

Statement of Statutory Accounting Principles No. 46

Investments in Subsidiary, Controlled, and Affiliated Entities

STATUS

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INT 01-22, INT 01-24, INT 02-07, INT 03-03, INT 03-16, INT 04-10

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Definitions

Superseded SSAPs and Nullified Interpretations

- a. In order to use the market valuation approach for SCA entities, the following requirements apply:
- i. The subsidiary must be traded on one of the following three major exchanges: (1) the New York Stock Exchange, (2) the American Stock Exchange, or (3) the NASDAQ National exchange;
 - ii. The reporting entity must submit subsidiary information to the Securities Valuation Office (SVO) for their calculation of the subsidiary's market value. Such calculation could result in further discounts in market value above the established base discounts based on ownership percentages detailed below;
 - iii. Ownership percentages for determining the discount rate shall be measured at the holding company level;
 - iv. If an investment in a SCA results in an ownership percentage between 10% and 50%, a base discount percentage between 0% and 20% on a sliding scale basis is required;
 - v. If an investment in a SCA results in an ownership percentage greater than 50% up to and including 80%, a base discount percentage between 20% and 30% on a sliding scale basis is required;
 - vi. If an investment in a SCA results in an ownership percentage greater than 80% up to and including 85%, a minimum base discount percentage of 30% is required. Further, the SCA must have at least two million shares outstanding, with a total market value of at least \$50 million in the public's control; and
 - vii. Any ownership percentages exceeding 85% will result in the SCA being recorded on an equity method.
- b. If a SCA investment does not meet the requirements for the market valuation approach in paragraph 7.a. or, if the requirements are met, but a reporting entity elects not to use that approach, investments in SCAs shall be recorded as follows:
- i. Investments in insurance SCA entities shall be recorded based on the underlying statutory equity of the respective entity's financial statements, adjusted for unamortized goodwill as provided for in *SSAP No. 68—Business Combinations and Goodwill* (SSAP No. 68).
 - ii. Investments in noninsurance SCA entities that have no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates, shall be recorded based on the underlying equity of the respective entity's financial statements adjusted to a statutory basis of accounting and the resultant proportionate share of the subsidiary's adjusted surplus, adjusted for unamortized goodwill as provided for in SSAP No. 68. Examples include but are not limited to: (i) an insurer and a SCA entity that leases autos, furniture, office equipment, or computer equipment to the insurer; (ii) an insurer and a SCA entity that owns real estate property that is leased to the insurer for office space; and (iii) an insurer and an SCA entity that holds investments that an insurer could acquire directly (i.e., "look through" investment subsidiary);

- iii. Investments in noninsurance SCA entities that have significant ongoing operations beyond the holding of assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates shall be recorded based on the audited GAAP equity of the investee. Examples include but are not limited to: (i) a property-casualty or life insurer and a SCA entity that is an oil and gas venture; and (ii) a property-casualty insurer or life insurer and a SCA manufacturer.

8. This statement requires that investments for noninsurance SCA entities that have no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates, and that do not qualify for the market valuation approach outlined in paragraph 7.a. or for which the reporting entity does not elect that approach, shall be recorded based on their underlying equity adjusted to a statutory basis of accounting. In applying the provisions of this statement to noninsurance SCA entities, the focus is on the primary operations of the SCA for purposes of determining if it is required to be accounted for under subparagraph 7.b.ii. Entities whose primary operations do not provide services to the insurance industry fall under provisions of subparagraph 7.b.iii. It is not the intent of subparagraph 7.b.ii. to apply to an affiliate which has insignificant transactions within the insurance industry. This rule requires judgment by the reporting entity in making the determination and provides flexibility to the regulator in analyzing the determination.

9. For investments in entities recorded based on the underlying audited GAAP equity of the investee, the amount to be recorded shall be defined as the initial investment in an investee at cost (as defined in SSAP No. 68). The carrying amount of the investment shall be adjusted to recognize the reporting entity's share of the audited GAAP basis earnings or losses of the investee after the date of acquisition, adjusted for any dividends received. A reporting entity's share of adjustments that are recorded directly to the investee's stockholder's equity under GAAP shall also be recorded as adjustments to the carrying value of the investment with an offsetting amount recorded directly to unrealized capital gains and losses on investments.

10. The statutory equity method as described in subparagraph 7.b.i. shall be applied by recording an initial and subsequent investment in an investee at cost, which is defined in SSAP No. 68 as the sum of

13. The procedures set forth below shall be followed by a reporting entity in applying an equity method of accounting (as described in paragraphs 7.b.i. through 7.b.iii.), as applicable, to investments in SCA entities:

a.

- h. An investment in a SCA entity that was previously accounted for under one method may become qualified for use of another method (as prescribed in paragraph 7) because of a change in the level of ownership (i.e., acquisition of additional interests by the reporting entity, acquisition or retirement of interests by the investee, or other transactions, or a change in facts or circumstances (e.g., paragraphs 7.a.i., 7.a.viii.)). When an investment qualifies for use of another method of accounting, the reporting entity shall adopt the new method of accounting and the investment shall be adjusted to reflect the reporting entity's equity interest in the SCA entity under the new method. A corresponding amount shall be recorded as an unrealized gain or loss.
14. A reporting entity that owns an interest in itself via direct ownership of shares of an upstream intermediate or ultimate parent shall reduce the value of such shares for the reciprocal ownership. If the shares of the parent are owned indirectly by a reporting entity, via a downstream SCA entity, the directly held entity, which owns the parent's shares, shall have its value reduced for the reciprocal ownership.
15. Any parent reporting entity that owns an interest in itself via either direct or indirect ownership of a down-stream affiliate, which in turn owns shares of the parent reporting entity, shall eliminate its proportionate interest in these shares from the valuation of such affiliate.

Impairment

16. When there is a decline in the fair value of an asset owned by a SCA entity that is other than temporary, the SCA entity shall write the asset down to fair value.
17. For any decline in the fair value of an investment in a SCA entity that is other than temporary, the investment 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. The write down shall first be considered as an adjustment to any portion of the investment that is nonadmitted (e.g., goodwill). 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. An impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to recover the carrying amount of the investment or there is evidence indicating inability of the investee to sustain earnings which would justify the carrying amount of the investment. A fair value of an investment that is below the carrying amount based on the statutory equity method or the existence of investee operating losses may indicate a loss in value, however, they are not necessarily indicative of a loss in value that is other than temporary.

Consolidation

18. Majority-owned subsidiaries shall not be consolidated for individual entity statutory reporting. This does not exempt certain reporting entities that are members of an affiliated group from the requirement to issue consolidated or combined annual statements as supplemental information in accordance with NAIC guidelines.

Disclosures

19. The significance of an investment to the reporting entity's financial position and results of operations shall be considered in evaluating the extent of disclosures of the financial position and results of operations of an investee. The following disclosures shall be made for all investments in SCA entities that exceed 10% of the total admitted assets of the reporting entity:
- a. Financial statements of a reporting entity shall disclose (i) the name of each SCA entity and percentage of ownership of common stock, (ii) the accounting policies of the reporting entity with respect to investments in SCA entities, and (iii) the difference, if any, between the amount at which the investment is carried and the amount of underlying

- equity in net assets (i.e., goodwill, other nonadmitted assets, market value or discounted market value adjustments) and the accounting treatment of the difference;
- b. For those SCA entities for which a quoted market price is available, the aggregate value of each SCA investment based on the quoted market price and the difference, if any, between the amount at which the investment is carried and the quoted market price shall be disclosed;
 - c. Summarized information as to assets, liabilities, and results of operations shall be presented for SCA entities, either individually or in groups; and
 - d. Conversion of outstanding convertible securities, exercise of outstanding options and warrants and other contingent issuances of an investee may have a significant effect on an investor's share of reported earnings or losses. Accordingly, material effects of possible conversions, exercises or contingent issuances shall be disclosed in notes to the financial statements of the reporting entity.
20. Any commitment or contingent commitment to a SCA entity shall be disclosed (e.g., guarantees or commitments to provide additional capital contributions).
21. A reporting entity that recognizes an impairment loss shall disclose the following in the financial statements that include the period of the impairment writedown:
- a. A description of the impaired assets and the facts and circumstances leading to the impairment; and
 - b. The amount of the impairment and how fair value was determined.
22. Refer to the preamble for further discussion regarding disclosure requirements. The disclosures in paragraph 19.d. above shall be included in the annual audited statutory financial reports only.

Relevant Literature

23. This statement adopts the *Purposes and Procedures Manual of the NAIC Securities Valuation Office*.
24. This statement adopts *FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18* as guidance to be considered in determining the existence of control.
25. This statement rejects *APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock, AICPA Accounting Interpretations, The Equity Method of Accounting for Investments in Common Stock: Accounting Interpretations of APB Opinion No. 18, FASB Technical Bulletin No. 79-19, Investor's Accounting for Unrealized Losses on Marketable Securities Owned by an Equity Method*

AUTHORITATIVE LITERATURE**Statutory Accounting**

- *Purposes and Procedures Manual of the NAIC Securities Valuation Office*

Generally Accepted Accounting Principles

- *FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18*

RELEVANT ISSUE PAPERS

- *Issue Paper No. 1—Consolidation of Majority-owned Subsidiaries*
- *Issue Paper No. 46—Accounting for Investments in Subsidiary, Controlled and Affiliated Entities*