

# Principles-Based Definition of Bond – NAIC SSAP 26



## Definition of a bond update

### Who this impacts:

U.S. NAIC statutory filers (life, health, P&C)

### Timeline:

Currently approved for implementation on Jan 1, 2025

### Description:

The NAIC is addressing creative financial structures that allow for Schedule D Part 1 (Bond) treatment of assets. This principles-based approach has been updated to identify what qualifies as a bond.

The focus of the proposal has been on structured securities, particularly those with underlying characteristics of equity. Also in scope are assets which require sale or refinancing of underlying assets to meet principal or income requirements, which could lead to increased volatility profiles.

Holdings that do not meet the criteria will be recorded as sales from Schedule D, and acquisitions onto the appropriate schedule in 2025.

### Investment implication:

We believe insurers should understand their exposure to structured securities to avoid potential rescheduled assets.



## Key observations

- Issued in August of 2023, this proposal takes effect on January 1, 2025, after being pushed back one year.
- Structured securities, such as asset backed securities or rated notes, are seen as “in scope.”
- Focus is on “equity-like characteristics” versus a contractual creditor relationship. This determination is largely driven by whether the investment has predictable cash flow generation.
- This cash flow generation **should not exclusively** rely on the sale, refinancing or performance of underlying equity or asset interests. Overcoming this hurdle can be done with significant overcollateralization to mitigate risk, but this requires onerous documentation and analysis.
- Securities that tie principal and income payments with appreciation or depreciation of underlying collateral are no longer eligible as a bond, excluding inflation or interest rate adjustments.

Source: National Association of Insurance Commissioners, 2024.

Understanding “meaningful levels of cash flow” to determine bond eligibility is a key factor of the proposal.