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NAIC Spring 2021 National Meeting Update

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The National Association of Insurance Commissioners (NAIC) recently held its Spring 2021 National Meeting (Spring Meeting). The following summarizes certain activities of the Statutory Accounting Principles (E) Working Group (SAPWG) and the activities of other select working groups and committees of the NAIC that took place during the Spring Meeting and on various conference calls since the conclusion of the Fall 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 2020-06 Debt - Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging - Contracts in Entity's Own Equity (Subtopic 815-40) "Accounting for Convertible Instruments and Contracts in Entity's Own Equity"
2. FASB ASU 2020-07 Not-for-Profit Entities (Topic 958) "Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets"

Bonds

SAPWG adopted non-substantive revisions to SSAP No. 26R "Bonds" (SSAP No. 26R). These revisions expand existing SSAP No. 26R disclosure requirements for called bonds to also include bonds terminated early through a tender offer. These revisions are effective immediately.

Preferred Stock Warrants

SAPWG adopted non-substantive revisions to SSAP No. 32R "Preferred Stock" (SSAP No. 32R) and SSAP No. 86 "Derivatives" clarifying that publicly traded preferred stock warrants are scoped into SSAP No. 32R and reported at fair value. These revisions are effective immediately.

Structured Securities

SAPWG adopted non-substantive revisions to SSAP No. 43R "Loan-backed and Structured Securities" (SSAP No. 43R) to reflect recent changes to the Freddie Mac Structured Agency Credit Risk (STACR) and Fannie Mae Connecticut Avenue Securities (CAS) programs which both structure offerings issued by a trust that is treated as a Real Estate Mortgage Investment Conduit (REMIC). These revisions scope STACR and CAS REMIC's into SSAP No. 43R and align the financial modeling of mortgage-referenced securities to the requirements within the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual). These revisions are effective immediately.

Perpetual Bonds

SAPWG adopted non-substantive revisions to SSAP No. 26R specifying perpetual bonds would be subject to amortized cost treatment utilizing the yield to worst method when a call date is known.

Additionally, fair value would be required for any perpetual bonds that do not have a call date. These revisions are effective immediately.

Separate Account Products

SAPWG previously solicited feedback regarding the degree of reporting transparency needed for separate account products specifically pertaining to pension risk transfer (PRT) transactions and registered indexed linked annuity (RILA) products. SAPWG voted to sponsor a Blanks (E) Working Group (Blanks) proposal recommending modifying the instructions to the General Interrogatories to require a distinct disaggregated product identifier be used for each product represented. A related Blanks proposal recommends additional product identifiers in the Separate Account General Interrogatories to specifically segregate PRT and RILA transactions. No changes to the Accounting Practices and Procedures Manual (AP&P Manual) was recommended.

Prescribed Accounting Practices

SAPWG adopted non-substantive revisions to the Preamble Implementation Questions and Answers in the AP&P Manual. These revisions clarify the prescribed accounting practices of the domiciliary state should be reflected in the company's financial statements filed with the NAIC which are subject to independent audit. It was noted that the provisions of the AP&P Manual are not intended to preempt states' legislative or regulatory authority and therefore, revisions also clarify that if a non-domiciliary state in which the company is licensed requires or allows a practice that is different from NAIC SAP or the domiciliary state, this provision is also considered a prescribed practice. These revisions are effective immediately.

Fixed Indexed Products

SAPWG re-exposed a substantive agenda item focused on establishing new accounting guidance for derivatives that effectively hedge the growth in interest credited for fixed indexed products, including fixed indexed annuities and indexed universal life products. This agenda item was re-exposed to allow more time for Interested Parties to develop a proposal. Discussions remain ongoing.

Related Parties

SAPWG adopted non-substantive revisions to SSAP No. 25 "Affiliates and Other Related Parties" to clarify identification of related parties and affiliates and 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 also intend to clarify the definition of a related party and specifies that a noncontrolling ownership interest greater than 10%, regardless of disclaimer of control or affiliation, 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 agreed with these revisions. These revisions are effective immediately.

Paycheck Protection Program Loans

SAPWG addressed recent inquiries received by NAIC staff regarding the reporting and extinguishment of Paycheck Protection Program (PPP) loans. SAPWG confirmed that the authoritative guidance for accounting for these types of loans is within SSAP No. 15 "Debt and Holding Company Obligations"

(SSAP No. 15). SSAP No. 15, paragraph 11 provides that debt is recognized until legally extinguished. Once legally extinguished, debt forgiveness is reported as a capital gain.

Levelized and Persistency Commissions

SAPWG adopted non-substantive 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 clarification of existing guidance. Revisions 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 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 submitted to Blanks to update the General Interrogatories to assist in identifying these types of arrangements.

Other Activities

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

Reinsurance (E) Task Force

The Reinsurance (E) Task Force (RTF) received a status report on the states' implementation of the 2019 revisions to the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786) (the Credit for Reinsurance Models). The Credit for Reinsurance Models were 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 with the United Kingdom (known as the Covered Agreements). 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. As of February 2021, eighteen and five jurisdictions have adopted the proposed changes to the Credit for Reinsurance Law Model (#785) and Credit for Reinsurance Model Regulation (#786), respectively. The revisions to the Credit for Reinsurance Models must be adopted by the states prior to September 1, 2022 which is when the revisions become an accreditation standard. Additionally, September 1, 2022 is the date that the Federal Insurance Office must complete its federal preemption reviews under the Covered Agreements.

Life Risk-Based Capital (E) Working Group

The Life Risk-Based Capital (E) Working Group (Life RBC Working Group) continued deliberations regarding the update to the risk-based capital (RBC) charges for real estate in the Life RBC calculation. The current RBC factor for real estate has been in place since the early 1990's. The current proposal suggests an update to 11% from 15% for the RBC C-1 base factor for Schedule A real estate (including investment, foreclosed and held for sale real estate). The same proposal also suggests an update to 12% for the factor related to Schedule BA real estate (which includes real estate held in joint ventures, limited liability companies, or similar structures). This is a decrease from a 23% risk factor for Schedule BA investments as updated industry data provides evidence that the current factor for Schedule BA investments is overly conservative. Updating the RBC charges for unrealized gains and losses and encumbrances on real estate is also suggested. Interested Parties commented that they are supportive of updating these factors but expressed that they believe there are four areas of conceptual concerns that currently exist with the proposal to update the real estate factors in the Life RBC calculation which include market value vs. statutory accounting issues, determination of market value, statistical safety level, and assuming the same risk profile for all types of real estate. Discussions remain ongoing.

Health Risk-Based Capital (E) Working Group

The Health Risk-Based Capital (E) Working Group (Health RBC Working Group) discussed the incorporation of investment income into the underwriting risk component of the health risk-based capital formula. Interested Parties recommended a range of potential investment return rates (ranging from 0.5% to 2%) for the Health RBC Working Group to consider. The Health RBC Working Group exposed for comment the utilization of either a 0.5% or 1.0% investment return adjustment.

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) adopted a proposal to clarify the instructions to the PR027 Interrogatories regarding how insurers with no gross exposure to hurricane or earthquake should complete these Interrogatories.

The Property and Casualty RBC Working Group also adopted a proposal to remove the embedded 3% operational risk component contained in the reinsurance contingent credit risk factor of Rcat as this is now addressed as a separate stand-alone capital add-on in the RBC calculation.

Valuation of Securities (E) Task Force

The Valuation of Securities (E) Task Force (VOS) adopted a proposal to remove the Modified Filing Exempt (MFE) instructions for structured securities from the P&P Manual. The Securities Valuation Office (SVO) has determined that the MFE process is no longer necessary as it is driven by price breakpoints and that a move towards a single NAIC designation process for structured securities is more appropriate. Price breakpoints will still be provided for legacy 2013 structured securities and prior, however, a move towards a single designation is required for all other structured securities. VOS stated that a move towards a single designation process for structured securities will standardize reporting, alleviate market disruption, permit a clearer credit risk assessment and alleviate any previously noted pricing issues. Interested Parties agreed with adoption of this proposal. This proposal is effective for year end 2021 reporting.

VOS continued discussion regarding a proposal to update the P&P Manual to require the filing of private rate letter rationale reports with the SVO for privately rated securities. Concerns were previously expressed that NAIC relied too heavily on credit rating provider (CRP) ratings to assess investment risk and for regulatory purposes. The proposal requires more oversight by the SVO for privately rated securities in order for the security to receive an NAIC designation. Proposed information to be filed with the SVO includes the private rating letter, a related private rating letter rationale report providing more in-depth analysis of the transaction, the methodology used to arrive at the private rating, and discussion of the transaction's credit, legal and operational risks. The proposal still needs to be updated for confidentiality and transition period provisions. Discussion of this proposal remains ongoing.

VOS received and exposed a proposal to clarify in the P&P Manual a fund's use of derivatives when considering an NAIC designation for that fund. Currently, the P&P Manual grants the SVO discretion when determining whether a fund's use of derivatives is consistent with a fixed income security in that it will generate predictable and periodic cash flows when assigning an NAIC designation. This discretion can lead to a possible lack of predictability when a fund is submitted to the SVO for assessment as to whether a fund should be assigned an NAIC designation and obtain applicable risk-based capital charges. The proposal recommends two bright-line test for funds in determining an NAIC designation. The first test for funds on the SVO-Identified Bond Exchange Traded Fund (ETF) List, the SVO-Identified Preferred Stock ETF List and the NAIC List of Schedule BA Non-Registered Private Funds with Underlying Assets Having Characteristics of Bonds or Preferred Stock, requires the gross notional amount of derivatives which pose no future down side risk to not exceed 10% of the net asset value in the fund except for derivatives that are used to create more bond like cash flows or are common for maintenance of bond portfolios (i.e. certain currency and interest rate hedges, certain futures or forwards on fixed income or preferred stock held by the fund, reverse repurchase agreements associated with fixed income or preferred stock held by the fund and non-margin borrowing for purposes of other than investment). The second test is for funds on the NAIC Fixed Income-Like SEC Registered Funds List that are reported on schedule D, Part 2, Section 2 and within the scope of SSAP No. 30R "Unaffiliated Common Stock" are permitted a larger derivative threshold of 20% of the net asset value of the fund with no exempt derivatives. Both tests also recommend incorporating an assessment of counterparty risk into the credit risk assessment. Criteria for assessment of a fund's management is also being recommended. Discussions remain ongoing.

Group Capital Calculation (E) Working Group

The Group Capital Calculation (E) Working Group (GCC) continued its discussion regarding the group capital calculation and related instructions which was adopted in 2020 into the NAIC's Model Insurance Holding Company System Regulatory Act (Model #440) and Model Insurance Holding Company System Model Regulation (Model #450). Insurance holding company groups will be expected to file a group capital calculation with their lead state regulators. The lead state commissioner can exempt holding company groups meeting specific criteria from having to perform the filing.

The GCC discussed additional data collection activities and stress testing needs which will continue to occur throughout 2021 to ensure that the calculation works as intended. The GCC and related reporting provides more transparency to insurance regulators regarding an insurance holding company group and makes risks more identifiable and more easily quantified. In this regard, the calculation assists regulators in understanding the financial condition of non-insurance entities within an insurance holding company group as a whole, how capital is distributed across an entire insurance holding company group, and whether and to what degree insurance companies may be supporting the operations of non-insurance entities within the insurance holding company group, potentially adversely impacting the insurance company's financial condition or policyholders. The goal of the GCC is to have the group capital calculation fully in place by year-end 2022. Field testing, data collection and further discussion is ongoing.

Connect With Us

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