NAIC Fall Meeting

December 2017

Issues & Trends

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Meeting highlights

On conference calls and at its Fall meeting, the National Association of Insurance Commissioners (NAIC) **adopted** the following guidance:[1]

— revisions to SSAP No. 86 to add aggregate disclosures about derivative contracts with deferred or financing premiums for year-end 2017;[2]
— revisions to SSAP No. 86 to recognize variation margin payments received or paid as unrealized gains or losses until the derivative instrument is sold, matures, expires or has another closing transaction;
— revisions to SSAP No. 100R to allow the use of net asset value (NAV) per share as a practical expedient to fair value and add disclosures to identify assets valued using NAV;[3] and
— changes to the Guaranty Association Model Act to add health maintenance organizations and provide for equitable assessment for long-term care insolvencies between accident / health and life / annuity insurers.[4]

The NAIC **exposed:**

— a proposal from NAIC consultant, Oliver Wyman, on changes to the variable annuity framework, including AG 43 and life risk-based capital (RBC), and
— revisions to SSAP No. 68 to add disclosures about acquisitions of subsidiary controlled and affiliated (SCA) entities, including the acquisition date of the SCA, the amount of goodwill as of the reporting date and admitted goodwill as a percentage of the SCA's book-adjusted carrying value.[5]

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1 NAIC Fall meeting was held December 2-4 in Honolulu
2 SSAP No. 86, Derivatives
3 SSAP No. 100R, Fair Value
4 Life and Health Insurance Guaranty Association Model Act 520
5 SSAP No. 68, Business Combinations and Goodwill

Investments – Page 8	
Bank loans	Statutory Accounting Working Group (SAPWG) adopted revisions to SSAP No. 26R that expand the definition of a bank loan to include those issued directly by an insurer.[6] The Blanks Working Group exposed a proposal to incorporate new reporting in Schedule D for bank loans to be effective for year-end 2018. Comments are due February 26, 2018.
Common stock	SAPWG exposed revisions to SSAP No. 30 to clarify items within its scope.[7] Comments are due January 19, 2018.
Effect of future settled premiums on option valuations	SAPWG adopted revisions to SSAP No. 86 to add aggregate disclosures about derivative contracts with deferred or financing premiums for year-end 2017. It exposed revisions to SSAP No. 86 to require disclosures at the contract level for derivatives with financing premiums. Comments were also requested on the proposed changes to exclude the effect of future settled premiums in the asset valuation reserve calculation. Comments are due January 19, 2018.
Variation margin	SAPWG adopted revisions to SSAP No. 86 to recognize variation margin payments received or paid as unrealized gains or losses until the derivative instrument is sold, matures, expires or has another closing transaction. Revisions are effective January 1, 2018, on a prospective basis, for insurers that previously recognized variation margin changes as realized gains and losses.
Derivatives and hedging	SAPWG directed the NAIC staff to review how the derivative guidance in SSAP No. 86 interacts with current US GAAP requirements, including the recently issued ASU about targeted improvements.[8]
Net asset value	SAPWG adopted revisions to SSAP No. 100R to allow the use of NAV as a practical expedient for fair value and add disclosures to identify assets valued using NAV. The change is effective January 1, 2018, with early adoption permitted for year-end 2017.

[6] SSAP No. 26R, Bonds
[7] SSAP No. 30, Unaffiliated Common Stock
[8] ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities

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Wash sales involving money market funds	SAPWG: — adopted revisions to SSAP No. 103R to exclude money market mutual fund shares from wash sale disclosures;[9] and — exposed revisions to SSAP No. 103R to exclude all cash equivalent, derivative instrument and short-term investments with credit assessments equivalent to NAIC 1-2 ratings from wash sale disclosures. The exposure also clarifies that the disclosures would be included in the financial statements when the investment is sold. Comments are due January 19, 2018.
Credit losses	SAPWG directed NAIC staff to draft revisions to adopt, with modification, US GAAP guidance on credit losses and replace the current incurred loss model within statutory guidance with an expected credit loss concept.[10]
Principle-based reserving (PBR) – Page 12	
Income annuities	On a December 14, 2017 call, LATF re-exposed a question and answer document about income annuity reserves subject to VM-22[11] for a 45-day comment period.
Experience reporting requirements	Life Actuarial Task Force (LATF) exposed changes to VM-50.[12] Comments are due January 12, 2018.
Term riders	At the Fall meeting, LATF re-exposed a proposal to clarify treatment of term riders when valued separately from the base policy. Comments are due January 15, 2018.[13]
PBR implementation task force	The NAIC disbanded PBR Implementation Task Force and its subgroups.

9 SSAP No. 103R, Transfers and Servicing of Financial Assets and Extinguishments of Liabilities
10 ASU 2016-13, Measurement of Credit Losses on Financial Instruments
11 VM-22, Maximum Valuation Interest Rates for Income Annuities
12 VM-50, Experience Reporting Requirements
13 VM-20, Requirements for Principle-Based Reserves for Life Products

Variable annuities – Page 13	
Variable annuity framework	At the Fall meeting, the Variable Annuities Working Group exposed a proposal from NAIC consultant, Oliver Wyman, for changes to the variable annuity framework, including AG 43 and life risk-based capital.[14] Comments are due March 2, 2018.
Group capital calculation – Page 15	
Captives	The Group Capital Working Group exposed an approach to use a look-through method in the group capital calculation for captives that assume XXX/AXXX business. Comments are due December 29, 2017.
Permitted and prescribed practices	The Group Capital Working Group did not have strong views about how permitted and prescribed practices should be treated in a group capital calculation because these practices did not appear to be significant. The Working Group will continue to consider the effect and treatment of permitted and prescribed practices.
Non-regulated entities	The Group Capital Working Group exposed a revised approach for factors in the group capital calculation for non-regulated entities. Comments are due January 15, 2018.
Surplus notes	The Group Capital Working Group exposed a proposal on the treatment of senior debt and surplus notes in the group capital calculation. Comments are due January 15, 2018.
Covered agreement– Page 18	
Covered agreements	At the Fall meeting, the Reinsurance Task Force discussed the next steps to implement the covered agreement, including removing reinsurance collateral requirements for the insurers that are subject to the agreement. The Task Force will hold a public hearing that has been tentatively scheduled for February 20, 2018 in New York to continue discussions.

[14] Actuarial Guideline XLIII – CARVM for Variable Annuities

Risk-based capital – Page 19	
Bonds	The Investment Risk-Based Capital Working Group exposed the American Academy of Actuary's (Academy) updated recommendations of C-1 factors for the RBC formula. Comments are due January 22, 2018.
Real estate	The American Council of Life Insurers (ACLI) responded to comments about lowering the real estate risk-based capital factor from 15 to 10 percent. The Academy told the regulators that it will review additional analysis provided by the ACLI and present its views during future calls or meetings.
Federal Home Loan Banks (FHLB)	The Life Risk-Based Capital Working Group re-exposed a proposal changing the C-0 charge for collateral held for FHLB advances from 1.3 percent to zero. The comment period ended November 22, 2017.
Medicaid pass-through payments	The Capital Adequacy Task Force exposed a proposal to apply a two percent RBC charge for Medicaid pass-through payments. Comments are due January 15, 2018.
Long-term care – Page 21	
Guaranty Association Model Act	At the Fall meeting, the NAIC adopted changes to the Guaranty Association Model Act to add health maintenance organizations and provide for equitable assessment for long-term care insolvencies between accident / health and life / annuity insurers.
Other accounting highlights – Page 22	
Leases	SAPWG discussed comments on revisions to SSAP No. 22R to consider US GAAP guidance on leases.[15] It directed NAIC staff to review the comments from interested parties to determine whether further revisions are needed.

[15] ASC 842, Leases

Other accounting highlights – Page 22	
Surplus notes	SAPWG re-exposed revisions to SSAP No. 41R and SSAP No. 97 to eliminate parent-issued surplus notes within the Investment in the Subsidiary, Controlled and Affiliated Entities line item to avoid double counting at the parent reporting entity.[16] Comments are due January 19, 2018.
Policy loans	SAPWG requested comments on the accounting for policy loans for business in a separate account. Comments are due January 19, 2018.
Risk transfer for short-duration policies	SAPWG directed NAIC staff to work with interested parties on informal drafting calls to develop changes to guidance for reinsurance contracts that would be responsive to regulatory needs and the concerns of interested parties.
Goodwill limitations	SAPWG exposed a revision to SSAP No. 68 to add additional disclosures about acquisitions of SCA entities, including the acquisition date of the SCA, the amount of goodwill as of the reporting date and admitted goodwill as percentage of the SCA's book-adjusted carrying value. Comments are due January 19, 2018.
Pension and other post-retirement benefit	On a call before the Fall meeting, SAPWG exposed revisions to SSAP No. 92 and SSAP No.102 to remove the fair value Level 3 reconciliation for plan assets.[17] Comments are due January 19, 2018.
Employee share-based payments	SAPWG adopted revisions to SSAP No. 104R and SSAP No. 12 to adopt, with modification, US GAAP guidance on improvements to employee share-based payments accounting.[18]
High-cost risk pooling under the Affordable Care Act	SAPWG adopted revisions to SSAP No. 107 to report high-cost risk pool claim reimbursements as increases to premium along with required new disclosures.[19] The change is effective for periods beginning on or after January 1, 2018.

[16] SSAP No. 41R, Surplus Notes; and SSAP No. 97, Investments in Subsidiary, Controlled and Affiliated Entities
[17] SSAP No. 92, Postretirement Benefits Other than Pensions; SSAP No. 102, Pensions
[18] SSAP No. 12, Employee Stock Ownership Plans; SSAP No. 104R, Share-Based Payments
[19] SSAP No. 107, Risk-Sharing Provisions of the Affordable Care Act

Other actuarial highlights – Page 27	
Longevity risk	The Academy reported on its progress to develop a longevity risk charge. It will share additional specifications with the Subgroup with the goal of beginning a field study after the Spring 2018 meeting.
Guaranteed issue and simplified issue tables	On a call after the Fall meeting, LATF decided to exclude Guaranteed Issue Life Insurance Policies from the requirement to apply PBR. LATF will continue to discuss Simplified Issue Mortality Tables.

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Investments

Bank loans

Action. SAPWG adopted revisions to SSAP No. 26R that expand the definition of a bank loan to include those issued directly by an insurer.

Action. The Blanks Working Group exposed a proposal to incorporate new reporting in Schedule D for bank loans to be effective for year-end 2018. Comments are due February 26, 2018.

Interested parties supported inclusion of the bank loans issued by insurers in the definition of a bank loan, however they did not believe that additional reporting requirements in Schedule D were needed.

Common stock

Action. SAPWG exposed revisions to SSAP No. 30 to clarify items in its scope. Comments are due January 19, 2018.

While maintaining the current definition of common stock, the exposure identifies instruments that are in its scope but are not considered common stock and expands the scope to include closed-end funds and unit investment trusts. Comments were requested on whether separate reporting lines are needed on Schedule D to differentiate between mutual funds, closed-end funds and unit-investment trusts.

SAPWG also requested feedback on responses to the 2014 Valuation of Securities Task Force referral about excluding equity or fund investments from SSAP No. 26R, reporting an NAIC designation assigned by a Securities Valuation Office on Schedule D-2-2, (common stocks owned during the year) and allowing RBC to be driven by underlying risk of investments within the fund.

Effect of future settled premiums on option valuations

Actions. SAPWG adopted revisions to SSAP No. 86 to add aggregate disclosures about derivative contracts with deferred or financing premiums for year-end 2017. It also exposed revisions to SSAP No. 86 to require disclosures at the contract level for derivatives with financing premiums. Comments were also requested on the proposed changes to exclude the effect of future settled premiums in the asset valuation reserve calculation. Comments are due January 19, 2018.

SAPWG discussed comments about proposed revisions to SSAP No. 86 to capture individual contract level and aggregate information for derivatives with financing premiums. Interested parties generally agreed with the proposed aggregate disclosures, but recommended a one-category presentation of amounts for all future years after the fourth year. They also expressed concerns that proposed individual contract note disclosures would be voluminous and should only be required once Schedule DB is updated.

In response to feedback provided by interested parties, SAPWG adopted aggregate-only disclosures for:

— non-discounted total premium cost and premiums cost due in each of the following four years and thereafter; and
— fair value of derivative instruments with financing premiums excluding the effect of the deferred or financing premiums.

Variation margin

Action. SAPWG adopted revisions to SSAP No. 86 to recognize variation margin payments received or paid as unrealized gains or losses until the derivative instrument is sold, matures, expires or has another closing transaction. Revisions are effective January 1, 2018, on a prospective basis, for insurers that previously recognized variation margin changes as realized gains and losses. Insurers already following this guidance will not be affected by this change.

In 2017, the Chicago Mercantile Exchange amended its rulebook to characterize variation margin payments for over-the-counter derivatives as legal settlement payments and not collateral. Interested parties indicated that continuing to report collateral separately on the balance sheet with the derivative recorded at fair value and the fair value adjustment recorded as an unrealized gain or loss is most consistent with statutory accounting principles.

Derivatives and hedging

SAPWG discussed how US GAAP guidance on derivatives and hedging activities should be incorporated into statutory accounting. The intention was to clarify current statutory accounting guidance and identify areas that align with or diverge from US GAAP guidance.

In August 2017, the FASB issued an ASU to simplify and expand the application of hedge accounting. The ASU changes the recognition and presentation requirements of hedge accounting, including:

— eliminating the requirement to separately measure and report hedge ineffectiveness; and
— presenting all items that affect earnings in the same income statement line as the hedged item.

The ASU also provides new alternatives for:

— applying hedge accounting to additional hedging strategies;
— measuring the hedged item in fair value hedges of interest rate risk;
— reducing the cost and complexity of applying hedge accounting by easing the requirements for effectiveness testing, hedge documentation and application of the critical terms match method; and

— reducing the risk of material error corrections if a company applies the shortcut method inappropriately.

Next steps. The Working Group directed the NAIC staff to review how the derivative guidance in SSAP No. 86 interacts with current US GAAP requirements, including the recently issued ASU about targeted improvements.

Net asset value

Action. SAPWG adopted revisions to SSAP No. 100R to allow the use of NAV per share as a practical expedient for fair value and add disclosures to identify assets valued using NAV. The change is effective January 1, 2018, with early adoption permitted for year-end 2017.

Insurers will be allowed to use NAV when:

— an SSAP specifically identifies NAV as a permitted practical expedient; or
— an investment does not have a readily determinable fair value, and it is an investment company or a real estate fund for which it is industry practice to measure investment assets at fair value on a recurring basis, and the issued financial statements are consistent with the measurement principles of an investment company.

Wash sales involving money market funds

Action. SAPWG:

— adopted revisions to SSAP No. 103R to exclude money market mutual fund shares from wash sale disclosures; and
— exposed revisions to SSAP No. 103R to exclude all cash equivalent, derivative instrument and short-term investments with credit assessments equivalent to NAIC 1-2 ratings from wash sale disclosures. The exposure also clarifies that the wash sale disclosure would be included in the financial statements when the investment is sold. Comments are due January 19, 2018.

After SAPWG adopted revisions to exclude money market funds from the wash sale disclosures, interested parties suggested that additional exclusions should be considered. Proposed revisions do not change guidance that requires all other investments that are non-rated or that have an NAIC 3-6 rating to be included in the disclosure. SAPWG requested comments about including or excluding common stock and mutual funds from the wash sale disclosure because their sale before year-end could improve an insurer's RBC.

Credit losses

On a call before the Fall meeting, SAPWG discussed three options to address the US GAAP guidance for credit losses in statutory accounting:

Option 1: Adopt US GAAP guidance, with modification, to incorporate the concept of expected credit losses.

Option 2: Reject US GAAP guidance, but incorporate the concept of expected credit losses through other methods.

Option 3: Reject US GAAP guidance and retain the incurred loss model.

Regulators supported Option 1. They believe that statutory accounting should incorporate the expected credit loss model to improve the timing of when the losses are reported. SAPWG acknowledged that this option may involve other revisions to statutory accounting such as changing the guidance to RBC formulas or Asset Valuation Reserve (AVR) because they currently consider credit risk. SAPWG also believes that depending on the results of the initial analysis, an alternative option may be needed.

However, interested parties voiced their concern about Option 1. Consistent with their comments on the original issue paper about how this US GAAP guidance should be incorporated for statutory accounting, they suggested that the current incurred loss model is appropriate because:

- statutory accounting and US GAAP have different reporting models for investments – statutory accounting requires investments to be reported at amortized cost, while US GAAP reports them at fair value, and
- the statutory framework includes concepts of AVR and RBC to address credit risk.

Next steps. SAPWG directed NAIC staff to draft revisions to adopt, with modification, US GAAP guidance on credit losses and replace the current incurred loss model with an expected credit loss concept.

3

Principle-based reserving

Income annuities

Action. On a December 14, 2017 call, LATF re-exposed a question and answer document about reserves subject to VM-22 for a 45-day comment period.

In April 2017, LATF adopted VM-22 that contains the valuation interest rates to be used for certain products in the scope of VM-22. Over time, the NAIC intends for VM-22 to include the valuation requirements for all annuity products not covered by VM-21.[20] Interested parties raised questions about the applicability of VM-22 for different products. In response to these questions, the Subgroup created the question and answer document.

Experience reporting requirements

Action. On a call before the Fall meeting, LATF exposed changes to VM-50. Comments are due January 12, 2018.

The proposed changes to VM-50 reflect that the NAIC will be an experience data collection agent on behalf of the states. The NAIC will collect and pool insurer PBR experience data that will be used to develop future assumptions.

Term riders

Action. At the Fall meeting, LATF re-exposed a proposal to clarify treatment of term riders when valued separately from the base policy. Comments are due January 15, 2018.

On calls before the Fall meeting, LATF discussed a previously exposed proposal requiring term riders to follow the methodology applicable to term plans under VM-20, rather than the valuation methodology of the base policy. Based on comments received, the regulators agreed that term riders with features that are intertwined with the base policy should be valued with the base policy.

Principle-based reserving task force

At the Fall meeting, the NAIC disbanded PBR Implementation Task Force and its subgroups. LATF and the Financial Condition E Committee will be completing any new tasks that may arise in conjunction with the maintenance of PBR going forward.

[20] VM-21, Requirements for Principle-Based Reserves for Variable Annuities

4

Variable annuities

Action. At the Fall meeting, the Variable Annuities Working Group exposed a proposal from NAIC consultant, Oliver Wyman, for changes to the variable annuity framework including AG 43 and life risk-based capital.[21] Comments are due March 2, 2018.

In 2015, the NAIC engaged Oliver Wyman to identify changes to the variable annuity framework that could remove or mitigate the motivation for insurers to engage in captive reinsurance transactions for variable annuities. At the Summer 2016 meeting, Oliver Wyman presented its recommendations to revise the variable annuity framework based on the first quantitative impact study (QIS). Based on comments received, the NAIC determined that a second QIS was needed.

At the Fall 2017 meeting, Oliver Wyman presented 28 recommendations based on the results of the second QIS. These recommendations included some that were first presented in 2016, and those that were updated based on the results of the second QIS and new proposals. These recommendations covered different topics including:

- determining the CTE amount;
- calculation of the Standard Scenario;
- application of C-3 RBC charge; and
- disclosure requirements.

Oliver Wyman stated that the key benefits of these recommendations are:

- better alignment of economic risk and reduction of disincentives to hedge;
- greater comparability across insurers and products;
- enhanced oversight of insurers assumptions through the use of the standard scenario; and
- simplification of the calculation and interpretation of the reserves.

It also believes that the proposed recommendations reduce most incentives, previously communicated by insurers, to use captives and meet most of the enhancement objectives including:

- ensuring robustness of funding requirements;
- promoting sound risk management and comparability; and
- preserving current statutory construct, where feasible.

However, Oliver Wyman acknowledged that the recommendations may result in a counterintuitive incentive to reduce hedging activity when an insurer is nearing insolvency.

Interested parties, who were not part of the QIS, raised general concern about the lack of involvement and visibility behind the rationale used to determine recommendations. They also questioned the ability to use propriety Economic Scenario Generators (ESG) only where they give higher total asset requirements, as well as the recommended calibration period for VM-20 ESG.

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[21] Actuarial Guideline XLIII – CARVM for Variable Annuities

They requested that Oliver Wyman's recommendations be considered as a starting point and suggested that because of the complexity of the changes being proposed, the recommendations should be exposed until April 30, 2018. Regulators acknowledged that the recommendations are complex and they expect to receive some comments after the end of the comment period. However, they wanted to be able to discuss comments about the proposal at the Spring 2018 NAIC meeting.

Next steps. The Working Group will be holding calls to discuss the proposed recommendations and plans to have an in-person discussion of the comments at the Spring 2018 NAIC meeting.

5

Group capital calculation

Captives

Action. The Group Capital Working Group exposed an approach to use a look-through method in the group capital calculation for captives that assume XXX/AXXX business. Comments are due December 29, 2017.

On calls the Working Group discussed comments received about how captives that assume XXX/AXXX business should be treated in the group capital calculation including the ability to:

- receive credit in the group capital calculation for assets backing XXX/AXXX reserves only when they are admissible under NAIC statutory accounting principles; and
- use PBR when calculating reserves for both new business and business inforce before January 1, 2017 by:
  - existing captives;
  - direct writers of business ceded to a captive; and
  - direct writers regardless of whether business is retained by the insurer, ceded to a reinsurer or captive insurer, or otherwise financed.

Some interested parties and regulators believe that the liabilities of such captives should be valued using PBR. However, others expressed concerns with that approach because it cannot be required for all groups with XXX/AXXX captives, which will result in inconsistencies between groups. Some regulators were also strongly opposed to using assets that are not allowed under statutory accounting principles. As a result, the chair of the Working Group proposed a look-through method to value these captives that could include:

- requiring the calculation for the XXX/AXXX captive to report the liabilities consistent with the valuation of the direct writer;
- requiring only those assets that are allowed by statutory accounting practices; and
- allowing the valuation used by captives, but requiring an on-top adjustment elsewhere in the calculation to achieve a similar net capital valuation of the XXX/AXXX.

Permitted and prescribed practices

The Group Capital Working Group continued to discuss whether the effect of permitted and prescribed practices should be included as an on-top adjustment in the group capital calculation. The chair of the Working Group believes that treatment could be different for permitted versus prescribed practices. The Working Group staff presented a summary showing the aggregate effect of permitted and prescribed practices on insurers' income and surplus.

Regulators did not have strong views about how these practices should be treated in the group capital calculation because they did not appear to be significant.

Next steps. The Working Group will continue to consider the effect and treatment of permitted and prescribed practices.

Non-regulated entities

Action. The Group Capital Working Group exposed a revised approach for factors for non-regulated entities in a group capital calculation. Comments are due January 15, 2018.

In previous discussions, the Working Group considered a flat 22.5 percent charge for non-regulated entities. It believed this approach would be consistent with the current treatment of non-insurance entities in the RBC formula. It also believed that it supported the position that all non-insurance entities should be treated the same.

The Working Group acknowledged that this approach is not risk-sensitive and could understate risk-adjusted capital or penalize well capitalized insurers. It agreed to consider three alternatives presented jointly by the ACLI and the American Insurance Association (AIA), which included applying different factors depending on the nature of the non-insurance entity. These approaches also proposed to exclude all non-financial entities and all immaterial entities that do not present demonstrable recourse to the group.

Some regulators expressed concern about excluding entities from the group capital calculation. In response, the Working Group developed a revised approach to address regulatory views and incorporate ACLI and AIA proposals. The revised approach would require an insurer to identify all legal entities within the group, but include only certain entities individually and allow all others to be included in aggregate. The Working Group proposed that the following factors be applied:

- all insurers (included individually by identified legal entity) – minimum required by the regulator, or as modified for captives, scalars, etc.;
- all banks and other deposit institutions (included individually by identified legal entity) – minimum required by their regulators, not scaled;
- all asset managers and registered investment advisors (included individually by identified legal entity) – 12 percent of three-year average revenue or another basis such as assets under management, with the possibility to use scalars in the future;
- all other financially regulated entities (included individually by identified legal entity) – minimum required by their regulator;
- other entities material to the group from a risk perspective (could be reported in aggregate) – to be further discussed and determined; and
- all other entities (could be included in aggregate) – 12 percent of revenue scaled to approximately 2 percent or 22.5 percent of book-adjusted carrying value.

Interested parties expressed significant concern about the scope of the entities that would be included. They believe that a separate discussion about scope is needed.

Surplus notes

Action. The Group Capital Working Group exposed a proposal on the treatment of surplus notes in the group capital calculation. Comments are due January 15, 2018.

The proposed approach would:

- treat the assets transferred to the issuer of the surplus note as available capital and eliminate the investment value from the affiliated purchaser, including the purchaser's RBC charge on the surplus note investment; and
- recognize structurally subordinated debt as available capital, if the purchaser has fully funded the debt instruments and specific criteria are met.

Although the proposal would recognize the proceeds of surplus notes and structurally subordinated senior debt as capital, it would also respect the quality of capital classifications that are defined by other US sectoral regulators on their regulated entities' available capital. The proposal also asked what limitation should be placed on the amount of available capital that could be comprised of subordinated senior debt.

6 Covered agreement

On September 22, 2017 the United States and the EU signed a Bilateral Agreement, also referred to as the covered agreement. The agreement eliminates collateral and host country physical presence requirements for reinsurers operating on a cross-border basis. It also enables jurisdictions to recognize each other's system of solvency and market conduct regulation.

At the Fall meeting, the Reinsurance Task Force discussed the next steps to implement the covered agreement, including removing reinsurance collateral requirements for the insurers that are subject to the agreement. The Task Force requested regulators and interested parties to submit comments about how the provisions should be implemented, including whether the treatment of EU insurers should be extended to other qualified jurisdictions. Interested parties voiced their support for treating them the same.

Next steps. The Reinsurance Task Force will hold a public hearing that has been tentatively scheduled for February 20, 2018 in New York to continue discussion.

7

Risk-based capital

Bonds

Action. The Investment RBC Working Group exposed the Academy's updated recommendations of C-1 factors for the RBC formula. Comments are due January 22, 2018.

The Academy's recommended factors for the life RBC formula that were presented before the Summer 2017 meeting were updated to meet a higher statistical safety level and revise the portfolio adjustment factors to only reflect portfolio diversification in an individual insurer's bond portfolio.

The Academy also updated the investment RBC factors for health and property & casualty (P&C) insurers that it believes could be used to update the bond factors for those entities. The Academy developed the base factors for health and P&C by adjusting the basic life C-1 factors to remove the effect from federal taxes and the provision for credit risk contained in statutory life reserves. All other assumptions were unchanged.

On the call, some regulators and interested parties continued to express concern about the factors developed for the life RBC formula to be used for health and P&C insurers.

Real estate

The Investment Risk-Based Capital Working Group continued discussing the RBC factor for real estate. The ACLI responded to comments about lowering the factor from 15 to 10 percent. Based on the additional analysis, the ACLI continues to believe that the proposed factor of 10 percent is appropriate.

Next steps. The Academy told the regulators that it will review the additional analysis provided by the ACLI and present its views on future calls or meetings.

Federal Home Loan Banks

Action. The Life Risk-Based Capital Working Group re-exposed a proposal changing the C-0 charge for collateral held for FHLB advances from 1.3 percent to zero. The comment period ended November 22, 2017.

The revisions add a provision for the factor to be based on a Baa-bond factor if the FHLB-funded advance liabilities associated with spread-ending activities exceed five percent of the total net admitted assets, and it has not been authorized for the higher amount by the insurer's domiciliary regulator. One regulator was concerned that the domestic regulator could approve amounts beyond the five percent limit, and questioned the purpose of having more than five percent of investments with a single issuer.

Interested parties believe that this provision is important because it will provide insurers with the flexibility to hold assets through various market cycles without incurring capital losses and could provide insurers with the ability to manage cash during the year.

Medicaid pass-through payments

Action. The Capital Adequacy Task Force exposed a proposal to apply a two percent RBC charge for Medicaid pass-through payments. Comments are due January 15, 2018.

States treat Medicaid pass-through payments differently. Some record them as premiums and receive the full underwriting risk charge, while other states treat them similar to uninsured businesses that receive a two percent charge.

The regulators believe that the risk associated with these payments is administrative in nature, similar to uninsured plans and that a two percent RBC factor should be applied.

8

Long-term care

Guaranty Association Model Act

Action. At the Fall meeting, the NAIC adopted changes to the Guaranty Association Model Act.

On calls before the Fall meeting, the Receivership Model Law Working Group worked with regulators and interested parties to update the Guaranty Association Model Act. Key changes to the Model Law include the addition of:

— health maintenance organizations; and
— equitable assessment for long-term care insolvencies between accident / health and life / annuity insurers.

Some interested parties did not believe that the division of long-term care insolvencies should be equitable because the majority of the long-term care business is written by life insurers. Although regulators acknowledged that the assessment may not be perfect, they believe it is better than current practice. They also believe that the changes create a better distribution of the assessment and a more predictable way for insurers to estimate their future liability.

9

Other accounting highlights

Leases

SAPWG discussed comments on revisions to SSAP No. 22R to consider US GAAP guidance on leases.

SSAP No. 22R requires all leases to be recorded as operating leases. Proposed revisions included retaining the concept of operating leases and clarifying guidance for sale-leaseback transactions and leveraged leases. Although revisions to the SSAP appeared significant, they were not intend to change current statutory accounting.

Interested parties agreed with retaining the concept of operating leases, and suggested that current accounting guidance for both sale-leaseback transactions and leveraged leases should also be retained. They expressed concerns that the proposed revisions for sale-leaseback transactions, the disclosure of right-of-use assets, and interest on lease liabilities as well as the straight-line expense recognition would result in unintended consequences.

In response to interested party comments, SAPWG said it would not consider the exposed revision to require disclosure of the right-to-use asset created by new US GAAP lease guidance.

Next steps. SAPWG directed NAIC staff to review the comments from interested parties to determine whether further revisions are needed.

Surplus notes

Action. SAPWG re-exposed revisions to SSAP No. 41R and SSAP No. 97 to eliminate parent-issued surplus notes within the Investment in the Subsidiary, Controlled and Affiliated Entities financial statement caption to avoid double counting at the parent reporting entity. Comments are due January 19, 2018.

The re-exposure clarifies that the elimination of the surplus note within the SCA's value reported by the parent is always required regardless of the method of acquisition (directly through the parent, through a third-party broker, etc.). The exposed guidance would not apply to debt instruments issued by the parent and held by the SCA. Interested parties indicated that current guidance is clear and that additional guidance is not needed.

SAPWG also discussed comments about proposed revisions to SSAP No. 41R to provide guidance on surplus notes issued at a discount, premium or with a zero coupon. These revisions are intended to address regulators' concerns about the accretion of discount or amortization of premium for surplus notes issued at an amount other than face value. SAPWG said that proposed revisions are intended to clarify guidance in SSAP No. 41R and not to modify current statutory accounting. Interested parties expressed concern with the proposed revisions and believe current accounting is appropriate. They also believe that the proposed revisions would produce a result that does not properly reflect the surplus available to satisfy policyholder liabilities.

Next steps. NAIC staff will work with interested parties to draft revisions and develop illustrations for subsequent consideration.

Policy loans

Action. SAPWG requested comments on the accounting for policy loans for business in a separate account. Comments are due January 19, 2018.

SAPWG received questions about accounting for policy loans that are associated with policies in a separate account, and determined that the current accounting guidance for these transactions is unclear. However, before proposing specific changes to SSAP No. 49 and SSAP No. 59, it requested comments on concepts including:[22]

- reporting policy loans as an asset or a contra-liability to the reserve related to that policy;
- classifying general account receivables from a separate account as non-admitted if funding from the separate account is not received within 90 days;
- including gross and non-admitted amounts on the liability page or allowing only net admitted amount to be reported; and
- reporting policy loans in the same annual statement (general account or separate account) where the reserve related to that policy is reported.

Reinsurance credit

SAPWG received comments on its proposed changes to SSAP No. 61R, SSAP No. 62R and Appendix A-791 that included:[23]

- updating the definition of proportional and non-proportional reinsurance;
- adding guidance to determine whether:
  - the contract is proportional or non-proportional; and
  - significant loss has transferred for a non-proportional reinsurance contract;
- clarifying that provisions that limit a reinsurer's losses should be reflected as a reduction in claims and losses ceded;
- adding detailed disclosures to SSAP No. 61R about risk-limiting features to be consistent with requirements of SSAP No. 62R;
- prohibiting reserve credit for non-proportional reinsurance in SSAP No. 62R, unless the aggregate attachment point has been penetrated; and
- updating Appendix A-791 to include the preamble from Life and Health Reinsurance Agreements Model Regulation that indicates that the Model was intended to prevent reinsurance accounting for reinsurance contracts that provide temporary surplus relief without transferring all of the significant risk.

22 SSAP No. 49, Policy Loans; SSAP No. 56, Separate Accounts

23 SSAP No. 61R Life, Deposit-Type and Accident and Health Reinsurance; SSAP No. 62R, Property and Casualty Reinsurance; Appendix A-791, Life and Health Reinsurance Agreements

Interested parties suggested that the proposed revisions would have significant changes to the risk transfer analysis for certain contracts and change the accounting and reporting for many insurers. They believe that current rules, if properly applied, address identified issues and that any proposed revisions should be narrowed to avoid unintended consequences. The Academy commented that the new language in SSAP No. 61R could have unintended and substantive effects. It believes that additional time is needed to review proposed revisions and that targeted improvements may meet regulatory objectives.

Next steps. SAPWG directed NAIC staff to work with interested parties on informal drafting calls to develop changes to guidance for reinsurance contracts that would be responsive to regulatory needs and the concerns of interested parties.

Goodwill limitations

Action. SAPWG exposed a revision to SSAP No. 68 to add additional disclosures about acquisitions of SCA entities including the acquisition date of the SCA, the amount of goodwill as of the reporting date and admitted goodwill as a percentage of the SCA's book-adjusted carrying value.[24] Comments are due January 19, 2018.

Previously, SAPWG proposed six options to address its concern that some insurance entities are reporting a substantial amount of goodwill in the value of their SCAs.

Option 1: Decrease the 10 percent limitation for admissible goodwill to 5 percent.

Option 2: Limit admissibility based on a percentage of the dollar amount of goodwill remaining after the initial 10 percent limitation amount based on the parent's capital and surplus using a formula.

Option 3: Limit goodwill to the asset or net asset dollar value of the SCA. If the SCA's net asset value is $10 million, then goodwill up to $10 million would be admitted.

Option 4: Eliminate the admissibility of goodwill.

Option 5: Do not change the current admissibility requirements.

Option 6: Require more disclosure about goodwill, including the percentage of goodwill compared to the SCA book-adjusted carrying value.

Interested parties supported Option 5 and did not believe that any further limitations were needed on the amount of goodwill that an insurer is allowed to record as an admitted asset. They believe that the current limitation of goodwill in SSAP No. 68 sufficiently addresses the solvency objective.

[24] SSAP No. 68, Business Combinations and Goodwill

Based on comments received, regulators believe that the additional disclosure about SCAs will allow them to review goodwill admissibility for each SCA and would add transparency to the SCA book value.

Pensions and postretirement benefits

Action. On a call before the Fall meeting, SAPWG exposed revisions to SSAP No. 92 and SSAP No.102 to remove the fair value Level 3 reconciliation for plan assets. Comments are due January 19, 2018.

SAPWG believes that detailed information about the Level 3 fair value reconciliation of the beginning and ending plan asset balances may not be necessary for statutory financial statements because:

— plan assets are not reported as assets in the balance sheet of an insurance entity; instead, fair value of the plan assets is compared to the pension or other postretirement benefit liability;
— if the plan is overfunded, an insurance entity is required to non-admit that asset; and
— if the plan is underfunded, an insurance entity is required to report a liability.

Employee share-based payments

Action. SAPWG adopted revisions to SSAP No. 104R and SSAP No. 12 to adopt, with modification, US GAAP guidance on improvements to employee share-based payments accounting.

Revisions mirror the US GAAP guidance including:

— recognizing income tax expense or benefit in the income statement for the tax effect of the difference between the cumulative compensation cost of an award recognized for financial reporting purposes and the deduction of an award for tax purposes;

— removing guidance about subsequent measurement when accounting for tax effects; and

— recognizing income tax benefit in the income statement from dividend equivalents that are charged to surplus and are paid to employees for nonvested equity shares, nonvested equity share units and outstanding equity share options.

High-cost risk pooling under the Affordable Care Act

Action. SAPWG adopted revisions to SSAP No. 107 to report high-cost risk pool claim reimbursements as increases to premium along with required new disclosures. The change is effective is for periods beginning on or after January 1, 2018.

The revisions require that the percent-of-premium charge that pays for reimbursements and high-risk cost pool distributions be reported as written premium on a net basis. Disclosures require that the high-cost risk pool payments be included in the 'Premium Adjustments Receivable/Payable due to ACA Risk Adjustment' line item.

In December 2016, the US Department of Health and Human Services adopted a new regulation that changes the Affordable Care Act risk-adjustment program starting in 2018. The risk-adjustment program now includes an element similar to reinsurance called high-cost risk pooling.

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Other actuarial highlights

Longevity risk

The Academy reported on its progress in developing a longevity risk charge. The Academy determined that the longevity risk stress event should cover risks that the:

— base table is not appropriate for an insurer's actual mortality; and
— mortality improvement varies from the assumed mortality improvement scale.

When determining the risk charge, the Academy assumed that the statutory reserve is at the 85th percentile. The risk-based capital charge is then intended to cover the risk over the 85th percentile up to the 95th percentile.

Some regulators questioned the assumption that current statutory reserves are at the 85th percentile because they believe that the actual percentage is lower. The Academy agreed that this may not always be the case and that it shares some concern about this assumption. However, it believes that this assumption can be validated using real company data during a field study.

Next steps. The Academy will share additional specifications with the Subgroup with the goal of beginning a field study after the Spring 2018 meeting.

Guaranteed issue and simplified issue tables

Action. On a call after the Fall meeting, LATF decided to exclude Guaranteed Issue Life Insurance Policies from the requirement to apply PBR.

At the Fall Meeting, LATF discussed comments received on the Guaranteed Issue and Simplified Issue Mortality Tables including:

— the definitions of Guaranteed Issue and Simplified Issue Tables, which need to be clarified;
— rates that are inconsistent between the Guaranteed Issue Table and insurers' actual experience; and
— concerns about gaps in applicable Simplified Issue Tables and the need to consider products that may not meet stated criteria.

The Academy agreed that the definitions should be clarified. However, because the data used in the study and the data used by interested parties to comment on actual company experience is confidential, the Academy was not able to identify the cause of the differences. The Academy suggested conducting a study to develop credibility and prescribe margins for Guaranteed Issues. The Academy also acknowledged that it is difficult to address the gaps in the Simplified Issue Tables because of the rapidly changing marketplace.

Next steps. LATF plans to discuss further actions about the Simplified Issue Tables on future calls.

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We would like to acknowledge the efforts of the main contributors to this Issues & Trends:

Jennifer D. Austin

Michael Beck

Darcie K. Garza

Alan W. Goad

Olga Roberts

kpmg.com/socialmedia