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NAIC Fall 2019 National Meeting Update

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The National Association of Insurance Commissioners (NAIC) recently held its Fall 2019 National Meeting (Fall Meeting). The following summarizes certain activities of the Statutory Accounting Principles (E) Working Group (SAPWG) that took place since the NAIC Summer 2019 National Meeting through January 8, 2020. Activities summarized below include both substantive and non-substantive items addressed as part of SAPWG's Hearing Agenda. These items were exposed for comment at previous NAIC National Meetings with comments received from Interested Parties as of January 8, 2020. SAPWG Meeting Agenda items exposed at the Fall Meeting for future comment and that will be deliberated at subsequent NAIC National Meetings will be addressed in future updates.

More information is available on the NAIC website at http://www.naic.org/cmte_e_app_sapwg.htm.

Accounting Standards Updates issued by the Financial Accounting Standards Board

SAPWG rejected the following FASB ASU's recently issued by the FASB:

1. FASB ASU 2018-08 Not-for-Profit Entities (Topic 958): "Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made"
2. FASB ASU 2019-03 Not-for-Profit Entities (Topic 958): "Updating the Definition of Collections"
3. FASB ASU 2019-05 Financial Instruments - Credit Losses (Topic 326): "Targeted Transition Relief"
4. FASB ASU 2019-06 Intangibles - Goodwill and Other (Topic 350), Business Combinations (Topic 805), and Not-for-Profit Entities (Topic 958): "Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit Entities"

SCA Loss Tracking

SAPWG previously re-exposed revisions to SSAP No. 97 "Investments in Subsidiary, Controlled and Affiliated Entities"(SSAP No. 97) and SSAP No. 5R "Liabilities, Contingencies and Impairments of Assets" (SSAP No. 5R) to update the accounting requirements for when an insurance reporting entity (i.e. the Parent) has a negative equity value in a subsidiary, controlled and affiliated (SCA) investment by removing the stipulations that would result in the parent recognizing both a liability for any financial commitment or guarantee of the SCA's obligations and a negative value for its investment under the equity method of accounting. Interested Parties proposed revised language clarifying these revisions. SAPWG agreed with this revised language and exposed these revisions at the Fall Meeting. With these revisions, guidance on negative SCA reporting is removed from SSAP No. 97 and reestablished in SSAP No. 5R. Revisions clarify that an investment in an SCA stops at zero and is not shown as a negative value. A corresponding liability for any guarantees or commitments pertaining to an investment in a negative SCA is established in accordance with SSAP No. 5R.

Reporting Deposit-Type Contracts

SAPWG previously re-exposed comments to provide clarity as to why guaranteed investment contracts or other deposit-type contracts that no longer have mortality or morbidity risk are reported in Exhibit 5 - Aggregate Reserves for Life Contracts (Exhibit 5) or in Exhibit 6 - Aggregate Reserves for Accident and Health Contracts (Exhibit 6) instead of in Exhibit 7 - Deposit Type Contracts (Exhibit 7) in the Annual Statement. Interested Parties commented that generally guaranteed investment contracts and other types of deposit-type contracts are reported in Exhibit 7. However, there are some contracts with deposit-like characteristics that also have other characteristics that allow these contracts to be reported in either Exhibit 5 or Exhibit 6. Interested Parties cited SSAP No. 50 "Classifications of Insurance or

Managed Care Contracts" which provides guidance as to how these types of contracts are classified and ultimately reported on Exhibits 5, 6, or 7. Interested Parties also commented that any reporting changes to these types of contracts would be a significant administrative burden to insurance entities. SAPWG agreed and requested feedback from Interested Parties regarding the inclusion of a footnote excerpt for Exhibit 5 and Exhibit 6 to disclose cases when a mortality risk is no longer present in a contract and annual statement instruction clarifications regarding deposit-type contracts captured in Exhibit 7. Discussions are ongoing.

Prepayments to Service and Claims Adjusting Providers

SAPWG previously exposed revisions to SSAP No. 55 "Unpaid Claims, Losses and Loss Adjustment Expenses" (SSAP No. 55). The revisions clarify that prepayment of unpaid losses and claims adjustment expenses to providers of claims adjustment services is recognized as a prepaid asset and non-admitted consistent with the guidance in SSAP No. 29 "Prepaid Expenses" and not recorded as a reduction of unpaid losses and claim adjustment expenses. Interested Parties commented that this guidance should exclude health insurance and managed care contracts since the guidance in SSAP No. 84 "Health Care and Government Insured Plan Receivables" already addresses the accounting for these types of contracts. SAPWG incorporated Interested Parties comments into the revisions and re-exposed for comment.

Other Derivatives

SAPWG adopted revisions to SSAP No. 86 "Derivatives" (SSAP No. 86) to address the accounting for derivatives classified as "other" in SSAP No. 86. These types of derivatives are typically not involved in either hedging, income generation or replication transactions. SAPWG's revisions clarify that these types of "other" derivatives are recorded at fair value and non-admitted (unless allowed to be admitted under state investment law) for statutory accounting purposes. Interested Parties commented that these revisions could have unintended consequences as it pertains to structured notes held by a reporting entity and that structured notes may be inappropriately scoped into these revisions. Interested Parties proposed language to SAPWG modifying SSAP No. 86 allowing for and clarifying the admittance of structure notes as assets on a reporting entities balance sheet. SAPWG disagreed with Interested Party comments stating that the intent of the revisions was to scope in all derivative instruments classified as "other" which would include structured notes and not specifically single out the accounting for just structured notes. Adopted revisions are effective immediately.

Goodwill

SAPWG exposed revisions to SSAP No. 68 "Business Combinations" (SSAP No. 68) to reject FASB ASU 2014-17 Business Combinations (Topic 805), Pushdown Accounting: "a consensus of the FASB Emerging Issues Task Force." The exposed revisions also prohibit pushdown accounting in SSAP No. 97 for SCA's reported in accordance with audited U.S. GAAP. Interested Parties disagreed with these revisions and stated that if the intent is to address concerns regarding goodwill at the SCA level then there are more direct approaches to addressing those concerns and current proposed revisions will most likely be confusing and costly to reporting entities. SAPWG re-exposed for comment three options as it pertains to pushdown accounting as follows:

1. Complete rejection of pushdown accounting;
2. Permission to use pushdown accounting for all non-insurance entities with revisions to include incorporation of goodwill at the SCA level in the reporting entity's goodwill admittance test; or
3. Permit pushdown accounting if elected by SEC Registrants, excluding non-insurance entities with revisions to include incorporation of goodwill at the SCA level in the reporting entity's goodwill admittance test.

Discussion with Interested Parties regarding the above is on-going. During the Fall Meeting, SAPWG adopted a minor revision to include goodwill from an insurance entity's acquisition of an SCA as part of the 10% admittance test within SSAP No. 68. This revision is effective for year-end 2019.

Attribution of Goodwill

SAPWG re-exposed revisions to SSAP No. 68 and SSAP No. 97 to explicitly state that the acquisition of a holding company requires the purchase price and goodwill amount to be attributed (i.e., assigned) to the downstream entities that are directly owned by the holding company with disclosure of the allocation of goodwill and method of allocation utilized allowing the identification of the proper amount of goodwill eliminated accordingly upon sale or non-admittance of the downstream entity. Discussion with Interested Parties on this matter is on-going.

Reinsurance

SAPWG adopted revisions to SSAP No. 61R "Life, Deposit-Type and Accident and Health Reinsurance" (SSAP No. 61) in order to clarify statutory accounting requirements for certain experience rated reinsurance contracts including experience rated yearly renewable term treaties. These revisions are the result of a referral from the Financial Analysis (E) Working Group that expressed concerns with trends regarding the use of reinsurance with risk limiting features for the purposes of providing surplus relief to troubled companies without a significant amount of risk transferred to the reinsurer. These revisions add disclosures to SSAP No. 61 which includes requiring reporting entities to identify contracts with certain risk limiting features or features resulting in delays in payment, the type of accounting applied to these contracts (i.e. reinsurance vs. deposit) and if reinsurance credit was reduced for any risk limiting features. These revisions are effective for annual reporting periods ending on or after December 15, 2020.

Revisions were also adopted to A-791 "Life and Health Reinsurance Agreements." (A-791) to clarify guidance regarding contracts with medical loss ratios. Additional revisions were exposed to A-791 clarifying the definition of "certain non-proportional contracts" and additional guidance regarding yearly renewable term treaties. Interested Parties supported the adopted revisions to SSAP No. 61 and A-791. Discussions regarding revisions exposed to A-791 remain on-going.

Supplemental Investment Risk Interogatory

SAPWG adopted revisions to the Supplemental Investment Risk Interogatory (SIRI) to identify what should be included in line 13 of SIRI (i.e. 10 Largest Equity Interests). SAPWG believes that the focus of line 13 of SIRI is to identify investment concentration risk for which that risk is not mitigated through investments in diversified funds. NAIC staff recommended additional guidance to clarify that entities must look-through non-diversified funds to identify individual issuer exposures held within those funds for purposes of line 13. The exposure further concludes that certain funds such as Securities Valuation Office (SVO) Identified U.S. Direct Obligations/Full Faith and Credit Exempt List of Money Market Mutual Funds, SVO Identified Bond Exchange Traded Funds, SVO Identified Bond Mutual Funds and SVO identified fund investments with underlying characteristics of fixed-income instruments that are outlined within the Purposes and Procedures Manual of the NAIC Investment Analysis Office are excluded from the aggregation of equity interests for purposes of line 13 of SIRI. Interested Parties had no comment on this exposure. A proposal was submitted to the Blanks (E) Working Group to incorporate this guidance for year end 2020 reporting. These revisions do not have an impact on statutory accounting.

Wash Sale Disclosures

SAPWG adopted revisions to SSAP No. 103R “Transfers and Servicing of Financial Assets and Extinguishments of Liabilities” (SSAP No. 103R) to clarify that only investments sold prior to a reporting period end and repurchased after that reporting date are subject to the wash sale disclosures in SSAP No. 103R. Interested Parties supported these revisions. These revisions are effective immediately.

Going Concern

SAPWG adopted revisions to SSAP No. 97 to expand language regarding the inadmissibility of an SCA investment when an unalleviated substantial doubt about the SCA’s ability to continue as a going concern is not only identified in the audit report opinion but also in the audited financial statement footnotes. Interested Parties had no comment on this item. These revisions are effective immediately.

Investment Classification Project

SAPWG exposed revisions to an issue paper and SSAP No. 32 “Preferred Stock” dedicated to revising the definitions and measurement and impairment guidance for preferred stock with SSAP No. 32. This is part of the NAIC’s ongoing Investment Classification Project. The issue paper improves the definition of preferred stock, incorporates a new exhibit to capture various terms prevalent in preferred stock, revises the measurement guidance to ensure appropriate, consistent measurement based on the type of preferred stock held and the terms of the preferred stock, incorporates guidance for mandatory convertible preferred stock and incorporates revisions to clarify impairment guidance and dividend recognition and redemption of preferred stock with the issuer. These revisions include comments submitted by Interested Parties. Discussion on this topic remain on-going.

Rolling Short-Term Investments

SAPWG exposed revisions to SSAP No. 2R “Cash, Cash Equivalents, Drafts and Short-Term Investments.” (SSAP No. 2R). These revisions focus on short-term investment structures that are intentionally designed to mature at or around 364 days (often with affiliates) with the expectation that such investments will be renewed or rolled over for subsequent years. SAPWG has expressed concerns that these practices are designed to achieve a more desirable risk-based capital ratio and avoid more appropriate risk based capital charges as a long term investment, avoid filing of the investment with the Securities Valuation Office or to avoid obtaining a rating from a credit rating provider. Revisions focus on all affiliated investments within the scope of SSAP No. 26R “Bonds,” all affiliated and non-affiliated investments within the scope of SSAP No. 43R “Loan-backed and Structured Securities” and all affiliated and non-affiliated investments reported on schedule BA. Revisions restrict the reporting of these investments as cash equivalents or short-term investments in the event that the reporting entity does not reasonably expect that the investment will mature within the timeframe permitted in accordance with SSAP No. 2R or the investment was sold or matured and the same or substantially similar investment was reacquired within a one year timeframe. Interested Parties expressed some concerns with these revisions and stated that such revisions could inadvertently scope short-term cash pooling arrangements and short-term lending arrangements out of SSAP No. 2R. At the Fall Meeting, SAPWG proposed further revisions to scope into SSAP No. 2R certain cash pooling arrangements if certain criteria was met. Other matters such as proper classification of short-term lending arrangements and investments with affiliates is still being deliberated.

Levelized and Persistency Commission

SAPWG exposed revisions to SSAP No. 71 “Policy Acquisition Costs and Commissions” to prevent reporting entities from deferring the recognition of commission expense using “financing transactions” including those in which a third party pays agents non-levelized commissions and the insurer pays the third party levelized amounts. Interested Parties stated that industry’s interpretation is that SSAP No. 71 allows such transactions when the contractual terms are tied to persistency of the underlying insurance policies. Interested Parties also expressed concerns that these revisions would impact the accounting for normal persistency commissions. SAPWG exposed further revisions at the Fall Meeting to clarify that the intent of the proposal is not to change the annual accrual of normal persistency commissions. SAPWG also reiterated its position that the intent of SSAP No. 71 is for the full amount of the unpaid principal and accrued interest pertaining to levelized commission arrangements that represent repayment of an advance to be accrued as a liability. Discussions remain ongoing.

Collateralized Fund Obligations

SAPWG exposed revisions to SSAP No. 43R "Loan-backed and Structured Securities" (SSAP No. 43R) in an effort to exclude from the scope of the statement equity instruments, investments with underlying assets that include equity instruments or structures representing an equity interest (i.e. joint ventures, LLC's or partnerships). Revisions also clarify the inclusion of lease-backed securities and equipment trust certificates as in scope only when eligible in accordance with the Purposes and Procedures Manual of the NAIC Investment Analysis Office. Interested Parties found the revisions to be unclear with concerns that such revisions are far too broad and could have unintended consequences. SAPWG directed NAIC staff to begin drafting an issue paper regarding these revisions with input from Interested Parties. Discussions remain on-going.

Other Working Groups

In addition to SAPWG, several other committees, working groups, and task forces met during the Fall Meeting. The following represents selected updates concerning the activities of some of these committees, working groups and task forces.

Risk Retention Group (E) Task Force

The Risk Retention Group (E) Task Force (RRG Task Force) met at the Fall Meeting to discuss the need for clarification regarding the registration of risk retention groups in non-domiciliary states. Discussion focused on revisions to the NAIC Uniform Risk Retention Group – Notice and Registration Form to assist in clarifying what information is required to be submitted by a risk retention group to a non-domiciliary state. These revisions were submitted to the Property and Casualty Insurance (C) Committee.

Additionally, the RRG Task Force adopted a frequently asked questions and best practices document for risk retention groups with the intent that this document assist non-domiciliary states in understanding state's authority as it applies to risk retention groups. This document will be incorporated into the risk retention group handbook.

Reinsurance (E) Task Force

The Reinsurance (E) Task Force (RTF) adopted the Process for Evaluating Qualified and Reciprocal Jurisdictions (the Qualified Process). The Qualified Process was developed as a result of revisions to the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786) (the Credit for Reinsurance Models) which was impacted by the Bilateral Agreement Between the United States of America and European Union on Prudential Measures Regarding Insurance and Reinsurance followed by a similar agreement entered into with the United Kingdom (known as the Covered Agreements). In 2012, the RTF was charged with developing a process to evaluate the reinsurance solvency systems of non-U.S. jurisdictions, for purposes of developing and maintaining a list of jurisdictions recommended for recognition by states as Qualified Jurisdictions. This charge was extended in 2019 to encompass the recognition of Reciprocal Jurisdictions in accordance with the 2019 amendments to the Credit for Reinsurance Models including the maintenance of a list of recommended Reciprocal Jurisdictions. The Qualified Process provides a documented evaluation process for creating and maintaining both the Qualified and Reciprocal Jurisdiction lists. The RTF has updated and revised the Qualified Process to specify how Qualified Jurisdictions (as defined by the Credit for Reinsurance Models) that recognize key NAIC solvency initiatives, including group supervision and group capital standards, and also meet the other requirements under the revised Credit for Reinsurance Models, will be recognized as Reciprocal Jurisdictions and receive similar treatment as that provided under the

Covered Agreements including the elimination of reinsurance collateral and local presence requirements by states.

The RTF adopted reevaluations to continue to recognize France, Germany, Ireland and the United Kingdom as Qualified Jurisdictions. These countries are automatically Reciprocal Jurisdictions under the Covered Agreements once fully implemented no later than September 22, 2022. The RTF also adopted evaluations to recognize Bermuda, Japan and Switzerland as Reciprocal Jurisdictions at the Fall Meeting.

Health Risk Based Capital (E) Working Group

The Health Risk Based Capital (E) Working Group (Health RBC Working Group) exposed for comment a proposed revised "health test" which would move filers who predominantly write health business and file on the life or property and casualty annual statement blank to begin filing on the health annual statement blank. The proposed tentative effective date is first quarter of 2021.

The Heath RBC Working Group continued deliberations on the granularity of the C1 bond factors and expanding the bond factor categories within the health risk based capital calculation. The Health RBC Working Group asked the American Academy of Actuaries to include investment income in the modeling of its factors.

Valuation of Securities (E) Task Force

The Valuation of Securities (E) Task Force exposed changes to the Purposes and Procedures Manual of the NAIC Investment Analysis Office to remove the instructions for the annual financial modeling of residential and commercial mortgage backed securities by external modeling companies. A single NAIC designation and designation category will be given to each security. Implementation is planned for year end 2020 reporting.

Mortgage Guaranty Insurance (E) Working Group

The Mortgage Guaranty Insurance (E) Working Group (MGIWG) exposed rejection of a previously proposed risk based capital standard to be replaced with a new risk-sensitive State Regulatory Mortgage Insurer Capital Standard. MGIWG also exposed a new Model Act (#630) and a Mortgage Guaranty Insurance Standards Manual as well as a new annual statement blank proposal. The proposed annual statement blank changes would include a new exhibit beginning year-end 2020 detailing disclosure of a five-year summary of trends, an aging of default inventory, risk and loss distribution by state, original loan-to-value on current unpaid loan balances by state and other detailed information.

Connect With Us

If you would like additional information, please contact:

Art Salvadori
Managing Director
Crowe LLP
+1 860 470 2117
arthur.salvadori@crowe.com