

CLIENT ALERT

NAIC Adopts Revisions to Related Party Transaction Reporting Requirements in NAIC's Accounting Practices and Procedures Manual

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Overview

This alert summarizes recently adopted changes to the National Association of Insurance Commissioners' ("[NAIC](#)") Accounting Practices and Procedures Manual (the "[Manual](#)") with respect to affiliates and related party reporting. On May 24, 2022, the NAIC's Statutory Accounting Principles (E) Working Group ("[SAPWG](#)") adopted [Agenda Item #2021-21](#), providing revisions to Statement of Statutory Accounting Principles ("[SSAP](#)") No. 25 (*Affiliates and Other Related Parties*) and SSAP No. 43R (*Loan-backed and Structured Securities*) regarding reporting disclosures for insurance companies for investments acquired from a related party. These revisions were effective upon adoption and will affect reporting for year-end 2022.

These revisions are intended to clarify the definition of control in the Manual and create new financial statement reporting requirements for investment transactions with *related parties*. The revisions to SSAP No. 25 add a new paragraph clarifying that control of an entity (including limited partnerships, trusts, and other special purpose entities) may be found through arrangements other than voting interests, and the revisions to SSAP No. 43R clarify that investments that are within the scope of SSAP No. 43R include those that are issued by a related party or acquired through a related party transaction or arrangement subject to SSAP No. 25. Under corresponding changes adopted by the NAIC's Blanks (E) Working Group, related party transactions are now to be reported using new reporting codes that identify the role of the

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related party on new columns on the year-end investment schedules (Schedules B, BA, D, DA, DB, DL, and E) for life, accident and health/fraternal insurers; property and casualty insurers; health insurers; and title insurers.

In addition, the NAIC's Macroprudential (E) Working Group ("MWG") has identified the reporting codes as a first step to identifying related party transactions and investments, particularly those involving private equity firms that have acquired insurance companies. Regulators believe that such disclosure will help them identify relevant transactions for further inquiry to ensure the fee structure is reasonable, the terms of the investment are competitive with third-party transactions, and the insurer is investing in the transaction without undue influence from the affiliated or related investment manager.

Background

As background, SSAP No. 25 establishes statutory accounting principles and disclosure requirements for related party transactions, and is applicable to all related party transactions, even if the transaction is also governed by other SSAPs or include unrelated parties as intermediaries. SSAP No. 25 sets forth rules for determining when related party transactions result in admitted assets (or non-admitted assets) and imposes specific disclosure requirements, particularly when such transactions involve loans or services. All "material related party transactions" are required to be disclosed on the investment schedules of a reporting entity's statutory financial statements, including a description of the transaction and other transaction-specific details enumerated in SSAP No. 25 (e.g., the nature of the relationships involved; a description of the transaction; and a description of amounts due from or to related parties).

SSAP No. 25 defines "related parties" as "entities that have common interests as a result of ownership, control, affiliation or by contract," which encompasses not only affiliates (as defined under the NAIC *Insurance Holding Company System Regulatory Act* (the "Holding Company Act")) of a reporting entity, but also many other relationships with "common interests". A revision of SSAP No. 25 effective in 2021 ([Agenda Item #2019-34](#)) expanded the examples of "related parties" to include directors and officers of the reporting entity, family and household members of officers, directors, or principal owners, entities with common officers and directors, and any person with a 10% or greater direct or indirect ownership interest, without regard for any disclaimers of control or affiliation that may have been accepted by regulators. "Related parties" therefore can exist solely on the basis of "common interests" — without "control."

Summary of Recent Revisions

SSAP No. 25

The revision to SSAP No. 25 adds a new paragraph 9 to clarify the application of existing affiliate and control definitions to limited partnerships, trusts, and other special purpose entities. This new paragraph provides that entities not controlled by voting interests may be controlled by a general partner, servicer, or other arrangement, and that a reporting entity (insurer preparing statutory financial statements) or its affiliates may hold indirect control of other entities through such arrangements. If control exists under these rules, whether direct or indirect, the arrangement is considered affiliated under

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paragraph 5 of SSAP No. 25, consistent with the Holding Company Act. Additionally, arrangements that are considered affiliated under this interpretation are treated as related party arrangements (and subject to the disclosure requirements for material transactions), notwithstanding the filing of a disclaimer of affiliation under the Holding Company Act.

SSAP No. 43R

The revisions to SSAP No. 43R provide additional guidance related to loan-backed and structured securities, by clarifying that investments within the scope of SSAP No. 43R that are issued by a related party or acquired through a related party transaction or arrangement are subject to SSAP No. 25. The revisions specifically highlight arrangements where a related party is involved in sponsoring or originating a loan-backed or structured security, or any type of underlying servicing arrangement, as examples of related party relationships that must be identified as related party investments on investment schedules regardless of whether they would be captured in the affiliated investment reporting lines.

Blanks

In conjunction with the revisions to SSAP Nos. 25 and 43R adopted by the SAPWG, the Blanks (E) Working Group has adopted [changes to the Annual and Quarterly Statement forms](#) promulgated by the NAIC to provide a new reporting column on investment schedules (Schedules B, BA, D, DA, DB, DL, and E) requiring reporting entities to identify if an investment involves a related party and, if so, the nature of the role of such related party in the investment. This reporting line is required for all investments involving related parties including, but not limited to, those captured as affiliate investments, regardless of whether the related party meets the affiliate definition or has successfully disclaimed control of the reporting entity. This new electronic reporting column will be required starting with reporting entities' 2022 Annual Statement filings.

Summary

The NAIC has characterized both these new revisions and those that took effect in 2021 as “non-substantive” revisions, and has stressed that they are not intended to change which investments are reported on NAIC investment schedules as affiliated or unaffiliated. Members of the SAPWG have indicated that they consider these changes to be consistent with the existing definition of affiliates and related parties under the Holding Company Act and SSAPs, despite comments from interested parties that the language of these revisions is more expansive than current industry practice (under which investments that pose credit risk to an affiliate are being reported as affiliated investments). This interpretation is of particular importance to reporting entities engaging in certain securitization transactions, e.g., investing in a collateralized loan obligation (“CLO”), where an affiliated entity is acting as a manager of the CLO. During the May 24th meeting, members of the SAPWG rejected the interpretation posed by interested parties that affiliated investments were limited to those that present credit risk exposure to an affiliate, and arrangements (such as an affiliate acting as a CLO manager) where the affiliate does not face credit risk are not “affiliated” transactions subject to reporting requirements.

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