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NAIC Fall 2021 National Meeting Update

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NAIC Fall 2021 National Meeting Update

The National Association of Insurance Commissioners (NAIC) recently held its Fall 2021 National Meeting (Fall Meeting). The following summarizes certain activities of the Statutory Accounting Principles (E) Working Group (SAPWG) and the activities of other select working groups and task forces of the NAIC Financial Condition (E) Committee that took place during the Fall Meeting and on various WebEx Meetings since the conclusion of the Summer 2021 National Meeting (Summer Meeting) through January 27, 2022.

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

Credit Tenant Loans

SAPWG previously clarified the statutory guidance for conforming and nonconforming credit tenant loans (CTLs) in accordance with SSAP No. 43R “Loaned Backed and Structured Securities” 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 could continue to be reported on that schedule if the reporting entity meets the conditions for the limited-time exception provided by INT 20-10 “Reporting Nonconforming Credit Tenant Loans” (INT 20-10). Since this clarification, the Valuation of Securities (E) Task Force adopted revisions to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) clarifying that the definition of CTLs, which defines CTLs as mortgage loans, is specific to mortgage loans within the scope of SSAP No. 37 “Mortgage Loans” (SSAP No. 37). Reporting entities with mortgage loans identified as CTLs and scoped into SSAP No. 37 can file with the Securities Valuation Office to determine if such a security can be reported on Schedule D-1 of the Annual Statement instead of Schedule B. SAPWG formally nullified INT 20-10 with disposal of any remaining credit tenant loan accounting and reporting agenda items without revisions. SAPWG also adopted modifications to SSAP No. 43R to include SVO approved CTLs within the scope of SSAP No. 43R. Any CTLs not approved by the Securities Valuation Office remain within scope of SSAP No. 37 and are reported on Schedule B.

Residual Tranches

SAPWG adopted revisions to SSAP No. 43R regarding non-rated residual tranches of securitized financial assets. Current practice has evolved in industry whereby reporting entities have commonly assigned an NAIC rating of 5GI to these non-rated residual tranches for reporting on Schedule D-1. These revisions clarify that non-rated residual tranches do not meet the requirements of a 5GI NAIC designation and should be reported on Schedule BA at the lower of cost or fair value instead of Schedule D-1. These tranches will remain in scope of SSAP No. 43R with revisions to clarify reporting requirements. Revisions are effective December 31, 2022 with early adoption permitted. Interested Parties agreed with these changes. Additionally, the Blanks (E) Working Group (Blanks) has exposed revisions to the Annual Statement to expand Schedule BA reporting lines to capture residual tranches based on underlying characteristics of fixed-income, common stock, real estate, mortgage loans and other.

Levelized and Persistency Commissions

At the NAIC Spring 2021 National Meeting, SAPWG adopted nonsubstantive 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. 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. While certain insurers may have a significant impact to their surplus and risk-based capital, SAPWG reaffirmed the revisions are non-substantive as they are a clarification of existing guidance. Revisions address 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 from being treated as a correction of an error to a change in accounting principle in accordance with SSAP No. 3 “Accounting Changes and Corrections of Errors”

These revisions are effective for December 31, 2021. A concurrent exposure was also adopted by Blanks to update the General Interrogatories to assist in identifying these types of arrangements.

At the Fall Meeting, SAPWG adopted *Issue Paper 165: Levelized Commissions* for purposes of providing historical background regarding discussions during the development of authoritative guidance.

Salvage - Legal Recoveries

SAPWG adopted nonsubstantive revisions to SSAP No. 55 “Unpaid Claims, Losses and Loss Adjustment Expenses” to clarify that salvage and subrogation recoveries should be recorded as a reduction to losses or loss adjusting expense reserves (LAE) depending upon the nature of the costs being recovered. Amounts received for salvage and subrogation should be recorded as a reduction to either paid losses or paid loss adjustment expenses in the financial statements. Certain disclosures in SSAP No. 55 were also modified to reflect the reporting of estimated salvaged and subrogation and their impact on unpaid claims, losses or associated LAE. Interested Parties agreed with these changes. Revisions are effective immediately.

Policy Statement Terminology Change

SAPWG received a referral from the Financial Condition (E) Committee to clarify the terms substantive and nonsubstantive in the NAIC Policy Statement on Maintenance of Statutory Accounting Principles. The Financial Condition (E) Committee suggested changing the term substantive to “New SAP Concept” and nonsubstantive to “SAP Clarification”. At the Fall Meeting, SAPWG adopted these changes on a going forward basis only. Previously adopted SSAPs, issue papers and agenda items will retain the old terminology as revising all previously issued literature for a terminology change would not be feasible. Interested Parties recommended eliminating the use of all terms to avoid confusion and instead evaluate the effective date of revisions to the statutory accounting framework based upon the complexity of each revision. SAPWG stated that the change to the new terminology is final but Interested Parties alternative approach could potentially be explored in a future agenda item.

Hurricane Ida

SAPWG adopted issue paper INT 21-02T “Hurricane Ida.” This interpretation proposes an optional extension of the 90-day non-admittance rule in SSAP No. 6 “Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due from Agents and Brokers” for policies impacted by Hurricane Ida. INT 21-02T will automatically be nullified on January 24, 2022.

FHLB Disclosure

SAPWG made a referral to Blanks to include a supplemental data capture footnote for FHLB borrowings reported in Exhibit 7 as a deposit-type contract. This did not result in any exposed or adopted revisions to the statutory accounting framework.

Preferred Stock

SAPWG adopted nonsubstantive revisions to SSAP No. 32 R “Preferred Stock” removing references indicating that historical cost is an acceptable valuation method for preferred stock. Revisions align with the recent release of Issue Paper No. 164 “Preferred Stock.” Interested Parties agreed with these revisions. Revisions are effective immediately.

Variable Annuities

SAPWG adopted nonsubstantive revisions to SSAP No. 108 “Derivatives Hedging Variable Annuity Guarantees” to align with VM-21 “Requirements for Principle-Based Reserves for Variable Annuities (VM-21).” Revisions remove the reference to the standard scenario and replacing with references to the conditional tail expectation and VM 21’s guidance. Interested Parties proposed minor changes to these revisions. These changes are effective December 31, 2021.

Related Party Reporting

SAPWG exposed nonsubstantive revisions to SSAP No. 43R and SSAP No. 25 “Affiliates and Other Related Parties.” These revisions propose new reporting disclosure requirements for investments acquired from a related party specifying the role of the related party in the acquired investment. Discussions on this matter remains ongoing.

Schedule D-6-1 Supplemental Reporting

SAPWG drafted a proposal for additional electronic data to be filed as a supplement to Schedule D-6-1 of the Annual Statement which captures investments and related values within scope of SSAP No. 97 “Investments in Subsidiary, Controlled and Affiliated Entities (SCA).” This electronic data will assist regulators in ensuring that NAIC SCA required filings are being submitted by reporting entities for proper confirmation of SCA reporting values and identify situations where the NAIC approved value varies significantly from the value reported on Schedule D-6-1. This proposal does not result in statutory accounting revisions. This proposal has been forwarded to Blanks.

Financial Modeling of Mortgage-Backed Securities

SAPWG exposed revisions to SSAP No. 43R as it pertains to changes adopted by the Valuation of Securities (E) Task Force (VOS) regarding the financial modeling of securities in the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual). Exposed revisions will either modify SSAP No. 43R to reflect any updates to the P&P Manual adopted by VOS or remove any financial modeling guidance from SSAP No. 43R and replace it with a reference to the P&P Manual. Discussions remain ongoing.

Cryptocurrency

SAPWG submitted a proposal to Blanks regarding investments in cryptocurrency. The proposal requests changes to the general interrogatories to clarify the use or acceptance of cryptocurrency by a reporting entity. Examples of proposed inquiries include where within the Annual Statement cryptocurrencies have been reported if held by a reporting entity and if cryptocurrencies have been accepted for the payment of premiums. Discussions remain ongoing.

Leasehold Improvements

SAPWG exposed revisions to SSAP No. 19 “Furniture, Fixtures, Equipment and Leasehold Improvements” and SSAP No. 73 “Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities” to clarify that any remaining leasehold improvements will be immediately expensed when a lease terminates. Discussions remain ongoing.

U.S. GAAP Accounting Standard Updates

SAPWG exposed several items related to the applicability or non-applicability of the following U.S. GAAP Accounting Standard Updates to the NAIC statutory accounting framework:

1. FASB ASU 2017-12 Derivatives and Hedging (Topic 815): “Targeted Improvements to Accounting for Hedging Activities”
2. FASB ASU 2021-03 Intangibles-Goodwill and Other (Topic 350): “Accounting Alternative for Evaluating Triggering Events”
3. FASB ASU 2021-04 Earnings Per Share (Topic 260), Debt-Modifications and Extinguishments (Subtopic 470-50), Compensation-Stock Compensation (Topic 718), and Derivatives and Hedging-Contracts in Entity’s Own Equity (Subtopic 815-40): “Issuer’s Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options”
4. FASB ASU 2021-05 Leases (Topic 842): “Lessors-Certain Leases with Variable Lease Payments”
5. FASB ASU 2021-06 Presentation of Financial Statements (Topic 205), Financial Services-Depository and Lending (Topic 942), and Financial Services-Investment Companies (Topic 946): “Amendments to SEC Paragraphs Pursuant to SEC Final Rule Releases No. 33-10786, Amendments to Financial Disclosures about Acquired and Disposed Businesses, and No. 33-10835, Update of Statistical Disclosures for Bank and Savings and Loan Registrants”

Formal adoption, adoption with modification or rejection of the above will be finalized at future meetings.

Life Reinsurance

SAPWG adopted nonsubstantive revisions to SSAP No. 61R "Life and Health Reinsurance" to clarify disclosure elements related to reinsurance risk transfer for short duration insurance contracts. Some of the clarifications exposed include clarification that required disclosures shall be included in the accompanying supplemental schedules to the annual audit report, certain stop loss or excess of loss reinsurance agreements do not require disclosure and if disclosures are not applicable then a clarifying statement in the notes to the financial statements can be made. These revisions are effective December 31, 2021.

Proposed Bond Definition

SAPWG continued deliberation of its proposed definition of a bond captured within the scope of either SSAP No. 26R Bonds or SSAP No. 43R and reported on Schedule D-1 of the Annual Statement. Discussions involved two documents that have been developed for exposure. These documents detail improved transparency and granularity reporting in the Annual Statement including a new sub-schedule D-1 and attempts to clarify the concept of "substantive credit enhancement" for purposes of the project. Discussions remain ongoing.

Troubled Debt Restructuring Due to COVID-19

SAPWG stated that it will allow INT 20-03 "Troubled Debt Restructuring Due to COVID-19" and INT 20-07 "Troubled Debt Restructuring of Certain Debt Instruments Due to COVID- 19" to automatically expire on January 2, 2022.

Other Activities

In addition to SAPWG, several other working groups and task forces of the Financial Condition (E) Committee met during the Fall Meeting and on various WebEx Meetings since the conclusion of the Spring Meeting. The following represents selected updates concerning the activities of some of these working groups and task forces.

Life Risk-Based Capital (E) Working Group

The Life Risk-Based Capital (E) Working Group (Life RBC Working Group) discussed guidance drafted to assist both state examiners and regulators on how to interpret the effect of the change in RBC factors adopted at the Summer Meeting in the RBC calculation.

The Life RBC Working Group also heard a presentation by the American Academy of Actuaries regarding the C-2 Mortality Factor in the RBC calculation. The recommended factors include key changes such as expanding factors into additional categories to reflect the assumed current mortality rate risk exposure period over the remaining lifetime of an inforce block of business, adding two catastrophe components for terrorism and risk of an unknown event and combining the current middle two sized categories into one category.

Health Risk-Based Capital (E) Working Group

The Health Risk-Based Capital (E) Working Group (Health RBC Working Group) exposed revisions to incorporate benchmarking guidelines for the Health RBC Working Group to follow in updating the investment income adjustment in the underwriting risk factors for Comprehensive Medical, Medicare Supplement and Dental & Vision.

Property and Casualty Risk-Based Capital (E) Working Group

The Property and Casualty Risk-Based Capital (E) Working Group (Property and Casualty RBC Working Group) discussed the need to make changes to the RBC calculation for reporting entities that are in runoff. Due to the diverse characteristics of these types of entities, it was determined that being able to summarize into one RBC formula would be too difficult. It was concluded that the best course of action would be to monitor runoff entities through state analysis and exam team functions.

The Property and Casualty RBC Working Group also discussed the removal of the embedded 2% operational risk contained in the R3 credit risk component.

Valuation of Securities (E) Task Force

The Valuation of Securities (E) Task Force (VOS) adopted changes to the P&P Manual regarding non-rated residual tranches of securitized financial assets. VOS clarified that the NAIC 5GI Designation process should not be applicable to these types of investments. Effective December 31, 2021, these types of securities can continue to be reported on Schedule D-1 with an NAIC Designation of 6* and not 5GI. Effective December 31, 2022, all non-rated residual tranches of securities financial assets must be reported on Schedule BA with no NAIC Designation. A reporting entity looking for an NAIC Designation on any types of these securities will need to submit to the Securities Valuation Office (SVO) for review.

VOS exposed a proposal to Part Three of the P&P manual to provide guidance related to the assignment of NAIC Designations to investments reported on Schedule BA with underlying bond or fixed income security characteristics. This proposed amendment would potentially make various types of assets eligible for an NAIC Designation which currently are not. Each asset would need to be individually assessed by the SVO for bond or fixed income characteristics.

VOS exposed a proposal to allow the SVO to assign NAIC Designations to unrated subsidiaries of Working Capital Finance Investments with unguaranteed and unrated obligors if supported by an obligor's Parent who is rated by an NAIC Credit Rating Provider (CRP).

VOS exposed a proposal to clarify the definition of both non-payment risk and principal protected securities.

VOS and the SVO discussed concerns surrounding the NAIC's extensive reliance on rating agency ratings to assess investment risk for regulatory purposes. The SVO expressed concerns over the lack of oversight for the basis of ratings provided by CRPs. The SVO also does not monitor CRP ratings or their methodologies for consistency and applicability and the SVO has not been authorized to determine how and when a CRP rating should be used for NAIC purposes. This raises concerns regarding how the utilization of these ratings impacts the NAIC solvency framework. The SVO suggested several courses of action to address these concerns as follows:

1. Require at least two (or more) CRP ratings for every security and use the lowest rating to determine the NAIC Designation. If a security has only one rating, require it to be reviewed by the SVO to determine whether the SVO deems the rating reasonable and, if not, determine whether a SVO analysis would be appropriate.

2. Conduct an in-depth study of the NAIC's use of CRP ratings and SVO-assigned NAIC Designations as to their consistency and comparability for regulatory purposes, specifically the determination of Risk Based Capital factors.

3. Put the CRP process under a contractual relationship by offering the opportunity to respond to a request for qualifications. Under this process, the NAIC would enter into a contract with only those CRPs that adequately meet certain criteria.

4. VOS can instruct the SVO to remove any rating agency from the CRP list at any time.

5. A combination of any of the above

Discussions of this matter remain ongoing.

Risk Retention Group (E) Task Force

The Risk Retention Group (E) Task Force (RRG Task Force) met to discuss a RRG Preliminary Memorandum that can be used as a guide by state regulators for the licensing of risk retention groups. The role of the RRG Preliminary Memorandum is for both internal communication within the domestic state and for external communication with other states in which the risk retention group is authorized to register and has submitted a registration form. The RRG Preliminary Memorandum is not a required document.

The RRG Task Force also discussed the applicability of the Insurance Holding Company System Model Act (#440) and the Insurance Holding Company System Regulation with Reporting Forms and Instructions (#450) as an accreditation standard for risk retention groups. Discussions remain ongoing.

Connect With Us

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