



Navigating the Transition: Adopting Principle-Based Bond Accounting for Statutory Insurers

NOVEMBER 7, 2024



Meet our Team



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AGENDA

1. BACKGROUND
2. UPDATES
3. TRANSITION
4. IMPLEMENTATION
5. CONCLUSION



BACKGROUND

Why a Principles-Based Bond Definition?

Original Focus on
Legal Form rather
than Substance

Risk-Based Capital
(RBC) Incentive

Innovative Bond
Market

Goals for Principles-Based Approach

Framework to
incorporate the
innovative bond
market

Evaluate the
substance of a
structure

Regulators more
understanding of
insurers investment
portfolios

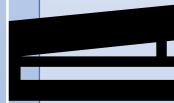
KEY ELEMENTS



Classification Driven By
Substance



Responsibility of the
reporting entity



Designations DO NOT
Determine Investment
Classification

COMPREHENSIVE UPDATES

EFFECTIVE DATE

JANUARY 1, 2025

BASIC SSAP REVISIONS

**SSAP No. 26
BONDS**

SSAP No. 43 ASSET-BACKED
SECURITIES

SSAP No. 21 OTHER
ADMITTED ASSETS

REVISIONS TO OTHER SSAPs
INCLUDING SSAP No. 2
CASH, CASH EQUIVALENTS,
DRAFTS AND SHORT TERM
INVESTMENTS

BASIC REPORTING REVISIONS

**SCHEDULE D 1:
LONG-TERM
BONDS**

**SCHEDULE D-1:
REPORTING
LINES**

**SCHEDULE D 1:
REPORTING
COLUMNS**

**BLANKS AND
INSTRUCTIONS THAT
REFER TO BONDS
AND SCHEDULE D**

**SCHEDULE BA:
OTHER LONG-TERM
INVESTED ASSETS**

SCHEDULE D PART 1-1 ISSUER CREDIT OBLIGATIONS UPDATES



Upcoming revisions to Schedule D Part 1, as outlined by the NAIC.

- Effective January 1, 2025, Schedule D Part 1 will be divided into two sections:
 - Section 1: Issuer Credit Obligations (SSAP No. 26R)
 - Section 2: Asset-Backed Securities (SSAP No. 43R)
- New Bond definition
 - SSAP No. 26, Bonds, defines a bond as: Any security representing creditor relationship, with a fixed schedule for one or more future payments, and qualifies as either an Issuer Credit Obligation (ICO) or an Asset-Backed Security (ABS).
 - These “principles” are based on cash flows, creditworthiness and contracts reflecting the Issuer/Bond Holder relationship.
 - Securities must be evaluated to determine their classification as bonds, equity, or other categories.
 - Securities not meeting the updated bond definition will be reclassified to Schedule BA or another appropriate schedule.

Key Note: Is the Security a Bond, Equity or something else.

Schedule D1 Section 1: Issuer Credit Obligations

ISSUER CREDIT OBLIGATIONS

A Bond for which the general creditworthiness of an operating entity or entities through direct or indirect recourse, is the primary source of repayment

Eligible operating entities may include businesses, not-for-profit organizations, governmental units, or other provider of goods or services but exclude natural persons or ABS issuers

Single Entity Backed Obligations includes Credit Tenant Loans, Equipment Trust Certificates, Other Lease-Backed Securities, Funding Agreement Backed Notes. Repayment Is Fully Supported by the Operating Entity.

Funds That Represent Operating Entities

SSAP 26 specifically scopes in; CDs with a maturity in excess of 1 year, Bank Loans, Debt Instruments in CAPCO, SVO-Identified Bond CTLs & SVO-Identified ETFs

CREDITOR RELATIONSHIP

Components that establish a “Relationship” between the issuer and the insurance investor

Repayment is primarily dependent on the creditworthiness of the operating entity

All interest and 95% of principal payments backed by a single operating entity

Principal and interest payments (fixed or variable) must be contractually pre-determined and not contingent upon the performance of the underlying collateral

Key Note: Debt instruments collateralized by assets with Contractual Cash Flows

➤ Exceptions:

- The new guidelines do not restrict:
- Plain-vanilla inflation.
- Benchmark interest rate adjustments.
- Scheduled interest rate step ups.

➤ Disqualification as Issuer Credit Obligations:

- Securities lacking a fixed payment schedule.
- Balloon payments at maturity exceeding 5% of the original principal.
- Securities with principal and interest income that fluctuate based on the performance of the underlying collateral.
- Synthetic securities or Derivatives.
- Surplus Notes.
- Interest Rate adjustments affecting total return by more than 10%.
- Structured Notes with at-risk principal and interest.
- Principal-Protected securities (classified as non-bond securities or other admitted assets).
- Residuals or First Loss positions.

➤ **Key Consideration: Principal and Interest payments are not contractually guaranteed.**

Issuer Obligations – Schedule D-1-1

Reporting Lines - Issuer Obligations:

- U.S. Government Obligations
- Other U.S. Government Securities
- Non-U.S. Sovereign Jurisdiction Securities
- Municipal Bonds – General Obligations
- Municipal Bonds – Special Revenue
- Project Finance Bonds Issued by Operating Entities (Unaffiliated / Affiliated)
- Corporate Bonds (Unaffiliated / Affiliated)
- Mandatory Convertible Bonds (Unaffiliated / Affiliated)
- Single Entity Backed Obligations (Unaffiliated / Affiliated)
- SVO-Identified Bond Exchange Traded Funds – Fair Value*
- SVO-Identified Bond Exchange Traded Funds – Systematic Value*
- Bonds Issued from SEC-Registered Business Development Corps, Closed End Funds & REITS (Unaffiliated / Affiliated)
- Bank Loans – Issued (Unaffiliated / Affiliated)*
- Bank Loans – Acquired (Unaffiliated / Affiliated)*
- Mortgage Loans that Qualify as SVO-Identified Credit Tenant Loans (Unaffiliated / Affiliated)*
- Certificates of Deposit*
- Other Issuer Credit Obligations (Unaffiliated / Affiliated)
- Total Issuer Credit Obligations (Unaffiliated & Affiliated)**
- Total Affiliated Issuer Credit Obligations**

Schedule D-1-1 will only include securities in scope of SSAP No. 26R.

Investments in *green italics* are not bonds but are explicit inclusions within scope of SSAP No. 26R.

SCHEDULE D PART 1-2 ASSET-BACKED SECURITIES UPDATES



SCHEDULE D1 SECTION 2

ASSET-BACKED SECURITIES

ASSET-BACKED SECURITIES	ASSET-BACKED SECURITIES PRINCIPLES
<p data-bbox="170 705 484 832">SUBSTANCE OVER LEGAL FORM REPORTING</p> <p data-bbox="581 705 929 832">PRIMARY SOURCE OF REPAYMENT FROM CASH FLOWS</p>	<p data-bbox="996 694 1325 841">SUBSTANTIVE CREDIT ENHANCEMENT</p> <p data-bbox="1460 722 1750 812">MEANINGFUL CASH FLOWS</p>
<p data-bbox="166 998 488 1079">SIMILAR TO RMBS, CMBS, CLOs</p> <p data-bbox="585 951 929 1122">NOT PERMITTED AS SHORT-TERM OR CASH EQUIVALENT INVESTMENTS</p>	<p data-bbox="1006 951 1344 1122">FINANCIAL ABS NON-FINANCIAL ABS</p> <p data-bbox="1470 965 1740 1112">CONSIDER UNDERLYING COLLATERAL</p>

SCHEDULE D PART 1-2 REPORTING CHANGES



SCHEDULE D PART 1

SECTION 2

REPORTING CHANGES

➤ SIX NEW CATEGORIES

- PAYMENT DUE AT MATURITY
- ORIGINATION BALLOON PAYMENT %
- OVERCOLLATERALIZATION %
- ORIGINATION EXPECTED PAYOFF DATE
- AGGREGATE DEFERRED INTEREST
- PAID IN KIND INTEREST

SIX NEW
CATEGORIES



➤ THREE REVISED CATEGORIES

- INVESTMENT CHARACTERISTICS
- AGENCY, SOVEREIGN JURISDICTION, OR STATE ABBREVIATION
- COLLATERAL TYPE

THREE REVISED
CATEGORIES



➤ TWO ELIMINATED FIELDS

- RATE USED TO OBTAIN FAIR VALUE
- LEI CODE

TWO
ELIMINATED
FIELDS



SCHEDULE D PART 1

SECTION 1

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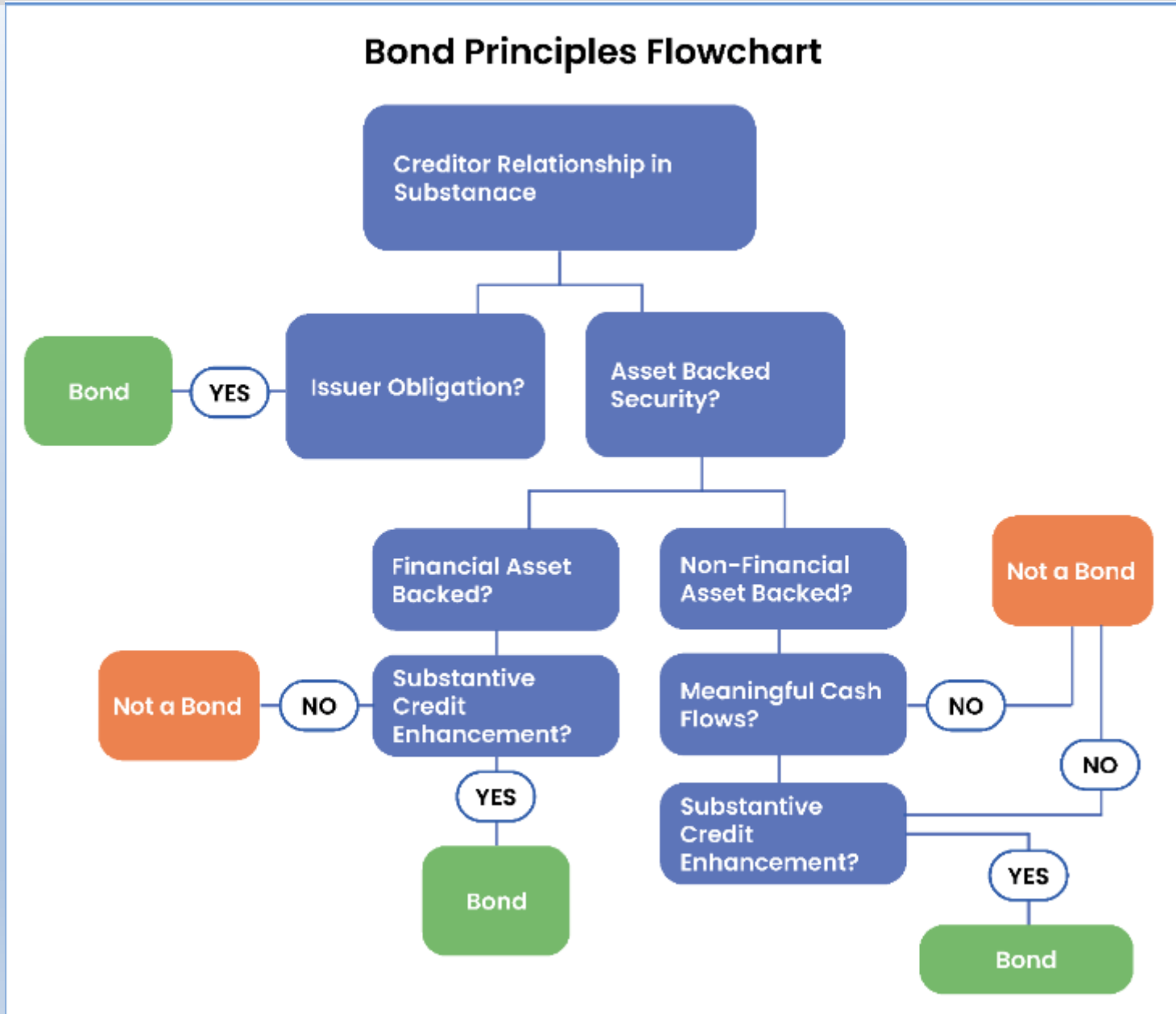
TWO ELIMINATED FIELDS



TRANSITION

AAM





TRANSITION

- REPORTING ENTITIES TO USE BEST EFFORTS TO ASSESS INVESTMENT DETERMINATION
- ASSESSMENTS SHOULD BE MADE AT THE TIME OF ACQUISITION, IF NOT AVAILABLE CURRENT INFORMATION MAY BE UTILIZED
- AFTER THE ASSEMENT DETERMINES THE INVESTMENT IS A BOND, NO FUTURE ASSESSMENTS ARE REQUIRED UNLESS QUESTIONED BY AN AUDITOR OR STATE REGULATOR

- AFTER THE ASSESSMENT DETERMINES THE INVESTMENT IS NOT A BOND, MUST BE REPORTED AS A DISPOSAL FROM SCHEDULE D-1 AND AN ACQUISITION ON SCHEDULE BA OR APPROPRIATE SCHEDULE AS OF JANUARY 1, 2025 AT AMORTIZED COST
- IF THE INVESTMENT IS HELD AT FAIR VALUE THEN THE UNREALIZED LOSS MUST BE REVERSED BEFORE THE DISPOSAL TO PREVENT A REALIZED LOSS AT THE TIME OF THE RECLASSIFICATION
- THERE SHOULD BE NO REALIZED GAIN/LOSS OR UNREALIZED GAIN/LOSS ON THE RECLASSIFICATION

IMPLEMENTATION



IMPLEMENTATION

- Rest assured, the investment accounting team at AAM is diligently collaborating with our service provider to ensure a seamless transition on January 1, 2025 for our clients.
- If you have any questions, please use the feature on the webinar or send me an email to stacy.crook@aamcompany.com

➤ THANK YOU FOR JOINING!

As a reminder, materials presented in this presentation should not be considered authoritative – please refer to the adopted statutory accounting guidance or your state regulator for complete guidance.

