NAIC Spring Meeting

Issues & Trends

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1 Meeting highlights

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

— INT 18-01 to provide a limited time, limited scope exception to not require the recognition of changes in reasonable estimates resulting from the Tax Cuts and Jobs Act (TCJA) after the issuance of statutory annual statements as Type I subsequent events in the audited financial statements.

The NAIC **exposed** the following guidance.

— Revisions to SSAP No. 101 to provide guidance for the effects of the TCJA. Comments were specifically requested on the assessment of the reversal patterns of deferred tax items resulting from the TCJA.

— Issue paper with a proposed treatment for certain derivative contracts related to variable annuity contracts that do not qualify to use the hedge accounting guidance in SSAP No. 86.

— A request for comments on the proposed response to the Valuation of Securities Task Force about the treatment of bank loans. The response suggests that borrowing base loans and debtor in possession (DIP) financing should be classified as collateral loans.

— An issue paper detailing its initial assessment of how the recent targeted improvements to the US GAAP accounting model for derivatives could be applied to statutory accounting and the differences between US GAAP and statutory accounting that would be retained.

— A discussion document on how the recently issued US GAAP guidance on credit losses could be considered for statutory accounting.

— A revised memo on the treatment of senior debt and surplus notes and a memo on the scope of the group in the group capital calculation.

The NAIC **discussed** the following ongoing projects.

— The Variable Annuities Working Group discussed comments received on the 28 recommendations proposed by Oliver Wyman to change the variable annuity framework, including AG 43 and life risk-based capital.

— The Group Capital Calculations Working Group discussed the use of a look-through method for captives assuming XXX/AXXX business and approach to treat non-regulated entities in the group capital calculation.

— The Reinsurance Task Force submitted requests to its parent committee to amend the reinsurance model law and regulation and assign it and other NAIC groups new charges to address the Covered Agreement.

[1] NAIC Spring meeting was held March 24-27 in Milwaukee.

Investments – Page 8	
Assets acquired in regulatory transactions	Statutory Accounting Principles Working Group (SAPWG) exposed revisions to SSAP No. 4 stating that invested assets acquired as part of transactions that require state review or approval (regulatory transactions) should only be admitted with approval of the domestic state insurance department as a prescribed or permitted practice.[2] The exposure also requests comments on whether all regulatory transactions should be reported on Schedule BA. Comments are due May 18, 2018.
Bank loans	The Blanks Working Group adopted a proposal adding new category lines for bank loans to Schedules D, Schedule DL and Schedule E and a new section for bank loans to Schedule D, Part 1A. SAPWG exposed a request for comments on its proposed response to the Valuation of Securities Task Force about the definitions of bank loans within the Purposes and Procedures Manual. The response suggests that borrowing base loans and DIP financing would be classified as collateral loans. Comments are due May 18, 2018.
Common stock	SAPWG directed NAIC staff to draft an issue paper proposing revisions to SSAP No. 30 to improve the common stock definition, expand the scope to include closed-end funds and unit investment trusts, and enhance reporting to capture NAIC designations on Schedule D-2-2.[3]
Effect of future settled premiums on option valuations	SAPWG adopted revisions to SSAP No. 86 to add contract level disclosures for derivatives with financing premiums, effective December 31, 2018.[4]
Derivatives and hedging	SAPWG exposed an issue paper detailing its initial assessment of how the recent targeted improvements to the US GAAP accounting model for derivatives could be applied to statutory accounting and the differences between US GAAP and statutory accounting that would be retained.[5] Comments are due June 22, 2018.

[2] SSAP No. 4, Assets and Nonadmitted Assets

[3] SSAP No. 30, Unaffiliated Common Stock

[4] SSAP No. 86, Derivatives

[5] ASU 2017-12, Derivatives and Hedging

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Subsidiary, Controlled and Affiliated (SCA) entity losses	SAPWG exposed revisions to SSAP No. 97 clarifying the guidance when an insurer's share of losses exceeds its investment in the SCA entity and adding a disclosure to track losses.[6] Comments are due May 18, 2018.
Wash sales	SAPWG adopted revisions to SSAP No. 103R to:[7] — exclude all cash equivalents, derivative transactions and short-term investments with credit assessments equivalent to NAIC 1-2 ratings from wash sale disclosures; and — clarify that disclosures are included in the financial statements when the investment is sold.
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Experience reporting requirements	Life Actuarial Task Force (LATF) reexposed changes to VM-50 and exposed changes to VM-51.[8] Comments are due April 25, 2018.
Income annuities	LATF exposed a redrafted VM-22 that clarifies the intent of the framework and includes revisions to improve it.[9] Comments are due April 25, 2018.
Variable annuities – Page 13	
Derivative contracts related to variable annuity products	SAPWG exposed an issue paper with a proposed treatment for certain derivative contracts related to variable annuity products that do not qualify to use the hedge accounting guidance in SSAP No. 86. Comments are due May 18, 2018.
Variable annuity framework	The Variable Annuities Working Group discussed comments received on the 28 recommendations proposed by Oliver Wyman to change the variable annuity framework, including AG 43 and life risk-based capital. The Working Group will continue discussions about the proposed recommendations.

6 SSAP No. 68, Business Combinations and Goodwill

7 SSAP No. 103, Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

8 VM-50, Experience Reporting Requirements and VM-51, Experience Reporting Formats

9 VM-22, Maximum Valuation Interest Rates for Income Annuities

Group capital calculation – Page 16	
Captives	On a call before the Spring meeting, the Group Capital Calculation Working Group discussed comments about the use of a look-through method for captives assuming XXX/AXXX business in the group capital calculation. The Working Group will continue to discuss the treatment of these captives.
Surplus notes	On a call before the Spring meeting, the Group Capital Calculation Working Group exposed a revised memo on the treatment of senior debt and surplus notes in the group capital calculation. Comments were due March 28, 2018.
Non-regulated entities	The Group Capital Calculation Working Group discussed comments on a proposed approach for non-regulated entities in the group capital calculation. It directed NAIC staff to revise the proposed approach based on comments received.
Scope	The Group Capital Calculation Working Group exposed a memorandum on the scope of the group for the group capital calculation. Comments are due May 8, 2018.
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Covered agreement	The Reinsurance Task Force submitted requests to its parent committee to amend the reinsurance model law and regulation and assign it and other NAIC groups new charges to address the Covered Agreement.[10]
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Bonds	Before the Spring meeting, the Investment Risk-Based Capital Working Group discussed comments about the American Academy of Actuary's (Academy) revised report on bond factors. The Working Group agreed to select the risk premium assumption, one of the key assumptions, for further review. The Working Group also discussed a suggestion from the Academy's joint P&C/health bond factor analysis working group that a revision to the time horizon assumption that matches the shorter liability runoff period for P&C and health insurers may be appropriate. The Working Group will have further discussions on the topic.

[10] Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786)

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Federal Home Loan Banks (FHLB)	The Life Risk-Based Capital (RBC) Working Group adopted a proposal changing the C-0 charge for pledged collateral held equal to the FHLB advance from 1.3 percent to zero.
Medicaid pass-through payments	The Capital Adequacy Task Force adopted a proposal to apply a two percent RBC charge for Medicaid pass-through payments.
Federal tax reform	The Life RBC Working Group received a presentation from interested parties about the effect of TCJA on RBC. The Working Group will hold calls to discuss what changes will be required.
Operational risk	The Capital Adequacy Task Force adopted a three percent add-on RBC charge for basic operational risk beginning in 2018.
Other accounting highlights – Page 23	
Surplus notes	SAPWG adopted revisions to SSAP No. 41R and SSAP No. 97 to clarify that double counting of surplus notes is not permitted.[11] SAPWG exposed revisions to SSAP No. 41R to clarify that surplus notes linked to other structures are not subordinate and do not qualify as statutory equity by the issuer. The revisions also indicate that assets linked to issued surplus notes are not available for policyholder claims and should be nonadmitted. Comments are due May 18, 2018.
Policy loans	SAPWG exposed revisions to SSAP No. 49 and SSAP No. 56 to specify that all policy loans related to separate account polices should be funded in order to be admitted in the general account. The exposure also asks whether a line item 'contract loan' in the separate account annual statement should be removed.[12] Comments are due May 18, 2018.

[11] SSAP No. 41R, Surplus Notes and SSAP No. 97, Investments in Subsidiary, Controlled and Affiliated Entities

[12] SSAP No. 49, Policy Loans and SSAP No. 56, Separate Accounts

Other accounting highlights – Page 23	
Private placement variable annuities	SAPWG exposed revisions to SSAP No. 56 to capture information on the issuance of private placement life insurance and private placement variable annuities. The exposure also requests comments on the characteristics differentiating investment-focused private placement products and traditional life insurance products intended to be captured under SSAP No. 21 when the insurer holds the product as owner and beneficiary.[13] Comments are due May 18, 2018.
Goodwill limitations	SAPWG adopted a revision to SSAP No. 68 adding disclosures about acquisitions of SCA entities including the acquisition date of the SCA, the original amount of admitted goodwill, the amount of admitted goodwill as of the reporting date and admitted goodwill as a percentage of the SCA's book-adjusted carrying value (gross of admitted goodwill).[14]
Pension and other post-retirement benefit	SAPWG adopted revisions to SSAP No. 92 and SSAP No.102 to remove the fair value Level 3 reconciliation for plan assets.[15]
Income taxes	On a call before the Spring meeting, SAPWG adopted INT 18-01 to provide a limited time, limited scope exception to not require the recognition of changes in reasonable estimates resulting from the TCJA after the issuance of statutory annual statements as Type I subsequent events in the audited financial statements.[16] SAPWG exposed revisions to SSAP No. 101 to provide guidance for the effects of the TCJA. Comments were specifically requested on the assessment of reversal patterns of deferred tax items resulting from the TCJA.[17] Comments are due April 23, 2018.
Credit losses	SAPWG exposed a discussion document on how the recently issued US GAAP guidance on credit losses could be considered for statutory accounting.[18] Comments are due May 18, 2018.

[13] SSAP No. 21, Other Admitted Assets

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

[15] SSAP No. 92, Postretirement Benefits Other than Pensions; SSAP No. 102, Pensions

[16] INT 18-01, Updated Tax Estimates Under the Tax Cuts and Jobs Act

[17] SSAP No. 101, Income Taxes

[18] ASU 2016-13, Measurement of Credit Losses on Financial Instruments

Other actuarial highlights – Page 27	
Longevity risk	At the Spring meeting, the Academy reported to the Life Actuarial Task Force (LATF) and Life RBC Working Group on the longevity risk-based capital charge that is intended to cover the risk over the 85th percentile statutory reserve up to the 95th percentile stressed reserve. It will conduct a field study to test the current assumptions.
Guaranteed Issue and Simplified Issue tables	LATF exposed four 2017 Guaranteed Issue mortality tables, the 1980 Commissioner Standard Ordinary (CSO) table and an amendment proposal form to include the mortality tables in the Valuation Manual. Comments are due April 25, 2018.

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Investments

Assets acquired in regulatory transactions

Action. SAPWG exposed revisions to SSAP No. 4 stating that invested assets acquired as part of transactions that require state review or approval (regulatory transactions) should only be admitted with approval of the domestic state insurance department as a prescribed or permitted practice. The exposure also requests comments on whether all regulatory transactions should be reported on Schedule BA. Comments are due May 18, 2018.

Assets acquired as part of other agreements that require state review and approval may have risk factors affecting the insurers' decision to continue holding the investment and/or to liquidate it that are different than standard investment securities. Regulatory transactions, as defined in the Practices and Procedures Manual, do not have specific statutory accounting or reporting guidance. As such, the referral from Reinsurance Task Force suggested that assets acquired as part of regulatory transactions, be nonadmitted unless the state regulator explicitly approves admittance as a permitted or prescribed practice. The referral indicated that although regulatory transactions may not be used by many insurers, distinguishing them from investment securities when they are present in the financial statements would be beneficial to the regulators.

Bank loans

Action. The Blanks Working Group adopted a proposal adding new category lines for bank loans to Schedules D, Schedule DL and Schedule E, and a new section for bank loans to schedule D, Part 1A.

Action. SAPWG exposed a request for comments on its proposed response to the Valuation of Securities Task Force about the definitions of bank loans within the Purposes and Procedures Manual. The response suggests that borrowing base loans and DIP financing would be classified as collateral loans. Comments are due May 18, 2018.

The Task Force requested SAPWG review a proposed amendment to the Practices and Procedures Manual about the treatment of specific structures identified as bank loans. The proposed response recommends not to include borrowing base loans, DIP financing and revolving credit facilities in the Purposes and Procedures Manual as bank loans. The response also suggests that for a revolving credit facility structure only actual loaned amounts would be considered assets and that a commitment to provide lending cannot be recognized in the financial statements.

Common stock

SAPWG discussed comments received on proposed revisions to SSAP No. 30 that identified instruments in its scope that are not considered common stock. SAPWG proposed expanding the scope of SSAP No. 30 to include closed-end funds and unit investment trusts. Interested parties generally supported these changes.

SAPWG also discussed:

— comments received in response to the 2014 Valuation of Securities Task Force referral about whether equity or fund investments should be reported as common stock; and
— whether reporting on Schedule D-2-2 should include an NAIC designation when assigned by the Securities Valuation Office (SVO) allowing RBC to be driven by the underlying risk of investments within the fund.[19]

Some interested parties supported the reporting of fund investments as common stock and allowing the reporting of an NAIC designation, as assigned by the SVO, on Schedule D-2-2. However, others asserted that the fund investments should be classified based on their underlying investment holdings and all bond mutual fund investments should be accounted for using the SVO-identified investments methodology in SSAP No. 26R.[20] SAPWG agreed to propose reporting enhancements to capture NAIC designations but did not believe that the scope of SSAP No. 26R should be expanded.

Next step. SAPWG directed NAIC staff to draft an issue paper proposing revisions to SSAP No. 30 to improve the common stock definition, expand the scope to include closed-end funds and unit investment trusts, and enhance reporting to capture NAIC designations on Schedule D-2-2.

Effect of future settled premiums on option valuations

Action. SAPWG adopted revisions to SSAP No. 86 to add contract level disclosures for derivatives with financing premiums, which will be effective December 31, 2018. For each derivative contract with financing premiums, insurers will have to disclose:

— whether the premium cost is paid throughout the contract or at maturity and the next payment date;
— premium cost amounts: in total, paid in prior years, paid in the current year and to be paid in the future;
— the fair value of the derivative instrument excluding the effect of financing premiums; and
— the unrealized gain or loss on the derivative instrument excluding the effect of financing premiums.

SAPWG discussed comments received about the calculation of the asset valuation reserve for derivative contracts with financing premiums. Interested parties expressed concerns about proposed revisions and generally believed the current calculation reflects the risks for these types of derivatives. They also

[19] Schedule D-2-2, Common stocks owned during the year

[20] SSAP No. 26R, Bonds

did not believe that further changes to SSAP No. 86 are necessary for financing premiums.

Next step. SAPWG directed the NAIC staff to reassess the asset valuation reserve and the need for further modifications to SSAP No. 86 after reviewing the new disclosures. It anticipates that this reassessment will occur no earlier than summer 2019.

Derivatives and hedging

Action. SAPWG exposed an issue paper detailing its initial assessment of how the recent targeted improvements to the US GAAP accounting model for derivatives could be applied to statutory accounting and the differences between US GAAP and statutory accounting that would be retained. Comments are due June 22, 2018.

The issue paper considers the targeted improvements to US GAAP and also the differences between US GAAP and statutory accounting for derivatives. Initial assessments suggest:

— maintaining consistency with US GAAP guidance by permitting hedge accounting for risk components in hedging relationships involving nonfinancial risk and interest rate risk;
— analyzing the US GAAP guidance on measuring the hedged item in fair value hedges of interest rate risk given the current divergence between US GAAP and statutory accounting for fair value hedges;
— analyzing the US GAAP guidance for recognition and presentation of the effects of the hedging instrument and the hedged item;
— excluding certain components from the assessment of hedge effectiveness and establishing appropriate accounting and reporting guidance for them;
— considering revisions to the documentation of hedge effectiveness, including adding the shortcut method, because the NAIC staff does not believe the intent was to require more documentation than what is required under US GAAP; and
— considering disclosure revisions to clearly depict the effect of hedging transactions on specific financial statement line items.

SAPWG requested comments to clarify current statutory accounting guidance, to identify areas that should align with or diverge from US GAAP guidance and to suggest transition options.

Subsidiary, controlled and affiliated (SCA) entity losses

Action. SAPWG exposed revisions to SSAP No. 97 clarifying the guidance when an insurer's share of losses exceeds its investment in the SCA entity and adding a disclosure to track losses. Comments are due May 18, 2018.

The proposed revisions would require an insurer to:

— track its share of losses when such losses exceed its investment in the SCA;

- reflect the negative equity in the book-adjusted carrying value for such investment when it has guaranteed obligations or committed further financial support to the SCA; and
- disclose its share of the SCA losses, as well as its overall investment in the SCA.

Wash sales

Action. SAPWG adopted revisions to SSAP No. 103R to:

- exclude all cash equivalents, derivative transactions and short-term investments with credit assessments equivalent to NAIC 1-2 ratings from wash sale disclosures; and
- clarify that disclosures are included in the financial statements when the investment is sold.

Interested parties generally agreed with the adopted revisions but were concerned the disclosures may be difficult to complete for sales occurring at or near the end of the reporting period because qualifying transactions could be identified 30 days after the sale. SAPWG stated that:

- reporting in the period the security is sold is appropriate because the intent of the disclosure is to identify whether lower-rated securities were sold during the reporting period and reacquired thereafter; and
- capturing this disclosure is similar to the reporting requirements of Type I and Type II subsequent events.

However, interested parties recommended that common stock and mutual funds should also be excluded from the disclosure because they are already reported at fair value throughout the holding period and would not affect surplus when sold. However, SAPWG believed that common stock and mutual funds should continue to be included because they are not rated.

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Principle-based reserving

Experience reporting requirements

Action. LATF reexposed changes to VM-50 and exposed changes to VM-51.[21] Comments are due April 25, 2018.

The proposed changes 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.

Income annuities

Action. LATF exposed a redrafted VM-22 that clarifies the intent of the framework and includes revisions to improve it. Comments are due April 25, 2018.

The clarifications and changes in VM-22 include:

— an expanded scope clarifying which issue years of contracts, certificates and contract features are covered;
— an updated definition of the premium determination date that includes a set of decision rules applied to each of the items covered in the scope section;
— a revised description of circumstances that require domestic regulatory approval to use a valuation interest rate other than the prescribed statutory maximum valuation interest rate; and
— a new definition of the reference period to ensure companies would not artificially place a non-life-contingent payment beyond life-contingent payments to obtain a highest valuation rate.

Interested parties were concerned with the expanded scope of the proposed guidance, specifically because it would affect policies issued before the effective date of the Valuation Manual.

[21] VM-50, Experience Reporting Requirements

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Variable annuities

Derivative contracts related to variable annuity products

Action. SAPWG exposed an issue paper with a proposed treatment for certain derivative contracts related to variable annuity contracts that do not qualify to use the hedge accounting guidance in SSAP No. 86. Comments are due May 18, 2018.

The issue paper incorporates the American Council of Life Insurer's (ACLIs) suggested guidance about the deferred gain/loss calculation and disclosures. It develops specific statutory accounting guidance for certain derivative contracts hedging variable annuity guarantees subject to interest rate sensitivity and reserved in accordance with AG 43.[22] The objective of the guidance is to reduce non-economic surplus volatility when companies have strong risk management programs and provide sufficient transparency with regulatory oversight.

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 would not be able to use this guidance for derivatives that do not meet all of the qualifications or for those not specifically addressed in the guidance. SAPWG anticipates issuing the guidance as a new SSAP.

Next step. SAPWG directed the NAIC staff to ask regulators that previously provided permitted or prescribed practices to assess those practices considering the provisions of the proposed guidance.

Variable Annuity Framework

The Variable Annuities Working Group discussed comments received on the 28 recommendations proposed by Oliver Wyman to change the variable annuity framework including AG 43 and life risk-based capital. Comments were grouped into three general topics:

- stochastic scenarios,
- standard scenario, and
- disclosures.

Discussion focused on the recommendations about stochastic scenarios. Regulators and interested parties reached general agreement and supported certain recommendations about the stochastic scenarios, including to:

- **Remove the working reserve.** This was generally viewed as a simplification to the model to avoid accounting mismatches.
- **Discount deficiencies at the net asset earned rate on additional assets.** Regulators agreed with comments by interested parties to add the iterative method to estimate the implied vector of net asset earned rate with the requirement to disclose which method is used, if it has changed and the

[22] Actuarial Guideline XLIII – CARVM for Variable Annuities

reason for the change. One regulator expressed concern about allowing optionality. Oliver Wyman confirmed that both methods will not generate material differences.

- **Follow VM-20 guidance on general account asset projections with additional constraint on borrowing cost.** Interested parties agreed with the concept of aligning the two frameworks; however, some thought that the spread and default cost assumptions may need further review because of the conservatism embedded in VM-20.
- **Reduce minimum Clearly Defined Hedging Strategy (CDHS) error factor, but require back-testing disclosure to support chosen error factor.** Regulators agreed that requirements for back-testing were unclear and requested that the Academy present clarifying language.
- **Use the current VM-20 interest rate scenario generator.**

Different views were expressed about the following recommendations related to the stochastic scenario:

- **Permit immediate liquidation of current hedges, non-reflections of mark-to-market hedge gains and losses.** Some regulators and interested parties asserted that the requirement to have CDHS to include hedges in the Conditional Tail Expectation Amount (CTE) calculation should be removed. There was general concern by the regulators about a company's ability to choose whether to include hedges in its models.
- **Change equity calibration criteria to include experience from a longer historical period and decrease in the proposed capital funding metric from CTE 98 to CTE 95.** Interested parties recommended that the current calibration criteria should be retained because it provides a better regulatory construct by more accurately reflecting the true costs and benefits of risk mitigation strategies. Some regulators were supportive of lengthening the historical experience while others thought that current calibration criteria were appropriate. The Working Group decided to maintain the current calibration criteria and review the VM-20 scenario generator to ensure that it provided for sufficient volatility.
- **Allow companies to use proprietary scenario generators only if they do not reduce total asset requirement (TAR).** Interested parties supported the use of the proprietary scenario generators, however they did not believe that it should be restricted to situations when TAR is equal to or higher than the prescribed generator. Some regulators were concerned with the use of proprietary generators, while others thought the use was appropriate but may need to be approved by the domiciliary regulator. The Working Group decided to proceed with the current recommendation, however it plans to perform further review of the prescribed generator.
- **Differentiate treatment of non-guaranteed revenue sharing income by affiliated and non-affiliated funds.** Some interested parties asserted that affiliated and non-affiliated funds should be treated the same. Others supported refinements to the current treatment for non-affiliated funds but recommended that treatment of affiliated funds should be updated. Some regulators thought the current framework for affiliated funds is appropriate, while others acknowledged that although the risk associated with affiliated funds is higher, the current margin of 50 percent may be too high.

The Working Group also began discussing the standard scenario. Regulators generally agreed that the standard scenario was needed. Some thought that it should be used as a floor reserve because variable annuities are complex and risky due to their high correlation to the market. However, others thought that a stochastic approach could be used if disclosure about the method and the reason why the standard scenario was not appropriate are included. Some regulators also said that multiple standard scenarios may need to be developed to stress the results.

Next step. The Working Group will continue its discussion about proposed recommendations.

5 Group capital calculation

Captives

On a call before the Spring meeting, the Group Capital Calculation Working Group discussed comments about the use of a look-through method for captives assuming XXX/AXXX business in the group capital calculation.

Interested parties and regulators had different views about how these captives should be treated. Some interested parties suggested that a look-through approach with an on-top adjustment was appropriate to achieve consistency and comparability, especially because this calculation may be used internationally. However others thought that existing state rules and regulations should be used without adjustment because, among other reasons, doing so affirms a state-based regulatory system.

The proposed look-through method to value these captives could include:

— **Option 1.** Requiring the calculation for the XXX/AXXX captive to report the liabilities consistent with what the direct writer would have reported and assets allowed as admitted assets in accordance with statutory accounting practices; or
— **Option 2.** Allowing the calculation to use the valuation for XXX/AXXX captives, but requiring an on-top adjustment elsewhere in the calculation to achieve a similar net capital valuation as Option 1.

Next steps. The Working Group will continue to discuss the treatment of captives that assume XXX/AXXX business on future calls.

Surplus notes

Action. On a call before the Spring meeting, the Group Capital Calculation Working Group exposed a revised memo on the treatment of senior debt and surplus notes in the group capital calculation. Comments were due March 28, 2018.

The revised memo addressed some of the initial comments received from interested parties by:

— clarifying the treatment of surplus notes purchased from an affiliated entity by requiring insurers to eliminate the investment value of surplus notes and the purchaser's capital charge on that investment; and
— eliminating the criteria that required the prohibition of accelerating the repayment of future scheduled principal or coupon payments for fully funded structurally subordinated debt.

One interested party observed that the health insurance industry operates differently from property and casualty (P&C) and life insurance industries because policy claims are paid soon after the occurrence of the claim. He requested that the Working Group discuss financial metrics used by other types of organizations to assess the financial health of health insurers.

Interested parties also requested that the Working Group allow the amount of senior debt greater than 20 percent of total available capital also be considered capital. The revised memo maintains the 20 percent limitation of available group capital to be comprised of senior debt, but recommends adding an allowance for a portion of hybrid debt consistent with Standard & Poor's formula for debt with an intermediate equity content. Another alternative the Working Group may consider is a single limitation on debt such as 20-45 percent, depending on the type of instrument.

Non-regulated entities

The Group Capital Calculation Working Group discussed comments on a proposed approach for non-regulated entities in the group capital calculation.

Although many respondents agreed with the inventory approach, they also thought that modifications were needed. Suggestions included:

— providing separate treatment for affiliated and non-affiliated asset managers and registered investment advisors;
— simplifying or providing specific metrics to enable insurers to determine if an entity may be material to the group;
— conducting further discussions about how health insurers, including health maintenance organizations, will be treated; and
— using existing capital requirements for each legal entity without adjustment.

Next step. The Working Group directed NAIC staff to revise the proposed approach based on comments from interested parties.

Scope

Action. The Group Capital Calculation Working Group exposed a memorandum on the scope of the group in the group capital calculation. Comments are due May 8, 2018.

The memorandum clarifies that the intent of the calculation is to include information on potential risks to policyholders arising from outside the insurance companies, as well as location and sources of capital within the group. It proposes the scope of the group be consistent with the Insurance Holding Company Act and other holding company analysis tools. However, the memo suggests that the lead state regulator should have the ability to define the scope differently if facts and circumstances warrant a different approach.

The memorandum requests comments on the proposed approach and on:

— whether there are disadvantages with an approach that allows relevant facts, other than control, as defined with the Holding Company Act, to be considered in making this determination;
— whether the calculation should include information on the companies that have been excluded from the calculation by the lead state regulator;

- nature and timing of communication that may be needed for other domestic or commercially-domiciled states when the lead state regulator makes a determination on the scope that differs from the person holding control, as defined in the Holding Company Act;
- criteria that should be considered by the lead state regulator when determining whether an entity other than the ultimate person holding control should be used as the starting point for the group in the group capital calculation; and
- other suggestions to the proposed approach or potential application issues.

6

Covered Agreement

Action. The Reinsurance Task Force submitted requests to its parent committee to amend the reinsurance model law and model regulation and assign it and other NAIC groups new charges to address the Covered Agreement.

Before the Spring meeting, the Reinsurance Task Force held a public hearing to address the reinsurance collateral provisions of the Covered Agreement. Although different views were expressed about how NAIC qualified jurisdictions should be treated, many interested parties supported extending the same collateral requirements included in the Covered Agreement to those jurisdictions that agree to treat and recognize the United States similarly to the EU countries.

Many commenters also recommended that the NAIC and states consider a framework of enforcement mechanisms and other protections in the event that a reinsurer breaches the Covered Agreement, or a similar agreement for other NAIC qualified jurisdictions.

The Task Force recommended that it be charged with revising the reinsurance model laws model by the Fall 2018 NAIC meeting to:

— conform the laws to the terms of the Covered Agreement;

— allow reinsurers domiciled in NAIC qualified jurisdictions other than within the EU to realize reinsurance collateral requirements similar to those provided under the Covered Agreement if they agree to adhere to all other standards imposed on the EU in the Covered Agreement, including the requirement that the qualified jurisdiction must agree to recognize the states' approach to group supervision, including group capital; and

— address the effect of a breach of the Covered Agreement on a reinsurer's collateral obligations and the effect of a failure of a non-EU qualified jurisdiction to meet the standards imposed by its agreement or acknowledgment to adhere to the terms of the Covered Agreement and/or the model law and regulation.

Action. On a call after the Spring 2018 meeting, the Executive Committee adopted the following charges recommended by the Task Force.

— **Qualified Jurisdictions Working Group.** Consider requiring qualified jurisdictions to recognize key NAIC solvency initiatives, including group supervision, group capital standards, and strengthening the information-sharing requirements between the states and qualified jurisdictions. Also consider processes to remove qualified jurisdiction status in the event of a breach. The charge targeted completion is the Fall 2018 NAIC meeting.

— **Capital Adequacy Task Force.** Review and possibly modify the Life and Health RBC formulas specific to reinsurance credit risk charges. One option would be based on the financial strength of the reinsurer consistent with the P&C RBC formula, and considering public default experience and current factors used by credit rating agencies. Also, consider whether adjustments are needed to the P&C RBC formula to reflect information related to non-rated reinsurers. The charge targeted completion is the Fall 2020 NAIC meeting.

— **Statutory Accounting Principles Working Group**. Review and possibly modify Schedule F and any corresponding annual financial statement pages to determine how best to reflect the expected changes to the Credit for Reinsurance Model Law and Credit for Reinsurance Model Regulation. Consider alternatives, including whether an allowance for doubtful accounts is appropriate. The charge targeted completion is the Fall 2020 NAIC meeting.

— **Reinsurance Financial Analysis Working Group.** Consider changes in its current methods of monitoring certified reinsurers domiciled in Qualified Jurisdictions to incorporate changes to state reinsurance collateral requirements caused by the Covered Agreement. Consider any changes to the Credit for Reinsurance Model Law and Credit for Reinsurance Model Regulation to provide similar treatment to reinsurers domiciled in Qualified Jurisdictions. The charge targeted completion is the Fall 2019 NAIC meeting.

In September, 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. States will need to take action with respect to reinsurance collateral reforms within 60 months or be subject to potential federal preemption.

7

Risk-based capital

Bonds

Before the Spring meeting, the Investment RBC Working Group discussed comments about the Academy's revised report on bond factors. Interested parties continued to be concerned with the proposed factors because they would materially increase the C-1 bond charges, particularly for smaller companies. The Working Group thought that two adjustments to the Academy's model used to derive the proposed C-1 factors may be appropriate:

— an adjustment to the risk premium assumption; and
— a recovery experience to include other asset classes such as municipal bonds and private placement bonds.

Next step. The Working Group agreed to select the risk premium assumption, one of the key assumptions, for further review. Interested parties agreed with this approach.

The Working Group also discussed activities of the Academy's joint P&C/Health Bond Factor Analysis Working Group. The joint Academy working group discussed various aspects of the RBC charges for bonds for P&C and health insurers. The group stated one of the primary adjustments that may be appropriate is a revision to the time horizon assumption that matches the shorter liability runoff period for P&C and health insurers. The Working Group stated that it will discuss whether a different methodology is appropriate.

Next step. The Academy plans to submit its report to the Investment RBC Working Group by the Summer 2018 NAIC Meeting.

Federal Home Loan Banks

Action. The Life Risk-Based Capital Working Group adopted the ACLI's Federal Home Loan Bank (FHLB) proposal to change the C-0 charge for pledged collateral held equal to the FHLB advance from 1.3 percent to zero. If the FHLB funded advance liabilities associated with funding agreement activities exceed 5 percent of total net admitted assets, collateral supporting funding agreements in excess of this 5 percent will receive a factor equivalent to a NAIC 2 corporate bond.

Medicaid pass-through payments

Action. The Capital Adequacy Task Force adopted a proposal to apply a two percent RBC charge for Medicaid pass-through payments.

This charge will allow Medicaid pass-through payments to be excluded from receiving a full underwriting charge and instead will be treated like uninsured business with the two percent charge.

Previously, some states required these payments to be recorded as premiums and receive the full underwriting risk charge, while other states required them to be treated 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.

Federal tax reform

The Life RBC Working Group received a presentation from interested parties about the effect of TCJA on RBC. The tax reform changes both the numerator and denominator of the RBC formula and is expected to decrease RBC ratios.

Interested parties asserted that the effect to RBC will be significant and that in many instances the NAIC requirements are general and no changes would be necessary, in some instances simple fixes would be needed while in other cases significant modeling effort would be required.

Interested parties also suggested that all tax reform related changes to RBC be adopted at the same time in 2019. However, the Working Group thought that changes should be adopted in 2018, acknowledging that a 2018 implementation of all changes may not be possible. If the Working Group determines it is not possible for all changes to be made in 2018, it will determine whether to make:

- partial changes in 2018 with the remaining changes in 2019; or
- make all changes in 2019 with no changes in 2018.

Next step. The Working Group will hold calls to discuss what changes will be required.

Operational risk

Action. The Capital Adequacy Task Force adopted a three percent add-on RBC charge for basic operational risk beginning in 2018.

On calls before the Spring meeting, the Operational Risk Subgroup worked with the Academy on revisions to the structure to address concerns about double-counting operational risk. Some interested parties agreed with the three percent factor to be applied in 2018, while others thought that the charge should be phased in.

8 Other accounting highlights

Surplus notes

Action. SAPWG adopted revisions to SSAP No. 41R and SSAP No. 97 to clarify that double counting of surplus notes is not permitted.

The revisions clarify that surplus note double counting restrictions apply regardless of whether the surplus note is issued by the parent or an SCA entity and regardless of the method of acquisition (directly through the parent or through a third-party broker). The guidance does not apply to debt instruments issued by the parent and held by the SCA.

Action. SAPWG exposed revisions to SSAP No. 41R to clarify that surplus notes linked to other structures are not subordinate and do not qualify as statutory equity by the issuer. The revisions also indicate that assets linked to issued surplus notes are not available for policyholder claims and should be nonadmitted. Comments are due May 18, 2018.

The revisions clarify that debt instruments similar to surplus notes linked (directly or indirectly) to other products or transactions that include the risk that a regulator will ultimately approve payment of the stipulated principal and interest, or allow for the netting or offset of cash flows, should be accounted for as debt under SSAP No. 15.[23] Changes also direct state regulators to evaluate whether approved surplus notes are subsequently linked to such other products or transactions, and should also be accounted for under SSAP No. 15.

Policy loans

Action. SAPWG exposed revisions to SSAP No. 49 and SSAP No. 56 to specify that all policy loans related to separate account polices should be funded to be admitted in the general account. The exposure also asks whether a line item 'contract loan' in the separate account annual statement should be removed. Comments are due May 18, 2018.

SAPWG received comments from interested parties on previously exposed concepts to clarify accounting for policy loans. Interested parties comments included their belief that:

- current guidance is clear and consistent with concepts discussed in the exposure;
- no inconsistencies were identified for policy loans related to insulated separate accounts supporting variable life or variable annuity products; and
- policy loans are assets and should be reported as assets.

[23] SSAP No. 15, Debt and Holding Company Obligations

SAPWG agreed with many of the interested party comments and thought that revisions to SSAP No. 56 and SSAP No. 49 were needed to clarify the reporting.

Private placement variable annuities

Action. SAPWG exposed revisions to SSAP No. 56 to capture information on the issuance of private placement life insurance and private placement variable annuities. The exposure also requests comments on the characteristics differentiating investment-focused private placement products and traditional life products intended to be captured under SSAP No. 21 when the insurer holds the product as owner and beneficiary. Comments are due May 18, 2018.

SAPWG expressed concern that certain private placement variable annuities do not reflect traditional annuity products because they may not depend on an individual's health or death, but can be tailored to incorporate a minimum death benefit to be considered a life insurance product under statutory accounting. SAPWG also stated that it does not intend to change existing accounting guidance for company-owned life insurance and bank-owned life insurance; rather, identify products that are structured to be similar to alternative investments.

Goodwill limitations

Action. SAPWG adopted a revision to SSAP No. 68 adding disclosures about acquisitions of SCA entities including the acquisition date of the SCA, the original amount of admitted goodwill, the amount of admitted goodwill as of the reporting date, and admitted goodwill as a percentage of the SCA's book-adjusted carrying value (gross of admitted goodwill).

Regulators were concerned that some insurers were reporting a substantial amount of goodwill in the value of their SCAs. The additional disclosure is intended to enable regulators to review an SCA's goodwill admission and add transparency to its recorded value.

Pensions and postretirement benefits

Action. SAPWG adopted revisions to SSAP No. 92 and SSAP No. 102 to remove the fair value Level 3 reconciliation for plan assets.

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 has a nonadmitted asset for the difference; and
— if the plan is underfunded, an insurance entity is required to report a liability.

Income taxes

Action. On a call before the Spring meeting, SAPWG adopted INT 18-01 to provide a limited time and limited scope exception to not require the recognition of changes in reasonable estimates related to the TCJA after the issuance of statutory annual statements as Type I subsequent events in the audited financial statements.

The interpretation also provided instructions for reporting changes in deferred taxes including:

— recording the effects of the change in tax law for all accounting estimates that are complete;
— recognizing effects of accounting estimates that may be considered incomplete or for which reasonable estimates cannot be determined by applying guidance in SEC Staff Accounting Bulletin (SAB) 118, including relevant disclosures;[24]
— recording changes in estimates for circumstances when a reasonable 2017 estimate is updated or an estimate is established after the issuance of the 2017 financial statements, but before the issuance of the 2017 audited financial statements;
— recording the change in deferred taxes resulting from the TCJA in:
  - Net Unrealized Capital Gains (Losses) less Capital Gains Tax;
  - Net Deferred Income Tax;
  - Nonadmitted assets; and
— clarifying that the footnote disclosures detailing deferred tax assets and liabilities for December 31, 2018 should be reported using the December 22, 2017 enacted tax rate, and prior year 2016 information should not be revised.

Action. SAPWG exposed revisions to SSAP No. 101 to provide guidance for the effects of the TCJA. Comments were specifically requested on the assessment of the reversal patterns of deferred tax items resulting from the TCJA. Comments are due April 23, 2018.

Before the Spring 2018 meeting, SAPWG exposed minor revisions to SSAP No. 101 to conform with the TCJA. Interested parties agreed with proposed changes and suggested an additional footnote to include information from INT 18-01 about reporting lines to be used when there is a change in tax rate.

[24] SEC Staff Accounting Bulletin 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act

Next step. SAPWG directed NAIC staff to draft separate agenda items to discuss accounting considerations for alternative minimum tax and global intangible low-taxed income.

Credit losses

Action. SAPWG exposed a discussion document on how the recently issued US GAAP guidance on credit losses could be considered for statutory accounting.[25] Comments are due May 18, 2018.

The NAIC staff created a discussion document that summarizes US GAAP guidance and assesses where the US GAAP guidance may be applicable for statutory accounting and where modifications may be needed. The discussion document is intended to facilitate detailed conceptual discussions by regulators and interested parties. SAPWG requested comments about other elements that should align with or diverge from the US GAAP guidance.

Previously, 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. In their view statutory accounting should incorporate the expected credit loss model to improve the timing of when the losses are reported. However, interested parties suggested that the current incurred loss model is appropriate because of differences between US GAAP and statutory accounting models and because the statutory framework includes an asset valuation reserve and risk-based capital requirements that address credit risk.

[25] ASU 2016-13, Measurement of Credit Losses on Financial Instruments

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Other actuarial highlights

Longevity risk

At the Spring Meeting, the Academy reported to the Life Actuarial Task Force and Life RBC Working Group on the longevity risk-based capital charge that is intended to cover risk over the 85th percentile statutory reserve up to the 95th percentile stressed reserve.

The Academy reported that it performed a simplified analysis of longevity risk using a sample block of reserves by applying longevity stresses to statutory reserves. The difference between the 85th percentile statutory reserve and the 95th percentile stressed reserve represents the capital for longevity risk. However, the Academy would like to supplement this analysis with actual company data through a field study. The goal of the field study is to determine how the statutory reserve changes under defined longevity stress events for different subsets of the insurance business.

The field study will involve determining statutory reserves for inforce blocks of business under four scenarios:

— 2017 CARVM Valuation Basis (assumed to be 85th percentile);
— 95th Percentile Stress on Mortality Rates, Assuming High Credibility;
— 95th Percentile Stress on Mortality Rates, Assuming Low Credibility; and
— 95th Percentile Stress on Mortality Improvement.

Next step. The Academy will conduct a field study to test the current assumptions.

Guaranteed Issue and Simplified Issue tables

Action. LATF exposed four 2017 Guaranteed Issue mortality tables, the 1980 CSO table and an amendment proposal form to include the mortality tables in the Valuation Manual. Comments are due April 25, 2018.

On a call before the Spring meeting, LATF agreed to exclude Guaranteed Issue Life Insurance policies from PBR.

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

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