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BULLETIN 01-9

To: President, All Domestic Insurance Companies, HMOs, Non-Profits, Dental Plans, MCOs, etc.

Re: NAIC Codification of Statutory Accounting Principles

Date: April 25, 2001

CC: Chief Financial Officer, All Domestic Insurance Companies, HMOs, Non-Profits, Dental Plans, MCOs, etc.

On June 25, 2000, MIA Bulletin #00-16 was issued advising you of the intention of the Maryland Insurance Administration to adopt the NAIC Codification of Statutory Accounting Principles, herein after referred to as the NAIC Codification, effective January 1, 2001. That Bulletin #00-16 informed you that Code of Maryland Regulations 31.04.01.04 states that, "A person who is required under Insurance Article, Annotated Code of Maryland or Health-General Article, Annotated Code of Maryland, to file an annual financial statement, interim financial statement, audited financial report, or annual actuarial opinion shall prepare the documents in accordance with the *Annual Statement Instructions* and the *Accounting Practices and Procedures Manual* adopted by the National Association of Insurance Commissioners (NAIC)." Effective January 1, 2001 the NAIC Codification was renamed as, and replaced the prior NAIC *Accounting Practices and Procedures Manual*. As a consequence current Maryland laws and regulations did not need to be amended for the State of Maryland to adopt the NAIC Codification.

In accordance with the statutory hierarchy provided by the NAIC Codification, state legislative and regulatory authority is not preempted by the NAIC Codification. Therefore, in instances where specific Maryland laws and regulations on a given accounting treatment exist, your entity will be required to follow the specific Maryland laws and regulations. In those instances where Maryland laws and regulations are silent, your entity will be required to follow the NAIC Codification.

During 2000, a working group comprised of industry representatives and MIA staff met numerous times to compare and devise a list of the differences between the NAIC Codification and the Maryland laws and regulations. For the differences that were identified, the working group determined if the laws and regulations should be amended to conform to the NAIC Codification or if the laws and regulations should remain as a continual conflict with the NAIC Codification. A schedule of the differences and our conclusion by accounting topic, and a schedule of our review by Statement on Statutory Accounting Principle Number may be found on the Administration's web-site (mdinsurance.state.md.us) under Insurer Services – Company Filing Requirements. The working group also drafted related amendments to Maryland laws and regulations as deemed necessary. The recommended amendments to the Maryland laws have been made as a result of the adoption of House Bill #1412 and Senate Bill #881 of the 2001 Legislative Session. The recommended amendments to the Maryland regulations will be proposed in the near future.

As a result of our review, we concluded that the NAIC Codification is adopted and the guidance provided by Codification should be followed, with the exception of the following instances where Maryland law supercedes the Codification:

- Insurance Article §5-101 for insurers, admits shares or deposits in a savings and loan association or building and loan association and the related interest, to the extent that the investment or account is insured by an instrumentality of the United States or of Canada. Statement on Statutory Accounting Principle (SSAP) #2 does not require these types of deposits to be insured by an instrumentality of the United States or of Canada to be admitted. We will continue to require insurance on these deposits for them to be considered admitted assets.
- COMAR 31.12.06.02, for managed care organizations (MCOs), admits the balance of any deposit in a solvent Maryland bank or trust company. In this regard, the Administration defines a Maryland bank or trust company to be those institutions defined in COMAR 31.04.09.01. Specifically, the following institutions would be considered a Maryland bank or trust company for purposes of this regulation:
 - An institution that is incorporated under the laws of Maryland as a state bank, trust company or savings bank;
 - An institution that is incorporated under federal law as a bank, having banking offices located in this state;
 - A national banking association or other bank that has its main office located in a state other than Maryland and operates one or more branches in Maryland;
 - An institution that is authorized to exercise trust or fiduciary powers and that is organized under the laws of Maryland as a state bank, trust company or savings bank or organized under the laws of the United states and has its principal office in this state.SSAP #2 does not require deposits to be in a Maryland bank to be admitted. We will continue to require deposits of MCOs to be in Maryland banks to be admitted.
- Insurance Article §5-101 for insurers, except for life insurance premiums, admitted the amount of premiums in the course of collection that are not more than 3 months past due, unless payable directly or indirectly by an instrumentality of the United States. This section

also admitted uncollected life insurance premiums and did not require them to be less than 90 days old. COMAR 31.12.01.04 admits, for HMOs, member charges in the course of collection, not more than 90 days past due but the foregoing limitation does not apply to amounts payable directly or indirectly by federal, State, or local governmental agencies or their instrumentalities. SSAP #6 non-admits premium receivables that are more than 90 days past due and does not make an exception for amounts payable directly or indirectly by federal, State, or local governmental agencies or their instrumentalities. House Bill #1412 and Senate Bill #881 of the 2001 Legislative Session amended Insurance Article §5-101 to change “3 months” to “90 days” and to require life insurance premiums to meet the “90 day” requirement. However, the exception to the “90 day” rule for amounts payable directly or indirectly by federal, State, or local governmental agencies or their instrumentalities will remain.

- Insurance Article §5-511(e) and (h) and §5-608 (h) and (m) allow as reserve investments (and thus admit) certain equipment trust obligations or similar secured instruments and ground rents. The NAIC Codification does not mention equipment trust obligations or ground rents. SSAP #4 and #20 states that those assets not specifically mentioned as admitted assets would be non-admitted. We will continue to allow as reserve investments (and thus admit) certain equipment trust obligations or similar secured instruments and ground rents in accordance with these sections.
- Insurance Article §5-401 states that if the Commissioner finds that a special investment reserve would be prudent in view of the character of investments, the Commissioner may require an insurer to establish and maintain a special investment reserve of a reasonable amount for losses or fluctuations in value. The NAIC Codification does not require such a reserve. Insurance Article §5-401 will not be amended to delete the Commissioner’s ability to require such a reserve.
- Insurance Article §5-101, for insurers, admits interest due or accrued on mortgage loans in any amount by which the value of the property, reduced by the amount of delinquent taxes, exceeds the unpaid principal if the interest has not accrued for more than 18 months. SSAP #37 indicates that accrued interest on a loan in default shall be recorded as interest due and accrued if deemed to be collectible, however, if any interest is over 180 days past due it shall continue to accrue with the entire amount of interest reported as a non-admitted asset. SSAP #37 also states that the difference between the net value of the collateral (fair value of the collateral less the costs to obtain and sell it) and the recorded investment in the mortgage loan shall be recognized as an impairment by creating a valuation allowance with a corresponding charge to unrealized loss. House Bill #1412 and Senate Bill #881 of the 2001 Legislative Session amended Insurance Article § 5-101 to non-admit the entire amount of interest on mortgage loans if any of the interest is over 180 days past due. However, we will continue to non-admit interest on mortgage loans that is accrued (even, if not due) for more than 18 months. In addition, we will non-admit the amount by which the interest plus the principal exceed the value of the property reduced by delinquent taxes and other costs to obtain and sell the property.

- Insurance Article § 5-101, for insurers, admits interest due or accrued on a collateral loan that does not exceed 1 year's interest on the loan. SSAP #21 admits collateral loans and interest, but requires write-offs of the portion of the unpaid balance of the loan and interest that exceeds the collateral that would be admitted less costs to obtain and sell it. House Bill #1412 and Senate Bill #881 of the 2001 Legislative Session amended Insurance Article § 5-101 to non-admit collateral loan interest to the extent that the unpaid balance of the loan and interest exceed the value of the collateral that would be admitted less costs to obtain and sell it. However, we will continue to require insurers to non-admit interest due or accrued on a collateral loan that exceeds 1 year's interest on the loan.
- COMAR regulations 31.12.01.04G, for HMOs, admits prepaid charges on other organizations, hospitals, and other persons as approved by the Commissioner and 31.12.06.02F, for MCOs, currently admits prepaid charges on health care contracts with hospitals or other health care organizations when approved by the Commissioner, including premiums prepaid for malpractice or general liability insurance. SSAP #29 states that prepaid expenses shall be reported as non-admitted assets and charged against unassigned funds (surplus). SSAP #25 dealing with transactions with affiliates and other related parties admits loans and advances made to related parties if they represent arm-length transactions and they are deemed collectible. SSAP #25 non-admits any advances under capitation arrangements made directly to providers or to intermediaries that represent providers that exceed one month's payment. It should be noted that SSAP #25 only pertains to related-party transactions and that advances to other entities would fall under SSAP #29 and would be non-admitted. However, SSAP #64 does permit offsetting and netting of assets and liabilities if the amount owed by each party is a determinable amount and the parties have a right to setoff which is enforceable by law and the parties intend to setoff their assets and liabilities. The NAIC currently has an issue paper (Issue Paper #107) regarding health care receivables including advances to hospitals or other providers, prescription rebates, etc. However, this issue paper is not final and currently does not allow insurers to admit advances to hospitals, and other providers, to the extent of the aforementioned Maryland regulations. We will be requesting an amendment to COMAR 31.12.06.02 to non-admit premiums prepaid for malpractice or general liability insurance. However, we intend to continue to admit advances to hospitals and other providers when approved by the Commissioner.
- COMAR 31.12.06.02, for managed care organizations (MCOs), limits the amount of leasehold estate improvements that may be admitted to 20% of admitted assets and limits the amount of real estate that may be admitted to 20% of admitted assets. In addition, we are recommending COMAR 31.12.01.04, for health maintenance organizations (HMOs), be amended to also adopt these limitations. SSAP #73 admits leasehold improvements used in the direct delivery of healthcare, however, this SSAP does not limit leasehold improvements to a percentage of admitted assets. SSAP #40 admits real estate, but it does not limit real estate to a percentage of admitted assets. We will continue to limit these assets to a % of admitted assets.
- Insurance Article Title 5, Subtitle 5 (*Investments of Life Insurers*) and Subtitle 6 (*Investments of Insurers Other Than Life Insurers*) prohibit insurers from making certain investments; establishes restrictions and limitations on the types and amount of investments that an insurer

may invest; and establishes restrictions on the types of assets that can be used to meet reserve requirements. Insurance Article §7-202 limits the amount an insurer can invest in a subsidiary to 10% of the insurer's assets and 50% of the insurer's surplus. Insurance Article §5-1005 limits the amount of risk on any one subject of insurance to 10% of the insurer's surplus. The NAIC Codification does not establish limits or restrictions on the types and amounts of investments nor do they limit the amount of insurance on any one subject. We will continue to require insurers to comply with these sections of the law.

NAIC Codification Appendix #205, requires regulated entities to include, as part of their independent audited financial statements, a reconciliation between state laws and regulations and the NAIC Codification. This reconciliation identifies the differences between net income per the state's prescribed or permitted practices and net income per Statutory Accounting Principles (NAIC Codification). Prescribed practices are those specifically stated in state law or regulation. In this regard, annually, regulated entities are required to submit their permitted practices to the Administration for review and approval. However, the Administration will more closely scrutinize permitted practices to determine if they are in accordance with NAIC Codification, and if not, whether the permitted practice should continue.

If you have any questions regarding these matters, please contact Lester C. Schott, Associate Commissioner, at (410) 468-2119.

Steven B. Larsen
Insurance Commissioner