NAIC Spring Meeting

April 2017

Issues & Trends

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Meeting highlights

At its Denver meeting and on conference calls, the National Association of Insurance Commissioners (NAIC) **adopted** the following guidance.

— Discount guaranty fund assessments and related assets resulting from insolvencies of insurers that wrote long-term contracts.
— Remove Securities Valuation Office (SVO) designated bond Exchange Traded Funds (ETFs) and Bond Mutual Funds that qualify for bond treatment from the definition of a bond and provide separate accounting guidance.
— Add disclosures for significant changes in methodologies and assumptions used to calculate the liability for unpaid claims and claim adjustment expenses and the amount of interest accretion recognized in the statement of income. The disclosure of interest accretion would include the line item in which it is classified and reject all other disclosures from US GAAP about short-duration contracts not already required by statutory accounting.[1]

The NAIC **exposed:**

— changes to the Principle-based Reserving (PBR) companywide exemption;
— an issue paper and requested comments to assess statutory accounting implications of the legal settlement distinction of variation margins by clearinghouses; and
— the third draft of the Insurance Data Security Model Law.

Principle-based reserving – Page 8	
Pilot project	The PBR Review Working Group presented its report on the 2016 PBR Pilot Project.
Companywide exception	On a call before the Spring meeting, the Life Actuarial Task Force (LATF) exposed changes to the PBR companywide exemption. Comments were due April 14, 2017.

[1] ASU 2015-09—Financial Services—Insurance: Disclosures about Short-Duration Contracts

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Project to review investment SSAPs	The Statutory Accounting Working Group (SAPWG) adopted Issue Paper No. 156 and substantive revisions to SSAP No. 26.[2] The revisions remove SVO designated bond ETFs and SVO identified Bond Mutual Funds from the definition of a bond and provide separate accounting guidance when using a systematic value for these instruments. The revisions are effective December 31, 2017, however changes related to the use of systematic value are effective on January 1, 2018.
Bank loans	SAPWG requested comments on the accounting for bank loans, and specifically asked whether bank loans issued directly by an insurance company, should be included within the scope of SSAP No. 26. SAPWG also directed NAIC staff to draft a referral to the Valuation of Securities Task Force requesting its view on whether differences in the risks between bank loans directly issued, and those acquired, warrant different accounting. Comments are due May 19, 2017.
Asset valuation reserve and interest maintenance reserve	SAPWG directed staff to draft revisions to SSAP No. 26 to clarify the statutory accounting guidance and annual statement instructions for Asset Valuation Reserve (AVR) and Interest Maintenance Reserve (IMR) to ensure consistency.
Mortgage loans	SAPWG exposed additional revisions to SSAP No. 37 to clarify that companies acting as a participant in a mortgage loan agreement should follow SSAP No. 37. However, SSAP No. 37 is not intended to capture participating mortgages, real estate funds or the securitization of assets.[3] Comments are due May 19, 2017.
Loan-backed and structured securities	SAPWG exposed the rejection of previously proposed amendments to the definition of loan-backed and structured securities and clarifications of the admitted asset requirements within SSAP No. 43R.[4] Comments are due May 19, 2017.

[2] SSAP No. 26, Bonds; and Issue Paper No. 156, Bonds
[3] SSAP No. 37, Mortgage Loans
[4] SSAP No. 43R, Loan-Backed and Structured Securities

Investments – Page 10	
Impact of future settled premiums on the option valuation	SAPWG reexposed revisions to SSAP No. 86 and requested that interested parties provide an illustrated Schedule DB to identify proposed revisions that clearly identify derivative transactions and deferred premiums.[5] SAPWG requested that revisions provide a consistent risk-based capital (RBC) effect for open derivative instruments, and allow a regulator to use automatic analytical tools to gather information from statutory reporting. Comments are due May 19, 2017.
Derivative contracts related to variable annuity products	SAPWG exposed revisions to an issue paper proposing special accounting treatment for certain derivative contracts related to variable annuity products that cannot follow the hedge accounting guidance in SSAP No. 86. Comments are due May 19, 2017.
Variation margin	SAPWG exposed an issue paper requesting comments to assess the statutory accounting implications of the legal settlement distinction of variation margins by clearinghouses. Comments are due May 19, 2017.
Reporting of investment schedules	Before the Spring meeting, SAPWG sent a referral to the Accounting Practices and Procedures Task Force detailing past discussions, exposures and its support for a policy change to collect semi-annual investment information. Comments were due April 14, 2017.

[5] SSAP No. 86, Derivatives

FASB accounting standards updates – Page 16	
US GAAP disclosures for short-duration contracts	SAPWG adopted disclosures from US GAAP for short duration insurance contracts that are not currently in statutory accounting and rejected all other US GAAP disclosure requirements. The revisions were effective upon adoption. Changes were made to: — SSAP No. 55 to disclose significant changes in methodologies and assumptions used in calculating the liability, including reasons for changes and the effect to the financial statements;[6] and — SSAP No. 65 to disclose the amount of interest accretion recognized in the statement of income and the line item in which it is classified.[7]
Cybersecurity – Page 17	
Working group activity	Before the Spring meeting, the Cybersecurity Working Group exposed the third draft of the Insurance Data Security Model Law. Comments were due April 13, 2017.
Group capital calculation – Page 18	
Working group activity	The Group Capital Working Group exposed a memorandum for determining minimum capital requirements for US insurers that do not file RBC and/or are not required to use statutory accounting. Comments are due May 26, 2017.
Qualified jurisdictions – Page 19	
Task force report	The Reinsurance Task Force heard a status report on the Bilateral Agreement between the European Union (EU) and the US about insurance and reinsurance.

[6] SSAP No. 55, Unpaid Claims, Losses and Loss Adjustment Expenses
[7] SSAP No. 65, Property and Casualty Contracts

Investment risk-based capital – Page 20	
Working group activity	The Investment Risk-Based Capital Working Group exposed a change to RBC filings for property and casualty (P&C) and health insurers to increase the bond granularity from 6 to 20 designations. Comments are due May 26, 2017. The Working Group also exposed a proposal to change the RBC calculation for real estate assets. Comments are due July 14, 2017.
Other accounting highlights – Page 21	
Equity method accounting	SAPWG adopted, with modification, new US GAAP guidance for equity method accounting in SSAP No. 30, SSAP No. 48 and SSAP No. 97.[8] These revisions provide guidance for the prospective application of equity method accounting when an investment qualifies to use the equity method as a result of an increase in the level of ownership interest or degree of influence. Revisions were effective upon adoption.
Discounting for guaranty fund assessment	On a call before the Spring meeting, SAPWG adopted revisions to SSAP No. 35R to allow discounting of guaranty fund assessments from insolvencies of insurers that wrote long-term care contracts.[9] The effective date was January 1, 2017.
Surplus notes	SAPWG exposed revisions to SSAP No. 41R to provide guidance on surplus notes issued at a discount, premium or with a zero coupon, and incorporate illustrations into a new exhibit to the SSAP.[10] Comments are due May 19, 2017.
High deductible policies	SAPWG and the Blanks Working Group exposed revisions to SSAP No. 65 to expand disclosures about high deductible policies for year-end 2017. Comments are due May 19, 2017.

[8] SSAP No. 30, Unaffiliated Common Stock; SSAP No. 48, Joint Ventures, Partnerships and Limited Liability Companies; SSAP No. 97, Investments in Subsidiary, Controlled and Affiliated Entities; and ASU 2016-07, Investments—Equity Method and Joint Ventures: Simplifying the Transition to the Equity Method of Accounting

[9] SSAP No. 35R, Guaranty Fund and Other Assessments

[10] SSAP No. 41R, Surplus Notes

Other accounting highlights – Page 21	
Cash flow statement classification of certain cash receipts and cash payments	SAPWG adopted revisions to SSAP No. 69 to adopt US GAAP guidance on the classification of certain cash receipts and cash payments in the statement of cash flows.[11] The effective date is the same as US GAAP. The standard is effective for public business entities in years beginning after December 15, 2017, and one year later for all other companies. Early adoption is permitted.
Restricted cash	SAPWG exposed revisions to SSAP No. 69 to adopt new US GAAP guidance for restricted cash.[12] Comments are due May 19, 2017.
Intra-entity transfers of assets other than inventory	SAPWG exposed revisions to SSAP No. 101 to reject US GAAP guidance for intra-entity transfers of assets other than inventory.[13] Comments are due May 19, 2017.
Employee share-based payments	SAPWG exposed revisions to SSAP No. 104R to adopt, with modification, US GAAP guidance for share-based payments. SAPWG also requested comments about the proposed transition guidance and asked whether transition guidance is needed for companies that do not prepare US GAAP financial statements.[14] Comments are due May 19, 2017.
Other regulatory highlights – Page 26	
Catastrophe risk charge	The Catastrophe Risk Subgroup and its parent committees adopted a proposal to include the earthquake and hurricane catastrophe risk charge in the RBC formula for 2017 RBC reporting.

[11] SSAP No. 69, Statement of Cash Flow; and ASU 2016-15, Statement of Cash Flows: Classification of Certain Cash Receipts and cash Payments

[12] ASU 2016-18, Statement of Cash Flows: Restricted Cash

[13] SSAP No. 101, Income Taxes; and ASU 2016-16, Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory

[14] SSAP No. 104R, Share-Based Payments; and ASU 2016-09, Compensation—Stock Compensation: Improvements to Employee Share-Based Payment Accounting

Operational risk charge	On calls before the Spring meeting, the Operational Risk Subgroup adopted the 2017 structure for the percentage of RBC methodology (the add-on method) for operational risk in the 2017 RBC calculation. The Subgroup also exposed the current informational factor of three percent to be used in the 2017 RBC calculation. Comments are due May 4, 2017.
Other actuarial highlights – Page 27	
Asset adequacy testing	The Long Term Care (LTC) Actuarial Working Group exposed a LTC Actuarial Guideline with an effective date of December 31, 2017 for a stand-alone asset adequacy test applicable to long-term care blocks of contracts. Comments are due May 11, 2017.
Longevity risk	LATF exposed revisions to VM-30 to provide clarity on evaluating longevity risk. The revisions require actuaries to document the rationale for base assumptions and future mortality improvements or deterioration and whether the assumptions contribute to the conclusion that the reserve makes provision for moderately adverse conditions. Comments are due April 25, 2017.

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Principle-based reserving

Pilot project

Action. The PBR Review Working Group presented its report on the results of the 2016 PBR Pilot Project (the Pilot). Eleven companies from nine states calculated reserves following VM-20, reported results using the VM-20 Supplement and completed the PBR Actuarial Report.

Regulators reviewed submissions from participants to:

- assess the clarity and completeness of the valuation manual;
- assess the adequacy of the VM-20 Reserve Supplement and the related instructions for reporting the reserves; and
- determine compliance with the requirements of PBR.

The Pilot had the following observations.

- Companies generally followed the Pilot's instructions about the mandatory calculations and the modelling of five years of issued business.
- All companies completed the VM-20 Reserve Supplement as well as the PBR Actuarial Report. Although the structure of the companies' PBR Actuarial Report was very similar, the details varied widely. No single report was deemed to be complete, and reports with less detail generated more follow-up questions.
- Three companies indicated they would value products issued in 2017 using PBR, with one additional company indicating it might value products using PBR depending on what the US Treasury will allow as a tax reserve.
- Two out of the ten companies testing term products had a negative Deterministic Reserve. Regulators discussed challenges in reviewing an individual company's results because a negative Deterministic Reserve may be caused by either the level of gross premium under the contract or unrealistic or aggressive company experience assumptions. Regulators suggested a benchmark for the level of gross premiums that could produce a negative Deterministic Reserve would be helpful with the review.
- All seven companies testing Universal Life with Secondary Guarantees had positive Deterministic Reserves. Four of the five companies that performed the stochastic calculation had a Stochastic Reserve that exceeded the Deterministic Reserve.
- Eight companies reported balances for ceded reserves. One of the eight companies reported ceded reserves greater than the gross reserves (without the effect of reinsurance). Given this unusual relationship between the gross and ceded reserves, the regulators discussed reviewing the reinsurance accounting guidance to determine whether any changes should be made.

The report also indicated that companies had a number of questions about the interpretation of provisions within VM-20 and VM-31. In response, the PBR Review Working Group formed a VM Review Drafting Group composed of regulators, interested parties and members of American Academy of Actuaries (Academy) to address questions and interpretations raised during the Pilot.

Next Steps. The Working Group is evaluating, based on the results of the Pilot Project, what areas within the Valuation Manual need additional clarification and will discuss any proposed changes on future calls and meetings.

Companywide exemption

Action. On a call before the Spring meeting, the LATF exposed changes to the PBR companywide exemption. Comments were due April 14, 2017.

The proposed changes intend to clarify which companies should be exempt from PBR. Proposed changes include:

- excluding companies with less than $50 million of ordinary life premium from the requirement to meet the 450 percent risk-based capital;
- allowing companies that fall below the 450 percent RBC requirement, but still meet all other exemption requirements, to seek an exemption from their state insurance commissioner;
- clarifying that companies cannot have material Universal Life with Secondary Guarantees policies on or after January 1, 2020; and
- excluding the following from the ordinary life premium threshold of $300 million:
  - premiums for preneed life contracts; and
  - transfers of reserves in-force as of the effective date of a reinsurance assumed transaction.

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Investments

Project to review investment SSAPs

Action. SAPWG adopted Issue Paper No. 156 and revised SSAP No. 26. The revisions remove SVO designated bond ETFs and SVO identified Bond Mutual Funds from the definition of a bond and provide separate accounting guidance when using a systematic value for these instruments. The revisions also add the definition of a security, and include definitions for non-bond, fixed-income instruments. These were substantive revisions and resulted in a revised SSAP No. 26. The revisions are effective December 31, 2017; however, changes to use the systematic value are effective on January 1, 2018.

On calls before the Spring meeting, SAPWG discussed comments about previously exposed changes to the accounting for ETFs and bank loans acquired through a participation. Discussions focused on these topics.

- Using a single standard for the systematic value, including the NAIC Investment Analysis Office's (IAO) view that the systematic value approach proposed by Blackrock is not consistent with an amortizing mechanism for debt-like ETFs. The IAO believes that the systematic value approach masks significant and permanent declines in cash-flow generating capacity and may not properly reflect the value of the ETF.
- Recognition of realized gains and losses and the allocation between the asset valuation reserve (AVR) or the interest maintenance reserve (IMR).
- Using a lower of systematic value or fair value after an ETF is no longer allowed to use the systematic value or an other-than-temporary impairment (OTTI) has been identified.
- Effective date for the proposed changes.

Based on these discussions, SAPWG modified the revisions to SSAP No. 26 and its Issue Paper to:

- require insurers to record the investment at fair value, after OTTI has been identified;
- define the systematic method to reflect an aggregated cash flow method in which the cash flows from the individual bond holdings are aggregated into a single cash flow stream;
- address concerns raised by the NAIC IAO by proposing a three-step approach to evaluate ETFs for OTTI based on changes in the net present value (NVP) of the projected cash flows; the fair value of the ETF on the OTTI date would become the new cost basis;
- require OTTI disclosures to include the percentage change in the NPV of the projected cash flows from the prior period;
- clarify that ETFs within the scope of SSAP No. 26 should follow a similar approach of using the weighted average life of the underlying bonds for establishing the IMR amortization duration bucket; and
- incorporate effective date guidance to require companies to identify ETFs as of December 31, 2017 that will be reported at systematic value.

ETFs designated for systematic value will continue with the previously used 2017 measurement method, and will use a systematic value as of January 1,

2018. For all ETFs that are not designated to use a systematic value as of December 31, 2017, the ETFs should be reported at fair value (net asset value) as of December 31, 2017.

SAPWG also decided to discuss changes related to accounting for bank loans in a separate agenda item.

Bank loans

Action. SAPWG requested comments on the accounting for bank loans, and specifically asked whether bank loans issued directly by an insurance company should be included within the scope of SSAP No. 26. SAPWG also directed NAIC staff to draft a referral to the Valuation of Securities Task Force requesting its views on whether differences in the risks between bank loans directly issued and those acquired should require different accounting. Comments are due May 19, 2017.

On a call before the Spring meeting, as part of the Investment Classification Project, SAPWG requested comments on whether bank loans should be captured within SSAP No. 26 or whether they should be moved to SSAP No. 21. Capturing bank loans within SSAP No. 21 would require revisions to address specific measurement and accounting guidance.

Interested parties believed that bank loans should continue to be reported on Schedule D and be within the scope of SSAP No. 26 regardless of whether they were acquired from a financial institution or directly issued by the insurance company because the terms of the underlying bank loan do not depend on who originates it. The current definition for bank loans is specific to bank loans made by a financial institution acquired through a participation, syndication or assignment. Therefore, interested parties believed that changes to this definition are needed.

Asset valuation reserve and interest maintenance reserve

Action. SAPWG directed staff to draft revisions to SSAP No. 26 to clarify the statutory accounting guidance and annual statement instructions for AVR and IMR to ensure consistency.

Before the Spring meeting, interested parties commented on current practices of allocating gains and losses between AVR and IMR.

— Companies use the annual statement instructions to determine the allocation of OTTI to the AVR or IMR because it is the best indicator of what is credit related versus interest related.
— The annual statement instructions do not conflict with SSAP No. 26 because companies use the NAIC designation change criteria found in the instructions to apply the guidance in SSAP No. 26.
— Companies generally apply the held-for-sale OTTI guidance at quarter end. Therefore when a security is sold in the same reporting period as OTTI

occurs, or if an OTTI security is sold at a loss before it matures, they will record a realized loss upon sale or maturity and will not recognize OTTI.
- Interested parties were not able to identify any instances where there was negative OTTI.

Mortgage loans

Action. SAPWG exposed additional revisions to SSAP No. 37 to clarify that companies acting as a participant in a mortgage loan agreement should follow SSAP No. 37. However, SSAP No. 37 is not intended to capture participating mortgages, real estate funds or the securitization of assets. Comments are due May 19, 2017.

Interested parties supported previously exposed revisions that:

- clarify that companies acting as a participant to a mortgage loan agreement are within the scope;
- clarify the related impairment assessment; and
- incorporate disclosures for these structures.

However, they commented that the proposal should be revised to incorporate other common participation situations used in the commercial mortgage lending market.

Participating mortgage loan arrangements generally occur in large commercial mortgage loans where there is one borrower with more than one lender identified in a single lending agreement. All lenders are secured with the same real estate, and no individual lender can unilaterally foreclose on the loan. The lenders in this arrangement are identified as participants in a co-lending arrangement and not parties to a participating mortgage.

Loan-backed and structured securities

Action. SAPWG exposed the rejection of previously proposed amendments to the definition of loan-backed and structured securities and clarifications of the admitted asset requirements within SSAP No. 43R. Comments are due May 19, 2017.

The proposed changes would have:

- revised the definition so securities with a single obligor would follow the accounting guidance in SSAP No. 26 and not SSAP No. 43R;
- revised the title of the SSAP from loan-backed and structured securities to structured finance securities, including all references to these securities within the SSAP;
- clarified that for the security to be an admitted asset:

  - 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 insurance company;
- updated the effective date guidance to remove outdated transition guidance; and
- removed outdated guidance from the Question and Answer Implementation Guide.

Interested parties had significant concerns about unintended consequences and potential punitive implications of the proposed revisions and believed that the revisions were not needed.

Impact of future settled premiums on option valuations

Action. SAPWG reexposed revisions to SSAP No. 86 and requested that interested parties provide an example Schedule DB to identify proposed revisions that clearly identify derivative transactions and deferred premiums. SAPWG requested that revisions ensure a consistent RBC effect for open derivative instruments, and allow a regulator to use automatic analytical tools to gather information from statutory reporting.

Comments are due May 19, 2017.

SAPWG previously exposed this issue paper proposing revisions to clarify that the initial cost to acquire derivative contracts (deferred or financing premium) should:

- not be combined with the expected cash flows or the fair value of the derivative,
- be recognized at the time a derivative contract is acquired with the unpaid amount recognized as a liability under SSAP No. 5R;[15] and
- be disclosed by identifying the aggregate liability recognized for unpaid derivative premiums and a schedule of expected future derivative premium payments.

Interested parties expressed concerns that the proposed revisions presented unintended consequences and inconsistencies with other sections of statutory accounting guidance. They also believed the proposed changes did not address the lack of transparency around the financial reporting and disclosure of future settled premiums on option valuations. Interested parties also recommended enhanced financial reporting disclosures be captured with a referral to the Blanks Working Group rather than as a revision to existing accounting guidance.

[15] SSAP No. 5R, Liabilities, Contingencies and Impairments of Assets

Derivative contracts related to variable annuity products

Action. SAPWG exposed revisions to an issue paper proposing special accounting treatment for certain derivative contracts related to variable annuity products that cannot follow the hedge accounting guidance in SSAP No. 86. Comments are due May 19, 2017.

The issue paper develops specific statutory accounting guidance for certain derivative contracts hedging variable annuity guarantees that are subject to interest rate sensitivity and reserved for using AG 43.[16] The objective of the guidance is to emphasize reducing non-economic surplus volatility when companies have strong risk management programs and provide sufficient transparency with regulatory oversight.

SAPWG requested regulator input about comments received on the original issue paper including the:

— length of the deferred asset amortization period;
— simplification of regulatory approval by removing required notification to other states;
— treatment of deferred gains and losses on hedge instruments that are no longer a part of a highly effective hedging strategy or no longer qualify as highly effective; and
— bifurcation between realized and unrealized capital gains, specifically the recording of gains and losses as other realized capital gains and losses.

The exposed revisions incorporate revisions to the original issue paper for interested party input including:

— amortization period guidance;
— governance procedures and enhanced regulatory reviews;
— accounting for hedging instruments, if a component of the hedging instrument is captured within the issue paper guidance; and
— termination guidance, including the effect to deferred assets (unrealized losses from prior fair value fluctuations).

The guidance in the issue paper would apply only if all the qualifications are met, including a strict limitation to contracts involving certain guaranteed benefits. 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 incorporated as a new SSAP.

[16] Actuarial Guideline XLIII – CARVM for Variable Annuities

Variation margin

Action. SAPWG exposed an issue paper requesting comments to assess the statutory accounting implications of the legal settlement distinction of variation margins by clearinghouses. Comments are due May 19, 2017.

In 2017, the Chicago Mercantile Exchange amended its rulebook to legally characterize variation margin payments for over-the-counter derivatives to be legal settlement payments and not collateral. NAIC staff identified potential effects on statutory accounting if a legal settlement is reflected including:

- reflecting daily changes in the variation margin as a realized gain/loss; and
- considering the effect on reporting schedules and potential necessary revisions.

This exposure disposes of an open 2013 agenda item to determine whether the variation margin should be treated as collateral or cash settlement without revising statutory accounting.

Reporting of investment schedules

Action. Before the Spring meeting, SAPWG sent a referral to the Accounting Practices and Procedures Task Force detailing past discussions, exposures and its support for a policy change to collect semi-annual investment information. Comments were due April 14, 2017.

Next Steps. The Task Force will have a conference call on May 2, 2017 to discuss comments received.

4 FASB accounting standards update

US GAAP disclosures for short-duration contracts

Action. SAPWG adopted disclosures from US GAAP for short duration insurance contracts that are not currently in statutory accounting and rejected all other US GAAP disclosure requirements. The disclosures were effective on adoption.

Changes were made to:

— SSAP No. 55 to disclose significant changes in methodologies and assumptions used to calculate the liability, including reasons for changes and the effect on the financial statements; and
— SSAP No. 65 to disclose the amount of interest accretion recognized in the statement of income and the line item in which it is classified.

Interested parties supported the adoption of the proposed revisions.

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Cybersecurity

Action. Before the Spring meeting, the Cybersecurity Working Group exposed the third draft of the Insurance Data Security Model Law (Model Law). Some interested parties already submitted their comments. In order to reach a consensus between the industry and regulators, the Working Group requested additional comments on this draft and the New York regulation by April 13, 2017.

At the Spring meeting, a representative from the New York State Department of Financial Services provided an update on the implementation and status of its cybersecurity requirements for financial services companies, which was effective on March 1, 2017. The regulation requires financial services companies to implement safeguards to detect and report cyber incidents with a particular emphasis on a thorough and well documented risk assessment.

Key areas of differences between the Model Law and New York's cybersecurity requirements include:

- notice of a cybersecurity event;
- encryption requirements; and
- information sharing practices.

On calls before the Spring meeting, the Data Security Model Law drafting group revised the second draft. Changes included:

- clarification that a licensee is not required to maintain a separate information security program if it is already doing so to comply with a federal statute or regulation that provides at least as much protection;
- addition of definitions for Data Breach Without Use of Personally Identifiable Information, Nonpublic Personal Information and refined definition of Personally Identifiable Information;
- revision to licensee's responsibilities for oversight of third-party service providers; and
- revision to notification requirements to both consumers and commissioners.

Interested parties continued to have significant concerns with the revised draft of the Model Law including:

- their belief that it does not address concerns about uniformity;
- proposed modifications to provide notice upon data breach; and
- definitions that are too broad for Data Breach and Data Breach Without Use of Personally Identifiable Information, which were newly added.

Some interested parties recommended that because there was no consensus on key provisions of the Model Law, the Working Group should consider focusing only on data security requirements and standards.

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Group capital calculation

Action. The Group Capital Working Group exposed a memorandum for determining minimum capital requirements for US insurers that do not file RBC and/or are not required to use statutory accounting. Comments are due May 26, 2017.

The memorandum included these proposals.

- US insurers that do not have an RBC formula would use the minimum capital as required by their state law as the basis for the group capital calculation. If requirements differ between states for a particular type of non-RBC insurer, one basis for the calculation should be chosen and applied to all insurers of that type.
- US insurers that have a US captive insurance company in their holding company structure would complete an NAIC RBC formula using their basis of accounting, but with limited adjustments similar to valuation used for US captives under SSAP No. 97.[17]
- An on-top adjustment should be recorded that represents all prescribed and permitted practices and their effect on capital.

The American Council of Life Insurers (ACLI) also presented three different approaches for non-insurance non-regulated companies within the group capital calculation. The three approaches:

- focused on capturing the capital requirements of all material financial companies and nonfinancial companies with demonstrable recourse to the group;
- excluded immaterial financial and nonfinancial companies without demonstrable recourse to the group; and
- excluded the assets and liabilities of excluded companies from the group capital calculation.

ACLI recommended the three approaches be explored further through field testing.

On a call before the Spring meeting, the Group Capital Working Group discussed comments about the two possible approaches to scalars for non-US insurers, the relative ratio approach and the distance to intervention approach. Many interested parties supported the relative ratio approach to determine scalars.

Next Steps. The Group Capital Working Group will use the three approaches as discussed by ACLI to develop a framework with company information to facilitate further discussion.

[17] SSAP No. 97, Investments in Subsidiary, Controlled and Affiliated Entities

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Qualified jurisdictions

Action. The Reinsurance Task Force heard a status report on the Bilateral Agreement between the EU and the US about insurance and reinsurance (the covered agreement). The covered agreement mutually recognizes both supervisory systems. US insurers will be supervised according to US standards and therefore will not be subject to the EU's Solvency II system. In return, EU insurers receive reciprocal treatment in the US. The covered agreement would eliminate reinsurance collateral requirements for EU reinsurers that maintain a minimum capital and surplus of €226 million and a solvency ratio of 100 percent under Solvency II.

On January 13, 2017, a covered agreement between the US and EU was finalized and submitted to Congress for a 90-day review period. The European Council will also need to approve the agreement. US regulators are opposed to the agreement as drafted because it may preempt state laws and regulations that may lessen consumer protections.

The NAIC submitted a letter to the US Treasury Department on March 15, 2017 asking it to work with the EU to clarify material terms of the agreement. The Reinsurance Task Force said further action would not occur until the form of the covered agreement has been finalized. At that time the Reinsurance Task Force will study and review whether any changes to reinsurance laws are needed.

The Qualified Jurisdiction Working Group stated that because of the uncertainty with the covered agreement that it has not taken any public action on EU member state implementation of Solvency II and the potential effect on its qualified jurisdiction status.

Next Steps. The Task Force will continue to monitor the covered agreement process.

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Investment risk-based capital

C-1 RBC charges

Action. The Investment Risk-Based Capital Working Group exposed a change to RBC filings for P&C and health insurers to increase the bond granularity from 6 to 20 designations. Comments are due May 26, 2017.

Before the Spring meeting, the Working Group discussed whether the bond structure for RBC should be consistent across all financial statement types and whether the bond granularity should be increased from 6 to 20 designations for P&C and health insurers similar to the proposal for life insurers. Both regulators and interested parties agreed that consistency was important. The proposal to increase granularity of Life RBC factors was exposed before the Fall 2016 meeting.

Before the Spring meeting, the Working Group received a proposal from the Academy to set new C-1 RBC factors for bonds and similar assets in the Life RBC calculation. Interested parties had many comments about the proposed factors including methodology and certain assumptions. The Academy is continuing to update its model based on comments from interested parties, including its work on alternatives for the portfolio adjustment factors.

Next steps. The Working Group will continue discussions when the Academy's report is made available.

RBC calculation for real estate

Action. The Working Group exposed a proposal to change the RBC calculation for real estate assets. Comments are due July 14, 2017.

The ACLI presented a proposal to update the RBC calculation for real estate to reflect updated experience and analysis since the development of the original RBC calculation. Key elements of the proposal included:

- updating the current base factors for real estate assets held on Schedule A and BA to be the same to provide further consistency in reporting on these schedules; and
- reflecting the effect of unrealized gains and losses on the potential loss for statutory surplus.

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Other accounting highlights

Equity method of accounting

Action. SAPWG adopted with modification new US GAAP guidance for equity method accounting into SSAP No. 30, SSAP No. 48 and SSAP No. 97. These revisions provide guidance for the prospective application of equity method accounting when an investment qualifies to use the equity method as a result of an increase in the level of ownership interest or degree of influence. Revisions are effective upon adoption.

Modifications reflect statutory terms, including the definition of control to match current statutory guidance, and statutory reporting concepts. This adoption revised SSAP No. 30 and SSAP No. 97 to provide guidance on accounting for an investment in a Subsidiary, Controlled and Affiliated company when ownership levels change.

Interested parties agreed with the proposed revisions and supported adoption.

Discounting for guaranty fund assessment

Action. On a call before the Spring meeting, SAPWG adopted revisions to SSAP No. 35R to allow discounting of guaranty fund assessments from insolvencies of insurers that wrote long-term care contracts. The effective date was January 1, 2017.

During the Fall 2016 meeting, interested parties commented that direct writers of long-term care policies were allowed to discount reserve liabilities. They requested that SAPWG consider similar treatment for guaranty fund assessment liabilities that are accrued from insolvencies of insurers that wrote long-term care contracts.

Regulators generally agreed with the requested changes, however, they believed that discounting should be required only if the payments will exceed one year. Any prefunding payments to guaranty associations where the full amount of the assessment is paid within 12 months should not be discounted.

Before the Spring meeting, SAPWG exposed revisions to SSAP No. 35R to:

- allow discounting as requested by interested parties;
- specify that the discount rate should be the whole life discount rate in effect at the reporting date; and
- add disclosures for:
  - discounted and undiscounted amount of the guaranty fund assessment;

  - discount rate used;
  - description of the estimated discount time period used for each jurisdiction and how the time periods were determined; and
  - changes to the discount time periods from prior reporting period.

Interested parties supported the proposed revisions, however, consumer advocate groups recommended rejection of the changes pending a more thorough review and analysis.

Surplus notes

Action. SAPWG exposed revisions to SSAP No. 41R to provide guidance on surplus notes issued at a discount, premium or with a zero coupon and incorporate illustrations into a new exhibit to the SSAP. Comments are due May 19, 2017.

The proposed changes would:

- clarify that discounts are expected to be de minimis in relation to the principal of the surplus note;
- provide reporting guidance for surplus notes issued at a discount, premium or with a zero coupon; and
- require disclosure of the:
  - amount of any discount, premium or effect of a zero coupon and the remaining portion that will be accreted or amortized; and
  - unapproved premium amortization or discount accretion.

The revisions address regulators’ concerns and request for illustrations of the accretion of discount or amortization of premium for surplus notes issued at an amount other than face value. SAPWG said that these revisions would clarify language but do not modify current statutory accounting.

High deductible policies

Action. SAPWG and the Blanks Working Group exposed revisions to SSAP No. 65 to expand disclosures about high deductible policies for year-end 2017. Comments are due May 19, 2017.

Additional disclosures related to high deductible policies would be required by line of business and include the:

- gross amount of unpaid loss reserves;
- amount of reserve credit for aggregate deductibles recorded on unpaid claims;
- paid recoverable amounts 90-days overdue and amounts non-admitted;
- amount recorded on- and off-balance sheet for deductible collateral pledged to the insurer and paid recoverables;
- amount of unpaid claims, paid recoverables and unsecured high deductibles; and

— deductible amount for the highest ten high deductible policies gross of collateral, including the name of the obligor.

Cash flow statement classification of certain cash receipts and cash payments

Action. SAPWG adopted revisions to SSAP No. 69 to adopt US GAAP guidance on the classification of certain cash receipts and cash payments in the statement of cash flows. The standard is effective for public business entities in years beginning after December 15, 2017, and one year later for all other companies. Early adoption is permitted.

The new US GAAP guidance targeted the following specific cash flow activities for which no guidance existed 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.

Restricted cash

Action. SAPWG exposed revisions to SSAP No. 69 to adopt new US GAAP guidance for restricted cash. Comments are due May 19, 2017.

The revisions would require insurers to disclose the nature of restrictions on cash and cash equivalents. SAPWG also requested comments on whether a definition for restricted cash and cash equivalents should be considered for statutory reporting. The recommended effective date for the revisions is year-end 2019 to correspond with the US GAAP revisions for nonpublic entities.

ASU 2016-18 was issued to reduce diversity in the classification and presentation of changes in restricted cash and requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents and amounts generally described as restricted cash or restricted cash equivalents.

Intra-entity transfers of assets other than inventory

Action. SAPWG exposed revisions to SSAP No. 101 to reject US GAAP guidance for intra-entity transfers of assets other than inventory. Comments are due May 19, 2017.

Interested parties expressed concerns with the previously exposed revisions to SSAP No. 101 to adopt with modification the new US GAAP guidance, because it primarily focused on recognizing intra-entity transfers on the consolidated US GAAP balance sheet. Currently, SSAP No. 101 requires insurers to recognize economic transactions as defined in SSAP No. 25, and compute income taxes consistent with ASC 740.[18] Because of this existing guidance, SAPWG has proposed that adoption of the new US GAAP guidance is not necessary and has asked for comments on whether rejection of this guidance would result in different recognition of income tax consequences between US GAAP and statutory accounting, which is not the intention.

Employee share-based payments

Action. SAPWG exposed revisions to SSAP No. 104R to adopt, with modification, US GAAP guidance for share-based payments. SAPWG also requested comments about the proposed transition guidance and asked whether transition guidance is needed for companies that do not prepare US GAAP financial statements. Comments are due May 19, 2017.

The FASB issued new US GAAP guidance for share-based payments as part of its simplification initiative. The areas for simplification involve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Proposed changes to SSAP No. 104R include:

- If an insurer has an accounting policy to account for forfeitures when they occur, it should reverse compensation cost previously recognized, in the period the award is forfeited for an award that is forfeited before completion of the requisite service period.
- To qualify for equity classification, employers must have a statutory obligation to withhold taxes on the employee's behalf, and the amount withheld cannot exceed the maximum statutory tax rates in the applicable jurisdictions.
- Cash paid by an employer when withholding shares for tax-withholding purposes should be classified as a financing activity in the statement of cash flow.
- Ability to make an accounting policy election to:
  - estimate the expected term using a practical expedient, and
  - determine the amount of compensation cost to be recognized in each period.

The adoption of the new US GAAP guidance for share based payments will also require tax deficiencies to be recognized as income tax expense or benefit in the income statement. The tax effects of exercised or vested awards would be

[18] SSAP No. 25, Affiliates and Other Related Parties; and ASC 740, Income Taxes

treated as discrete items in the reporting period in which they occur. A company also would recognize excess tax benefits regardless of whether the benefit reduces taxes payable in the current period. Excess tax benefits would be classified along with other income tax cash flows as an operating activity.

The revisions proposed that insurers follow the transition method that is consistent with how they adopted the US GAAP revisions. US GAAP guidance allows either retrospective, prospective or modified retrospective transition separately for each amendment.

10 Other regulatory highlights

Catastrophe risk charge

Action. The Catastrophe Risk Subgroup and its parent committees adopted a proposal to include the earthquake and hurricane catastrophe risk charge in the RBC formula for 2017 RBC reporting.

The catastrophe risk charge for earthquake and hurricane risks will be calculated by multiplying the RBC factors by the corresponding modeled losses and reinsurance recoverables using one of five approved commercially available models. The Subgroup agreed to allow one insurer to report its catastrophe exposures for the 2017 year-end using its internal model, while it works on developing procedures to allow the use of internal models for all insurers. The Subgroup will also continue to evaluate whether risk charges for other catastrophe perils, such as tornados, wildfires and terrorism, should be included in the RBC formula.

Operational risk charge

Action. On calls before the Spring meeting, the Operational Risk Subgroup adopted the 2017 structure for the percentage of RBC methodology (the add-on method) for operational risk in the 2017 RBC calculation. The Subgroup also exposed the current informational factor of three percent to be used in the 2017 RBC calculation. Comments are due May 4, 2017. On a call after the Spring meeting, the Subgroup exposed changes to the annual statement instructions for the adopted structure and to avoid the duplication in operational risk charges for subsidiaries. Comments are due May 24, 2017.

Some interested parties agreed with the three percent factor while others believed that it should be a cap or that a lower or a transitional factor should be used. Several interested parties also questioned the justification for factors to be used for 2017 reporting. The Subgroup acknowledged that there are worldwide problems related to the availability of specific data to analyze operational risk, but stated that other global insurance regulators have moved forward to include operational risk into their regulatory capital formulas.

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Other actuarial highlights

Asset adequacy testing

Action. The LTC Actuarial Working Group exposed a LTC Actuarial Guideline with an effective date of December 31, 2017 for stand-alone asset adequacy tests applicable to long-term care blocks of contracts. Comments are due May 11, 2017.

The LTC Actuarial Guideline incorporates comments received from interested parties from previous exposures and is intended to provide uniform guidance and requirements for certain assumptions in the asset adequacy testing for an insurer's LTC block of contracts. In particular, this Guideline:

- specifies that the appropriate form of asset adequacy analysis may be in the form of a gross premium valuation or in a more robust form, such as cash-flow testing, with Actuarial Standards of Practice providing guidance in this area;
- clarifies the type of adequacy testing methods that must be used for aggregation with other blocks of business for asset adequacy analysis purposes;
- requires a uniform approach to support acceptable assumptions for future LTC premium rate increases;
- provides requirements to document assumptions associated with all key LTC risks; and
- provides requirements to document stand-alone LTC asset adequacy testing results.

This Guideline would apply to an insurer with both direct and assumed LTC insurance contracts with over 10,000 inforce lives as of the valuation date. Accelerated death benefit products or other combination products where the substantial risk of the product is associated with life insurance or an annuity would be excluded.

Next steps. The LTC working group plans to incorporate these requirements into the Valuation Manual (VM-30) requirements at a future date, which would supersede this Guideline.

Longevity risk

Action. LATF exposed revisions to VM-30 to provide clarity on evaluating longevity risk. The revisions require actuaries to document the rationale for base assumptions and future mortality improvements or deterioration and whether the assumptions contribute to the conclusion that the reserve makes provision for moderately adverse conditions. Comments are due April 25, 2017.

The Longevity Risk Subgroup reported on the progress of developing a method to reflect the longevity risk in two components, reserves and risk-based capital, which would:

— recognize statutory reserve shortfalls from locked-in/outdated mortality tables through asset adequacy testing by updating reserves for older products using mortality standards 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 stressed mortality rates recommended by the Academy.

The Longevity Risk Subgroup has been addressing risk by evaluating the reserve requirements, while the Longevity Risk Task Force of the Academy has been analyzing the RBC C-2 charge. The Longevity Risk Subgroup believes that:

— more clarity within VM-30 was needed for standards to evaluate longevity risk and to understand moderately adverse conditions; and
— a new Valuation Manual chapter should be drafted on the meaning of moderately adverse conditions.

The Academy provided an update to the Life RBC Working Group on its progress to determine whether a longevity risk RBC C-2 charge is needed. This charge would be applied to the difference between the current reserve requirements, which are generally held at the 85^{th} percentile level and those needed for the RBC calculation, which is designed to cover risk up to the 95^{th} percentile (longevity stress). They believed that stressed mortality for RBC should use:

— historical data (not fitted to a normal curve) from a 20-year period; and
— the same shock across genders and below age 85 with the use of a higher shock at ages greater than 85;

Based on these views, the overall calibration would result in a 15 percent shock to mortality improvement.

Next Steps. LATF will consider the Subgroup's recommendation to develop a new VM chapter on future calls. In addition, the Academy will continue discussions with the Life RBC Working Group to incorporate regulator feedback and refine the longevity risk RBC methodology.

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