

NAIC Summer 2021 National Meeting Update



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NAIC Summer 2021 National Meeting Update

The National Association of Insurance Commissioners (NAIC) recently held its Summer 2021 National Meeting (Summer 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 Summer Meeting and on various WebEx Meetings since the conclusion of the Spring 2021 National Meeting (Spring Meeting) up to September 10, 2021.

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

Proposed Bond Definition

SAPWG continued deliberation of its proposed definition of a bond captured within the scope of either SSAP No. 26R or SSAP No. 43R and reported on Schedule D-1 of the Annual Statement. Discussions involved SAPWG's May 20, 2021 exposure of concepts surrounding a principle-based bond definition created by a designated group of industry representatives and regulators. SAPWG and Interested Parties heard comments surrounding the proposed bond definition and considered the future development of this project regarding its viability for integrating the proposed bond definition into the statutory accounting general framework and ultimate development of an issue paper and SSAP revisions.

The proposal defines a bond as any security representing a creditor relationship, whereby there is a fixed schedule for one or more future payments, and which qualifies as either an issuer credit obligation or an asset backed security.

Regulators and industry continue to try to clarify this definition further by drafting guidance as to what constitutes an issuer credit obligation and an asset backed security including drafting examples of securities both within and not within scope of the definition. Interested Parties further commented during the meeting that such examples are important in applying the proposed bond definition as a way of preventing perceived regulatory abuses such as ensuring that legal form bonds with in-substance equity like characteristics are not inappropriately reported as bonds. Although some comment letters received expressed concerns regarding the proposed bond definition, Interested Parties were generally supportive but noted that the proposed bond definition needs greater clarity regarding certain investment products, requires additional accounting and reporting guidance for those securities that do not meet the proposed bond definition but are recognized as bonds in the financial markets, and comes at a cost to industry in order to comply with adoption.

SAPWG directed NAIC staff to move forward with continued deliberation of this matter including development of an issue paper and related SSAP revisions. Until revised guidance is issued, reporting entities can continue to report securities within the scope of SSAP No. 26R and SSAP No. 43R as they have been. If reporting equity tranches of securitizations on Schedule D, unrated equity tranches should be self-reported as NAIC 6 with a measurement method of lower of cost or fair value. If a reporting entity prefers, it can report the equity tranches on Schedule BA as an "Any Other Class of Asset" at fair value. Tranches from securitization structures are considered in scope of SSAP No. 43R, and therefore qualify as admitted assets. It is anticipated that these equity tranches will not be eligible to be reported as bonds on Schedule D-1 under the proposed bond definition, and reporting entities that have previously reported these types of securities as bonds should consider reporting them on Schedule BA. Discussions remain ongoing.



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 (SVO) to determine if such a security can be reported on Schedule D-1 of the Annual Statement instead of Schedule B. NAIC staff has recommended that INT 20-10 be nullified with disposal of any remaining credit tenant loan accounting and reporting agenda items. NAIC staff has also recommended modification of SSAP No. 43R to include SVO approved CTLs within the scope of SSAP No. 43R. Any CTLs not approved by the SVO remain within scope of SSAP No. 37 and on Schedule B. Discussions remain ongoing.

Residual Tranches

SAPWG exposed 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. SAPWG also recommended sponsoring a blanks proposal to capture a new reporting line specific for these investments on Schedule BA and sending a referral to the Valuation of Securities (E) Task Force to identify that the NAIC 5GI designation process should not be applicable to these types of investments. Discussions remain ongoing.

Valuation of Foreign Insurance SCAs

SAPWG adopted nonsubstantive revisions to SSAP No. 48 “Joint Ventures, Partnerships and Limited Liability Companies” and SSAP No. 97 “Investments in Subsidiary, Controlled and Affiliated Entities” specific to investments in foreign insurance Subsidiary, Controlled and Affiliated (SCA) entities. These revisions clarify that an investment in a foreign insurance SCA cannot go below zero except in certain circumstances where the foreign insurance SCA provides services to or holds assets on behalf of the U.S. reporting entity. If such transactions are occurring, then a negative equity valuation in a foreign insurance SCA can result, however, it was noted that such circumstances are uncommon. The revisions also clarify that the equity method valuation referenced in SSAP No. 97 can result in a negative equity valuation for SSAP No. 48 entities. Interested Parties agreed with these revisions.

Clarification of Effective Call Price

SAPWG adopted nonsubstantive revisions to SSAP No. 32R “Preferred Stock” to clarify that when applying the valuation ceiling in SSAP No. 32R to preferred stock that the limitation should only apply when the call is currently exercisable by the issuer or the issuer has provided notice that the instrument will be redeemed or called. Interested Parties supported these revisions.



Levelized and Persistency Commissions

At the Spring 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 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 adopted by Blanks to update the General Interrogatories to assist in identifying these types of arrangements.

At the Summer Meeting, SAPWG exposed *Issue Paper 16x: Levelized Commission* for purposes of providing historical background regarding discussions during the development of authoritative guidance.

Salvage - Legal Recoveries


SAPWG exposed nonsubstantive revisions to SSAP No. 55 “Unpaid Claims, Losses and Loss Adjustment Expenses” to clarify that salvage and subrogation recoveries related to legal expenses should be recorded as a reduction to paid loss adjustment expenses in the financial statements, depending on the nature of the costs being recovered. It was also recommended that certain disclosures in paragraph 17h of SSAP No. 55 be modified and conforming revisions to the annual statement instructions should also be made. Discussions remain ongoing.

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”. These items were exposed for further comment. Discussion remains ongoing.

Hurricane Ida

SAPWG exposed 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.



Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

SAPWG adopted nonsubstantive revisions to SSAP No. 103R “Transfers and Servicing of Financial Assets and Extinguishments of Liabilities” regarding disclosures of a transferor’s continuing involvement in assets transferred as part of a securitization, asset backed financing or similar transfer transaction. These disclosures include the amount recognized (allocated fair value) by the insurer for the acquired participation in the transferred assets and the percentage of beneficial interests from the insurer’s transferred assets acquired by affiliated entities. A data-capture template was also adopted for existing disclosure elements in the Annual Statement.

Cryptocurrency

SAPWG adopted INT 21-01 “Accounting for Cryptocurrencies” clarifying that directly held cryptocurrencies do not meet the definition of cash under SSAP No. 2R “nor meet the definition of an admitted asset under SSAP No. 4.”

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 adopted additional product identifiers in the Separate Account General Interrogatories to specifically segregate PRT and RILA transactions. This adoption did not result in revisions to the Accounting Practices and Procedures Manual (AP&P Manual).

Reference Rate Reform

SAPWG adopted INT 20-01 “ASU 2020-04 – Reference Rate Reform” providing optional guidance, allowing for the continuation of certain existing hedge relationships and does not require hedge de-designation for derivative instruments affected by changes to interest rates due to reference rate reform. This interpretation is meant to capture all hedging transaction types.



Other Activities

In addition to SAPWG, several other working groups and task forces of the Financial Condition (E) Committee met during the Summer 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.

Reinsurance (E) Task Force

The Reinsurance (E) Task Force (RTF) continued discussion of 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. During the meeting the RTF adopted non-substantive revisions to the process for evaluating Qualified and Reciprocal Jurisdictions and reviewed and received comments from Interested Parties regarding the process for passporting Reciprocal and Certified Jurisdiction Reinsurers.

It was disclosed in the meeting that forty-two and fifteen jurisdictions have adopted the proposed changes to the Credit for Reinsurance Law Model (#785) and Credit for Reinsurance Model Regulation (#786), respectively. The RTF communicated the NAIC's recommended revised guidelines for adoption of the Credit for Reinsurance Models. The RTF strongly recommended that all states adopt the proposed changes to the Credit for Reinsurance Models as soon as possible and no later than July 1, 2022 in order to give file time to complete the federal preemption review by the Federal Insurance Office. The final deadline for adoption is September 1, 2022.

The RTF also discussed adoption of the Term and Universal Life Insurance Reserve Financing Model Regulation (#787) (Regulation #787 also referred to as the XXX/AXX Model Regulation). The purpose and intent of this regulation is to establish uniform, national standards governing reserve financing arrangements pertaining to life insurance policies containing guaranteed nonlevel gross premiums, guaranteed nonlevel benefits and universal life insurance policies with secondary guarantees in order to ensure that with respect to these financing arrangements, funds consisting of primary and other security, as defined in Regulation #787 are held by ceding insurers. Regulation #787 becomes an accreditation standard on September 1, 2022 with an enforcement date beginning on January 1, 2023. Regulation #787 is not subject to any federal preemption. It was discussed during the meeting that five jurisdictions have adopted Regulation #787.



Life Risk-Based Capital (E) Working Group

The Life Risk-Based Capital (E) Working Group (Life RBC Working Group) adopted significant changes to the life risk-based capital formula. The changes adopted are as follows:

1. The current RBC factor for real estate which has been in place since the early 1990's was updated 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) and from 23% to 13% for real estate reported on Schedule BA.
2. The Life RBC Working Group finalized and adopted its new bond factors for its 20 NAIC designation categories in the life RBC formula. These factors were updated based upon factors modeled by both the American Council of Life Insurers (ACLI) and Moody's Analytics as opposed to those factors originally recommended by the American Academy of Actuaries.
3. The Life RBC Working Group adopted a proposal to implement a separate charge for longevity risk for certain products within scope such as single premium immediate annuities and other payout annuities in pay status, deferred income annuities that will enter annuity pay status in the future, structured settlements for annuitants with any life contingent benefits and group annuities.

The above changes are effective for year-end 2021.

Health Risk-Based Capital (E) Working Group

The Health Risk-Based Capital (E) Working Group (Health RBC Working Group) adopted the 20 bond rating factor categories for the health risk-based capital formula. The bond factors adopted related to the American Academy of Actuaries proposed five-year time horizon bond factors deliberated in previous Health RBC Working Group meetings.

The Health RBC Working Group also adopted the incorporation of investment income into the underwriting risk component of the health risk-based capital formula using a 0.5% investment return adjustment.

The above changes are effective for year-end 2021.

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 the 20 bond rating factor categories for the property and casualty risk-based capital formula suggested by the American Academy of Actuaries. These changes include the bond size factor/portfolio adjustment as well as revised factors for off-balance sheet collateral, Schedule DL and asset concentration pages.

The Property and Casualty RBC Working Group also adopted instructional changes to PR012, Credit Risk for Receivables and its annual update of the Line 1 factors for PR017 (Underwriting Risk-Reserves) and PR018 (Underwriting Risk – Net Written).

The above changes are effective for year-end 2021.



Valuation of Securities (E) Task Force

The Valuation of Securities (E) Task Force (VOS) continued discussion regarding 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 previous proposal recommended 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. 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. After receiving comments from Interested Parties, VOS revised its proposal from the two bright-line test approach to adopting a single test approach. Under the single test approach, a fund's exposure to certain derivatives, short sale borrowings and reverse repurchase agreements or similar financing is limited to 10% of the fund's net assets in normal market conditions. Certain currency and interest rate hedging derivatives are exempt from the 10% calculation.

Additionally, VOS adopted revisions to the P&P Manual to amend the Working Capital Finance Investments (WCFI) section of the P&P Manual to remove any inconsistencies with SSAP No. 105R "Working Capital Finance Investments."

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 moving toward trial implementation and adopted changes to the stress scenario instructions. Trial implementations are expected to occur 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. Discussion also took place regarding certain decisions made by the GCC regarding the group capital calculation that may also be considered for the risk-based capital calculation. The goal of the GCC is to have the group capital calculation fully in place by year-end 2022. Discussion is 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.

Risk Retention Group (E) Task Force

The Risk Retention Group (E) Task Force (RRG Task Force) met at the Summer Meeting to discuss its recent 2021 risk retention group survey which was completed in order to gather information on regulatory issues surrounding non-domiciliary and domiciliary regulation of risk retention groups.

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. The RRG Task Force cited the inclusion of the group capital calculation accreditation standard and its applicability to risk retention groups. The RRG Task Force plans to provide a comment letter regarding this matter which would include extending an insurance commissioner's ability to allow exemptions for risk retention groups related to these standards. Discussions remain ongoing.

Connect With Us

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