NAIC 2016 Summer Meeting

The National Association of Insurance Commissioners (NAIC) held its Summer meeting in San Diego and discussed the status of adopting principles-based reserving, including the timing of implementation. Other discussion topics included regulation of captives and special purpose vehicles, group capital calculations, cybersecurity, and statutory application of recently issued FASB standards.¹

**Key Issues and Actions**

- **Adopted** the Credit for Reinsurance Model Regulation that establishes standards governing reserve financing arrangements for life insurance policies with guaranteed non-level gross premiums, guaranteed non-level benefits, and universal life insurance policies with secondary guarantees.²

- **Exposed:**
  - An issue paper allowing special accounting treatment for certain derivative contracts used to hedge variable annuities guarantees that do not meet hedge effectiveness requirements.³
  - Revisions to SSAP No. 2 to reclassify money market mutual funds from short-term investments to cash equivalents.⁴
  - A request for feedback on how the new FASB guidance on credit losses should be considered for statutory accounting.⁵
  - A revised Model Law about cybersecurity, which is intended to establish consistent standards for data security, investigation, and notification of a breach of data security for licensees in all states.⁶
  - Revisions to SSAP No. 61R and SSAP No. 56 related to variable annuities disclosures and a new variable annuities supplement.⁷
  - The results of the variable annuities quantitative impact study.

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¹ Meeting materials and summaries for the meeting held on August 24-29 are available at [www.naic.org](http://www.naic.org).

² Term and Universal Life Insurance Reserve Financing Model Regulation.

³ SSAP No. 92, Postretirement Benefits Other than Pensions, and SSAP No. 102, Pensions.

⁴ SSAP No. 2 Cash, Drafts and Short Term Investments.


⁶ Insurance Data Security Model Law.

⁷ SSAP No. 56, Separate Accounts and SSAP No. 61R Life, Deposit-Type and Accident and Health Reinsurance.
Principle-Based Reserving

Status of Adoption

The Principle-Based Reserving (PBR) Implementation Working Group received a report stating that 46 states and territories consisting of 85.7 percent of premiums have adopted PBR and five additional states have bills in process. At the Spring meeting, the NAIC recommended that each state issue a regulation identifying when the Valuation Manual will become effective. So far, 24 states have acted. PBR is effective on January 1, 2017 with a three-year transition period.

Implementation

The Society of Actuaries provided to the Life Actuarial Task Force (LATF) a preliminary report on the results of a recent survey sent to 218 insurers and reinsurers about their plans to implement PBR and whether they will use the 2017 Commissioners Standard Ordinary (CSO) tables in 2017. The Society of Actuaries received responses from 72 insurers and reinsurers that indicated:

- Fifteen insurers and reinsurers plan to use PBR for at least one product in 2017. Thirteen of these insurers have some level of reinsurance coverage and expect to qualify for a credit for reinsurance. Three companies plan to continue using captives even with the adoption of PBR.
- Fifty-seven insurers and reinsurers will not be adopting PBR during the first year of implementation.
  - Eleven cited the uncertainty about tax reserve implication as the reason for using the transition period;
  - Eleven plan to use captives instead of adopting PBR; and
  - Eleven believe they will qualify for the small company exemption.
- With respect to using the 2017 CSO tables, of the insurers surveyed:
  - Forty-four percent of respondents will adopt the table in 2017;
  - Thirty-eight percent do not plan to use the table in 2017; and
  - Eighteen percent were undecided.

Next Steps. The Society of Actuaries expects to provide its final report on the survey results by the end of September.

Pilot Project

LATF received an update on the 2016 PBR pilot project evaluating the PBR regulatory process and determining whether changes are needed. The project focuses on:

- PBR calculations for term and universal life with secondary guarantees products as required by VM-20;
- VM-20 Reserve Supplement and the related instructions; and
- VM-31 Actuarial Reporting.
Twelve insurers from nine states initially agreed to participate in the pilot project, however one insurer withdrew. To date, the regulators received VM-20 calculations and VM-31 reports from six of the participating insurers and expect to receive the remaining reports shortly.

**Next Steps.** The Working Group plans to have weekly regulator-only calls beginning the week of September 19 to review the calculations and information in the reports.

**VM-20—Net Premium Reserves**

**Action.** On a call before the Summer meeting, LATF deferred action until 2018 on proposed changes to the Net Premium Reserve (NPR) for term policies because further analysis is needed. New York Life proposed these changes because it believed that the changes would result in a VM-20 reserve that is more balanced between the modeled reserves and the formula-based requirements.

**Action.** On the same call, LATF adopted a proposal for the NPR for term products to remove perceived anomalies caused by the expense allowance and post-level term profits. At the Summer meeting, the LATF’s parent committee adopted this proposal. The regulators believe that this change will not have a significant effect on the 2017 reserves.

The proposed change to remove perceived anomalies was suggested because of concerns about the deterministic reserve. Some regulators were concerned that anti-selection (with only unhealthy people paying the higher premiums) would eliminate post-level term profits, which may not produce a sufficient reserve under the principle of solvency protection.

**Accounting and Disclosure Changes**

**Action.** The Statutory Accounting Principles Working Group (SAPWG) adopted revisions to SSAP No. 51 to incorporate references to the Valuation Manual and to facilitate the implementation of PBR. The revisions include guidance on how to evaluate the change in valuation basis to determine whether it meets the definition of a change in accounting as defined in SSAP No. 3. This would:

- Include changes in methodology or voluntary choices in application of the methodology; and
- Exclude updates to reserving assumptions based on experience as required under the existing methodology.

The revisions also clarify that insurers should continue the current process of reporting the effect to changes in valuation basis in surplus. Because PBR will be adopted on a prospective basis, the change in valuation basis for the initial application of PBR is not expected to result in a day one impact to surplus.

**Action.** On a call before the Summer meeting, SAPWG adopted revisions to Appendix A-820, which incorporates relevant aspects of the Standard Valuation Law. These revisions are effective January 1, 2017 and will facilitate the implementation of PBR.
Credit for Reinsurance Model Regulation

**Action.** The Reinsurance Task Force adopted the Credit for Reinsurance Model Regulation.

On calls before the Summer meeting, the Task Force discussed ways to respond to noncompliance with the Model Regulation. Interested parties and some of the regulators believed that due to the complexity of remediating a shortfall and the short period granted for remediation, the effect of noncompliance should be amended. However, other regulators disagreed and believed that severe penalty for noncompliance was appropriate because they thought that affiliated captive reinsurance should not be used. The regulators also discussed adding the ability to recapture as a remediation option, but decided against it. They clarified that state commissioners have discretion to grant an insurer a permitted practice by expanding the period of time to remediate or by permitting a recapture of the ceded business as an alternative to remediation. The regulators decided to:

- Modify the consequence of noncompliance to allow a reporting entity to record a reinsurance credit for the amount of primary security held, if any shortfall in primary or other security is not remediated;
- Add an exemption for reinsurers that have more than 500 percent of the authorized control level risk-based capital without recognition of any permitted practices;
- Continue to exclude real estate from the definition of a primary security asset;
- Modify language about exemption from regulation to specify that attained-age-based yearly renewable term life insurance policies, certain n-year renewable term life insurance policies, and yearly renewable reinsurance are not exempt from the regulation; and
- Modify actuarial language to synchronize the regulation with the Valuation Manual.

Variable Annuities

**Quantitative Impact Study**

**Action.** The Variable Annuities Issues Working Group (VAIWG) exposed recommendations from Oliver Wyman to change the statutory framework for variable annuities. Comments are due November 14, 2016.

Oliver Wyman presented its recommendations from the quantitative impact study (QIS or the study), which focused on identifying changes to the statutory framework for variable annuities that can remove or mitigate insurers’ motivation to engage in captive reinsurers. One of the findings was that under the current framework, economic-based hedging can adversely impact statutory financial statements. Fifteen insurers covering nine domiciliary states participated in the QIS. The study aimed to ensure (1) adequate capital to meet future liabilities, (2) sound risk management, and (3) comparability across insurers and products. The study reaffirmed recommendations presented in September 2015 and added new ones. These included:

- Aligning economically focused hedge assets with liability valuations by:
Implementing the hedge accounting proposal that is being considered by the SAPWG;

- Setting the accumulated deficiency equal to accumulated assets in the stochastic calculation (new);
- Permitting a simplified method to include the impact of hedging in liability projections; and
- Increasing the weighting applied to the explicit and implicit hedge modeling to be up to 100 percent when calculating the conditional tail expectation (CTE) if the insurer can demonstrate that there is already sufficient conservatism in reflecting hedge effectiveness. This recommendation would also require annual back-testing comparing the historical hedge performance to hedge modeling (new).

- Aligning the AG 43 standard scenario with the stochastic framework and removing the C3 Phase II standard scenario (new). Also, periodically refreshing policyholder behavior assumptions to better align with industry experience.
- Aligning the total asset requirement with reserves by (1) requiring the starting assets used in the liability projections to remain close to the stochastic reserve, similar to what is done in VM-20 (new) and (2) calculating C3 RBC charge as the difference between reserves and a CTE on the same distribution.
- Increasing admissibility limits for derivatives that are designated variable annuity hedges originated as part of a defined hedging strategy. Also, increase admissibility of the deferred tax assets associated with variable annuity portfolios.
- Standardizing capital market assumptions by (1) harmonizing interest rate and general account net investment income assumptions (new) and (2) evaluating alternative calibration criteria for equity securities and other market risk factors.

Oliver Wyman believes that the initial recommendations presented at a September 2015 meeting are still appropriate, however additional study is needed to evaluate the impact of the new recommendation and the aggregate impact of all recommendations.

Interested parties raised initial concerns about the recommendations because unlike most other proposals, the recommendations would apply to the existing book of business not just new business and, thus, could have a significant effect on insurers. They also said that the proposed changes focused on interest rate hedges and had a bias toward specific hedging instruments. They said that they wanted to understand the rationale for the recommendations that were not tested under the study. Interested parties agreed that additional analysis and testing were needed to evaluate the aggregate effect of all proposed recommendations and suggested that other alternatives should be investigated.

**Next Steps.** The regulators stated that after they receive comments they will consider changes and perform an additional study. The second QIS is anticipated to take approximately six months and be completed around June 2017.
Variable Annuities Supplement

**Action.** Before the Summer meeting, the Blanks Working Group exposed a proposal to delete the general interrogatory questions about variable annuities with guarantees and replace them with a variable annuities supplement. Comments are due October 24, 2016.

The goal of the proposed supplement is to add more meaningful information about the valuation of liabilities for variable annuities guarantees. It would require insurers to disclose the:

- Number of contracts or certificates with those benefits;
- Amount of the benefit base related to each type of benefit;
- Net amount at risk for death benefits and the guaranteed annual payout for income and withdrawal benefits;
- Gross amount of the reserve for guaranteed benefits;
- Portion of the contract/certificate account value related to contract/certificate funds in the general or the separate account; and
- Percent of the guaranteed benefit reinsured.

The VAIWG adopted the proposed disclosures before they were sent to the Blanks Working Group for consideration.

Variable Annuities Captive Disclosures

**Action.** SAPWG exposed revisions to SSAP No. 61R to amend disclosure requirements related to variable annuities captives for the 2016 year end and thereafter.

At the Fall 2015 meeting, the NAIC adopted disclosure requirements for variable annuities captives that were effective only for the 2015 year end. The NAIC intends for these disclosures to improve transparency and capture information about captive reinsurance transactions.

Before the Summer meeting, the VAIWG adopted updated disclosures to clarify the purpose of the disclosure and the nature of the transactions that should be disclosed. The updated disclosures clarified that insurers need to disclose the reserve methodology for the affiliated captive insurer’s financial statements, provide a brief description of the hedge target, and describe how the reserve methodology is different from the requirements of AG 43. The proposal also adds a requirement for insurers to disclose permitted practices used by captive reinsurers that follow the guidance in SSAP No. 1.11

**Action.** SAPWG exposed an issue paper to provide special accounting treatment for certain derivative contracts that do not meet hedge effectiveness requirements. Comments are due November 28, 2016.

At the Spring meeting, SAPWG exposed a proposal to provide a special accounting provision for specific derivative contracts rather than following the hedge accounting guidance in SSAP No. 86.12 After reviewing the comments,

10 Actuarial Guideline XLIII—CARVM For Variable Annuities.
11 SSAP No. 1, Accounting Policies, Risks & Uncertainties and Other Disclosures.
12 SSAP No. 86, Derivatives.
and discussing with Oliver Wyman, the NAIC staff drafted an issue paper on the accounting for derivatives used to hedge variable annuities guarantees. The issue paper stated that this guidance would apply only if all the listed qualifications are met, and that the guidance should not be considered an acceptable statutory accounting approach for derivatives that do not meet all of the qualifications or that are not specifically addressed in the guidance. It also includes questions intended to highlight key discussion points and potential concerns with the proposed guidance. It is anticipated that this guidance will be included as a new SSAP.

**Action.** SAPWG exposed revisions to SSAP No. 56 to remove the requirement to disclose total maximum guarantees. Comments are due October 10, 2016.

The VAIWG requested that SAPWG consider removing the disclosure of the total maximum guarantee from SSAP No. 56, effective year-end 2017. The VAIWG believed that this disclosure will not be necessary with the new variable annuities supplement.

**Investments**

**Project to Review Investment SSAPs**

Before the Summer meeting, SAPWG exposed changes to SSAP No. 26 to incorporate revised guidance for exchange-traded funds (ETFs) and bond mutual funds. The changes would require insurers to report ETFs and bond mutual funds at fair value (FV), allowing for the net asset value as a practical expedient, unless the insurer elects to use a domiciliary-state approved documented systematic-value approach.

Comments received included concerns from vendors about the implementation and timing of modifications needed for the systematic-value approach because example calculations and models were not included in the proposal. Interested parties agreed that the systematic-value method may cause confusion because it does not specify what approach should be used.

At the Summer meeting, SAPWG discussed an alternative to eliminating the systematic approach and measuring ETFs and bond mutual funds at FV. Small insurers expressed significant concerns about eliminating the systematic approach stating that it would be disruptive to small and mid-size insurers because they use ETFs to gain access to diversified, low cost, liquid investment securities with favorable risk-based capital requirements. They believed that the requirement to measure ETFs at FV may force insurers to liquidate their positions to comply with their risk management strategy, which could create disruption in the ETF market and affect liquidity.

BlackRock provided a document detailing how it plans to calculate the value of ETFs using a systematic-value approach. Regulators believe the example provided by BlackRock makes the calculation transparent, which may address some of the concerns raised by vendors and interested parties. SAPWG agreed to maintain this option.

**Next Steps.** SAPWG will prepare an issue paper about ETFs and bond mutual funds in scope of SSAP No. 26 to require measurement at fair value, unless the

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13 SSAP No. 26, Bonds.
reporting entity elects to use a domiciliary state-approved documented systematic-value approach. The issue paper will also include the definition of a security, and the definition for non-bond items, e.g., loan participations and loan syndications. SAPWG will also post on its website BlackRock’s suggested systematic value calculation.

**Reclassification of Money Market Mutual Funds**

*Action.* SAPWG exposed revisions to SSAP No. 2 to reclassify money market mutual funds from short-term investments to cash equivalents. This change would be effective as of January 1, 2018. Comments are due October 10, 2016.

SAPWG eliminated the reference to Class 1 Money Market funds from SSAP No. 2, SSAP No. 26, SSAP No. 30, and SSAP No. 32 because of changes in the SEC money market mutual fund regulations. The NAIC decided to further discuss the classification of money market mutual funds after receiving comments from interested parties.

**Prepayment Penalties and Amortization on Callable Bonds**

*Action.* On a call before the Summer meeting, SAPWG adopted revisions to SSAP No. 26 and SSAP No. 43R that:

1. Clarify the amount of investment income and/or realized capital gains/losses to be reported on disposal of an investment; and
2. Create a new disclosure in the annual statement, requiring an insurer to identify the amount of the investment income generated as a result of prepayment penalties and/or acceleration fees.

These changes are effective January 1, 2017.

**Repurchase Agreements**

*Action.* SAPWG exposed revisions to SSAP No. 103R to add enhanced disclosures for repurchase agreements. Comments are due October 10, 2016.

On a call before the Summer meeting, the Restricted Asset Subgroup referred the proposed disclosure revisions for SSAP No. 103 to SAPWG. These disclosures collect general information about repurchase and reverse repurchase agreements and have specific disclosure requirements for agreements that are accounted for as secured borrowing and sale transactions. The goal of the proposed disclosures is to gather aggregate information to help regulators understand the financial effect of these transactions.

**NAIC 5-Star Designated Securities**

*Action.* On a call before the Summer meeting, SAPWG adopted revisions to SSAP No. 1 to include new disclosures to capture current and prior period information about the number of 5-star (5*) securities, and the book-adjusted carrying value, and fair value for those securities.

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14 SSAP No. 30, Investment in Common Stock and SSAP No. 32, Investments in Preferred Stock.
15 SSAP No. 43R, Loan-Backed and Structured Securities.
16 SSAP No. 103, Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.
Investments in Subsidiaries

Action. SAPWG adopted a proposal to add a new appendix to SSAP No. 97 that provides filing guidance for subsidiaries, controlled, and affiliated entities (SCAs).17

The new appendix moves filing guidance from the Purposes and Procedures (P&P) Manual to SSAP No. 97. The guidance clarifies that all SCA entities, except for investments in domestic SCA insurance companies accounted for under SSAP No. 97 paragraph 8.b.i, in which the reporting entity has an equity interest, are subject to the filing guidance. The guidance also clarifies that joint ventures, partnerships, and limited liabilities companies are not subject to the SCA filing guidance. Interested parties had concerns about moving that guidance into the Accounting Practices and Procedures Manual because it represents instructional guidance that is typically included in either annual statement instructions or the P&P manual. They also did not believe that entities deemed to be immaterial to the insurer, especially those with zero carrying value, should be subject to the filing requirements.

Next Steps. SAPWG agreed to discuss the concern about filing non-admitted or immaterial entities.

Quarterly Reporting of Investment Schedules

Action. SAPWG exposed an additional alternative for quarterly investment reporting to include an option for a mid-year collection of investment data. This would be a data-only submission of Schedule D investments, with information detailing CUSIP, par value, book/adjusted carrying value, and fair value due with the second quarter statutory financial statements. Comments are due October 10, 2016.

Some regulators provided comments on the previously exposed options proposed by interested parties. One regulator said that it would agree to receive only acquisition and disposition information throughout the year, while another wanted to receive full schedule D information but acknowledged that an extended filing deadline may be needed.

Interested parties continued to be concerned with the proposal, especially its effect on small or mid-size insurers. They stated that those insurers may incur significant costs to implement this request because it would require systems upgrades or they would need to hire new vendors.

Regulators acknowledged the concern, but noted that receiving information throughout the year was important to understanding an insurer’s risk. However, some said that a semi-annual filing instead of a quarterly filing could be sufficient.

Loan-Backed and Structured Securities

Action. On a call before the Summer meeting, the Valuation of Securities Task Force adopted a proposal to amend the definition of loan-backed and structured securities. The Task Force referred the revised definition to SAPWG, which has not yet considered this change for SSAP No. 43R.

References:
17 SSAP No. 97, Investments in Subsidiary, Controlled and Affiliated Entities.

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Short Sales

**Action.** On a call before the Summer meeting, SAPWG adopted revisions to SSAP No. 103 and Issue Paper No. 152 to change the accounting guidance for short sales and secured borrowing transactions.\(^{18}\)

The revisions include a definition of a short sale and the accounting and reporting treatment when a short sale is supported by a secured borrowing. The revisions also added additional disclosure requirements including:

- For unsettled transactions, the amount of proceeds received and the fair value of securities to deliver with current unrealized gains and/or losses and the number of days until the expected settlement; and
- For settled transactions, the aggregate amount of proceeds received and the fair value of the securities as of the settlement date with recognized gains and/or losses.

These revisions are effective prospectively for new short-sale transactions occurring on or after January 1, 2017, unless the insurer has previously been following guidance similar to what is included in the revised SSAP.

Clarification of Investment Proceeds Disclosure

**Action.** SAPWG exposed revisions to SSAP No. 2, SSAP No. 26, and SSAP No. 43R to clarify the disclosure requirements for bond categories, bond maturity distributions, and proceeds from sale of bonds. Comments are due October 10, 2016.

The NAIC received questions about whether only the investments in the scope of SSAP No. 26 are required to be included in the disclosures of:

- Book-adjusted carrying value (BACV), fair value (FV), and excess of BACV over FV by bond category;
- BACV and FV for maturities in one year or less, after one year to five years, after five years to ten years, or in excess of ten years; and
- Proceeds received from sales of bonds and the gross realized gains and losses recognized on such sales.

The exposure recommended that these disclosures include all securities reported in the Annual Statement Schedule D and that maturities, paydowns, and other redemptions should be included as part of the proceeds from instruments.

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\(^{18}\) Issue Paper No. 152, Short Sales, and SSAP No. 103, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.
FASB Accounting Standards Updates

U.S. GAAP Disclosures for Short-Duration Contracts

Interested parties reported to SAPWG that they are continuing their work with the AICPA to analyze whether or how the requirements of ASU 2015-09 should be adopted for statutory financial reporting.19 SAPWG deferred discussion on this item.

The FASB issued guidance in May 2015 that requires additional disclosures for claims development including:

- Disaggregated net incurred and paid claim and allocated claim adjustment expense development must be disclosed by accident year; and
- A reconciliation of the total net amount for all tables presented to the amounts in each statement of financial position presented is required with disclosure of disaggregated reinsurance balances.

Disclosures are also required about claims frequency and average annual percentage paid claims by age based on the information in the claims development table. Interested parties have a technical group that is working with the AICPA to recommend how these disclosures should be addressed for statutory reporting.

Leases

The FASB issued ASU 2016-02 in February 2016 to increase transparency and comparability among organizations by requiring lessees to recognize most leases on the balance sheet and disclosing key information about lease arrangements.

Next Steps. SAPWG directed the NAIC staff to draft an issue paper indicating that operating and finance leases should continue to follow the existing guidance in SSAP No. 22.20 This option was consistent with the recommendation from interested parties. SAPWG will also evaluate ASU 2016-02 for potential revisions to statutory accounting including:

- Lessor accounting;
- Leveraged leases;
- Non-lease components;
- Sale and leaseback transactions;
- Definition of a lease;
- Effective date and disclosures;
- Effect on previously adopted GAAP guidance; and
- Effect on previously deferred agenda items.

20 SSAP No. 22, Leases.
Classification and Measurement of Financial Instruments

Action. SAPWG rejected ASU 2016-01 because statutory accounting already has specific measurement guidance. It adopted a proposal to exclude deposit liabilities with no defined or contractual maturities from the fair value financial instruments disclosures.\(^{21}\)

ASU 2016-01, which the FASB issued in January 2016, includes new guidance on the classification and measurement of financial instruments and certain disclosure requirements about the fair value of financial instruments.

Credit Losses

Action. SAPWG requested comments on how ASU 2016-13 should be considered for statutory accounting. Comments are due November 28, 2016.

ASU 2016-13 was issued to improve financial reporting by requiring timely recording of credit losses and removing the concept of other-than-temporary impairment on loans and other financial instruments. It eliminates the probability threshold, instead reflecting an entity’s current estimate of expected credit losses. The SAPWG requested feedback about:

- Development of a new SSAP to incorporate concepts of ASU 2016-13 into statutory accounting to eliminate the differences between U.S. GAAP and statutory accounting. This includes nullifying the guidance in INT 06-07.
- Interaction of the guidance within the new proposed SSAP with the asset valuation reserve, which is designed to address credit and equity risks.
- Consistency in the application of the amortized cost and available-for-sale securities approach outlined in the ASU for securities under SSAP No. 26 and SSAP No. 43R.
- Consistency in the approach for assessment of credit losses for securities measured at amortized cost and fair value.

Cybersecurity

Action. Before the Summer meeting, the Cybersecurity Task Force exposed a revised version of the Insurance Data Security Model Law. The Model Law is intended to establish standards for data security, investigation, and notification of a breach of data security applicable to licensees for each state. Licensees are defined within the Model Law as any person or entity licensed; authorized to operate; registered; or required to be licensed, authorized, or registered under state insurance laws. Comments are due September 16, 2016.

The Cybersecurity Task Force held an interim meeting to discuss comments from interested parties about the proposed Model Law. Interested parties continued to have significant concerns about the Model Law including:

- Lack of uniformity – most interested parties believed that it is crucial to create uniform state standards related to data security to eliminate duplicative requirements among states.

• Definition of personal information – many believed that the definition is very broad and that *sensitive personal information* should be used with a narrower definition.

• Requirement to have an information security program – small businesses may not have the resources to implement all of the requirements outlined in this section of the Model Law.

• Requirement for oversight of third-party provider agreements – concerns were raised about the ability to regulate third parties, especially by small businesses or if the vendor itself was a small business not subject to the jurisdiction of the state insurance department.

• Privacy notices – many believed that this requirement is redundant with current requirements, such as HIPAA.

• Notification of a breach of data security – many believed that the timing for notification to both the state regulator and the consumer was too short. They also believed that the lack of a harm trigger was problematic and potentially having to provide notices to 50 insurance departments was burdensome.

• Eliminating certain sections – many believed that the sections on cease and desist orders, penalties, judicial review of orders and reports, individual remedies, immunity, and obtaining information under false pretense were not needed within this Model Law because they are addressed by other existing laws and regulations.

Title insurers said that the Model Law presented some unique challenges because:

• Insurance regulators do not regulate certain aspects of the title insurance industry; and

• It is not always possible to identify a policyholder.

However, a consumer advocate group supported the Model Law and believed that the Task Force is moving in the right direction.

Based on the comments received, the Cybersecurity Task Force made certain changes to the Model Law including:

• Revised the section on the purpose and intent of the Model Law;

• Added a definition for *harm or inconvenience* and revised the definition for *personal information*;

• Revised certain aspects of an information security program including the requirement for oversight of third-party service providers; and

• Removed certain sections of the Model Law including Cease and Desist Orders and Reports, Penalties, Judicial Review of Orders and Reports, Individual Remedies, Immunity, and Obtaining Information under False Pretenses.

At the Summer meeting, a large number of interested parties continued to voice concern about the proposed Model Law. They said that they did not believe that the changes adequately addressed their concern, most importantly the goal of uniformity.
Group Capital Calculation

Action. The Group Capital Working Group exposed questions about various aspects of the inventory method used to calculate group capital. Comments are due October 25, 2016.

On calls before the Summer meeting, the Group Capital Working Group discussed a methodology to assist regulators in measuring group risks. Discussion focused on the inventory approach in which financial amounts such as total available capital and minimum capital would be submitted for all entities and this information would give regulators an additional supervisory analytical tool. The Working Group also considered how the group capital calculation would treat:

- U.S. insurers that are subject to RBC requirements;
- U.S. insurers that are not subject to RBC requirements;
- Non-U.S. insurers;
- Banks and other regulated entities that are subject to capital requirements; and
- Non-regulated entities that are not subject to capital requirements.

The Working Group considered the potential for differences in the outcome of the calculation depending on whether a U.S. insurance company that follows statutory accounting is at the top of the holding company structure versus a structure in which the top-tier company follows U.S. generally accepted accounting principles (U.S. GAAP). The Working Group created questions to facilitate further discussion with regulators and interested parties. The questions asked for feedback on these topics:

- The appropriateness of applying a flat charge, for example 22.5 percent, to an entity’s book adjusted/carrying value for non-insurance entities that are not subject to other capital requirements.
- The appropriateness of initially applying a flat risk charge and then adjusting it over time as more data is collected to better reflect risk.
- The best approach for non-insurance entities that are subject to existing sectorial capital requirements or a flat equity charge and the amount of that charge, for example 22.5 percent.
- The appropriateness of developing country-specific scalars by analyzing information from non-U.S. insurers, and whether data calls are needed to gather information.
- The best short-term approach for non-U.S. insurers to either use the current flat RBC charge or the entity’s non-scaled capital requirements.

Interested parties supported the inventory approach and agreed with the nature of the questions included in the document. However, they also stated that the document should include a question about what entities should be included in the scope of the group capital calculation. They also said that a risk-sensitive approach is needed and that a flat risk charge may not be appropriate.
Regulators agreed that scope will be important to discuss, and added the question to the document. Additionally, meetings may be scheduled after the comment period concludes.

**Investment Risk-Based Capital**

**Action.** On calls before the Summer meeting, the Investment Risk-Based Capital Working Group made preliminary decisions about the C-1 bond factors for insurers subject to the Asset Valuation Reserve (AVR), including:

- Expanding bond factors from 6 to 20 designations for RBC calculation and reporting. The current six designations will be maintained for statutory accounting purposes.

- For long-term and short-term bonds, the 20-designation framework will apply in determining the AVR amount.

There will be a discussion about other assets that receive bond treatment (e.g., Schedule BA and Schedule DB assets). Additionally, a more comprehensive study of the RBC treatment of structured securities will be performed when the working group discusses other asset classes.

**Next Steps.** The working group will consider whether the changes that will be applied to the life bond structure are appropriate for the Health and P&C formulas.

**Other Accounting Highlights**

**Correction of an Error in SSAP No. 3**

**Action.** SAPWG re-exposed a revision to SSAP No. 3, clarifying that guidance included in SSAP No. 3 should be applied to only accounting errors. Comments are due October 10, 2016.

The revised SSAP No. 3 requires that corrections of accounting errors in previously issued financial statements be reported as adjustments to unassigned surplus in the period detected. It also directs insurers to file amended financial statements when they become aware of a material accounting error, unless otherwise directed by their domiciliary regulator.

**Salvage and Subrogation Recoveries**

**Action.** SAPWG adapted SSAP No. 55 to clarify that the reporting of salvage and subrogation expenses should be netted with recoveries. These revisions are consistent with the annual statement instructions, and with the language in SSAP No. 65.

**Measurement of Net Periodic Benefit Cost**

**Action.** On a call before the Summer meeting, SAPWG adopted revisions to SSAP No. 92 and SSAP No. 102 to allow an insurer to use the spot-rate approach.
for measuring service cost and interest cost components of net periodic benefit cost.

This approach allows insurers to use individual duration-specific discount rates derived from an acceptable high-quality corporate bond yield curve and matched with separate cash flow for each future year.

**Health Care Receivables**

**Action.** SAPWG exposed a modification to SSAP No. 84 to clarify that receivables must originate from the government to remain an admitted asset if they are over 90 days past due. Comments are due October 10, 2016.

This exposure addresses circumstances related to pharmacy price concessions, such as a performance network rebate program for pharmacies participating in Medicare Part D plans in which a large percentage of the rebate is refunded to the Part D plan and a small percentage is pooled to pay the pharmacy providers. In these cases, although the receivable is captured as a Medicare Part D plan receivable, it is not due from the government, but rather from the pharmacies. The modification to SSAP No. 84 clarifies that the admittance allowance for receivables over 90 days was not intended to capture non-government receivables that may be related to a government plan.

**Prescribed and Permitted Practices**

**Action.** SAPWG adopted revisions to SSAP No. 1 to clarify that disclosure of permitted or prescribed practices should include practices that result in different statutory accounting reporting, such as gross or net presentation or different financial statement reporting lines. The revisions included an example to clarify how to complete the permitted practice disclosure.

**Other Regulatory Highlights**

**Eliminating Public Meetings for Assumption Setting Process**

**Action.** On a call before the Summer meeting, the Securities Valuation Office (SVO) adopted a proposal to eliminate the requirement for public meetings to set macro-economic assumptions, scenarios, and risk weighting for the annual financial modeling of residential mortgage-backed securities and commercial mortgage-backed securities.

Regulators said that interested parties will have a forum in which they can raise issues because the macro-economic assumptions and scenarios will be posted on the Valuation of Securities Task Force’s website and the Structured Securities Group will continue to present reports on the financial modeling process.

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24 SSAP No. 84, Health Care and Government Insured Plan Receivables.
Other Actuarial Highlights

Risk Adjustment

Before the Summer meeting, the Health Care Reform Actuarial Group discussed a proposal from Consumers for Health Options, Insurance Coverage in Exchanges in States (CHOICES) to modify the Federal ACA Risk Adjustment Program. CHOICES believed that the existing program limitations are harming consumers and the insurance markets because:

- CMS is not fully recognizing the current negative effects;
- Flaws in the program require near term solutions; and
- CMS has not shown interest in near term changes to address the existing concerns with Risk Adjustment.

To resolve the issues in the short term, CHOICES proposed a reduced volatility approach under which state regulators would reduce all transfer amounts by a fixed percentage after the transfer payments are calculated. The regulators had significant concerns with the proposal because they thought that it would:

- Change the regulatory requirements and amount of funds due to/from after insurers set prices for the policies;
- Not resolve what is perceived as the true cause of the issue, lack of risk corridor payments; and
- Use an arbitrary volatility factor.

CHOICES revised its proposal to present options for state regulators to:

- Limit the risk adjustment transfers as a percentage of premium for all carriers;
- Reduce risk adjustment transfers by flat percentage across the board; or
- Reduce risk adjustment transfers based on a defined target corridor for medical cost ratio.

Regulators did not think that the revised proposals addressed the previous concerns and asked CHOICES to revise its proposal.

Next Steps. An updated proposal is expected at the Fall 2016 meeting.

Asset Adequacy Testing

Action. The Long Term Care Actuarial Working Group exposed for a 60-day comment period a proposal for standalone asset adequacy testing for long-term care blocks of contracts.

This proposal would require a standalone asset adequacy analysis for valuations associated with December 31, 2017 and subsequent annual statutory financial statements, unless exempted due to the small size of the block of business. The proposal did not define small in the context of evaluating the exemption. The analysis would not anticipate premium rate increases unless a rate increase plan is approved by management; is highly likely to be executed; and contains documented, realistic estimated approved timing and amounts by jurisdiction. Interested parties raised concerns about the proposal including the lack of the definition for the size of the block of business that would be excluded and the limitations on including anticipated premium rate increases.
Longevity Risk

The Longevity Risk Subgroup reported on its progress. While the Subgroup continues to work on a long-term solution to refine the approach for longevity risks, the Subgroup believes short-term actions can be taken. The Subgroup suggested modifying the instructions for asset adequacy testing to clarify that longevity risk is expected to be included in the test. A survey was conducted and responses from 17 insurers representing four domestic regulators found that insurers with significant longevity risk exposure appear to recognize the risk in their asset adequacy testing. However, longevity sensitivity was not always part of the analysis. They also presented a proposal to conduct a study to determine the appropriate RBC charge for the longevity risk.

The American Academy of Actuaries also presented its report on longevity risk, which said that the industry’s exposure to longevity risk has increased over time and is likely to continue to increase. Thus, the risk needs to be appropriately captured in reserves and capital. The group believed that asset adequacy testing is the appropriate approach to ensure that reserves sufficiently consider longevity and other risks. However, more specific guidance may be needed.

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