Issues & Trends In Insurance®

January 2017, No. 17-1

NAIC 2016 Fall Meeting

The National Association of Insurance Commissioners (NAIC) recently discussed topics such as implementing principle-based reserving, group capital calculations, status of qualified jurisdictions, cybersecurity, and applying recently issued FASB standards to statutory financial reporting at its Fall meeting in Miami.[1]

Key Issues and Actions

- ***Adopted***
  - Reclassification of money market mutual funds from short-term investments to cash equivalents.[2]
  - A new variable annuities supplement and revised current disclosures for variable annuities.[3]
  - Enhanced disclosures for repurchase and reverse-repurchase agreements.[4]
- ***Exposed***
  - A report on implementing Solvency II by European (EU) member states and its potential effect on the qualified jurisdiction status of France, Germany, Ireland, and the United Kingdom (UK).
- ***Other Topics***
  - Received the test results on whether changes are needed to the net premium reserves calculation for term products under VM-20.[5]
  - Discussed the status of the third draft of the model law for cybersecurity, which aims to establish consistent standards for data security, investigation, and notifications to consumers about data security breaches.[6]

Contents

[1] Meeting materials and summaries for the meeting held on December 8-13 are available at www.naic.org.

[2] SSAP No. 2 Cash, Drafts, and Short Term Investments.

[3] SSAP No. 56, Separate Accounts and SSAP No. 61R Life, Deposit-Type, and Accident and Health Reinsurance.

[4] SSAP No. 103R, Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.

[5] Valuation Manual 20, Requirements for Principle-Based Reserves for Life Products.

[6] Insurance Data Security Model Law.

Principle-Based Reserving (PBR)

PBR Industry Testing

The American Council of Life Insurers (ACLI) provided a summary of the testing performed to evaluate whether changes were needed to the net premium reserves calculation for term products under VM-20.

Thirteen companies volunteered to be part of the testing; however, only eight companies submitted the data for analysis. The participants represented a diverse group of insurers, varying by company size, competitive positioning, target market, and mortality credibility. Each one calculated the net premium reserves and the deterministic reserves for level-term products following VM-20. They also calculated the gross premium valuation using their pricing assumptions.

Test results illustrated a majority of the assumptions used in calculating the deterministic reserves included implicit and/or explicit margins. As a result, the deterministic reserves had a considerable margin over the gross premium valuation, with most of the margin present in the early durations of the contracts when uncertainty is the greatest.

The ACLI used three criteria to determine if the term net premium reserves were appropriate:

(1) Deterministic reserves should generally be higher than the net premium reserves for term products.

(2) The net premium reserves must be suitable for use as a tax reserve.

(3) The net premium reserves should produce reasonable reserve patterns, appropriately reflecting pre-funding with the patterns ideally following those developed by the deterministic reserves.

The testing data indicated that net premium reserves generally followed the same reserving curve as the deterministic reserves over the life of the reserves. Each company's PBR reserves, whether they were deterministic reserves or net premium reserves, had substantial margin over the gross premium valuation. Some companies showed the net premium reserves as dominant while others showed the deterministic reserves as dominant. The aggregated results were reasonably consistent with criteria #1 and #3 and the current net premium reserves are expected to satisfy criterion #2.

The ACLI also tested ten net premium reserves scenarios using different assumptions. Eight of ten scenarios increased the net premium reserves relative to the deterministic reserves and violated criterion #1.

The ACLI had the following observations:

- Current net premium reserves should be maintained because they meet the guiding criteria above.
- The deterministic reserves are appropriately conservative to meet the regulatory standard for moderately adverse conditions.
- The net premium reserves cannot substitute for regulatory oversight of the reserve process. Regulators should frequently review companies' reserving methods and documentation to ensure that the reserves meet the requirements of VM-20.

- If companies document their reserving methods and regulators perform their reviews, the net premium reserves would simply be a safeguard. Greater benefit would be derived from regulators analyzing the deterministic reserves rather than the net premium reserves.

Next Steps. The Life Actuarial Task Force (LATF) will continue to monitor and analyze the appropriateness of the net premium reserves and deterministic reserves.

Pilot Project

The PBR Review Working Group updated LATF on the 2016 PBR pilot project, stating that it received VM-20 calculations and VM-31 actuarial reports from all eleven participants. Based on the information reviewed, and follow-up discussions held with participants, the Working Group observed that participants followed the PBR instructions and generally complied with VM-31 requirements. The Working Group also stated that reinsurance ceded reserves generated a number of questions about whether reserves should be reported gross or net of reinsurance.

The goals of the PBR project are to evaluate the regulatory process and determine 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 its related instructions; and
- VM-31, Actuarial Reporting.

Next Steps. The Working Group expects to complete its final report on the PBR pilot project by the end of January 2017.

VM–20 Supplement

Action. On a call after the Fall meeting, the Blanks Working Group adopted for 2017 reporting (1) a new supplement for VM-20 reserves, and (2) additional requirements to existing schedules, including adding:[7]

- A caption in the Analysis of Increase in Reserves During the Year for the VM-20 deterministic/stochastic reserves over the net premium reserves; and
- Captions in the Five-Year Historical Data for the VM-20 deterministic/stochastic reserves over the net premium reserves.

Variable Annuities

Quantitative Impact Study

On a call before the Fall meeting, the Variable Annuities Issues Working Group (VAIWG) received comments on Oliver Wyman’s recommendations to change the statutory framework for variable annuities. Generally, interested parties supported the goals of the VAIWG; however, they suggested changes to the recommendations. They requested the Working Group perform a thorough evaluation of the total effect of the proposals by conducting a second

[7] VM-20 Reserves Supplement.

Quantitative Impact Study (QIS) that is open to all insurers that wish to participate. On subsequent calls, the Working Group discussed the different scenarios and assumptions for the second QIS.

Next Steps. Oliver Wyman expects to complete the second QIS by August of 2017, and present the final report at the Fall 2017 meeting.

Variable Annuities Supplement

Action. On a call after the Fall meeting, the Blanks Working Group adopted a proposal to delete the general interrogatory questions for variable annuities with guarantees and replace them with a variable annuity supplement. This change will affect the 2017 Annual Statement reporting.

The goal of the proposed supplement is to add more meaningful information about the valuation of the liabilities for variable annuities guarantees. The supplement would require separate charts for individual contracts and for group contracts with individual certificates. It would also include:

- Type of guaranteed benefits;
- Number of contracts or group certificates with those benefits;
- Amount of the benefit base related to each type of benefit;
- Net amount at risk for death benefits and 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;
- Percent of the guaranteed benefit reinsured; and
- Reinsurance reserve credit for treaties with affiliated captive reinsurance and for other reinsurers.

Variable Annuities Captive Disclosures

Action. On a call before the Fall meeting, the Statutory Accounting Principles Working Group (SAPWG) adopted revisions to SSAP No. 61R that amend disclosure requirements about variable annuity captives for the 2016 year end and thereafter.

These revisions clarify the purpose of the disclosures, the nature of the disclosed transactions, and include requirements to:

- Disclose the reserve methodology used in the affiliated captive insurer's financial statements;
- Provide a brief description of the hedged target, and describe how the reserve methodology is different from the requirements of AG 43; and[8]
- Disclose permitted practices used by captive reinsurers under the requirements of SSAP No. 1.[9]

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[8] Actuarial Guideline XLIII—CARVM For Variable Annuities.

[9] SSAP No. 1, Accounting Policies, Risks & Uncertainties and Other Disclosures.

Action. SAPWG adopted revisions to SSAP No. 56 to remove disclosure of the total maximum guarantees because this information will be included in the new variable annuity supplement. Revisions are effective December 31, 2017.

Derivative Contracts related to Variable Annuity Products

At the Fall meeting, SAPWG discussed comments received on an issue paper proposing special accounting treatment for certain derivative contracts related to variable annuity products that are unable to follow the hedge accounting guidance under SSAP No. 86.[10] Interested parties were supportive of the issue paper because the guidance could reduce an accounting mismatch between changes in reserves for guaranteed benefits on variable annuities and changes in the fair value of the hedging instruments. However, they commented that the proposal should be changed to reduce non-economic accounting volatility in both income and surplus. They also requested early adoption to reduce the number of companies that use different solutions to reduce volatility.

The guidance in the issue paper would apply only if all the qualifications are met. Companies will not be able to use this guidance for derivatives that do not meet all of the qualifications, or for those derivatives not specifically addressed in the guidance. The Working Group anticipates that this guidance will be included as a new SSAP.

Next Steps. The NAIC staff will evaluate comments received on the issue paper and discuss them on future calls or meetings.

Investments

Project to Review Investment SSAPs

Statutory Accounting Principles Working Group

Before the Fall meeting, SAPWG exposed an issue paper proposing revisions to SSAP No. 26, including updates related to the valuation methodology for exchange-traded funds (ETFs) and certain bond mutual funds. The issue paper:

- Removes ETFs and certain bond mutual fund instruments from the definition of a bond and requires insurers to measure them at fair value allowing the use of net asset value as a practical expedient. Upon meeting certain conditions, insurers could elect to measure these instruments using a documented systematic-value approach. The systematic value would be similar to amortized cost, and reflect the systematic recognition of cash flows from the underlying bond holdings.
- Incorporates the U.S. GAAP definition of "security."
- Incorporates definitions for non-bond, fixed-income instruments captured in the scope of SSAP No. 26, including bank loans, hybrid securities, trust preferred securities, convertible bonds, mandatory convertible bonds, Yankee bonds, and zero-coupon bonds.

SAPWG sent a referral to the Valuation of Securities Task Force (VOSTF) requesting comments on:

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[10] SSAP No. 86, Derivatives.

- The proposed approach to determine systematic value; and
- The restrictions on the use of systematic value in the issue paper.

During the Fall meeting, SAPWG stated that it received comments on the exposed revisions to SSAP No. 26, but deferred discussion of the comments until it receives feedback from VOSTF.

Next Steps. SAPWG said it will hold a conference call in January 2017 to discuss the issue paper and feedback from VOSTF.

Valuation of Securities Task Force

VOSTF received a report from the Investment Analysis Office (IAO) about its evaluation of a proposed systematic-value approach developed by Blackrock. The IAO stated that the methodology:

- Produced a stable book value when there were no material changes to the cash flows; but
- Produced minimal changes in amortization and book values when the ETF was subjected to a 20 percent permanent impairment of future cash flows.

The IAO concluded that the methodology does not support statutory accounting objectives, because it would not identify a change in the cash flows of the underlying portfolio between annual reviews. Blackrock agreed with the IAO's conclusion; however, Blackrock believed that the issues identified are addressed under separate statutory accounting impairment guidance. VOSTF asked Blackrock to document its analysis of the accounting guidance for consideration by SAPWG.

Next Steps. On receipt, VOSTF will submit Blackrock's analysis to SAPWG.

Money Market Mutual Funds

Action. SAPWG adopted revisions to SSAP No. 2R that:

- Reclassify money market mutual funds from short-term investments to cash equivalents.
- Report money market mutual funds at fair value, with the net asset value allowed as a practical expedient. Unrealized gains and losses on money market mutual funds follow the guidance in SSAP No. 7 (for AVR filers), or are recorded directly in surplus for non-AVR filers.

These revisions are effective December 31, 2017.

Interested parties were concerned that some state statutes may impose different limitations on money market funds not designated as "Class 1 Money Market Funds," as this designation was removed in 2015. They believed that money market funds previously designated as Class 1 could be subject to those limitations before the effective date of the adopted guidance. To address this concern, SAPWG directed the NAIC staff inform all states about the previously removed reference to Class 1 Money Market funds from SSAP No. 2, SSAP No. 26, SSAP No. 30, and SSAP No. 32, and request that states consider revising statutes, as appropriate.[11]

[11] SSAP No. 30, Investments in Common Stock and SSAP No. 32, Investments in Preferred Stock.

Action. VOSTF adopted revisions to the Purposes and Procedures manual to delete reporting instructions for money market mutual funds, effective immediately.

Repurchase Agreements

Action. SAPWG adopted revisions to SSAP No. 103R to add enhanced disclosures for repurchase and reverse-repurchase agreements. Revisions are effective for December 31, 2017.[12]

Insurers will need to disclose general information about repurchase and reverse repurchase agreements, as well as detailed information for agreements accounted for as secured borrowing and sale transactions. Based on comments received, SAPWG modified its proposed disclosures to:

- Clarify that the book-adjusted carrying value is a balance as of a reporting date; and
- Replace the requirement to disclose the number of bilateral and/or tri-party trades with a requirement to identify whether repurchase agreements are bilateral or third party.

Reporting of Investment Schedules

SAPWG continued discussions on an approach to collect more timely investment information. Interested parties expressed continuing concerns with the exposure from the Summer 2016 meeting for an electronic-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. Interested party concerns focused on the ongoing costs to insurers for systems upgrades, as well as potential requests for additional information. However, SAPWG believes that a change in the NAIC policy is needed to aid collection of semi-annual investment information.

Next Steps. SAPWG will send a referral to the Accounting Practices and Procedures Task Force detailing past discussions, exposures, and its support for making a policy change, as exposed, to collect semi-annual investment information.

Loan-Backed and Structured Securities

Action. SAPWG exposed revisions to SSAP No. 43R to amend the definition of loan-backed and structured securities and to clarify the admitted asset requirements. Comments are due February 10, 2017.

The revisions to SSAP 43R would:

- Revise the definition such that securities with a single obligor would follow the accounting guidance in SSAP No. 26, rather than that in SSAP No. 43R;
- Revise the title of the SSAP from "loan-backed and structured securities" to "structured finance securities," including all references to these securities within the SSAP;
- Clarify that in order for the security to be an admitted asset:

[12] SSAP No. 103, Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.

  - The underlying asset generating the cash flows of the structured security would need to qualify as an admitted asset; and
  - All obligors to the structured finance security would need to be unrelated to the reporting entity;
- Update the effective date guidance to remove transition guidance discussion; and
- Remove outdated guidance from the Question and Answer Implementation Guide.

The proposal was referred to the Structured Securities Group to verify that the proposed definition changes will not affect the scope of securities captured within the financial modeling process to assign an NAIC designation.

Mortgage Loans

Action. SAPWG exposed revisions to clarify that entities acting as a participant to a mortgage loan agreement are within the scope of SSAP No. 37. Revisions also:

- Clarify the related impairment assessment, and
- Incorporate disclosures for these structures.

Comments are due February 10, 2017.

The proposed revisions are in response to an interested party request to clarify if partial interest mortgage loans are within the scope of SSAP No. 37. These arrangements generally occur in large commercial mortgage loans where there is one borrower with more than one lender identified in a single lending agreement, and all lenders are secured with the same real estate. No individual lender can unilaterally foreclose on the loan. Rather, all of them are identified as "participants" and each must agree to the foreclosure.

Asset Valuation Reserve and Interest Maintenance Reserve

Action. SAPWG exposed a request for information on the current practices of allocating gains and losses between the asset valuation reserve (AVR) and the interest maintenance reserve (IMR), as well as information on the recognition of other-than-temporary-impairment (OTTI) if the security sold in the same reporting period that the OTTI was identified. Comments are due February 10, 2017.

As part of the investment classification project, SAPWG identified potential inconsistencies with the existing AVR and IMR guidance in the annual statement instructions and SSAP No. 26. They also identified possible interpretation differences on applying the OTTI guidance. Based on preliminary information, insurers may be recognizing the total realized loss in AVR or IMR, rather than bifurcating the loss between credit-related OTTI (AVR) and interest-related OTTI (IMR), as required by SSAP No. 26. SAPWG asked for comments on current practices of allocating gains and losses between AVR and IMR for the following situations:

- OTTI is recognized for a security with a NAIC 6 designation;
- An impaired security is sold and loss is realized in the same reporting period as the decision to sell with (i) no NAIC designation change, and (ii) with a two-NAIC designation change;

- A security with previous OTTI is sold at maturity for less than the carrying value; and
- Instances when an insurer would record negative OTTI.

Clarification of Investment Proceeds Disclosure

Action. SAPWG adopted nonsubstantive 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.

Insurers should include the following disclosures for all bonds and securities receiving bond treatment:

- 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 from sales of bonds and gross realized gains and losses recognized on such sales.

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 to treat the requirements of ASU 2015-09 for statutory financial reporting.[13] SAPWG continued to defer 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 by accident year; and
- A reconciliation of the total net amount for all tables presented to the amount in the statement of financial position presented with 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 working with the AICPA to recommend how to address these disclosures for statutory reporting.

Credit Losses

Action. SAPWG deferred discussion of this topic until the second half of 2017.

Interested parties have the following concerns about adopting ASU 2016-13 for statutory reporting.

- Adopting the ASU would require modifying the Life Risk Based Capital (RBC) factors and the AVR calculation to avoid double counting for expected credit

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[13] FASB Accounting Standards Update No. 2015-09, Disclosures about Short-Duration Contracts, available at www.fasb.org.

losses. They believe there are appropriate mechanisms for the conservative treatment of credit losses within both solvency and required capital measurements (risk based capital factors and the AVR).

- Most receivables in the statutory balance sheet are subject to both non-admission requirements and RBC charges. The existing conservative treatment of receivables does not warrant the overlay of an expected credit loss model.
- Adopting the ASU would have a significant effect on small and medium size companies that do not apply U.S. GAAP. Implementing the guidance would be a substantial task for these entities, with the cost outweighing the benefit given the conservatism of the statutory accounting model used today.
- Insurers with available-for-sale bond portfolios would be affected if the credit loss model has to be applied to all financial assets reported at amortized cost on a statutory basis. For U.S. GAAP, these bonds are measured at fair value, whereas for statutory reporting, they are measured at amortized cost (unless their rating requires lower of cost or fair value). Thus, insurers would need to apply the expected credit loss model to their bond portfolios for statutory reporting but not for U.S. GAAP reporting.

Next Steps. SAPWG will:

- Assess the comments received and how the rejection of ASU 2016-13 would align with statutory accounting concepts; and
- Continue to work with interested parties and the AICPA to evaluate whether the ASU should be adopted, modified, or rejected for statutory accounting.

Cybersecurity

Before the Fall meeting, the Cybersecurity Task Force received comments on the second draft of the Insurance Data Security Model Law. On the call, interested parties continued to express significant concerns about the Model Law, which included these beliefs.

- The Model Law will not achieve uniformity because it suggests minimum requirements while giving states the ability to enact more stringent laws than those in the Model.
- Many of the definitions are too broad, such as data breach and personal information.
- The language about a licensee’s responsibility for oversight of third party providers should be changed because it may subject the licensee to liability and a grandfathering provision should be added for existing contracts.
- Licensees subject to other requirements, such as Health Information Portability and Accountability Act (HIPPA), should be exempt from the Model Law.
- The requirement to notify a consumer of a data breach should include a harm trigger.

- The requirement allowing commissioners to prescribe the appropriate level of consumer protection should be modified because it may result in consumers in different states receiving different remediation for the same breach.
- Confidentiality protections should be similar to those provided in the Own Risk and Solvency Assessment.

Consumer representatives also believed that the draft Model Law provides too much flexibility to the licensees. The information security program allows tailoring based on the size and complexity of the licensee, the nature and scope of the licensee's activities, and the sensitivity of the personal information in the licensee's possession, custody, or controls.

In response to the comments received, the Task Force formed a drafting group including regulators, industry, and consumer representatives to revise the Model Law. At the Fall meeting, the drafting group updated the Task Force on its progress, indicating that it is redrafting the Model Law to address concerns raised during the comment period. The six most important issues the group believes it will need to address are:

- Uniformity and exclusivity of the law;
- Whether to have an exemption for licensees subject to HIPPA or Gramm Leach Bliley Act;
- Inclusion of a harm trigger in the definition of a data breach and the timing of breach notification to the consumer;
- Definition of personal information;
- Scalability of information security requirements; and
- Oversight of third-party service providers.

Next Steps. The drafting group will continue to hold calls to develop the third draft of the Model Law.

Group Capital Calculation

Action. The Group Capital Working Group exposed a memorandum discussing two approaches to developing a scalar to use for non-U.S. insurers in a group capital calculation:

- Relative ratio approach, and
- Distance to intervention approach.

Comments are due January 24, 2017.

On a call before the Fall meeting, the Group Capital Working Group discussed comments about various aspects of an inventory method used to calculate group capital. Comments expressed different views on most topics previously exposed, which included these opinions.

- For non-insurance entities not subject to capital requirements, some believed that a flat charge is appropriate. Others believed applying a risk-sensitive charge would ensure it does not penalize well-capitalized companies.
- For non-insurance affiliates requirements, there was general consensus that existing sector capital requirements would be appropriate (e.g., banking).

- For non-U.S. insurers, some supported development of country specific scalars, while others did not.

Commenters also requested further defining the scope of companies that would be included in the group capital calculation. Some believed that entities where regulators can obtain information from the group-wide supervisor, similar to what is done for the Own Risk Solvency Assessment, should be excluded.

Based on comments received, the Working Group decided to take these actions.

- Use the 22.5 percent flat charge for non-insurance affiliates not subject to capital requirements. However, the Working Group stated it will consider other alternatives in the future.
- Use the sectoral capital requirements for non-insurance entities subject to capital requirements.
- Set the scope consistent with that of the Holding Company System Regulation Act.

The Working Group also requested interested parties to prepare a presentation about an approach using scalars.

At the Fall meeting, the Working Group discussed two approaches to determining scalars. The relative ratio approach would require performing detailed calculations each year. This approach is similar to what interested parties support; however, there is concern with the effort necessary to complete it because it requires extensive country-specific information.

The distance to intervention approach is based on the premise that a company with a stronger capital ratio should receive a lower charge in the capital calculation. Insurers further away from the action level would have a smaller factor (or scalar) applied to the jurisdictional capital requirement. This approach has both the benefit of being relatively simple to apply and uses the current RBC approach.

Interested parties presented high-level principles to consider in the group calculation as well as for calibration mechanisms. They highlighted that field testing would be needed under either approach to determine group capital.

Next Steps. The Working Group is planning a field test of the group capital calculation beginning mid-2017 through mid-2018, with tentative implementation in 2020 using 2019 data.

Qualified Jurisdictions

Action. The Reinsurance Task Force exposed a report about the implementation of Solvency II by EU member states and its potential effect on the qualified jurisdiction status of four countries: France, Germany, Ireland, and the UK. Comments are due January 10, 2017.

The Qualified Jurisdiction Working Group reported to the Reinsurance Task Force that some regulators and interested parties view Solvency II implementation as imposing restrictions on U.S. insurance and reinsurance companies doing business in certain EU countries.

The Working Group presented results of a survey conducted to understand how particular actions of EU insurance supervisors under Solvency II may affect U.S.

insurers and reinsurers. There were 21 respondents representing state insurance regulators, U.S. ceding insurance companies, and U.S. reinsurers. The results of the survey included these responses.

- The actions taken by the four jurisdictions had a quantifiable negative effect on the capacity of U.S. insurers and reinsurers doing business in the EU.
- A termination of the qualified jurisdiction status may have a negative effect on reinsurance capacity in the U.S. market.
- The Solvency II implementation issues, and their effect on U.S. companies, are not limited to actions taken by these four qualified jurisdictions.
- The actions taken by the four jurisdictions constitute a material change in circumstances, which could result in revocation of the qualified jurisdiction status.
- The issue is complex and the NAIC should proceed with caution and avoid taking any retaliatory action that might disrupt the market or otherwise negatively affect U.S. insurers and reinsurers.

The Working Group also reported on the volume of the business assumed from and ceded to the four EU qualified jurisdictions. Based on information obtained from 2015 filings, U.S. assumed premiums totaled $6.3 billion and ceded premiums totaled $22.3 billion. Although quantifiable data is not available, the potential exists that a significant amount of business might not renew on January 1, 2017. Interested parties also believed that at least one other country in the EU (Belgium) that is not a qualified jurisdiction is restricting access to U.S. insurers by requiring a physical presence. They believed that this requirement further shows inconsistent implementation of Solvency II between the various countries within the EU.

The Working Group also stated that no formal reevaluations of qualified jurisdictions have been completed. If a reevaluation is completed and the status of the qualified jurisdiction is revoked, it could have negative effects, including a requirement for ceding insurance companies to post reinsurance collateral supporting all reserve balances. This outcome would increase costs and the availability of reinsurance in the U.S. marketplace.

Next Steps. The Task Force plans to contact the four EU qualified jurisdictions and provide them an opportunity to comment on the analysis obtained by the Working Group to confirm the Working Group has a full understanding of the actions taken by these jurisdictions. The Task Force also directed the Working Group continue its study of EU member state implementation of Solvency II and provide a report recommending the qualified jurisdiction status for France, Germany, Ireland, and the UK. Factors that could affect the conclusion include:

- The domiciliary regulator’s willingness to share information and cooperate with U.S. regulators in general, and
- The extent of reciprocal recognition afforded by the non-U.S. jurisdiction to reinsurers domiciled in the United States.

Investment Risk-Based Capital

In August 2015, the Investment Risk-Based Capital Working Group received a proposal from the Academy of Actuaries (Academy) to set new C-1 RBC factors for bonds and similar assets in the Life RBC calculation. This proposal included the expansion of bond factors from 6 to 20 designations.

On a call before the Fall meeting, the Working Group exposed for a 30-day public comment period, preliminary decisions about the C-1 bond factors for insurers subject to the AVR, including these decisions.

- 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 bonds, the 20-designation framework will apply in determining the AVR amount.

On a subsequent call, the Academy responded to comments submitted by ACLI. The Working Group also referred its preliminary decisions to VOSTF and SAPWG for review.

At the Fall meeting, the ACLI recommended to the Working Group that alternative C-1 factors be considered based on the ACLI's internal bond model. The key differences between the ACLI and the Academy's models is the use of different assumptions to calculate the C-1 factors. The ACLI's model also proposed factors that are more granular, including different C-1 factors based on asset classes such as public corporates, privates, U.S. municipals, and government-related bonds.

The Working Group also received the Academy's recommendation related to the portfolio adjustments for bonds in the life RBC formula. The Academy suggested two possible approaches to the adjustment:

- Update the portfolio factors for the number of issuers; or
- Evaluate a new portfolio adjustment measure designed to capture the variation in invested amount by issuer, in addition to the number of issuers.

Next Steps. The Working Group decided to keep the C-1 factors as proposed by the Academy, but asked the Academy to consider any appropriate updates to its model based on ACLI's proposal and report its findings to the Working Group on future calls. The Working Group will continue discussion of portfolio adjustment factor alternatives on future calls.

Other Accounting Highlights

Correction of an Error in SSAP No. 3

Action. SAPWG adopted a revision to SSAP No. 3 clarifying that insurers should report corrections of accounting errors in previously issued financial statements as adjustments to unassigned surplus in the period identified. Insurers should file amended financial statements when they become aware of a material accounting error, unless otherwise directed by their domiciliary regulator.[14]

[14] SSAP No. 3, Accounting Changes and Corrections of Errors.

Cash Flow Statement Classification of Certain Cash Receipts and Cash Payments

Action. SAPWG exposed revisions to SSAP No. 69 to adopt recent U.S. GAAP guidance on the classification of certain cash receipts and cash payments in the cash flow statement to improve consistency in statutory reporting as well as minimize differences in cash flow presentation between statutory and U.S. GAAP accounting. Comments are due February 10, 2017.

The FASB issued ASU 2016-15 to address how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The ASU targeted the following specific cash flow activities for which there was no GAAP guidance, or where the guidance was unclear:

- Debt prepayment and extinguishment costs;
- Settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing;
- Contingent consideration payments made after a business combination;
- Proceeds from the settlement of insurance claims;
- Proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies;
- Distributions received from equity method investees;
- Beneficial interests in securitization transactions; and
- Separately identifiable cash flows and application of the predominance principle.

Guaranty Fund Credits for Short Duration Contracts

Action. SAPWG adopted a revision to SSAP No. 35R that allows consideration of expected renewals of short-term contracts for long-term care assessments when determining the premium tax credits and policy surcharge assets recognized when accruing guaranty and fund liability assessments. The change is effective January 1, 2017.

The adopted revision permits considering renewals of short-term contracts in recognizing the related asset when:

- Retrospective-premium-based assessments are imposed on short-term health contracts for insolvencies of long-term care contract insurers; and
- It is probable that accrued liability assessments will result in a future recoverable for premium tax credits or policy surcharges for business currently in force.

These revisions will result in more comparable accounting treatment between life and health insurers subject to similar retrospective guaranty assessments for long-duration products. However, the revisions will create a difference between statutory accounting and U.S. GAAP, which excludes consideration of renewals for short-duration contracts.

SAPWG deferred discussion on the discounting of the liability for guaranty fund assessments and requested the NAIC staff to perform further research and provide a recommendation.

Health Care Receivables

Action. SAPWG adopted 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.[15]

This modification 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.

Definition of a Notional

Action. SAPWG adopted revisions to SSAP No. 86 to define notional amount for instruments other than futures contracts, and clarify that the definition serves as a principle for determining the notional amount for all derivative instruments. The change is effective January 1, 2017.

Companies use different approaches when determining the notional amount because SSAP No. 86 only has a definition for future contracts. The notional balance is not recorded on the balance sheet, but is a volume indicator and used to assess derivative activity. At the Summer 2016 meeting, SAPWG exposed two options for the definition of a notional.

- Option 1: the notional is determined based on the type of contract.
- Option 2: the notional is determined based on the underlying contract.

Interested parties preferred Option 1 because they believe this definition would result in a consistent and static notional amount. They believed that Option 2 would cause more confusion and diversity in practice and could be operationally difficult. SAPWG adopted Option 1 to define the notional amount as either the amount to which interest rates are applied to calculate periodic payment obligations, or the amount of the contract value used when determining the cash obligations. SAPWG also clarified that the notional amount should remain static over the life of a trade unless the instrument is partially unwound or has a contractually amortizing notional.

Intra-Entity Transfer of Assets Other Than Inventory

Action. SAPWG exposed revisions to SSAP No. 101 to adopt with modification, recent U.S. GAAP guidance for intra-entity transfer of assets other than inventory.[16] The modification instructs companies to follow guidance in SSAP

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[15] SSAP No. 84, Health Care and Government Insured Plan Receivables.

[16] ASU 2016-16, Income Taxes: Intra-entity Transfers of Assets Other Than Inventory.

No. 25 to determine if gains or increases in surplus from related party transactions should be deferred.[17] Comments are due February 10, 2017.

The FASB issued ASU 2016-16 to improve the accounting for income tax effects of intra-entity transfers of assets other than inventory. The ASU requires an entity to recognize income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs.

Other Regulatory Highlights

Action. The executive and plenary committee adopted the Credit for Reinsurance Model Regulation.[18]

The model regulation establishes uniform, national standards governing reserve financing arrangements for life insurance policies containing guaranteed non-level gross premiums, guaranteed non-level benefits, and universal life insurance policies with secondary guarantees. The model regulation is used to ensure that, with respect to each such financing arrangement, funds consisting of primary security and other security are held by or on behalf of ceding insurers in the forms and amounts required.

Other Actuarial Highlights

Risk Adjustment

During 2016, 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 insurers. Regulators had concerns with the proposal and asked CHOICES to revise it for further discussion.

At the Fall meeting, the Health Care Reform Actuarial Group closed its review of the proposal because there has been no recent action and a revised proposal was not submitted.

Asset Adequacy Testing

At the Fall meeting, the Long Term Care Actuarial Working Group discussed its proposal and comment letter responses received from interested parties for a standalone asset adequacy test for long-term care blocks of contracts.

This proposal would require a standalone asset adequacy analysis for valuations beginning with December 31, 2017 reporting, unless exempted due to the small size of the block of business. The proposal did not provide additional information on defining 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 amounts and timing of approvals by state jurisdiction.

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[17] SSAP No. 25, Affiliates and Other Related Parties.

[18] Term and Universal Life Insurance Reserve Financing Model Regulation.

Interested parties had significant concerns with the proposal.

- The change would apply to the minimum reserve standard for long-term care (LTC) insurance policies after the date of issuance of the policies.
- The multi-scenario analysis often used in standalone asset adequacy testing does not add any additional information about whether reserves are adequate for long-term care blocks of contracts. The existing assets do not have to be segregated or modeled together with liabilities in a single projection because the long-term care benefit cash flows are not interest sensitive.
- There are existing requirements to test reserve adequacy for LTC insurance and those requirements should be the basis to ensure that reserves are sufficient.

Next Steps. The working group will continue discussion of the standalone asset adequacy testing for long-term care blocks of contracts.

Actuarial Guideline 48

Action. On a call before the Fall meeting, the NAIC adopted revisions to AG 48 to align the guideline with Reinsurance Model Regulation.

Revisions add a new section on coordination between the guideline and the Reinsurance Model Regulation and aim to mirror the guideline to the Reinsurance Model Regulation. However, AG 48 still differs from the Reinsurance Model Regulation including in the following respects:

- Actuarial section;
- Eliminates references to credit for reinsurance for treaties containing both Non-Covered Policies and Covered Policies because they are outside the scope of an Actuarial Guideline;
- Expands prohibition on double counting security used for Non-Covered Policies when determining compliance with the requirements for Covered Policies to cover Other Security;
- Requires a qualified actuarial opinion rather than a loss of credit in the event of an un-remediated deficiency;
- Requires analysis, and remediation, if needed, annually and not quarterly as required by the Reinsurance Model Regulation; and
- Does not require on-going compliance by the insurer.

Longevity Risk

Before the Fall 2016 meeting, the Longevity Risk Task Force (LRTF) held calls to discuss alternatives to include longevity risk in RBC and/or reserves. At the Fall meeting, the LRTF reported on its progress and discussed a method of allocating the longevity risk between reserves and risk based capital, which would:

- Address statutory reserve shortfalls through asset adequacy testing, update statutory reserves for older products, and bring the locked-in mortality tables in line with mortality standards for new business; and
- Add a new RBC C-2 charge that represents the future longevity risk, based on prescribed rates recommended by the Academy.

The LRTF believes that insurers already account for accumulated longevity risk in either reserve strengthening or asset adequacy testing. The proposed approach would introduce a regulator prescribed and uniform method to measure longevity risk. The Academy will conduct further studies to assess both the structure of the applied rates, and how to calibrate them.

Next Steps. Once the LRTF receives the recommendation from the Academy, it will evaluate the proposal and make the recommendations to LATF.

Contact us: This is a publication of KPMG's Department of Professional Practice 212-909-5600

Contributing authors: Jennifer D. Austin, Matt J. Boran, Olga Roberts, Robert. B. Kasinow, Michael Beck, Brett L. Endler, and Darcie K. Garza.

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