Statutory Issue Paper No. 30

Investments in Common Stock (excluding investments in common stock of subsidiary, controlled, or affiliated entities)

STATUS
Finalized March 16, 1998

Original SSAP and Current Authoritative Guidance: SSAP No. 30

Type of Issue:
Common Area

SUMMARY OF ISSUE

1. Current statutory guidance pertaining to the valuation of and accounting for common stock is contained in the Accounting Practices and Procedures Manuals for Life and Accident and Health and for

4. Common stocks meet the definition of assets as defined in *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this paper.

5. Common stock acquisitions and dispositions shall be recorded on the trade date. Private placement stock transactions shall be recorded on the funding date.

6. Dividends on common stock shall be recorded as investment income on the ex-dividend date with a corresponding receivable to be extinguished upon receipt of cash (i.e., dividend income shall be recorded on stocks declared to be ex-dividends on or prior to the statement date). For reporting entities required to maintain an Asset Valuation Reserve (AVR), the accounting for realized capital gains and losses on sales of common stock shall be in accordance with *Issue Paper No. 7—Asset Valuation Reserve and Interest Maintenance Reserve* (Issue Paper No. 7). For reporting entities not required to maintain an AVR, realized gains and losses on sales of common stock shall be reported as realized gains/losses in the statement of operations.

7. At acquisition, common stocks shall be reported at their cost, including brokerage and other related fees. At each reporting date, investments in common stocks shall be valued and reported in accordance with the *Purposes and Procedures Manual of the NAIC Securities Valuation Office*. In those instances where fair market value is not available from the SVO, it is the responsibility of management to determine market value based on analytical or pricing mechanisms. For reporting entities required to maintain an AVR, the accounting for unrealized capital gains and losses shall be in accordance with Issue Paper No. 7. For reporting entities not required to maintain an AVR, unrealized capital gains and losses shall be recorded as a direct credit or charge to surplus.

8. For any decline in the fair value of a common stock which is determined to be other than temporary, the common stock shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. For those reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with Issue Paper No. 7. Subsequent fluctuations in market value shall be recorded as unrealized gains or losses. Future declines in market value which are determined to be other than temporary, shall be recorded as realized losses. A decline in fair value which is other than temporary includes situations where a reporting entity has made a decision to sell a security at an amount below its carrying value (association value). This is consistent with *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets.*

9. An investor can subscribe for the purchase of stock, but not be required to make payment until a later time. Transactions of this nature are common in the formation of corporations. Common stock acquired under a subscription represents a conditional transaction in a security authorized for issuance but not yet actually issued. Such transactions are settled if and when the actual security is issued and the exchange or National Association of Securities Dealers (NASD) rules that the transactions are to be settled. Common stock acquired under a subscription shall be recorded as an admitted asset when the reporting entity or its designated custodian or transfer agent takes delivery of the security and the security is recorded in the name of the reporting entity or its nominee (i.e., the accounting for such common stock acquisitions shall be on the settlement date).

Loaned Stock

10. When stocks are loaned, they remain assets of the reporting entity and are not removed from the accounting records as the reporting entity remains the owner of the stocks. When collateral is provided for the general use of the reporting entity, the asset is recorded and the admissibility of the asset is determined as if the reporting entity owned the collateral asset. A liability for the return of that collateral must be established. When collateral not available for the general use of the reporting entity is provided, it should not be recognized as an asset of the reporting entity. When non-cash collateral is provided, the

current market value of that collateral must be used to determine adequacy of the collateral held relative to the current market value of the loaned stocks/securities.

Stock Splits, Stock Dividends, Payment in Kind Dividends, and Stock Exchanges

11. Stock splits, stock dividends, payment in kind dividends and stock exchanges shall be accounted for in accordance with *Issue Paper No. 73—Nonmonetary Transactions*.

Disclosures

12. The following disclosures shall be made for common stocks in the notes to the financial statements.

a. Basis at which the common stocks are stated.

b. If the reporting entity has entered into securities lending transactions, its policy for

Drafting Notes/Comments

- Accounting for common stock holdings of subsidiary, controlled and affiliated entities is addressed in *Issue Paper No. 46—Accounting for Investments in Subsidiary, Controlled and Affiliated Entities*.
- Investment income due and accrued is addressed in *Issue Paper No. 34—Investment Income Due and Accrued*.
- Accounting for the Asset Valuation Reserve (AVR) equity component required for common stock holdings will be addressed in *Issue Paper No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*.
- Securities not yet valued by the SVO will follow SVO procedures for valuing such securities as being drafted by the SVO as directed by the Invested Asset Working Group of the Valuation of Securities (EX4) Task Force.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

17. The Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies provides guidance with respect to common stock (similar guidance is also in the Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies). Pertinent excerpts are as follows:

> Shares of capital stock represent units of ownership in a corporation, including common and preferred stock, mutual fund shares, transferable savings and loan association shares, warrants, and options to purchase stock. A return on stock held for investment is generally in the form of cash dividends which are paid to the owner. Occasionally, dividends are paid in the form of additional shares of stock. Liquidation of stock investments may give rise to capital gains or losses. (Investment in stock of parents, subsidiaries or affiliates is discussed in Chapter 6.)
>
> Common stockholders are the residual owners of the corporation and assume the ultimate risk associated with ownership up to the limit of their investment. They are usually entitled to voting powers of ownership. At liquidation, their claim to assets is after those of creditors and preferred stockholders. Common stockholders may liquidate their ownership rights in a corporation by selling their shares in the secondary market.
>
> Valuation
>
> Common and preferred stocks are generally required to be reported at the value published in the Valuations of Securities manual published by the NAICs Valuation of Securities Task Force at the end of each year. This value is the subcommittee's determination of "market" for each listed stock.
>
> The valuation of stock purchase warrants, stock purchase options that may be exercised on December 31 of the year for which the annual statement is being prepared, loaned securities, and investments in subsidiaries shall be in accordance with the practices and procedures prescribed by the NAIC and the state of domicile.
>
> Securities not listed in the manual, securities listed with no value because insufficient information for valuation was submitted to the Valuation of Securities Task Force, and restricted stock require the determination of an acceptable value. Insurance companies are required to submit sufficient information on these securities to the NAIC Securities Valuation Office to permit them to determine market value.

Investments in Common Stock, (excluding investments in common stock of

The valuation of the stocks remain unaffected by the loan as long as the amount of collateral is at least equal to the minimum amounts specified above. Failure to hold sufficient collateral may result in the admitted assets value being decreased by the amount of insufficient collateral.

18. The *Purposes and Procedures Manual of the NAIC Securities Valuation Office* - Section 5 - *Procedures for Valuing Common Stocks and Stock Warrants* contains the following guidance:

(A) Common Stocks of Companies Not Classified as Being Subsidiaries, Controlled or Affiliated, Under Section 5(B).

(a) Association values for publicly traded common stocks and warrants, including, where permitted by law or regulation of an insurer's state of domicile, shares against which exchange traded call options are outstanding, and where the requirements of Section 5(C)(1) are met, shall be equal to market value at date of statement, excepting that, where permitted by law or regulation of an insurer's state of domicile, shares loaned to others shall be valued at the market value at date of statement if the Acceptable Collateral, as hereinafter defined, is pledged as security for the loan and except as set forth in the following sentence, the Acceptable Collateral pledged as security is, at the inception of the loan, in an amount equal to 102% of the market value of the loaned shares. In event that foreign shares are the subject of the loan and the denomination of the currency of the Acceptable Collateral is other than the denomination of the currency of the loaned foreign shares, the amount of Acceptable Collateral which shall be pledged shall be an amount equal to 105% of the market value of the loaned shares. A decline in value of the Acceptable Collateral or an increase in the value of the loaned shares during the term of the loan shall not result in disqualification from valuation in accordance with the above if, during the term the loan is outstanding, additional Acceptable Collateral is posted any time the amount of Acceptable Collateral declines to 100% of the market value of the loaned shares (or 102% of the market value or the loaned shares if Acceptable Collateral in an amount equal to 105% was required to be posted at the inception of the loan) in an amount equal to the difference between the 102% or 105% initially required to be posted and 100% or 102%, respectively. For purpose of this provision, Acceptable Collateral shall mean cash and cash equivalents and shall include securities issued by the U.S. Government or its agencies. Any shortfall in the amount of the actual Acceptable Collateral posted and the required 102% or 105%, as applicable, shall be deducted from the otherwise determined statement value.

Shares of mutual funds, except for certain money market funds as defined by 17 CFR 270.2a-7 under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.) and further defined in section 5(A)(a)(i) and 5(A)(ii), regardless of the types or mix of securities owned (bonds, stock, money market instruments, or other type of investments) by the fund, are considered to be common shares which should be reported on Schedule D-Part 2-Section 2.

(i) A money market fund shall not require a reserve if the fund meets all of the following conditions:

(1) The fund shall maintain a money market fund rating in the highest category from an SVO recognized rating agency; and

(2) The fund shall maintain a constant net asset value per share at all times; and

(3) The Fund shall allow a maximum of seven day redemption of proceeds; and

(4) (a) The fund shall invest 100% of its total assets in U.S. treasury bills, notes, and bonds and collateralized repurchase agreements comprised of those obligations at all times (see Section 5(F) for a list of qualifying Funds), or

(b) The fund shall invest 100% of its total assets in certain securities listed in Section 6(B)(g)(i) and collateralized repurchase agreements comprised of those obligations at all times (see Section 5(G) for a list of qualifying Funds).

(ii) A money market fund shall establish a reserve using the bond class one reserve factor if the fund meets all of the following conditions:

(1) The fund shall invest at least 95% of its total assets in exempt securities listed in Section 6A(a), short-term debt instruments with a maturity of 397 days or less, class one bonds, and collateralized repurchase agreements comprised of those securities at all times (see Section 5(H) for a list of qualifying Funds): and

(2) The fund shall maintain a money market fund rating in the highest category by an SVO approved rating agency: and

(3) The fund shall maintain a constant net asset value per share at all times: and

(4) The fund shall allow a maximum of seven day redemption of proceeds:

(iii) A money market fund which qualifies for reserve exemption pursuant to Section 5(A)(a)(i) or inclusion in the bond class one reserve category pursuant to Section 5(A)(a)(ii) shall be reported on Schedule DA-Part 1.

(iv) In order to qualify for a reserve exemption pursuant to Section 5(A)(a)(i) or inclusion in the bond class one reserve category pursuant to Section 5(A)(a)(ii), a money market fund shall submit documentation on forms provided by the SVO staff. The forms shall include sufficient information to demonstrate compliance with the above requirements.

(v) In order to maintain the qualifications for exemption or inclusion in the bond class one reserve category, the fund shall report annually, current fund information to the SVO staff by November 15. In addition, the fund shall report to the SVO any change in investment policy which requires notice to shareholders.

(b) Association Values for common stocks which are not publicly traded, other than those issued by insurance companies (for which see Section (c) hereunder), shall be determined by the SVO Staff.

(c) Association Values for common stocks which are not publicly traded which are issued by insurance companies will be equal to book value, which shall be calculated as follows: by dividing the amount of its capital and surplus as shown in its last annual statement or subsequent report of examination (excluding from surplus, reserves required by statute and any portion of surplus properly allocable to policyholders, rather than stockholders) less the value (par or redemption value, whichever is the greater) of all of its preferred stock, if any, outstanding, by the number of shares of its common stock issued and outstanding.

(d) The foregoing provisions shall in all cases be subject to the procedures prescribed by state insurance department practices or laws concerning the use of acquisition cost or any other basis for the valuation of stocks of insurance companies.

(B) Common Stocks of Subsidiary, Controlled or Affiliated Companies (*section not included as not relevant to this issue paper*)

(C) Stock Warrants.

(1) Stock Warrants.

All warrants which are exercisable on the date of the Statement shall be valued at Association Value as defined below whether or not physically attached to any other security (See (D), hereunder, for the valuation of warrants exercisable into securities which are restricted as to transferability.)

(a) For publicly traded warrants (other than exchange traded) the Association Value shall be equal to market value.

(b) The Association Value for a warrant having no public market which is currently exercisable into shares of common stock which have no public market shall be the difference resulting from the subtraction from the analytically determined Association Val

Market values, where used in the determination of Association Values carried in the SVO manual, are not intended for use in valuing restricted common stocks, warrants as described in this section. Values for such restricted common stocks, warrants will not be carried in the SVO publication.

(E) Exceptions.

Where required by special conditions the foregoing standards may be varied by the Task Force.

(F) Money Market Funds Filed With The SVO Which Qualify Under Section 5(A)(a)(i)(4)(a)

(listing not included for purposes of this issue paper)

19. Several states have statutes that address valuation of common stocks not listed in the Valuations of Securities manual. In addition, one state clarifies the definition of common stock. See excerpts below:

- Delaware Statutes - Insurance Laws, Title 18 Insurance Code, Part I, Chapter 13 - Investments, Section 1311:

  As used in this section the term "common stock" includes transferable certificates of participation in business trusts.

- Utah Regulations - Utah Administrative Rules, Insurance, R590 Administration, Rule R590-116--Valuation of Assets

  6. Common Stocks.

     a. Common stocks are to be valued at market value. Market value as used for valuation of common stocks means in accordance with the values listed in "Valuation of Securities." For securities which are traded on a registered national
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(b) Purchase price shall in no case be taken at a higher figure than the actual market value at the time of purchase, plus actual brokerage, transfer, postage or express charges paid in the acquisition of such securities.

(c) Common, preferred or guaranteed stocks shall be valued at their market value or at the option of the company, they may be valued at purchase price if purchase price is less than market value.

- Florida Statutes - Insurance Laws, TITLE XXXVII-- INSURANCE, Chapter 625 -- Accounting, Investments, and Deposits by Insurers, Part I. Assets and Liabilities, 625.151- Securities valuation

(1) Securities, other than those referred to in §§ 625.141, held by an insurer shall be valued, in the discretion of the department, at their market value, or at their appraised value, or at prices determined by it as representing their fair market value.

- Georgia Regulations, Rules and Regulations of the State of Georgia, TITLE 120. -- Rules of the Comptroller General, 120-2. Insurance Department, Chapter 120-2-5 -- Valuation Procedures and

collateral on short notice, for example, by substituting other collateral or terminating the contract, then

(i) The debtor shall reclassify that asset and report that asset in its statement of financial position separately (for example, as securities receivable from broker) from other assets not so encumbered.

(ii) The secured party shall recognize that collateral as its asset, initially measure it at fair value, and also recognize its obligation to return it.

b. If the secured party sells or repledges collateral on terms that do not give it the right and ability to repurchase or redeem the collateral from the transferee on short notice and thus may impair the debtor's right to redeem it, the secured party shall recognize the proceeds from the sale or the asset repledged and its obligation to return the asset to the extent that it has not already recognized them. The sale or repledging of the asset is a transfer subject to the provisions of this Statement.

c. If the debtor defaults under the terms of the secured contract and is no longer entitled to redeem the collateral, it shall derecognize the collateral, and the secured party shall recognize the collateral as its asset to the extent it has not already recognized it and initially measure it at fair value.

d. Otherwise, the debtor shall continue to carry the collateral as its asset, and the secured party shall not recognize the pledged asset.

Disclosures

17. An entity shall disclose the following:

a. If the entity has entered into repurchase agreements or securities lending transactions, its policy for requiring collateral or other security

b. If debt was considered to be extinguished by in-substance defeasance under the provisions of FASB Statement No. 76, Extinguishment of Debt, prior to the effective date of this Statement, a general description of the transaction and the amount of debt that is considered extinguished at the end of the period so long as that debt remains outstanding

c. If assets are set aside after the effective date of this Statement solely for satisfying scheduled payments of a specific obligation, a description of the nature of restrictions placed on those assets

d. If it is not practicable to estimate the fair value of certain assets obtained or liabilities incurred in transfers of financial assets during the period, a description of those items and the reasons why it is not practicable to estimate their fair value

e. For all servicing assets and servicing liabilities:

(1) The amounts of servicing assets or liabilities recognized and amortized during the period

(2) The fair value of recognized servicing assets and liabilities for which it is practicable to estimate that value and the method and significant assumptions used to estimate the fair value

(3) The risk characteristics of the underlying financial assets used to stratify recognized servicing assets for purposes of measuring impairment in accordance with paragraph 37

(4) The activity in any valuation allowance for impairment of recognized servicing assets—including beginning and ending balances, aggregate additions charged and reductions credited to operations, and aggregate direct write-downs charged against the allowances—for each period for which results of operations are presented.

Isolation beyond the Reach of the Transferor and Its Creditors

23. The nature and extent of supporting evidence required for an assertion in financial statements that transferred financial assets have been isolated—put presumptively beyond the reach of the transferor and its creditors, either by a single transaction or a series of transactions taken as a whole—depend on the facts and circumstances. All available evidence that either supports or questions an assertion shall be considered. That consideration includes making judgments about whether the contract or circumstances permit the transferor to revoke the transfer. It also may include making judgments about the kind of bankruptcy or other receivership into which a transferor or special-purpose entity might be placed, whether a transfer of financial assets would likely be deemed a true sale at law, whether the transferor is affiliated with the transferee, and other factors pertinent under applicable law. Derecognition of transferred assets is appropriate only if the available evidence provides reasonable assurance that the transferred assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor or any of its affiliates, except for an affiliate that is a qualifying special-purpose entity designed to make remote the possibility that it would enter bankruptcy or other receivership (paragraph 57.c.).

24. Whether securitizations isolate transferred assets may depend on such factors as whether the securitization is accomplished in one step or two steps (paragraphs 54-58). Many common financial transactions, for example, typical repurchase agreements and securities lending transactions, isolate transferred assets from the transferor, although they may not meet the other criteria for surrender of control.

Conditions That Constrain a Transferee

25. Many transferor-imposed or other conditions on a transferee's contractual right to pledge or exchange a transferred asset constrain a transferee from taking advantage of that right. However, a transferor's right of first refusal on a bona fide offer from a third party, a requirement to obtain the transferor's permission to sell or pledge that shall not be unreasonably withheld, or a prohibition on sale to the transferor's competitor generally does not constrain a transferee from pledging or exchanging the asset and, therefore, presumptively does not preclude a transfer containing such a condition from being accounted for as a sale. For example, a prohibition on sale to the transferor's competitor would not constrain the transferee if it were able to sell the transferred assets to a number of other parties; however, it would be a constraint if that competitor were the only potential willing buyer.

Qualifying Special-Purpose Entity

26. A qualifying special-purpose entity[7] must meet both of the following conditions:

a. It is a trust, corporation, or other legal vehicle whose activities are permanently limited by the legal documents establishing the special-purpose entity to:
   (1) Holding title to transferred financial assets
   (2) Issuing beneficial interests (If some of the beneficial interests are in the form of debt securities or equity securities, the transfer of assets is a securitization.)
   (3) Collecting cash proceeds from assets held, reinvesting proceeds in financial instruments pending distribution to holders of beneficial interests, and otherwise servicing the assets held
   (4) Distributing proceeds to the holders of its beneficial interests.

b. It has standing at law distinct from the transferor. Having standing at law depends in part on the nature of the special-purpose entity. For example, generally, under U.S. law, if a transferor of assets to a special-purpose trust holds all of the beneficial interests, it can unilaterally dissolve the trust and thereby reassume control over the individual assets held in the trust, and the transferor "can effectively assign his interest and his creditors can reach it."[8] In that circumstance, the trust has no standing at law, is not distinct, and thus is not a qualifying special-purpose entity.

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[7] The description of a special-purpose entity is restrictive. The accounting for transfers of financial assets to special-purpose entities should not be extended to any entity that does not satisfy all of the conditions articulated in this paragraph.

[8] *Scott's Abridgment of the Law on Trusts,* §156 (Little, Brown and Company, 1960), 296.

Agreements That Maintain Effective Control over Transferred Assets

27. An agreement that both entitles and obligates the transferor to repurchase or redeem transferred assets from the transferee maintains the transferor's effective control over those assets, and the transfer is therefore to be accounted for as a secured borrowing, if and only if all of the following conditions are met:

a. The assets to be repurchased or redeemed are the same or substantially the same as those transferred (paragraph 28).
b. The transferor is able to repurchase or redeem them on substantially the agreed terms, even in the event of default by the transferee (paragraph 29).
c. The agreement is to repurchase or redeem them before maturity, at a fixed or determinable price.

Measurement of Interests Held after a Transfer of Financial Assets

Assets Obtained and Liabilities Incurred as Proceeds

31. The proceeds from a sale of financial assets consist of the cash and any other assets obtained in the transfer less any liabilities incurred. Any asset obtained that is not an interest in the transferred asset is part of the proceeds from the sale. Any liability incurred, even if it is related to the transferred assets, is a reduction of the proceeds. Any derivative financial instrument entered into concurrently with a transfer of financial assets is either an asset obtained or a liability incurred and part of the proceeds received in the transfer. All proceeds and reductions of proceeds from a sale shall be initially measured at fair value, if practicable.

Securities Lending Transactions

61. Securities lending transactions are initiated by broker-dealers and other financial institutions that need specific securities to cover a short sale or a customer's failure to deliver securities sold. Transferees ("borrowers") of securities generally are required to provide "collateral" to the transferor ("lender") of securities, commonly cash but sometimes other securities or standby letters of credit, with a value slightly higher than that of the securities "borrowed." If the "collateral" is cash, the transferor typically earns a return by investing that cash at rates higher than the rate paid or "rebated" to the transferee. If the "collateral" is other than cash, the transferor typically receives a fee.

64. The transferor of securities being “loaned” accounts for cash received (or for securities received that may be sold or repledged and were obtained under agreements that are not subject to repurchase or redemption on short notice, for example, by substitution of other collateral or termination of the contract) in the same way whether the transfer is accounted for as a sale or a secured borrowing. The cash (or securities) received shall be recognized as the transferor's asset—as shall investments made with that cash, even if made by agents or in pools with other securities lenders—along with the obligation to return the cash (or securities).

Illustration—Securities Lending Transaction Treated as a Secured Borrowing

65. Accounting for a securities lending transaction treated as a secured borrowing:

Facts

Transferor’s carrying amount and fair value of security loaned	$1,000
Cash “Collateral”	1,020
Transferor’s return from investing cash collateral at a 5 percent annual rate	5
Transferor’s rebate to the borrower at a 4 percent annual rate	4

The loaned securities cannot be redeemed on short notice, for example, by substitution of other collateral. For simplicity, the fair value of the security is assumed not to change during the 35-day term of the transaction.

Journal Entries for the Transferor

At inception:

Cash	1,020	
Payable under securities loan agreements		1,020
To record the receipt of cash collateral		
Securities loaned to broker	1,000	
Securities		1,000
To reclassify loaned securities that cannot be redeemed on short notice		
Money market instrument	1,020	
Cash		1,020
To record investment of cash collateral		

At conclusion:

Cash	1,025	
Interest		5
Money market instrument		1,020
To record results of investment		
Securities	1,000	
Securities loaned to broker		1,000
To record return of security		
Payable under securities loan agreements	1,020	
Interest ("rebate")	4	
Cash		1,024
To record repayment of cash collateral plus interest		

Journal Entries for the Transferee

At inception:

Receivable under securities loan agreements	1,020	
Cash		1,020
To record transfer of cash collateral		

Securities	1,000

At conclusion:

Obligation to return borrowed securities	1,000

- Florida Statutes - Insurance Laws, TITLE XXXVII-- INSURANCE, Chapter 625 -- Accounting, Investments, and Deposits by Insurers, Part I. Assets and Liabilities, 625.151- Securities valuation
- Georgia Regulations, Rules and Regulations of the State of Georgia, TITLE 120. -- Rules of the Comptroller General, 120-2. Insurance Department, Chapter 120-2-5 -- Valuation Procedures and Instructions for Bonds and Stocks, 120-2-5-.01 Establishing Values

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