Crowe

Smart decisions. Lasting value.™

NAIC Fall 2020 National Meeting Update

Table of Contents

NAIC Fall 2020 National Meeting Update

The National Association of Insurance Commissioners (NAIC) recently held its Fall 2020 National Meeting (Fall Meeting). The following summarizes certain activities of the Statutory Accounting Principles (E) Working Group (SAPWG) that took place on various conference calls since the Summer 2020 National Meeting. 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. SAPWG Meeting Agenda items exposed 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 2019-09 Financial Services - Insurance (Topic 944): "Effective Date"
2. FASB ASU 2020-01 Equity Securities (Topic 321), Investments - Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815): "Clarifying the Interactions between Topic 321, Topic 323, and Topic 815"
3. FASB ASU 2020-05 Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): "Effective Dates for Certain Entities"

Loan-Backed and Structured Securities

SAPWG continued its deliberations regarding revisions to SSAP No. 43R "Loan-backed and Structured Securities" (SSAP No. 43R). The deliberations focused on two areas which were classification of securities issued from a trust or special purpose vehicle (SPV) and the definition of an asset backed security. NAIC believes that all securities issued from a trust or SPV were intended to be within the scope of SSAP No. 43R. Interested Parties commented that many of the securities issued from a trust or SPV do not have prepayment or extension risk and should therefore continue to follow regular amortized cost accounting under SSAP No. 26R "Bonds" and reported on Schedule D-1. Additionally, Interested Parties questioned whether the presence of a trust or SPV should have any part in forming a conclusion on the proper accounting classification of related securities and noted that other factors, such as cash flow patterns, are more pertinent. Insurance regulators have responded that, given the broad definition of a bond, any insurer can acquire assets through a trust or SPV that would otherwise be inadmissible if acquired on a stand-alone basis and still report those securities on Schedule D-1. Insurance regulators have further commented that SAPWG should focus its efforts on developing a principles-based definition for asset backed securities that qualify for Schedule D-1 reporting. SAPWG has requested comments on the concept of developing this principles-based definition. Discussions remain on-going.

Participation in Mortgages

SAPWG adopted non-substantive revisions to SSAP No. 37 "Mortgage Loans" (SSAP No. 37) to clarify that it is not required that a participant have the rightto solely take legal action against the borrower or, under typical circumstances, require the ability to communicate directly with the borrower in order to be considered within the scope of SSAP No. 37. Interested Parties supported these revisions.

Leasehold Improvements

SAPWG adopted non-substantive revisions to SSAP No. 22R "Leases" to update the amortization guidance for leasehold improvements allowing for the useful life to match the associated lease term which is consistent with U.S. GAAP reporting. Interested Parties supported these revisions.

Designation Categories for Mortgage Backed Securities

SAPWG adopted non-substantive revisions to SSAP No. 43R in order to clarify language regarding final NAIC designations for residential and commercial mortgage backed securities for consistency with the Purposes and Procedures Manual of the NAIC Investment Analysis Office. Interested Parties supported these revisions.

SCA Entities

SAPWG adopted revisions to SSAP No. 97 "Investments in Subsidiary, Controlled and Affiliated Entities (SCA)" (SSAP No. 97) to remove language stating that guarantees or commitments from the insurance reporting entity to the SCA entity can result in a negative equity valuation for the SCA entity. Revisions were also adopted to Question 7 in Exhibit C: Implementation Questions and Answers to SSAP No. 97 clarifying that foreign insurance SCA entities remain subject to equity adjustments as required in SSAP No. 97. Interested Parties were supportive of these changes.

Perpetual Bonds

SAPWG exposed non-substantive revisions to accounting guidance for perpetual bonds within the scope of SSAP No. 26R "Bonds" (SSAP No. 26R). SAPWG stated that perpetual bonds have similar characteristics to perpetual preferred stocks (including lack of maturity date) and should be recorded at fair value. Interested Parties disagreed with this treatment stating that perpetual bonds take on more of the characteristics of a bond within the scope of SSAP No. 26R. Interested Parties further stated that most insurance carriers utilize the call date as a "pseudo-maturity date" for purposes of amortizing these types of bonds. Additionally, Interested Parties stated that the market view of perpetual bonds is the same as traditional bonds and therefore are traded like normal bonds. As a result, perpetual bonds are more sensitive to interest rate movements, are generally priced like bonds (inclusive of accrued interest) and are quantified and measured in terms of par value and not in terms of shares of stock. SAPWG agreed with these views and exposed non-substantive revisions to SSAP No. 26R requiring insurance carriers to utilize the call date for purposes of amortizing (or accreting) perpetual bonds (i.e. the yield to worst method) for purposes of recording perpetual bonds at amortized cost. Additionally, fair value would be required for any perpetual bonds that do not have a call date.

Premium Refunds

SAPWG directed NAIC staff to draft revisions to SSAP No. 53 "Property and Casualty Contracts" and SSAP No. 54R "Individual and Group Accident and Health Contracts." Revisions will clarify accounting guidance for premium refunds including discretionary premium refunds and premium refunds associated with new property and casualty related products such as data telematics policies. Many of these revisions will align to previous content outlined in INT 20-08 "COVID-19 Premium Refunds, Limited-Time Exception, Rate Reductions and Policyholder Dividends." Discussions remain ongoing.

COVID -19 Interpretations

As a result of the coronavirus pandemic afflicting the United States during 2020, SAPWG previously adopted a series of interpretations in order to provide relief to reporting entities impacted by the pandemic. INT 20-02 "Extension of Ninety - Day Rule for the Impact of COVID-19," INT 20-04 "Mortgage Loan Impairment Assessment Due to COVID-19," INT 20-05 "Investment Income Due and Accrued," INT 20-06 "Participation in the 2020 TALF Program" and INT 20-08 "COVID-19 Premium Refunds, Limited-Time Exception, Rate Reductions and Policyholder Dividends" were not extended. On January 21, 2021, SAPWG voted to extend INT 20-03 "Troubled Debt Restructuring Due to COVID-19" and INT 20-07 "Troubled Debt Restructuring of Certain Debt Investments Due to COVID-19" to January 1, 2022 or 60 days after the national emergency regarding COVID-19 terminates.

Other Interpretations

SAPWG adopted the following non-COVID-19 related interpretations:

1) INT 20-10 "Reporting Nonconforming Credit Tenant Loans" provides a limited-time exception to allow a reporting entity to continue to report nonconforming Credit Tenant Loans on Schedule D-1 for 2020 year-end reporting which are filed with the NAIC SVO by February 15, 2021. Credit Tenant Loans reported on Schedule D-1 that have not received an SVO-assigned designation are required to be disclosed as if a permitted practice has been applied. The provisions of this interpretation can continue to be applied until October 1, 2021 until an SVO-assigned designation is received.

2) INT 20-11 "Extension of Ninety-Day Rule for the Impact of 2020 Hurricanes, California Wildfires and Iowa Windstorms" provides an optional exception to the normal 90-day admissibility rule for premiums receivable and other amounts due from policyholders related to policies affected by certain hurricanes, wildfires and windstorms. An impairment analysis on the underlying assets remains in effect. This interpretation will be nullified on March 1, 2021.

Related Parties

SAPWG previously exposed revisions to SSAP No. 25 "Affiliates and Other Related Parties" to incorporate new disclosures in an effort to assist regulators in understanding a reporting entity's complex business structure. The proposed new exposures focus on minority ownership information (i.e. greater than 10%) and significant relationships between minority owners and other U.S. domestic insurers. SAPWG revisions intend to clarify the identification of related parties in statutory accounting consistent with those parties identified under U.S. GAAP or SEC reporting requirements. SAPWG revisions intend to clarify the definition of a related party and specifies that a noncontrolling ownership interest greater than 10%, regardless of disclaimer of control, constitutes a related party classification under SSAP No. 25. SAPWG also proposed rejection of several U.S. GAAP standards regarding variable interest entities. Interested Parties proposed several edits to the exposed revisions in order to help clarify SAPWG's intent. SAPWG re-exposed revisions and incorporated Interested Parties edits in the re-exposure.

Preferred Stock

SAPWG adopted 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. Interested Parties provided certain edits to these revisions which SAPWG included. These revisions are effective as of January 1, 2021. Subsequent to adoption SAPWG adopted additional revisions to allow for early adoption for year-end 2020.

Rolling Short-Term and Cash Equivalent Investments

SAPWG previously adopted revisions to 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 related party or affiliated investments within the scope of SSAP No. 26R, SSAP No. 43R or otherwise reported as other invested assets. 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. The revisions also add a disclosure requirement for short-term investments that remain on the short-term investment schedule for longer than one consecutive year. As part of the Fall 2020 meeting and upon recommendation from Interested Parties, SAPWG added these same disclosure requirements for rolling cash equivalent investments with the clarification that the disclosure is satisfied through the use of a designated code in the investment schedules. These revisions were effective immediately.

Credit Tenant Loans

SAPWG clarified the statutory guidance for conforming and nonconforming credit tenant loans (CTLs) in accordance with SSAP No. 43R and SSAP No. 21 “Other Admitted Assets.” Conforming CTLs are in the scope of SSAP No. 43R and should continue to be reported on Schedule D-1. Nonconforming CTLs previously reported on Schedule D-1 may continue to be reported on that schedule and not Schedule BA if the reporting entity meets the conditions for the limited-time exception provided by INT 20-10 “Reporting Nonconforming Credit Tenant Loans”. SAPWG requested feedback from the NAIC Securities Valuation Office (SVO) if it would be appropriate to change the existing 5% residual risk threshold applied when evaluating whether a credit tenant loan is conforming.

Levelized and Persistency Commissions

SAPWG continued to discuss previously exposed revisions to SSAP No. 71 "Policy Acquisition Costs and Commissions" (SSAP No. 71) 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 commission and the insurer pays the third party levelized amounts. Interested Parties argued that SAPWG's revisions to SSAP No. 71 are more substantive than non-substantive in nature. SAPWG stated 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 and that such clarification is not considered a substantive change. SAPWG exposed further revisions to clarify the following key points:

1. Improve the description of funding agreements
2. Delete some of the previously exposed revisions to address Interested Parties concerns over unintended consequences previous revisions could have on traditional renewal commissions
3. Modify previously exposed revisions deleting language that required changes to the accounting for levelized and persistency commission arrangements to be treated as a correction of an error in accordance with SSAP No. 3 "Accounting Changes and Corrections of Errors"

Connect With Us

If you would like additional information, please contact:

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

