurance entities domiciled in those states to comply with the guidance provided in the NAIC *Accounting Practices and Procedures Manual* (the manual) except as otherwise prescribed or permitted by state law. The NAIC codified statutory accounting practices for certain insurance entities, resulting in a revised *Accounting Practices and Procedures Manual*. States generally require insurers to comply with most, if not all, provisions of the manual. Preparers of financial statements and as discussed in paragraph .12a of AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*,<sup>9</sup> auditors of an insurance entity should continually monitor the status of the new guidance adopted as part of the manual and the effects on the prescribed practices of the domiciliary state.

**1.78** The manual is published annually as of March containing all updates adopted through December 31 of the preceding year. Changes adopted during the year are available on the NAIC website under the Accounting Practices and Procedures Task Force, notably the Statutory Accounting Principles Working

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<sup>9</sup> All AU-C sections can be found in AICPA *Professional Standards*.

Group. The primary SAP material in the manual is presented in Statements of Statutory Accounting Principles (SSAPs) and with interpretations of the Statutory Accounting Principles Working Group (SAPWG). Other related material is also included in the manual. State insurance laws and regulations require insurers to comply with the guidance provided in the manual except as prescribed or permitted by state law. States adopted the manual in whole, or in part, as an element of prescribed SAP in the states. If, however, the requirements of state laws, regulations, and administrative rules differ from the guidance provided in the manual or subsequent revisions, those state laws, regulations, and administrative rules will take precedence. The NAIC also published *States' Prescribed Difference from NAIC Statutory Accounting Principles*, organized by state including reference to each state's applicable statute or regulation, as a means of providing further information to regulators, public accountants, and entity personnel regarding these differences.

**1.79** The preamble of the manual notes the following as the statutory hierarchy, which is not intended to preempt state legislative or regulatory authority:

*Level 1*

- The SSAPs, including U.S. GAAP reference material, to the extent adopted by the NAIC from FASB ASC<sup>10</sup> (FASB ASC or GAAP guidance)

*Level 2*

- Consensus positions of the Emerging Accounting Issues Working Group as adopted by the NAIC (INTs adopted before 2016)
- Interpretations of existing SSAPs as adopted by the Statutory Accounting Principles Working Group (INTs adopted in 2016 or beyond)

*Level 3*

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

*Level 4*

- Statutory Accounting Principles Preamble and Statement of Concepts<sup>11</sup>

*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 guidance not included in FASB ASC,

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<sup>10</sup> Effective September 15, 2009, FASB ASC is the source of authoritative GAAP. As of that date, FASB ASC superseded all then-existing non-SEC accounting and reporting standards. All other non-grandfathered, non-SEC accounting literature not included in FASB ASC is nonauthoritative.

<sup>11</sup> The Statutory Accounting Principles (SAP) Statement of Concepts incorporates by reference FASB Concept Nos. 1, 2, 5, and 6 to the extent they do not conflict with the concepts outlined in the statement. However, for purposes of applying this hierarchy, 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.

(d) International Financial Reporting Standards, (e) pronouncements of professional associations or regulatory agencies, (f) Technical Questions and Answers included in *Technical Questions and Answers*, and (g) accounting textbooks, handbooks, and articles.

Paragraph 42 of the preamble of the manual states,

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 SAP. If an established SAP 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 SAP 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*.

**1.80** The manual, the NAIC's annual statement instructions, *Financial Condition Examiners Handbook*, *Purposes and Procedures Manual of the Investment Analysis Office*, committee minutes, model rules, regulations, and guidelines provide sources of SAP. Some states may issue circular letters or bulletins describing their positions on various areas of accounting. In areas in which specific accounting practices are not prescribed, widely recognized practices may be permitted in a given state or specific accounting applications may be approved by the state insurance department, either orally or in writing. Auditors are able to review state examiners' reports to obtain evidence of accounting practices that have either been explicitly or implicitly accepted on examination.

**1.81** Each state insurance department requires all insurance entities licensed to write business in that state to file an annual statement, also referred to as the convention blank, statutory blank, or, simply, the blank, with the state insurance commissioner for each individual insurance entity. Most states require the blank to be filed by March 1 of the following year. All states require that the annual statement for the calendar year be comparative, presenting the amounts as of December 31 of the current year and the amounts as of the immediately preceding December 31. The annual statement includes numerous supplementary financial data, such as analysis of operations by lines of business and detailed schedules of investments, losses, and reinsurance. The NAIC's instructions to the annual statement require that insurance entities file in conjunction with their annual statement (a) an opinion by a qualified actuary concerning the adequacy of reserves and other actuarial items and that such reserves conform with statutory requirements and (b) a narrative document captioned "management discussion and analysis" discussing material changes in significant annual statement line items and material future operating events, similar to the disclosures currently required by the SEC for public entities. The management discussion and analysis is due April 1 of the following year.

**1.82** The NAIC requires most insurance entities in all states to file, by June 1, an audited financial report with the insurance commissioners of their state of domicile and all other states in which they are licensed. Exemptions to

requirements to file include insurance entities that write less than one million dollars in direct premiums. The financial statements included in the audited financial report should be prepared in a form and using language and groupings substantially the same as the relevant sections of the annual statement of the insurer. The annual audited financial report is to include a reconciliation of differences, if any, between the audited statutory financial statements contained in that report and the annual statement filed with the state commissioner and a written description of the nature of the differences.

**1.83** The NAIC Model Audit Rule requires insurance entities to have their auditors prepare and file a report on material weaknesses, if any, in the entity's internal controls, an accountant's awareness letter, and an accountant's letter of qualification to the insurer. In addition, subject to a premium threshold being met, a separate report by the entity's management on internal controls over financial reporting is required to be filed with the insurance regulators.

**1.84** It may not be necessary for some public entity risk pools and captive insurers to prepare reports on a SAP basis. Enabling legislation generally sets forth such entities' reporting requirements and may require reporting to the state insurance commissioner or state agency. Separate rules may apply to reporting, capitalization requirements, and so forth.

**1.85** Insurance entities are examined regularly by state or zone (a group of states) insurance examiners, usually once every three to five years. The annual statements filed with the regulatory authorities are used to monitor the financial condition of insurance entities in the period between examinations and to provide the financial data to help regulate the industry.

**1.86** In addition to the audits of financial statements, insurance examiners review compliance with laws or regulations concerning policy forms, premium rates, kinds of investments, composition of the board of directors, members' attendance at board meetings, reinsurance contracts, intercompany transactions, and fair treatment of policyholders. Insurance examiners use the *Financial Condition Examiners Handbook*, a publication of the NAIC that outlines the procedures for conducting an examination as a guide in performing examinations and in preparing reports. The examination approach outlined in the handbook incorporates a risk-focused framework and approach to the conduct of examinations. Some of the steps followed in the examination are similar to those followed by independent auditors as the handbook specifies that auditors should consider and include appropriate procedures described in the handbook as the auditor deems necessary.

**1.87** Insurance entities prepare their statutory financial statements in accordance with accounting principles and practices prescribed or permitted by the insurance department of their state of domicile, that is, SAP. Paragraph .07 of AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, states that financial statements prepared on a regulatory basis of accounting (for example, the basis of accounting used by insurance companies pursuant to the accounting practices prescribed or permitted by a state insurance commission) are considered special purpose financial statements (prepared in accordance with a special purpose framework).

**1.88** Prescribed SAP are practices incorporated directly or by reference in state laws, regulations, and general administrative rules applicable to all insurance enterprises domiciled in a particular state.

**Permitted Statutory Accounting Practices<sup>12</sup>**

**1.89** Permitted SAP include practices not prescribed in paragraph 1.75 but allowed by the domiciliary state regulatory authority. An insurance entity may request permission from the domiciliary state regulatory authority to use a specific accounting practice in the preparation of its statutory financial statements if either of the following occur:

- a. The entity wishes to depart from the prescribed SAP
- b. The prescribed SAP does not address the accounting for the transaction specifically

Accordingly, permitted accounting practices differ from state to state, may differ from entity to entity within a state, and may change in the future.

**1.90** In instances where the domiciliary state regulator is considering approval of a request for an accounting practice that departs from the NAIC *Accounting Practices and Procedures Manual* and state prescribed accounting practices, the domiciliary regulator must provide notice (to other states) under the requirements as defined in paragraphs 58–60 of the manual's preamble.

**1.91** Paragraph 59 of the manual's preamble states that the notice must disclose the following information regarding the requested accounting practice to all other states in which the insurer is licensed prior to the financial statement filing date:

- a. The nature and a clear description of the permitted accounting practice request.
- b. The quantitative effect of the permitted accounting practice request with all other approved permitted accounting practices currently in effect as disclosed in appendix A-205, "Illustrative Disclosure of Differences Between NAIC Statutory Accounting Practices and Procedures and Accounting Practices Prescribed or Permitted by the State of Domicile," for that insurer in the domiciliary state.
- c. The effect of the requested permitted accounting practice on a legal entity basis and on all parent and affiliated U.S. insurance entities, if applicable.
- d. Identify any potential effects on and quantify the potential impact to each financial statement line item affected by the request. The potential impact may be determined by comparing the financial statements prepared in accordance with NAIC SAP and the financial statements incorporating the requested permitted accounting practice.

**1.92** Paragraph 60 of the manual's preamble states that the granting of approval for an accounting practice request by the domiciliary state regulator does not preempt or in any way limit any individual state's legislative and regulatory authority.

**1.93** The disclosures in this paragraph should be made if (a) state prescribed SAP differ from NAIC SAP or (b) permitted state SAP differ from either state prescribed SAP or NAIC SAP. The disclosures should be made if the

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<sup>12</sup> For additional information, see the National Association of Insurance Commissioners (NAIC) *Accounting Practices and Procedures Manual* preamble and its section "Permitted Practices Advance Notification Requirement Implementation Question and Answers."

use of prescribed or permitted SAP (individually or in the aggregate) results in reported statutory surplus or risk-based capital that is significantly different from the statutory surplus or risk-based capital that would have been reported had NAIC SAP been followed. If an insurance enterprise's risk-based capital would have triggered a regulatory event had it not used a permitted practice, that fact should be disclosed in the financial statements. Insurance enterprises should disclose, at the date each financial statement is presented, a description of the prescribed or permitted SAP and the related monetary effect on statutory surplus of using an accounting practice that differs from either state prescribed SAP or NAIC SAP.<sup>13</sup> Paragraph 7 of SSAP No. 1, also requires that the individual notes to financial statements impacted by the prescribed or permitted practice refer to the summary prescribed or permitted note.

**1.94** The NAIC *Accounting Practices & Procedures Manual* (AP&P Manual) establishes comprehensive guidance that addresses the accounting and disclosure requirements for the insurance statutory basis of accounting, which integrates the framework established by GAAP with objectives exclusive to statutory accounting. Paragraph 53 of the preamble of the NAIC AP&P Manual states the following:

GAAP guidance that 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 GAAP guidance to be included in statutory accounting. Elements of the FASB Codification do not become part of SAP<sup>14</sup> until and unless adopted by the NAIC. Future SAP pronouncements will specifically identify any element of the FASB Codification that is to be included in SAP whether in whole, in part, or with modification as well as any rejected GAAP guidance. GAAP guidance which the NAIC has not addressed shall not be considered as providing authoritative guidance for reporting under the insurance statutory basis of accounting.

**1.95** Paragraph 62 of the preamble of the NAIC AP&P Manual further states the following:

Annual statutory financial statements which are not accompanied by annual statement exhibits and schedules (for example, annual audit report) shall include all disclosures required by the SSAPs based on the applicability, materiality and significance of the item to the insurer.

**1.96** To codify and maintain the insurance statutory basis of accounting, including related disclosures, an evaluation of GAAP accounting and disclosure guidance is performed to determine if the GAAP guidance is applicable and should be included in this basis. The NAIC established and appointed the SAPWG with the responsibility of developing and proposing new SSAPs and amendments to adopted SSAPs. SAPWG has a documented SAP Maintenance

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<sup>13</sup> Disclosures in this paragraph should be applied by a U.S. insurance enterprise, a U.S. enterprise with a U.S. insurance subsidiary, or a foreign enterprise with a U.S. insurance subsidiary, if the enterprise prepares GAAP financial statements. If a foreign insurance enterprise that does not have a U.S. insurance subsidiary prepares GAAP financial statements or is included in its parent's consolidated GAAP financial statements, the notes to the financial statements should disclose permitted regulatory accounting practices that significantly differ from the prescribed regulatory accounting practices of its respective regulatory authority, and their monetary effects.

<sup>14</sup> SAP is described in the NAIC *Accounting Practices & Procedures Manual* as the statutory accounting principles (that is, the insurance statutory basis of accounting).



Process and is responsible for developing and adopting substantive, nonsubstantive and interpretation revisions to the AP&P Manual. This includes the review of all new or revised accounting and disclosure guidance in the GAAP Hierarchy to determine whether the guidance is applicable to the insurance statutory basis of accounting. The AP&P Manual provides the basis for insurers to prepare financial statements for financial regulation purposes. If the guidance is deemed applicable to insurance entities, SAPWG develops proposed guidance that is exposed for public comment via its national and interim meetings and on the NAIC website, similar to the exposure process for new GAAP guidance. After exposure, the NAIC publicly discusses comments received to finalize changes to existing SSAPs or new SSAPs. The process is deliberative and substantive issues may go through more than one comment period. The NAIC also maintains a list of the conclusions of SAPWG, and the status of GAAP guidance currently being considered.

**1.97** The insurance statutory basis of accounting is a regulatory basis of accounting,<sup>15</sup> which is considered a special purpose framework. AU-C section 800 addresses special considerations in the application of the auditing standards to an audit of financial statements prepared in accordance with a special purpose framework (for example, regulatory basis of accounting).

**1.98** AU-C section 800 indicates that financial statements prepared in accordance with a special purpose framework, including a regulatory basis of accounting, should include all informative disclosures that are appropriate for the basis of accounting used. Paragraph .15 of AU-C section 800 indicates that the auditor should evaluate, among other things, whether the financial statements prepared in accordance with a regulatory basis of accounting include a summary of significant accounting policies, and adequately describe how the special purpose framework differs from GAAP. The effects of these differences need not be quantified.

**1.99** Paragraph .17 of AU-C section 800 states the following:

Section 700A requires the auditor to evaluate whether the financial statements achieve fair presentation. In an audit of special purpose financial statements when the special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, the auditor should evaluate whether the financial statements include informative disclosures similar to those required by GAAP. The auditor should also evaluate whether additional disclosures, beyond those specifically required by the framework, related to matters that are not specifically identified on the face of the financial statements or other disclosures are necessary for the financial statements to achieve fair presentation.

**1.100** In applying the requirement in paragraph .17 of AU-C section 800 to financial statements prepared on the insurance statutory basis of accounting,

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<sup>15</sup> AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, defines the *regulatory basis of accounting* as a basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission).



factors for the auditor to consider include (a) the overall presentation, structure, and content of the financial statements and (b) whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.

**1.101** Paragraph .A7 of AU-C section 800 notes that the financial reporting standards established by an organization that is recognized to promulgate standards for special purpose financial statements, will be presumed acceptable for that purpose if the organization follows an established and transparent process involving deliberation and consideration of the views of relevant stakeholders. For the insurance statutory basis of accounting, the NAIC establishes financial reporting provisions to meet the requirements of insurance regulators, industry and users of financial statements, and states adopt these provisions as their regulatory basis of accounting. The NAIC follows a deliberative and comprehensive process for considering new disclosures, including those required by GAAP.

**1.102** Accordingly, GAAP disclosure requirements that have been rejected by the NAIC in whole or in part would not need to be evaluated by the auditor in order to determine whether the annual audited statutory financial statements achieve fair presentation in accordance with the insurance statutory basis of accounting. However, if the NAIC has not finalized action on GAAP disclosure requirements, an auditor would need to assess whether informative disclosure in the annual audited financial statements would be needed to achieve fair presentation in accordance with paragraph .17 of AU-C section 800. This assessment would occur when the entity is required to adopt the new standard for GAAP.

**1.103** In accordance with AU-C section 730, *Required Supplementary Information*, required supplementary information (RSI) is not part of the basic financial statements and the auditor's opinion on the basic financial statements does not cover RSI. The auditor does not need to apply AU-C section 800 to RSI, because AU-C 800 addresses the need for disclosure of financial information in order for the basic financial statements to achieve fair presentation and RSI by definition is not part of the basic financial statements.

### **Nonadmitted Assets**

**1.104** SSAP No. 4, *Assets and Nonadmitted Assets*, paragraph 2 defines an *asset* under SAP, "For the purposes of statutory accounting, an asset shall be defined as: probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.... These assets shall then be evaluated to determine whether they are admitted." Paragraph 3 of SSAP No. 4 discusses nonadmitted assets as follows:

As stated in the Statement of Concepts, "The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third-party interests should not be recognized on the balance sheet," and are, therefore, considered nonadmitted. For purposes of statutory accounting principles, a nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2 above, which

is accorded limited or no value in statutory reporting, and is one which is:

- a. Specifically identified within the *Accounting Practices and Procedures Manual* as a nonadmitted asset; or
- b. Not specifically identified as an admitted asset within the *Accounting Practices and Procedures Manual*.

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

## Generally Accepted Accounting Principles<sup>16</sup>

**1.105** FASB ASC 944, *Financial Services—Insurance*, classifies insurance contracts as short-duration or long-duration contracts. As noted in FASB ASC 944-20-15-2, insurance contracts shall be classified as short- or long-duration contracts depending on whether the contracts are expected to remain for an extended period. As discussed in FASB ASC 944-20-15-7, the factors that shall be considered in determining whether a particular contract can be expected to remain in force for an extended period are as follows for a short-duration contract:

- a. The contract provides insurance protection for a fixed period of short duration
- b. The contract enables the insurer to cancel the contract or adjust the provisions of the contract at the end of any contract period, such as adjusting the amount of premiums charged or coverage provided

<sup>16</sup> Readers should refer to the section "Insurance Contracts Project" in the preface of this guide.

In May 2015, FASB issued ASU No. 2015-09, *Financial Services—Insurance (Topic 944): Disclosures about Short-Duration Contracts*, that requires additional disclosures about the liability for unpaid claims and claim adjustment expenses for all insurance entities that issue short-duration contracts as defined in FASB ASC 944, *Financial Services—Insurance*.

In August 2018, FASB issued ASU No. 2018-12, *Targeted Improvements to the Accounting for Long-Duration Contracts Issued by Insurance Companies*, to improve financial reporting for insurance companies that issue long-duration contracts. FASB ASU No. 2018-12 is effective for calendar-year public business entities at the beginning of 2021. For all other calendar-year entities, the changes are effective at the end of 2022. Early application is permitted.

In August 2019, FASB exposed proposed ASU *Financial Services—Insurance (Topic 944): Effective Date*, which proposes to amend the effective dates for FASB ASU No. 2018-12. The proposed ASU would amend the effective date as follows:

For SEC filers, excluding entities eligible to be SRCs as defined by the SEC, the amendments in ASU No. 2018-12 would be effective for fiscal years beginning after December 15, 2021, and interim periods within those fiscal years. The determination of whether an entity is an SRC would be based on an entity's most recent determination in accordance with SEC regulations as of the issuance of amendments in a final update on the effective date for Topic 944. Early application of the amendments in ASU No. 2018-12 would be permitted.

For all other entities, the amendments in ASU No. 2018-12 would be effective for fiscal years beginning after December 15, 2023, and interim periods within fiscal years beginning after December 15, 2024. Early application of the amendments in ASU No. 2018-12 would be permitted.

**1.106** Also discussed in FASB ASC 944-20-15-10, the factors that shall be considered in determining whether a particular contract can be expected to remain in force for an extended period are as follows for a long-duration contract:

- a. The contract generally is not subject to unilateral changes in its provisions, such as a noncancelable or guaranteed renewable contract
- b. The contract requires the performance of various functions and services, including insurance protection, for an extended period

**1.107** Determining whether a contract is short-duration or long-duration requires both judgment and an analysis of the contract terms. Most property and liability insurance contracts currently issued are classified as short-duration contracts.

**1.108** Under FASB ASC 944-605-25-1, premiums from short-duration contracts should be recognized as revenue over the contract period in proportion to the amount of insurance provided. For those few types of contracts for which the period of risk differs significantly from the contract period, premiums should be recognized as revenue over the period of risk in proportion to the amount of insurance protection provided. That generally results in premiums being recognized as revenue evenly over the contract period (or the period of risk, if different), except for those few cases in which the amount of insurance protection declines according to a predetermined schedule.

**1.109** As noted in FASB ASC 944-30-25-1A, an insurance entity shall capitalize only certain acquisition costs related directly to the successful acquisition of new or renewal insurance contracts. As discussed in FASB ASC 944-30-25-1 and 944-30-35-1, acquisition costs should be capitalized and charged to expense in proportion to premium revenue recognized. (Particular sections of this guide discuss the requirements of FASB ASC 944, but the reader should refer to FASB ASC 944 itself for specific guidance.)

**1.110** FASB ASC 944 provides guidance on accounting by insurance enterprises for deferred acquisition costs on internal replacements of insurance and investment contracts.

**1.111** FASB ASC 944-805 provides guidance to insurance entities on accounting for and financial reporting of insurance and reinsurance contracts acquired in a business combination:

- FASB ASC 944-805-25-1 states that the insurance and reinsurance contracts acquired shall be considered new contracts upon acquisition for measurement and accounting purposes.
- FASB ASC 944-805-25-2 states that the acquirer shall carry forward the acquiree's classification of an acquired contract as an insurance or reinsurance contract or a deposit contract based on an understanding of the contractual terms of the acquired contract and any related contracts or agreements at the inception of the contract or, if the terms of those contracts or agreements were later modified in a manner that would change the classification, at the date of that modification (which may be the acquisition date).

## Property and Liability Insurance Entities

- FASB ASC 944-805-25-4 states that other related contracts that are not insurance or reinsurance contracts shall be recognized at the date of acquisition in accordance with FASB ASC 805, *Business Combinations*. For instance, a contingent commission arrangement is a contingency that the acquirer shall account for in accordance with paragraphs 18A–20B of FASB ASC 805-20-25 and FASB ASC 805-20-30-9.

- FASB ASC 944-805-25-5 states:

An example of an indemnification agreement that may be in the form of a reinsurance contract is a guarantee by the seller of the adequacy of the acquired claims and claims expense liabilities at the date of acquisition. The acquirer shall recognize any indemnification asset resulting from such an agreement in accordance with ASC 805-20-25-27 through 25-28 and ASC 805-20-30-18 through 30-19.

- FASB ASC 944-805-30-1 states:

The acquirer shall measure at fair value the assets and liabilities recognized under ASC 944-805-25-3. However, the acquirer shall recognize that fair value in components as follows:

- a. Assets and liabilities measured in accordance with the acquirer's accounting policies for insurance and reinsurance contracts that it issues or holds. For example, the contractual assets acquired could include a reinsurance recoverable and the liabilities assumed could include a liability to pay future contract claims and claims expenses on the unexpired portion of the acquired contracts and a liability to pay incurred contract claims and claims expenses. However, those assets acquired and liabilities assumed would not include the acquiree's deferred acquisition costs and unearned premiums that do not represent future cash flows.
  - b. An intangible asset (or occasionally another liability), representing the difference between the following:
    1. The fair value of the contractual insurance and reinsurance assets acquired and liabilities assumed
    2. The amount described in (a)
- FASB ASC 944-805-35-1 states that after the business combination, the acquirer shall measure the intangible asset (or liability) on a basis consistent with the related insurance or reinsurance liability. FASB ASC 944-805-35-2 further states for example, for most short-duration contracts such as property and liability insurance contracts, claims liabilities are not discounted under GAAP,

so amortizing the intangible asset like a discount using an interest method could be an appropriate method.

**1.112** GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, as amended and interpreted by various GASB pronouncements, sets forth the accounting and financial reporting requirements for public entity risk pools. GASB Statement No. 10, as amended and interpreted, is based primarily on FASB ASC 944, but includes certain accounting and financial reporting requirements that differ from FASB ASC 944. In addition to the requirements of GASB Statement No. 10, there are other GASB pronouncements that affect accounting and financial reporting by public entity risk pools. For example, GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, requires pools to make certain disclosures about the credit and market risks of their investments. Further, GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, requires pools to present a statement of cash flows using cash flows categories that differ from those required by FASB ASC 230, *Statement of Cash Flows*. This guide does not attempt to highlight the areas in which different accounting or reporting is required for public entity risk pools.

## Comparison of SAP and GAAP

**1.113** The differences between SAP and GAAP result from their differing emphasis, as noted in the preamble of the manual paragraph 20:

GAAP is designed to meet the varying needs of the different users of financial statements. SAP is designed to address the concerns of regulators, who are the primary users of statutory financial statements. As a result, GAAP stresses measurement of emerging earnings of a business from period to period... while SAP stresses measurement of the ability to pay claims in the future.

Adequate statutory surplus provides protection to policyholders and permits an entity to expand its premium writing. Accordingly, SAP places a great deal of emphasis on the adequacy of statutory surplus. Table 1-1, "Summary of Statutory Accounting Practices and Generally Accepted Accounting Principles," presents a summarized comparison of the major differences in accounting treatment between SAP and GAAP for selected financial statement components. The reader ordinarily should, however, refer to the actual pronouncements for explicit guidance in accounting for transactions in each of the areas.

Table 1-1

### Summary of Statutory Accounting Practices and Generally Accepted Accounting Principles

The following are highlights of significant differences in accounting treatment between SAP and GAAP for certain financial statement components. As described in paragraph 1.86, statutory accounting may vary by state. The SAP and GAAP references in the chart pertaining to each area are not necessarily inclusive of all guidance applicable to the subject matter.

	<b>Codified Statutory Accounting Practices</b>	<b>Generally Accepted Accounting Principles<sup>17</sup></b>
Bonds	<p>Debt securities with a National Association of Insurance Commissioners (NAIC) designation of 1 or 2 should be reported at amortized cost; all other debt securities (NAIC designations 3–6) should be reported at the lower of amortized cost or fair value.</p> <p>See Statement of Statutory Accounting Principles (SSAP) No. 26R, <i>Bonds</i>, and SSAP No. 43R, <i>Loan-backed and Structured Securities</i>, as amended.</p>	<p>See FASB <i>Accounting Standards Codification</i> (ASC) 320, <i>Investments—Debt Securities</i>.<sup>18</sup> FASB ASU No. 2016-01, <i>Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities</i>, was issued in January 2016, and is effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. For all other entities including not-for-profit</p>

<sup>17</sup> GAAP in this chart contain numerous references to both financial and nonfinancial assets and liabilities that are subject to fair value measurement. FASB ASC 820, *Fair Value Measurement*, establishes a framework for measuring fair value that applies broadly to financial and nonfinancial assets and liabilities and improves the consistency, comparability, and reliability of the measurements. The guidance in FASB ASC 820 applies under other accounting pronouncements that require or permit fair value measurements. Accordingly, FASB ASC 820 does not require any new fair value measurements but the application of it will change current practice. For further information, see [www.fasb.org](http://www.fasb.org) and chapter 5.

<sup>18</sup> FASB's Accounting for Financial Instruments project is intended to significantly improve the decision usefulness of financial instrument reporting for users of financial statements. The project has effectively been split into three components: classification and measurement, impairment, and hedge accounting projects:

- a. **Classification and Measurement:** In January 2016, FASB issued ASU No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, to enhance the reporting model for financial instruments and to provide users of financial statements with more decision-useful information. The amendments in the ASU are intended to improve certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. FASB ASU No. 2016-01 is effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. For all other entities including not-for-profit entities and employee benefit plans within the scope of FASB ASC 960 through 965 on plan accounting, the amendments in ASU No. 2016-01 are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019.
- b. **Credit Impairment:** In June 2016, FASB issued ASU No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. Upon the effective date of this ASU, the incurred loss impairment methodology in current GAAP is replaced with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates.

For public business entities that are U.S. SEC filers, the amendments in FASB ASU No. 2016-13 are effective for fiscal years beginning after December 15, 2019,

(continued)

	<i>Codified Statutory Accounting Practices</i>	<i>Generally Accepted Accounting Principles</i>
		<p>entities and employee benefit plans within the scope of FASB ASC 960 through 965 on plan accounting, the amendments in this ASU are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019.</p> <p>Debt securities are classified as:</p> <ul style="list-style-type: none"> <li>• Trading securities are measured subsequently at fair value in the statement of financial position. Unrealized holding gains and losses for trading securities should be included in earnings.</li> </ul>

*(continued)**(footnote continued)*

including interim periods within those fiscal years. For all other public business entities, the amendments in ASU No. 2016-13 are effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. For all other entities, including not-for-profit entities and employee benefit plans within the scope of FASB ASC 960 through 965 on plan accounting, the amendments in ASU No. 2016-13 are effective for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. All entities may adopt the amendments in ASU No. 2016-13 earlier as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.

In August 2019, FASB exposed proposed ASU *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*, which proposes to amend the effective dates for FASB ASUs Nos. 2016-13; 2017-12, *Derivatives and Hedging*; and 2016-02, *Leases*.

The proposed ASU would amend the effective date for ASU No. 2016-13 as follows:

Credit Losses currently is not effective for any entities; early application is permitted for fiscal years beginning after December 15, 2018. Its mandatory effective dates are as follows:

1. Public business entities that meet the definition of an SEC filer for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years
2. All other public business entities for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years
3. All other entities (private companies, not-for-profit organizations, and employee benefit plans) for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years.

Under the revised effective date philosophy, the mandatory effective dates for Credit Losses in this proposed update would be amended to the following:

1. Public business entities that meet the definition of an SEC filer, excluding entities eligible to be SRCs as defined by the SEC, for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years
  2. All other entities for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years
- c. Hedge Accounting: In August 2017, FASB issued ASU No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*, to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. In addition to that main objective, the amendments in FASB ASU No. 2017-12 make certain targeted improvements to simplify the application of the hedge accounting guidance in current GAAP.

In August 2019, FASB exposed proposed ASU *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective*

*(continued)*



	<i>Codified Statutory Accounting Practices</i>	<i>Generally Accepted Accounting Principles</i>
		<ul style="list-style-type: none"> <li>• Held-to-maturity securities are measured subsequently at amortized cost in the statement of financial position. Investments in debt securities should be classified as held-to-maturity only if the reporting entity has the positive intent and ability to hold those securities to maturity. A transaction gain or loss on a held-to-maturity foreign-currency-denominated debt security should be accounted for pursuant to Subtopic 830-20.</li> <li>• Investments in debt securities not classified as trading securities or as held-to-maturity securities should be classified as available-for-sale securities and measured subsequently at fair value in the statement of financial position. Unrealized holding gains and losses for available-for-sale securities (including those classified as current assets) should be excluded from earnings and reported in other comprehensive income until realized except as indicated in the following sentence. All or a portion of the unrealized holding gain and loss of an available-for-sale security that is designated as being hedged in a fair value hedge should be recognized in earnings during the period of the hedge, pursuant to paragraphs 815-25-35-1 and 815-25-35-4.</li> </ul>

(footnote continued)

*Dates*, which proposes to amend the effective dates for FASB ASUs Nos. 2016-13; 017-12; and 2016-02.

The proposed ASU would amend the effective date for ASU No. 2017-12 as follows:

Hedging currently is effective for some entities. Its effective dates are as follows (early application is allowed):

1. Public business entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years
2. All other entities for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.

Because Hedging already is effective for all public business entities, the Board retained the effective date for those entities, including SRCs. The board also decided, consistent with having bucket two be at least two years after the initial effective date, to defer the mandatory effective date for Hedging for all other entities by an additional year. Therefore, Hedging would be effective for entities other than public business entities for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. Early application would continue to be allowed.

	<b>Codified Statutory Accounting Practices</b>	<b>Generally Accepted Accounting Principles</b>
Common stock	Common stocks (excluding investments in affiliates) are reported at fair value. See SSAP No. 30R, <i>Unaffiliated Common Stock</i> .	Fair value through earnings. Under FASB ASU No. 2016-01 equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) are measured at fair value with changes in fair value recognized in net income. However, an entity may elect to measure equity investments without a readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer.
Nonredeemable preferred stock	Perpetual preferred should be valued based on the underlying characteristics of the security, the quality rating of the security expressed as a NAIC designation, and whether an asset valuation reserve is maintained by the reporting entity. See SSAP No. 32, <i>Preferred Stock</i> .	Fair value through earnings. Under FASB ASU No. 2016-01 equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) are measured at fair value with changes in fair value recognized in net income. However, an entity may elect to measure equity investments without a readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer.
Mortgages	First mortgages, including mortgages acquired through assignment, syndication or participation, that are not in default with regard to principal or interest are carried at outstanding principal balance, or amortized cost if acquired at a discount or premium less impairment. See SSAP No. 37, <i>Mortgage Loans</i> .	Unpaid balance plus unamortized loan origination fees as prescribed by FASB ASC 310, <i>Receivables</i> .
Real estate — investment	Properties occupied or held for the production of income are reported at depreciated cost less encumbrances less impairment. See SSAP No. 40R, <i>Real Estate Investments</i> . Additional information can be found in SSAP No. 90, <i>Impairment or Disposal of Real Estate Investments</i> .	Depreciated cost, after impairment write-down as per FASB ASC 360, <i>Property, Plant, and Equipment</i> .

(continued)

## Property and Liability Insurance Entities

	<b><i>Codified Statutory Accounting Practices</i></b>	<b><i>Generally Accepted Accounting Principles</i></b>
Real estate — held for sale	Report at the lower of depreciated cost or fair value less encumbrances and estimated costs to sell the property. See SSAP No. 40R. Additional information can be found in SSAP No. 90.	Lower of carrying value or fair value less cost to sell.
Investment in affiliates	Investments in subsidiary, controlled, or affiliated entities should be reported using either a market valuation approach or one of the equity methods adjusted as appropriate in accordance with paragraph 16.d. of SSAP No. 25, <i>Affiliates and Other Related Parties</i> . See SSAP No. 97, <i>Investments in Subsidiary, Controlled, and Affiliated Entities</i> .	Consolidated, equity basis, or cost as appropriate. See FASB ASC 970-323; FASB ASC 835-20; FASB ASC 810, <i>Consolidations</i> ; and FASB ASC 272, <i>Limited Liability Entities</i> .
Unrealized gains (losses) for securities	Unrealized gains (losses) on investments held at other than amortized cost are recorded directly to surplus. Guidance comes from a variety of sources, including but not limited to, SSAP Nos. 26R, 30R, 32, 43R, and 86.	Recorded in net income for trading, or other comprehensive income for available for sale, as appropriate (except for held-to-maturity). Equity securities are fair value through earnings under FASB ASU No. 2016-01. See FASB ASC 320 and FASB ASC 220, <i>Comprehensive Income</i> .
Other-than-temporary impairment issues (debt securities)	An impairment should be considered to have occurred if it is probable that the reporting entity will be unable to collect all amounts due according to the contractual terms of a debt security in effect at the date of acquisition.  For debt securities, excluding real-backed and structured securities, if it is determined that a decline in fair value of a bond is other-than-temporary, an impairment loss should be recognized as a realized loss equal to the entire difference between the bonds carrying value and its fair value at the balance sheet date of the reporting period for which the assessment is made.  The new cost basis shall not be changed for subsequent recoveries in fair value. Future declines in fair value which are determined to be other than temporary, shall be recorded as realized losses.	For debt securities, if an other-than-temporary impairment has occurred, the amount of the other-than-temporary impairment recognized in earnings depends on whether an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary

	<b><i>Codified Statutory Accounting Practices</i></b>	<b><i>Generally Accepted Accounting Principles</i></b>
	<p>See SSAP No. 26R and also NAIC Interpretation 06-7, <i>Definition of Phrase "Other Than Temporary."</i></p> <p>For loan backed and structured securities, the impairment guidance within SSAP No. 43R requires bifurcation of "interest" and "noninterest" components for impairment recognition in situations when the entity does not have an intent to sell and has the intent and ability to hold the investment for a period of time sufficient to recover the amortized cost basis:</p> <p>When an other-than-temporary impairment has occurred because the entity intends to sell or has assessed 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.</p> <p>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 different 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.</p> <p>SSAP No. 43R includes the definition of a loan-backed security.</p>	<p>impairment shall be separated into both of the following:</p> <ol style="list-style-type: none"> <li>a. The amount representing the credit loss</li> <li>b. The amount related to all other factors</li> </ol> <p>The amount of the total other-than-temporary impairment related to the credit loss shall be recognized in earnings. The amount of the total other-than-temporary impairment related to other factors shall be recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the other-than-temporary impairment recognized in earnings 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. However, the amortized cost basis shall be adjusted for accretion and amortization as prescribed in FASB ASC 320-10-35-35.</p> <p>See FASB ASC 320.</p>

(continued)

	<i>Codified Statutory Accounting Practices</i>	<i>Generally Accepted Accounting Principles</i>
Other-than-temporary impairment issues (equity securities)	<p>For any decline in fair value of unaffiliated common stock that is determined to be other than temporary, the common stock should be written down to fair value as the new cost basis and the amount of the write down should be accounted for as a realized loss.</p> <p>See SSAP No. 30R.</p> <p>For any declines in fair value of preferred stock that is determined to be other than temporary, an impairment loss should be recognized as a realized loss equal to the entire difference between the stock's carrying value and its fair value at the balance sheet date of the reporting period for which the assessment is made.</p> <p>The fair value of the stock on the measurement date should become the new cost basis of the stock and the new cost basis should not be adjusted for subsequent recoveries in fair value.</p> <p>See SSAP No. 32.</p>	<p>An equity security without a readily determinable fair value that does not qualify for the practical expedient to estimate fair value shall be written down to its fair value if a qualitative assessment indicates that the investment is impaired and the fair value of the investment is less than its carrying value, as determined using the guidance in paragraph 321-10-35-2. At each reporting period, an entity that holds an equity security shall make a qualitative assessment considering impairment indicators to evaluate whether the investment is impaired. Impairment indicators that an entity considers include, but are not limited to, the following:</p> <ol style="list-style-type: none"> <li>A significant deterioration in the earnings performance, credit rating, asset quality, or business prospects of the investee</li> <li>A significant adverse change in the regulatory, economic, or technological environment of the investee</li> <li>A significant adverse change in the general market condition of either the geographical area or the industry in which the investee operates</li> <li>A bona fide offer to purchase, an offer by the investee to sell, or a completed auction process for the same or similar investment for an amount less than the carrying amount of that investment</li> <li>Factors that raise significant concerns about the investee's ability to continue as a going concern, such as negative cash flows from operations, working capital deficiencies, or noncompliance with statutory capital requirements or debt covenants.</li> </ol>

	<b><i>Codified Statutory Accounting Practices</i></b>	<b><i>Generally Accepted Accounting Principles</i></b>
		If an equity security without a readily determinable fair value is impaired, an entity shall include an impairment loss in net income equal to the difference between the fair value of the investment and its carrying amount. That is, if the investment is deemed to be impaired after conducting the evaluation required by paragraph 321-10-35-3, the entity shall estimate the fair value of the investment to determine the amount of the impairment loss.
Nonadmitted assets	Excluded from the statutory balance sheet and charged to surplus. Major nonadmitted assets include agents' balances/uncollected premiums over three months due, certain amounts of deferred tax assets, certain intangible assets and furniture, fixtures, and equipment.  See SSAP No. 4, <i>Assets and Nonadmitted Assets</i> ; No. 6, <i>Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due from Agents and Brokers</i> ; No. 19, <i>Furniture, Fixtures, Equipment and Leasehold Improvements</i> ; No. 20, <i>Nonadmitted Assets</i> ; No. 25, <i>Affiliates and Other Related Parties</i> ; No. 29, <i>Prepaid Expenses</i> ; No. 68, <i>Business Combinations and Goodwill</i> ; and No. 101, <i>Income Taxes</i> .	Not applicable.
Loss reserves	Claims, losses, and loss/claim adjustment expenses should be recognized as expense when an event occurs. Liabilities should be established for any unpaid expenses, with a corresponding charge to income.  See SSAP No. 55, <i>Unpaid Claims, Losses and Loss Adjustment Expenses</i> ; No. 62R, <i>Property and Casualty Reinsurance</i> ; and No. 65, <i>Property and Casualty Contracts</i> .	Accrued when insured events occur and based on the estimated ultimate cost of settling the claims. Estimated recoveries are deducted from the liability for unpaid claims. See FASB ASC 944, <i>Financial Services—Insurance</i> , and Securities and Exchange Commission Staff Accounting Bulletin No. 62, <i>Discounting by Property and Casualty Insurance Companies</i> .
Premium balances receivable	Uncollected premium balances, and bills receivable for premiums meet the definition of an asset as defined in SSAP No. 4, and are admitted assets to the extent they conform to the requirements of SSAP No. 6.	Due and uncollected premiums are recorded as assets. An appropriate allowance should be established. See FASB ASC 944.

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	<b><i>Codified Statutory Accounting Practices</i></b>	<b><i>Generally Accepted Accounting Principles</i></b>
Contract holder dividend liability	Dividends to policyholders immediately become liabilities when they are declared and should be recorded as a liability. See SSAP No. 65.	If limitations exist on the amount of net income from participating insurance contracts of insurers that may be distributed to stockholders, provision is made for accumulated earnings expected to be paid to contract holders, including pro rata portion of dividends incurred to valuation date; If there are no net income restrictions, the future dividends are accrued over the premium-paying period of the contract. Accounting varies depending on the applicability of FASB ASC 944.
Reinsurance	Full credit generally given for authorized reinsurers; net reporting required; reinsurance recognized based on adequate risk transfer; liability for unauthorized reinsurers.  See SSAP No. 62R. Effective January 1, 2019, guidance from EITF 93-6, Accounting for Multiple-Year Retrospectively-Rated Contracts by Ceding and Assuming Enterprises, and EITF D-035, FASB Staff Views on Issue No. 93-6, has been adopted.	Reinsurance recognized based on adequate transfer of risk; provision for uncollectible reinsurance and gross reporting of balance sheet amounts required under FASB ASC 944, net reporting is not allowed unless a right of offset exists as defined in FASB ASC 210-20.
Deferred taxes	SSAP No. 101 establishes SAP for current and deferred federal and foreign income taxes and current state income taxes. In general, SSAP No. 101 adopts the concepts of FASB ASC 740, <i>Income Taxes</i> , with modifications.  A reporting entity's balance sheet should include deferred income tax assets (DTAs) and liabilities (DTLs), the expected future tax consequences of temporary differences generated by statutory accounting. SAP reporting requires an admissibility test, in addition to the statutory valuation allowance, to determine how much of the gross DTAs should be admitted.  In August 2019, the NAIC Statutory Accounting Principles Working Group approved changes to SSAP No. 101, Example A – Implementation Questions and Answers for (1) necessary revisions	Under FASB ASC 740, provision made for temporary differences, net operating losses, and credit carryforwards. It is necessary to determine if a DTA valuation allowance is needed. DTAs are reduced by a valuation allowance if, based on all available evidence (both positive and negative), it is more likely than not (a likelihood of more than 50%) that some portion or all of the tax benefit will not be realized. The weight given to the potential effect of negative and positive evidence should be commensurate with the extent to which it can be objectively verified. The valuation allowance should be sufficient to reduce the DTA to the amount that is more likely than not to be realized.  In 2018, FASB adopted the following related to the Tax Cuts and Jobs Act:



	<b>Codified Statutory Accounting Practices</b>	<b>Generally Accepted Accounting Principles</b>
	to reflect the federal Tax Cuts and Jobs Act in and (2) clarification on deferred tax asset and deferred tax liability offsetting under paragraph 11.c of SSAP No. 101. These changes are effective for financial accounting years ending December 31, 2019, with any change in income tax balances resulting from the revisions to be accounted for as a change in accounting principle in accordance with SSAP No. 3, <i>Accounting Changes and Correction of Errors</i> .	<ul style="list-style-type: none"> <li>ASU No. 2018-05, <i>Income Taxes (Topic 740)—Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118</i>.</li> <li>ASU No. 2018-02, <i>Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax effects from Accumulated Other Comprehensive Income</i> — Permits reclassification of effects of 2017 tax reform legislation stranded in accumulated other comprehensive income to retained earnings.</li> </ul>
Leases	All leases, except leveraged leases should be considered operating leases. See SSAP No. 22, <i>Leases</i> . SSAP No. 22R, <i>Leases</i> , effective January 1, 2020.	Classified as finance or operating under FASB ASC 842, <i>Leases</i> . The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases.  For entities that have not yet adopted FASB ASC 842, classified as capital or operating according to the provisions of FASB ASC 840. <sup>19</sup>

(continued)

<sup>19</sup> FASB issued ASU No. 2016-02, *Leases (Topic 842)*, in February 2016. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, for any of the following:

1. A public business entity
2. A not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market
3. An employee benefit plan that files financial statements with the U.S. SEC

For all other entities, the amendments in this update are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early application of the amendments in the update is permitted for all entities. See appendix B, "The New Leases Standard: FASB ASU No. 2016-02," for more details on ASU No. 2016-02.

In August 2019, FASB exposed proposed ASU, *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815)*, and *Leases (Topic 842): Effective Dates*, which proposes to amend the effective dates for FASB ASUs Nos. 2016-13; 2017-12; and 2016-02.

The proposed ASU would amend the effective date for ASU No. 2016-02 as follows:

Leases currently is effective for some entities. Its effective dates are as follows (early application is allowed):

1. Public business entities; not-for-profit entities that have issued or are conduit bond obligors for securities that are traded, listed, or quoted on an exchange or an over-the-counter market; and employee benefit plans that file or furnish financial statements with or to the SEC for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.
2. All other entities for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.

Because Leases already is effective for entities within (1) above, the board retained the effective date for those entities, including SRCs. The board also decided, consistent with having bucket two be at least two years after the initial effective date, to defer the effective date for all other entities by an additional year. Therefore, Leases would be effective for entities within (2) above for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. Early application would continue to be allowed.

	<b><i>Codified Statutory Accounting Practices</i></b>	<b><i>Generally Accepted Accounting Principles</i></b>
Liability for postretirement benefits other than pensions	SSAP No. 92, <i>Postretirement Benefits Other Than Pensions</i> , adopts, with modifications, FASB ASC 715, <i>Compensation—Retirement Benefits</i> , and has an effective date of January 1, 2013, through either a direct adjustment to opening surplus or an option to phase in the impact over a period not to exceed 10 years.	Expected postretirement benefit obligations are recognized over the working life of employees; liability based on vested and nonvested benefits under FASB ASC 715.
Pension benefits	SSAP No. 102, <i>Pensions</i> , adopts, with modifications FASB ASC 715 and has an effective date of January 1, 2013, through either a direct adjustment to opening surplus or an option to phase in the impact over a period not to exceed 10 years.	<p>Pension costs calculated based on the projected unit credit method under FASB ASC 715.</p> <p>The amendments in FASB ASU No. 2017-07 require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost as defined in paragraphs 715-30-35-4 and 715-60-35-9 are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item or items are used to present the other components of net benefit cost, that line item or items must be appropriately described. If a separate line item or items are not used, the line item or items used in the income statement to present the other components of net benefit cost must be disclosed.</p> <p>The amendments in FASB ASU No. 2017-07 also allow only the service cost component to be eligible for capitalization when applicable (for example, as a cost of internally manufactured inventory or a self-constructed asset).</p>
Contract acquisition costs	Charged to expense when incurred. See SSAP No. 71, <i>Policy Acquisition Costs and Commissions</i> .	Under FASB ASC 944-30-25-1A, an insurance entity should capitalize only certain acquisition costs related directly to the successful acquisition of new or renewal insurance contracts. Such costs are amortized in relation to the revenue generated (premiums or estimated gross profit, as appropriate) if recoverable from such revenue. See FASB ASC 944.

	<i><b>Codified Statutory Accounting Practices</b></i>	<i><b>Generally Accepted Accounting Principles</b></i>
Consolidation	Generally not applied given financial statement focus on presentation from a liquidity of assets standpoint for regulatory purposes. Majority-owned subsidiaries are not consolidated for individual entity statutory reporting. See SSAP No. 97.	Generally required in accordance with FASB ASC 810.

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