MARKET INSIGHT PAPER

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NAIC SPRING 2021

National Meeting Update

NAIC working groups held a series of conference calls for the 2021 Spring National Meeting. This paper includes updates and commentary from those calls.

Clearwater Analytics® is dedicated to keeping insurers updated on the latest regulatory guidance changes regarding investment accounting and reporting. In order to provide a comprehensive view of these changes, our insurance experts attended conference calls and tracked guidance as it was adopted and discussed. The following market insight paper is a summary of the NAIC's updates pertinent to investment accounting and reporting.

Statutory Accounting Principles Working Group

Monday, March 15, 2021

ADOPTED NONSUBSTANTIVE ITEMS EFFECTIVE IMMEDIATELY

Ref #2020-32: SSAP No. 26R – Disclosure Update

This item expands an existing disclosure regarding called bonds to include bonds terminated early through a tender offer. The SAPWG previously clarified in Ref #2020-02 that the accounting and reporting of bond investment income and capital gains/losses due to early liquidation either through a call or a tender offer shall be similarly applied.

Interested parties had no comments. NAIC staff recommended the working group adopt this item.

Ref #2020-33: SSAP No. 32R – Publicly Traded Preferred Stock Warrants

This item expands the scope of *SSAP No. 32R – Preferred Stock* to include publicly traded preferred stock warrants, requires publicly traded preferred stock warrants to be reported at fair value, and revises *SSAP No. 86 – Derivatives* to identify this treatment.

Interested parties had no comments. NAIC staff recommended the working group adopt this item.

Ref #2020-34: SSAP No. 43R – GSE CRT Program

This item proposes to include recent changes to the Freddie Mac Structured Agency Credit Risk (STACR) and Fannie Mae Connecticut Avenue Securities (CAS) programs into the scope of *SSAP No. 43R* and align *SSAP No. 43R* guidance regarding the financial modeling of mortgage reference securities to the requirements as directed in the *P&P Manual*. NAIC staff said it anticipates that future STACR and CAS issuances will be solely conducted through a Real Estate Mortgage Investment Conduit (REMIC) trust. The trust will pay interest and principal to the investors on a monthly basis and all other material characteristics remain unchanged (e.g., STACR notes are not guaranteed by Freddie Mac and CAS notes are not guaranteed by Fannie Mae). Both entities maintain the senior risk tranche which is unfunded and not issued for public investors. The main difference in the use of a REMIC trust is that it insulates investors from a possible Freddie Mac or Fannie Mae insolvency. NAIC staff believes a REMIC trust remains functionally equivalent and retains the same material risk structure as the original STACR and CAS programs.

Interested parties had no comments. NAIC staff recommended the working group adopt this item.

> *SAPWG met via conference call on March 15, 2021*

Ref #2020-41: ASU 2020-06, Convertible Instruments

This item rejects for statutory accounting ASU 2020-06, which addresses the five accounting models for convertible debt instruments. Four of the five models require convertible debt instruments be separated into a debt component and an equity or a derivative component. This is not a practice recognized by SAP. It proposes to include the rejections of this accounting standard update in *SSAP No. 5R – Liabilities, Contingencies and Impairments of Assets*, *SSAP No. 72 – Surplus and Quasi-Reorganizations*, and *SSAP No. 86 – Derivatives*.

Ref #2020-22: Accounting for Perpetual Bonds

Interested parties previously requested revisions clarifying that "perpetual bonds are within scope as a 'bond,' therefore shall apply the yield-to-worst concept (i.e., applicable premium or discount shall be amortized or accreted for perpetual bonds with an effective call option). Additionally, for perpetual bonds that do not possess or no longer possess a call feature, fair value reporting is required." Additional revisions supplied with the most recent exposure recommended fine-tuning a new footnote to clarify that the yield-to-worst method would be used to amortize any applicable premium.

NAIC staff recommended the working group adopt the revisions along with interested parties' suggested edit to the footnote.

Ref #2020-39: Interpretation Policy Statement

This item revises Appendix F in the NAIC Policy Statement on Maintenance of Statutory Accounting Principles regarding the issuance and adoption of accounting interpretations (INT).

"The revisions clarified actions available to the Working Group (including but not limited to postponing the effective date until the item has been discussed by the Accounting Practice and Procedures (E) Task Force and the Financial Condition (E) Committee) as well as the voting requirements for when an INT can be overturned, amended, or deferred by the Task Force or E Committee."

Interested parties suggested some wording edits to "clarify the policy for issuing interpretations which amend, supersede, or conflict with existing SSAPs (please see attached)."

NAIC staff recommended the SAPWG adopt the item with the proposed revisions that prevent use of INTs that provide temporary exceptions from SAP that may not be considered emergencies.

Ref #2020-40: Prescribed Practices

This item clarifies prescribed practices and how they are defined and applied in the NAIC *Accounting Practices & Procedures Manual* (*AP&P Manual*). Insurance companies are regulated by the domiciliary state in which they are licensed. However, there is conflict in that a non-domiciliary state in which the company is licensed may require supplemental information to be filed. At times, this may require a different accounting practice than which is required by the *AP&P Manual*. In that case, such a provision would be a prescribed practice. NAIC staff stated, "If the company files supplemental financial information that reflect this practice(s), even if the supplemental financial information is filed only in the non-domiciliary state, then the prescribed practice disclosure of Note 1 shall apply."

Interested parties stated that the discussion of prescribed and permitted practices in the proposal could cause confusion and suggested edits referring to supplemental financial information. "We believe the proposal should be amended to clarify that if a non-domiciliary state in which the company is licensed requires or allows a practice by state statute/bulletin (or other state-wide provision) in such supplemental financial information that is different from NAIC SAP, that practice(s) is also considered a prescribed practice. We recommend changes to the proposed wording to clarify these points."

NAIC staff recommended the working group adopt the item with the edits proposed by interested parties.

Ref #2019-34: Related Parties, Disclaimer of Affiliation and Variable Interest Entities

This item clarifies any related party identified under US GAAP or SEC reporting requirements would also be considered a related party under statutory accounting principles. Non-controlling ownership over 10% results in a related party classification despite disclaimer of control or affiliation. It emphasizes disclaimer of control or affiliation impact holding company group allocation and reporting as an SCA under *SSAP No. 97*, but it doesn't eliminate the related party classification and the required disclosure of material transactions. Also, it proposes to reject seven FASB Accounting Standards Updates as not applicable for *SSAP No. 25*.

Interested parties and NAIC staff had a conference call on December 10, 2020, to discuss the exposed draft. During the conference call, they discussed concerns that the draft "unintentionally impacted passive investments held by insurers in addition to investment in insurers."

The draft was amended to reflect interested parties' concerns. NAIC staff recommended the SAPWG adopt the item.

EXPOSED WITH COMMENT DEADLINE APRIL 30, 2021

Ref #2021-01: ASU 2021-01, Reference Rate Reform

In March 2020 the FASB issued ASU 2020-04, Reference Rate Reform (Topic 848) Facilitation of the Effects of Reference Rate Reform on Financial Reporting in order "to ensure the financial reporting of hedging relationships would reflect a continuation of the original contract and hedging relationship during the period of the market-wide transition to alternative reference rates."

Since that time there have been various transitions in the derivatives market due to reference rate reforms. However, they do not modify an interest rate that is expected to be discontinued.

In January 2021, FASB issued ASU 2021-01, Reference Rate Reform in order to "clarify that all derivative instruments affected by changes to the interest rates used for discounting, margining or contract price alignment (regardless of whether they reference LIBOR or another rate that is expected to be discontinued as a result of reference rate reform) are in afforded the contract modification relief provided in ASU 2020-04." According to the meeting notes, ASU 2021-01 expands the scope of ASU 2020-04 "by allowing an entity to apply the optional expedients, by stating that a change to the interest rate used for margining, discounting or contract price alignment for a derivative is not considered to be a change to the critical terms of the hedging relationship that requires dedesignation."

Staff recommends that the SAPWG move this item to the active listing as nonsubstantive and expose temporary (optional) expedient and exception interpretative guidance with an expiration date of December 31, 2022. These optional expedients would expand the guidance in INT 20-01: ASU 2020-04 - Reference Rate Reform. Under that guidance, derivative instruments impacted by interest rate changes used for discounting, margining, or contract price alignment would be within the scope of INT 20-01. This exception would allow for continuation of the existing hedge relationship and thus not requiring hedge dedesignation.

Ref #2021-02: ASU 2020-08 – Premium Amortization on Callable Debt Securities

The FASB issued ASU 2020-08, Codification Improvements to Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs in October 2020 in order to clarify the amortization of premium associated with callable debt securities.

"ASU 2020-08 requires that to the extent the amortized cost basis of a callable debt security exceeds the amount repayable by the issuer, any associated premium (above the call price) is to be amortized to the next effective call price/date. For example, if a reporting entity held a bond at $104 in which could be called at $102 in a year, the $2 excess premium would be amortized over that particular year. Once amortized to $102, the reporting entity would then reassess for any excess premium to the next effective call price/date. If there is no remaining premium or further call dates, the effective yield is reset using the payment terms of the debt security."

NAIC staff recommends that the item be moved to the active listing as nonsubstantive and expose revisions to *SSAP No. 26R – Bonds* to reject ASU 2020-08 for statutory accounting as it precludes statutory accounting's yield-to-worst concept.

Ref #2021-03: SSAP No. 103R – Disclosures

This item proposes additional disclosures and to data-capture certain elements of *SSAP No. 103R – Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* in response to SAPWG's deliberation of item 2019-21: *SSAP No. 43R – Equity Instruments*. That project is intended to determine what investments fall within *SSAP No. 43R – Loan-Backed and Structured Securities*, and was expanded in October 2020 to include a review of the investments eligible for reporting on Schedule D-1: Long Term Bonds.

In the course of that project, regulators expressed a desire to identify when a reporting entity has "entered into a securitization, asset-backed financing or similar transfer transaction where a significant economic interest in the transferred assets is retained by the reporting entity, its related parties or another member within the holding company group."

NAIC staff recommends that the SAPWG move this item to the active listing as nonsubstantive in order to: 1) expose new disclosure elements, and 2) propose data-capture templates for existing disclosures in *SSAP No. 103R – Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. A concurrent Blanks proposal is also expected (2021-05BWG).

Ref #2021-04: SSAP No. 97 – Valuation of Foreign Insurance SCAs

In November 2020, the SAPWG adopted item 2020-18 - *SSAP No. 97* Update. While that item was being discussed, industry asked for specific consideration of "whether 8.b.iv entities should be subject to the provisions of *SSAP No. 97*, specifically that paragraph 9 adjustments may result in a negative equity valuation." Industry's primary feedback was that foreign insurance operations are subject to foreign jurisdiction and should stand independent of a domestic insurer.

The SAPWG drafted this item in order to determine if further edits to *SSAP No. 97* are required. In response, "NAIC staff reviewed all SCA filings for the last 3 years, noting that less than 7% of all SCA filings were 8.b.iv entities. It was further noted that there was not a single instance of an 8.b.iv in a negative equity situation."

Staff recommends the item be moved to the active listing as nonsubstantive and expose the intent to move this item to the disposal listing without statutory edits. However, an interested party said NAIC staff might not be able to find the foreign investments that are reported on Schedule BA by simply reviewing Sub 2 filings. The interested party understood *SSAP No. 97* Para 9 adjustment is needed for domestic investments but it is not appropriate to record negative equity for foreign investments that are solvent. The interested party is looking forward to working with NAIC staff and providing them with some examples.

The chair agreed to re-expose this item.

Ref #2021-05: Cryptocurrencies

NAIC staff has received several inquiries regarding STAT accounting treatment for cryptocurrencies like Bitcoin, including whether Bitcoin is captured as cash under *SSAP No. 2R – Cash, Cash Equivalents, Drafts, and Short-Term Investments*. In response, NAIC staff notes that cryptocurrencies do not meet the definition of cash under *SSAP No. 2R* because they are currently not accepted by major banks and do not operate like a traditional currency. They are nonadmitted pursuant to *SSAP No. 4* Para 3.

NAIC staff recommended moving this item to the active listing and exposing the interpretive guidance in INT 21-01T: Statutory Accounting Treatment for Cryptocurrencies. The SAPWG would like input from interested parties and insurance trade groups on the following topics:

1. Extent to which companies currently hold cryptocurrencies
2. How the acquisition in cryptocurrency is held (directly by the insurer or indirectly through an SCA)
3. Which cryptocurrencies they are acquiring in (Bitcoin, Ethereum, Litecoin, etc.)
4. General level of interest for future acquisition by both companies that currently do and do not own cryptocurrencies

Ref #2020-36: Derivatives Hedging Fixed Indexed Products

This item proposes two concepts to address reporting mismatches for derivatives that are used for hedging Fixed Indexed Products:

1. Establish guidance that permits effective hedge treatment that is in line with *SSAP No. 86*. The derivative would be reported at amortized cost. The fair value changes would be recognized at settlement to offset the change in FIA/IUL reserve.
2. Establish guidance that permits effective hedge treatment that is in line with *SSAP No. 108*. The derivative would be reported at fair value. The change in fair value is bifurcated for reporting based on whether the change is an effective hedge to the interest crediting rate change in the hedged FIA/IUL reserve.

When exposed on Nov. 12, 2020, the working group notified the Life Actuarial (E) Task Force of this proposal. Staff planned to work on an issue paper as this is a substantive guidance change and a potential new SSAP.

Interested parties kept their response brief with the initial exposure, stating that they are still reviewing it, assessing the proposal, and working on potential variations. Interested parties reiterated their commitment to continue working with staff and the SAPWG on "this very complicated and important topic."

NAIC staff recommended the working group re-expose the item to give interested parties more time to develop their proposal and work with them in the interim.

DISPOSED ITEMS

Ref #2020-35: SSAP No. 97 – Audit Opinions

This item proposes to expand the quantification exception guidance to 8.b.iii entities in limited situations. The proposal states under the existing guidance, this exception is only permitted for US insurance subsidiaries (aka 8.b.i entity). When US subsidiaries received qualified or adverse audit opinion due to departure from US GAAP, the investment in this subsidiary is admitted if the departure is consistent with SAP accounting that resulted in a more conservative financial statement representation.

Interested parties stated they are not aware of any situations where existing guidance hinders admittance of 8.b.iii entities under the situation outlined.

NAIC staff recommended the working group dispose of the agenda item, noting no changes to statutory accounting. Citing formal and informal feedback, the issue is not prevalent and does not warrant changes to *SSAP No. 97*.

OTHER ITEMS

Ref #2019-21: SSAP No. 43R – Update

A small group has been working since December 1, 2020, to determine what should be categorized as a "bond" in Schedule D-1: Long-Term Bonds. This review stems from comments made regarding the *SSAP No. 43R* project. The group is nearly ready to share its proposal publicly; in the meantime, it would like to highlight two things:

› Schedule D-1 definition "focuses on investments that reflects issuer credit obligations and asset-backed securities." The initial project is to identify what will be captured for Schedule D-1; revisions for both *SSAP No. 26R* and *SSAP No. 43R* will follow.

› Investments that are determined to be outside of Schedule D-1 will likely be captured in Schedule BA. NAIC staff plans to work with the Capital Adequacy Task Force (CADTF) to ensure these investments will get appropriate accounting, reporting and RBC treatment.

INT 19-02: Freddie Mac Single Security Initiative

After its periodic review, SAPWG notes that the Freddie Mac Single Security Initiative appears to be an ongoing program, and so will not likely be terminated in the near future. A decision was made to not move this interpretation to Appendix H – Superseded SSAPs and Nullified Interpretations, and INT 19-02 remains in full effect. NAIC staff will continue to monitor and report to the working group if there are any changes.

VOSTF Referral – WCFI – Pending

The VOSTF is considering revisions to the *P&P Manual* in relation to revisions to *SSAP No. 105R – Working Capital Finance Investment*, which was adopted in May 2020 (2019-25). VOSTF directed this to SAPWG at the November 2020 meeting, and according to the SAPWG, "the NAIC staff anticipates addressing this referral when received in the interim."

Valuation of Securities Task Force

Monday, March 22, 2021

ADOPTED ITEMS

Discuss Comments and Consider for Adoption an Updated Proposed Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) to Update the Financial Modeling Instructions tor RMBS/CMBS Securities and Direct IAO Staff to Produce NAIC Designation and NAIC Designations Categories for Non-Legacy Securities

IAO staff made a recommendation to the NAIC that all Non-Legacy Securities (those financially modelled Residential Mortgage-Backed Securities/Commercial Mortgage-Backed Securities that closed on or after January 1, 2013) move to a single NAIC designation and NAIC designation category with no SVO Administrative Symbol, e.g., 3.C. This was first proposed by IAO staff in 2019, but the VOSTF opted to defer the change at a February 2020 meeting due to concerns from industry about significant adverse risk-based capital consequences.

The current practice provides a series of book adjusted carrying value price breakpoints to companies to determine the NAIC designation then map to the mid-point modifier. The effects of the 2020 pandemic on RMBS and CMBS securities in year-end financial modeling showed several securities no longer qualified as zero-loss because of the more conservative scenarios being applied to reflect the economic impact of the pandemic. As a result, these became subject to the book adjusted carrying value price breakpoints process.

> *Staff has received several inquiries regarding STAT accounting treatment for cryptocurrencies like Bitcoin*

After reviewing year-end 2020 modeling, industry and IAO staff agreed that the price break points caused insurer-owned securities with otherwise strong credit to be reported as NAIC 2, NAIC 3, and NAIC 4. This is because many of these securities are held at a premium due to the low-interest rate environment and received these designations because of their book adjusted carrying value and not for a credit concern.

During a December 2020 meeting of the VOSTF, there was discussion and concern that the current process was causing possible market disruptions. Moving away from financial modeling price breakpoints process for these non-Legacy Securities will avoid further and future market disruptions and permit a clearer assessment of the credit risk assessment for these securities that will not be impacted by their book adjusted carrying value.

Staff recommended a referral to the SAPWG because of potential impact to *SSAP 43R - Loan-Backed and Structured Securities*.

There was dialog to see if some of the problematic breakpoints could be resolved in the future. The NAIC is open to identifying additional disclosures at a more granular level so an insurance company can better understand what was driving the problematic modeling.

This item was adopted for a 2021 implementation date. The date could change to 2022 if it is not able to be implemented from a technology standpoint, but that will be reviewed at a later date.

Discuss Comments Received and Consider for Adoption — An Updated Proposed Amendment to the P&P Manual to Require the Filing of Private Rating Letter Rationale Report

In February 2020, the VOSTF exposed a memo from IAO staff expressing concerns over bespoke securities and the NAIC's overreliance on credit rating provider ratings to assess investment risk and for regulatory purposes. The VOSTF then asked the SVO to make recommendations addressing these concerns.

Further, the Financial Condition (E) Committee directed VOSTF in October 2020 to include a new charge for 2021 to, "implement policies to oversee the NAIC's staff administration of rating agency ratings used in NAIC processes, including, staff's discretion over the applicability of their use in its administration of Filing Exemption."

As a result of these actions and concerns, the SVO proposed moving forward with implementation of some of its recommendations and increasing SVO scrutiny of PL (privately rated) securities. Many PL securities are bespoke securities. In a memo, the SVO had concerns that its lack of authority to use its judgment in determining whether a CRP rating is useful for NAIC purposes has led to an increase in the use of bespoke securities, many of which are assigned NAIC designations through the Filing Exempt (FE) process.

To receive an NAIC designation for PL securities, the SVO must receive the private rating letter and a rationale report that provides more in-depth analysis of the transaction, private rating methodology, as well as risks and mitigants. This information will allow the SVO to determine if the private credit rating is an Eligible NAIC CRP Rating and eligible to be reported on Schedule D. The SVO will also determine if it agrees with the private credit rating. If the SVO deems a PL security is ineligible for Filing Exemption or is outside the scope of *SSAP No. 26R – Bonds*, *SSAP No. 32R – Preferred Stock*, or *SSAP No. 43R – Loan Backed and Structured Securities*, the SVO will provide a brief explanation in VISION why the security will not be provided an NAIC Designation Category.

In November, the VOSTF directed the SVO to update its proposed amendment to have the rationale reports filed with SVO, but without the SVO's discretion over evaluating the appropriateness of the rating or methodology utilized. A regulator-only call will be scheduled to review transactions that appear to be ineligible for filing exemption, Schedule D reporting or if there is a difference in opinion on risk.

The interested parties (American Council of Life Insurer (ACLI), North American Securities Valuation Association (NASVA), and Private Placement Investors Association (PPIA)) agree to increase the level of transparency and information sharing with the SVO and regulators to address potential concerns with bespoke securities by providing private rating letters, rating rationale reports and even the deal documents upon the SVO's request if necessary. However, they also raised the practical challenges resulting from the contractual agreements between credit rating providers, insurers, and issuers. The insurers are not allowed to share ratings rationale reports with the SVO in accordance with the current agreements. For the PL securities issued between January 1, 2018 and January 1, 2022, they will work to persuade issuers and credit rating providers to amend existing contractual agreements. However, they expect this process will take time and they will ensure the SVO is continually aware of their progress.

The SVO incorporated the edits by the interested parties and proposed amendments to Parts One and Three of the *P&P Manual* to require insurance company filers to provide private rating letter rationale reports for each PL security effective January 1, 2022. Insurers are required to report those PL securities issued between January 1, 2018 and January 1, 2022, on the General Interrogatory (i.e., a PL GI security) if they cannot provide the SVO a copy of a rating rationale report due to confidentiality or contractual reasons. If there are no such limitations, the PL securities will be reported with a self-designated NAIC Designation Category of NAIC 5.B GI.

Charles Therriault with the NAIC team is working with the taskforce to clean up the wording on some of the amendments and will release the changes for a 30-day exposure period.

Discuss Comments Received and Consider for Adoption — A Proposed Amendment to the P&P Manual to Update the List of NAIC Credit Rating Providers to Reflect NRSRO Changes

Following Morningstar, Inc.'s acquisition of DBRS, the SVO recommended adoption of a non-substantive amendment to the *P&P Manual* to remove references to the legacy entities and refer to the new combined entity, DBRS, Inc., doing business as "DBRS Morningstar Credit Ratings" or "DBRS Morningstar." This change will update the rating agency names on the List of NAIC Credit Rating Providers to match those on the U.S. Securities and Exchange's Office of Credit Ratings list of current nationally recognized statistical ratings organizations (NRSROs) and the CRP Credit Rating Equivalents to NAIC Designations and NAIC Designation Categories.

It also removes the Morningstar ratings from the *P&P Manual* Part Three Paragraph 23 – mapping table for both long- and short-term ratings.

There were no comments on this item from the task force or interested parties.

EXPOSED ITEM FOR 45 DAYS WITH COMMENT DEADLINE ENDING MAY 6, 2021

Discuss and Receive a Proposed Amendment to the P&P Manual to Clarify Guidance for Fund Leverage

In response to requests from VOSTF members for a more definitive limitation on the use of derivatives, the SVO proposed creating two new tests aimed at providing greater clarity and predictability to fund sponsors and investors regarding the acceptable use of derivatives and to allow some funds to have greater flexibility in their use of derivatives. One test would cover all funds not on the NAIC Fixed Income-Like SEC Registered Funds List, and the second test would apply only to funds on that list.

For funds on the SVO-Identified Bond ETF List, the SVO-Identified Preferred Stock ETF List and the NAIC List of Schedule BA Non-Registered Private Funds with Underlying Assets Having Characteristics of Bonds or Preferred Stock, the SVO proposed a threshold rule in which "the gross notional amount of derivatives which impose no future payment or margin posting obligation on the fund, cannot exceed 10% of the net asset value of the fund, under normal market conditions, except for certain currency and interest rate hedges, certain futures or forwards on fixed-income or preferred stock to be held in the fund's portfolio, reverse-repurchase agreements associated with specific fixed-income or preferred stock investment held by the fund, and non-margin borrowing for purposes other than investment, each of which could impose a future payment or margin posting obligation on the fund."

Funds on the NAIC Fixed Income-Like SEC Registered Funds List are in scope of *SSAP No. 30R – Unaffiliated Common Stock* and reported on Schedule D, Part 2, Section 2. In this case, NAIC Designations assigned to those funds could be permitted to include assessments of risk other than credit risk, including market and liquidity risk, and it would increase the range of funds eligible to receive NAIC Designations. These funds would also be allowed a larger derivative threshold of up to 20% of the net asset value of the fund, under normal market conditions, preventing violation of the *P&P Manual* fund methodology's "predominantly hold" requirement, according to the SVO.

The SVO is not proposing any types of derivatives be exempt from the 20% threshold calculation.

Blanks Working Group

Tuesday, March 16, 2021

Receive Memorandum from the VOSTF

BWG received a memorandum from the VOSTF that the new SVO Administrative Symbol "FS" has been added to identify non-legacy security financially modeled residential mortgage-back securities (RMBS) and commercial mortgage-backed securities (CMBS) that are closed on or after January 1, 2013, with SSG assigned as the NAIC Designation Category. This new administrative symbol will be added to the "Valid Designation, Designation Modifier and Administrative Symbol" list and posted on the BWG website.

IAO staff planned to provide a single NAIC Designation for all modeled RMBS/CMBS in 2019 but the VOSTF decided to defer this change in February 2020 because industry expressed concerns over the risk-based capital (RBC) impact. Due to the pandemic impact in 2020, some securities no longer qualified as being zero-loss under more conservative scenarios and ended up getting a lower NAIC Designation for 2020 year-end because they were held at a significant premium (i.e., high book adjusted carrying value) in this low interest rate environment and price break points were applied.

During the VOSTF meeting on December 18, 2020, industry agreed with the IAO staff that the mechanics of the price break points were causing some modeled RMBS/CMBS with strong credit to be reported at a lower NAIC Designation, and not because of their credit risk. Instead of getting rid of the price breakpoints process for all modeled RMBS/CMBS, the IAO staff proposes to assign a single NAIC Designation and NAIC Designation Category for all non-legacy financially modeled RMBS/CMBS that closed on or after January 1, 2013. The single NAIC Designation assigned by SSG does not depend on the insurer's book/adjusted carrying value of each RMBS or CMBS. Legacy financially modeled RMBS/CMBS will remain getting breakpoint prices for NAIC Designation calculation which will then be mapped to the mid-point modifier.

ADOPTED ITEMS EFFECTIVE 2020 ANNUAL (UNLESS STATED OTHERWISE)

2020-35BWG Modified — Expand the number of characters used from seven to ten in the investment line categories for Schedules D, DA, DL and E excluding Schedule D, Part 6 (Sections 1 and 2) and Schedule E (Part 1 and 3). Add line categories for Unaffiliated Certificates of Deposit and Exchange Traded Funds. Split the line categories for Mutual Funds, Investment Unit Trusts and Closed-End Funds into lines indicating if the fund has been assigned a designation by the Securities Valuation Office (SVO) or not. Make changes to Summary Investment Schedule, Summary by Country and Schedule D, Part 1A (Sections 1 and 2) to reflect the additional line categories.

A proposal was made to change the line number size to accommodate more line categories and to allow for room in the numbering scheme for Schedules D, DA, DL, and E. The change allows additional lines to be added without disrupting the line numbering in the future. The proposal also addresses previously raised crosscheck issues and reporting questions.

The adopted proposal:

- Expands the number of characters used from seven to ten in the investment line categories for Schedules D, DA, DL, and E, excluding Schedule D, Part 6 (Sections 1 and 2) and Schedule E (Part 1 and 3)
- Removes Bond Mutual Funds from SVO Identified Funds Category
- Adds line categories for Unaffiliated Certificates of Deposit and Exchange Traded Funds
- Splits the line categories for Mutual Funds, Investment Unit Trusts and Closed-End Funds into lines indicating if the fund has been assigned a designation by the SVO or not
- Removes code "$" for Certificates of Deposits under the FDIC limit

- Makes changes to the Summary Investment Schedule, Summary by Country and Schedule D, Part 1A (Sections 1 and 2) to reflect the additional line categories

This item is effective for 2022 quarterly reporting.

2020-36BWG — Modify the General Schedules Investment Instructions and Schedule DB General Instructions to reflect treatment of publicly traded stock warrants as being in the scope of SSAP No. 30R – Unaffiliated Common Stock or SSAP No. 32R – Preferred Stock and reporting as common and preferred stock (SAPWG 2020-33).

Blanks adopted a proposal to include publicly traded preferred stock warrants captured in the scope of *SSAP No. 32R* in the "Industrial and Miscellaneous Unaffiliated" category on Schedule D and those captured in the scope of *SSAP No. 30R* in the same category on Schedule D. It excludes publicly traded stock warrants captured in either scope of *SSAP No. 30R* or *32R* from Schedule DB.

2020-37BWG Modified — Add a new Schedule Y, Part 3 to capture all entities with ownership greater than 10%, the ultimate controlling parties of those owners and other entities that the ultimate controlling party controls (SAPWG 2019-34).

This proposal was adopted to reflect disclosure changes adopted by the SAPWG for *SSAP No. 25 – Affiliates and Other Related Parties* (Ref #2019-34) regarding disclosure of owner(s), its ultimate controlling party, and other entities the ultimate controlling party controls. It adds a new Schedule Y, Part 3 to capture all entities with ownership great than 10%, the ultimate controlling parties of those owners and other entities that the ultimate controlling party controls.

Editorial Change — Schedule BA Part 1 Column 7 and Schedule BA Part 2 Column 6 "NAIC Designation, NAIC Designation Modifier and SVO Administrative Symbol"

This item clarifies that lines 07, 08, 15, 16, and 45 are expected to have NAIC Designation Category with Administrative Symbol but the rest of the lines may be completed if the Schedule BA investments are assigned NAIC Designation Categories by the SVO or rated by an NAIC credit rating provider. It removed the paragraph stating the field should be left blank if the investments have not been assigned an NAIC Designation by the SVO.

The change on Schedule BA Part 1 is effective for 2021 annual reporting whereas the change on Schedule BA Part 2 is effective for 2021 quarterly reporting.

EXPOSED ITEM WITH COMMENT DEADLINE OF APRIL 27, 2021

2021-05BWG — Modify the instructions for Note 17B(4) b1(a) – Sale, Transfer and Servicing of Financial Assets and Extinguishments of Liabilities and add a table to the illustrations to data capture the disclosure (SAPWG 2021-03).

Blanks exposed a proposal to modify the instructions for Note 17B(4)b1(a) and add a table to the illustrations to data capture the disclosure. This proposal reflects disclosure changes adopted by the SAPWG.

Capital Adequacy Task Force

Tuesday, March 23, 2021.

ADOPTED ITEM

Consider Adoption of Proposal 2020-10-CA Bond Structure for Health and P&C Insurers

This item was exposed for a 45-day comment period in October 2020. It modifies the structure for the bonds to pull directly from the Book Adjusted Carrying Value Footnotes of Schedule D Part 1, Schedule DA Part 1, and Schedule E Part 2 for the 20 NAIC Designation Categories. It removes hybrid securities from equity assets pages, i.e., XR010 and PR007, and they will be included as a bond on the Bonds pages and asset concentration (i.e., XR012, PR011).

Other Item

The Task Force will expose the RBC bond factors by the end of April and adopt for 2021 Annual by June 30, 2021.

Life Risk-Based Capital Working Group

Tuesday, March 30, 2021; and Tuesday, April 6, 2021

ADOPTED ITEM

Proposal 2021-01-L Reporting Structure for Real Estate Worksheet

This item updates the RBC calculation for real estate by modifying the reporting structure of the Real Estate Worksheet. It adds two new columns — Fair Value and Adjusted RBC Factor — and modifies several column names. The fair value of the property is not reduced for any encumbrances.

The instructions and factors included are not final and will be addressed by exposed item 2021-06-L.

This item is effective for 2021 annual reporting.

EXPOSED ITEM FOR 10 DAYS WITH COMMENT DEADLINE APRIL 9, 2021

This item proposes to update both bond factors and the portfolio adjustment formula recommended by the American Academy of Actuaries (AAA). AAA recommends capping the base factor for the lowest quality of bond designation at 30% which is same the factor for unaffiliated stocks and rounding the bond factors, as was done for the current bond factors.

AAA provided updated bond factors to the NAIC's Investment RBC Working Group, which disbanded in October 2017. The updated bond factors use a 21% corporate tax rate and are expected to establish required capital at the 96th percentile over a 10-year time horizon. The assumptions AAA used in developing the new factors are based on expected loss given historic default rates for a portfolio of bonds that is representative of a typical life insurer's bond portfolio.

The item proposes to update the portfolio adjustment formula used to capture differences in a company's diversification risk relative to the representative portfolio. The larger the number of issuers in the insurer's portfolio, the more diversification benefit the insurer will gain. It also decreases the base capital requirement.

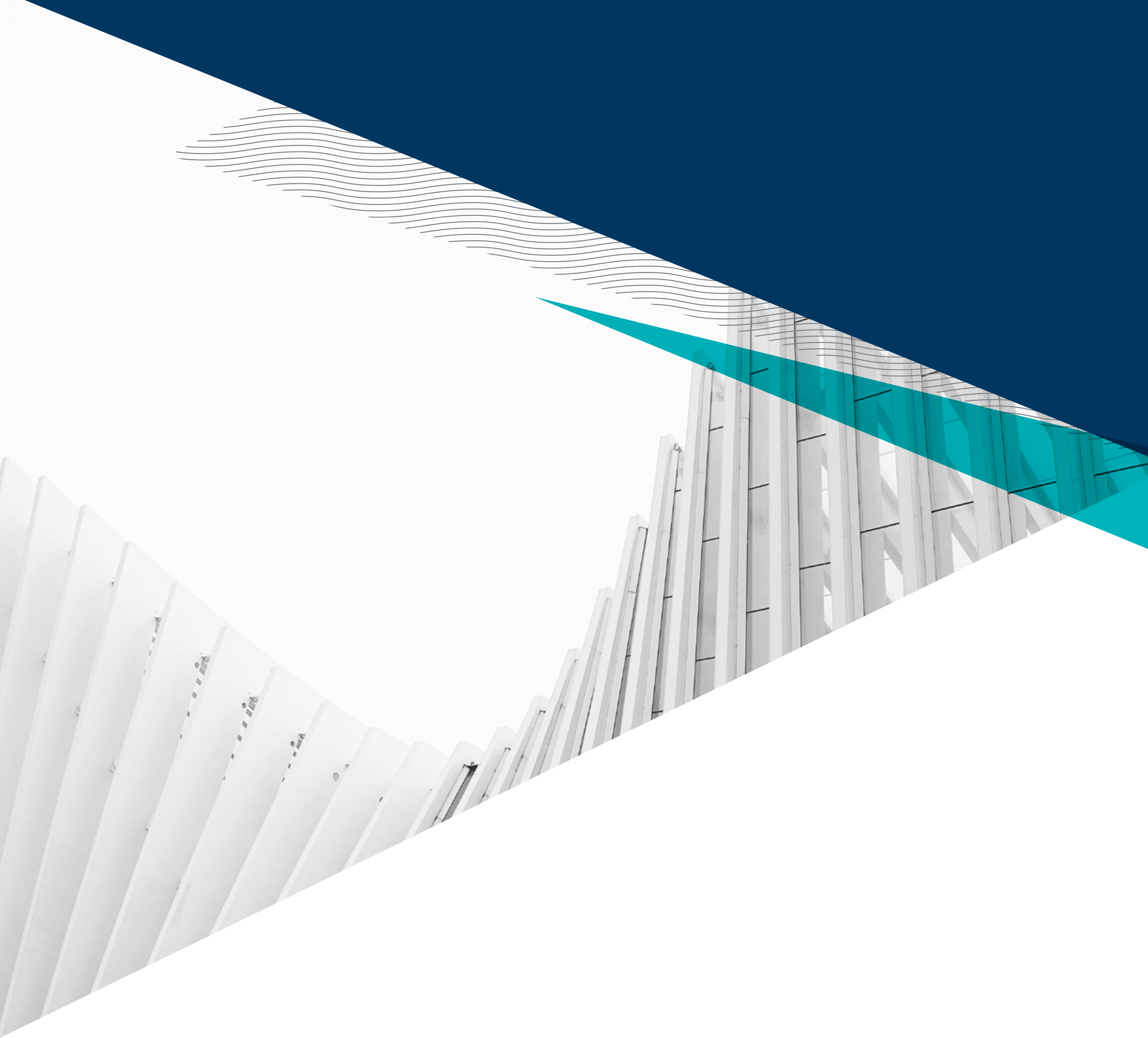
Interested parties said the proposed portfolio adjustment factors places a burden on smaller insurance companies. Some recommend lowering the factors to reduce that burden, but in the process, they don't want to reduce the capital requirement for larger insurers. Another solution was suggested that would grant smaller companies capital charge relief, but this would require changing the structure of the RBC reports. However, since the working group has a tight timeline to adopt the factor changes by the end of June in order to take effect for 2021 annual reporting, changing the report structure is not an option for this year.

EXPOSED ITEM FOR 45 DAYS WITH COMMENT DEADLINE MAY 24, 2021

Exposure of American Council of Life Insurer's (ACLI's) Proposed Instructions and Factors for Real Estate 2021-06-L

This item proposes to update the RBC calculation for real estate by modifying the RBC factors and instructions. It proposes to lower the RBC factor for:

- Schedule A Real Estate Investment from 15% or 23% to 11%
- Encumbrance Credit Factor from 12% or 20% to 1.75%
- Schedule BA Real Estate Investment from 23% to 13%



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