



NAIC Summer Meeting

Issues & Trends

Latest actions include adoption of an actuarial guideline focusing on modeling of complex assets in asset adequacy testing, plus exposure of revisions that would define investments eligible to be reported as a bond on Schedule D-1.

September 2022

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Meeting highlights

During its Summer meeting and on calls through August 19, 2022, the National Association of Insurance Commissioners (NAIC) **adopted** the following guidance.

- SSAP No. 86 to expand effective hedge relationships consistent with ASU 2017-12.
- Revisions to VM-20 and VM-21 to reflect all future hedging strategies.
- An actuarial guideline on modeling of complex assets in asset adequacy testing.

The NAIC **exposed** revisions to the following guidance.

- SSAP Nos. 19 and 73 to clarify that when a lease terminates early, the amortization of leasehold improvements would cease, and any remaining unamortized leasehold improvement balance would be expensed. There would be an exclusion for health care delivery assets.
- SSAP Nos. 26R and 43R that would define investments eligible to be reported as a bond on Schedule D-1. The exposure also includes a revised bond definition and related issue paper.
- SSAP No. 86 to adopt, with modification, US GAAP guidance about portfolio and partial-term fair value hedges.
- Nullification of INT 03-02 to eliminate inconsistent guidance with SSAP No. 25 for economic and non-economic related party transactions.
- A memorandum on alternatives to add fixed income analytical risk measures to investments reported on Schedule D, Part One.

The NAIC **discussed** the following guidance.

- Progress of the Economic Scenario Generator field test.

Accounting highlights >>	
Conceptual Framework	<p>The Statutory Accounting Principles Working Group (SAPWG) adopted revisions to the Preamble and SSAP No. 4 to incorporate updates from the FASB conceptual framework in the definition of an asset and reexposed revisions to SSAP No. 5R to incorporate updates in the definition of a liability.¹</p> <p>Comments are due October 7, 2022.</p>
Leasehold improvements after lease termination	<p>SAPWG reexposed revisions to SSAP Nos. 19 and 73 to clarify that when a lease terminates early, the amortization of leasehold improvements would cease, and any remaining unamortized leasehold improvement balance would be expensed. There would be an exclusion for health care delivery assets.²</p> <p>Comments are due October 7, 2022.</p>
Collateral loans	<p>SAPWG exposed revisions to SSAP No. 21R to clarify that an asset pledged as collateral must qualify as an admitted asset for a collateral loan to be admissible.³</p> <p>Comments are due October 7, 2022.</p>
Government assistance	<p>SAPWG adopted revisions to SSAP No. 24 to include certain government assistance disclosures from ASU 2021-10.⁴</p>
Related party	<p>SAPWG exposed revisions to SSAP Nos. 25 and 97 to add foreign open-end investment funds to the list of investments where the ownership percentage does not reflect control unless the insurer controls the fund with the power to direct or cause the direction of management of an underlying company.⁵</p> <p>Comments are due October 7, 2022.</p>

¹ SSAP No. 4, Assets and Nonadmitted Assets; SSAP No. 5R, Liabilities, Contingencies and Impairments of Assets

² SSAP No. 19, Furniture, Fixtures, Equipment and Leasehold Improvements; SSAP No. 73, Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities

³ SSAP No. 21R, Other Admitted Assets

⁴ SSAP No. 24, Discontinued Operations and Unusual or Infrequent Items; FASB Accounting Standards Update 2021-10 Government Assistance (Topic 832)—Disclosures by Business Entities about Government Assistance

⁵ SSAP No. 25, Affiliates and Other Related Parties; SSAP No. 97, Investments in Subsidiary, Controlled and Affiliated Entities

Accounting highlights >>

Proposed bond definition	SAPWG exposed revisions to SSAP Nos. 26R and 43R that would define investments eligible to be reported as a bond on Schedule D-1. The exposure also includes a revised bond definition and related issue paper. ⁶ Comments are due October 7, 2022.
Troubled debt restructuring	SAPWG exposed revisions to SSAP No. 36 to reject ASU 2022-02. The ASU eliminates previous US GAAP guidance for a troubled debt restructuring by creditors and requires an entity to evaluate whether the modification represents a new loan or a continuation of an existing loan. ⁷ Comments are due October 7, 2022.
Alternative valuation of minority ownership interests	SAPWG adopted revisions to SSAP No. 48 to clarify that the audit of US tax basis financial statements should occur at the investee level when used as an alternative valuation method for a minority ownership interest. ⁸
Derivatives – hedge effectiveness	SAPWG adopted revisions to SSAP No. 86 adopting, with modification, US GAAP guidance to determine hedge effectiveness. ⁹ Revisions are effective January 1, 2023 with early adoption permitted.
Derivatives – portfolio layer method	SAPWG exposed revisions to SSAP No. 86 to adopt, with modification, US GAAP guidance about portfolio and partial-term fair value hedges. Comments are due October 7, 2022.
Share-based payments	SAPWG adopted revisions to SSAP No. 104R to incorporate the practical expedient in ASU 2021-07 when determining the current price input in option-pricing models used to estimate the fair value of share-based payments. ¹⁰

⁶ SSAP No. 26R, Bonds; SSAP No. 43R, Loan-Backed and Structured Securities

⁷ SSAP No. 36, Troubled Debt Restructuring; ASU 2022-02, Financial Instruments—Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures.

⁸ SSAP No. 48, Joint Ventures, Partnerships and Limited Liability Companies

⁹ SSAP No. 86, Derivatives; ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities

¹⁰ SSAP No. 104R, Share-Based Payments, ASU 2021-07, Compensation—Stock Compensation (Topic 718): Determining the Current Price of an Underlying Share for Equity-Classified Share-Based Awards

Accounting highlights >>	
Intercompany pooling	SAPWG exposed its intent to nullify INT 03-02 to eliminate inconsistent guidance with SSAP No. 25 for economic and non-economic related party transactions. ¹¹ Comments are due October 7, 2022.
Actuarial highlights >>	
Non-variable annuities	On a call before the Summer meeting, the VM-22 Subgroup exposed a proposal to treat longevity reinsurance as a third reserving category and limit loading on recurring gross premiums from being reflected in the stochastic reserve. ¹² Comments were due August 12, 2022.
Index-linked variable annuities	Before the Summer meeting, the Index-Linked Variable Annuity (ILVA) Subgroup reexposed Actuarial Guideline ILVA specifying the conditions under which an index-linked variable annuity would be exempt from NAIC Model 805 as well as the nonforfeiture requirements. ¹³ Comments were due August 23, 2022.
Economic scenario generator – field test	Life Actuarial Task force (LATF) heard an update about the status of the Economic Scenario Generator field test currently in process with 29 insurance groups and 42 legal entities.
Actuarial guideline for modeling of complex assets	LATF and its parent committees adopted the actuarial guideline on modeling of complex assets in asset adequacy testing (AG AAT). ¹⁴
Clearly defined hedging strategy	LATF adopted revisions to VM-20 and VM-21 to reflect all future hedging strategies in VM-20 and VM-21, including the use of an increased error factor ('E factor') or residual risk when future hedging strategies are not clearly defined. ¹⁵

¹¹ INT 03-02, Modification to an Existing Intercompany Pooling Arrangement

¹² VM-22, Statutory Maximum Valuation Interest Rates for Income Annuities

¹³ NAIC Model 805, Standard Nonforfeiture Law for Individual Deferred Annuities

¹⁴ Actuarial Guideline LIII – Application of the Valuation Manual for Testing the Adequacy of Life Insurer Reserve (AG 53)

¹⁵ VM-20, Requirements for Principle-Based Reserves for Life Products; VM-21, Requirements for Principle-Based Reserving for Variable Annuities

Actuarial highlights >>	
Mortality	The American Academy of Actuaries (the Academy) presented their recommendations for the historical mortality improvement (HMI) and future mortality improvement (FMI) scales that include the effects of COVID-19.
Short-term and long-term swap rates	LATF adopted a proposal to transition from the London Interbank Offered Rate (LIBOR) to the Secured Overnight Financing Rate (SOFR) for the purpose of calculating short-term and long-term swap rates prescribed for principle-based reserve (PBR) valuations beginning in 2023.
Group capital calculation >>	
Modifications to group capital calculation	Before the Summer meeting, the Group Capital Calculation Working Group (GCCWG) adopted changes to the Group Capital Calculation (GCC) template and instructions based on both the GCC trial implementation and comments received from interested parties.
Risk-based capital >>	
Affiliated investments	The Capital Adequacy Task Force exposed revisions to the affiliated investment instructions for Life, Health, and Property and Causality instructions. Comments are due October 10, 2022.
Life RBC – C-2 mortality factors	On calls before the Summer meeting, the Life RBC Working Group adopted changes to the C-2 mortality factors, categories to which these factors will be applied and the related instructions that will be effective for year-end 2022. The adoption of these new factors will be phased-in.
Valuation of Securities Task Force >>	
Principal protected securities	VOSTF adopted revisions to the Purposes and Procedures Manual (PPM) to amend the definition of principal protected securities to account for alternate structures that pose similar risks as those previously defined.

Valuation of Securities Task Force >>	
Analytical measures for bond investments	VOSTF exposed a memorandum on alternatives to add fixed income analytical risk measures to investments reported on Schedule D, Part One. Comments were due September 12, 2022.
Collateralized loan obligations	The VOSTF exposed the Structured Securities Group (SSG) report on the Investment Analysis Office (IAO) issue paper about the risk assessment of collateralized loan obligations (CLOs) that included responses to comments received on the recommendation to permit SSG to model CLOs. Comments were due September 12, 2022.
Group Solvency >>	
Own Risk and Solvency Assessment	The Group Solvency Working Group adopted changes to the ORSA Guidance Manual to incorporate the IAIS Common Framework for the Supervisions of Internationally Active Insurance Groups (IAIGs) (ComFrame) elements deemed appropriate for the US system of solvency regulation.
Financial Stability Task Force >>	
Private equity owned insurers	On a call before the Summer meeting, the Macroprudential Working Group completed their discussion of topics related to private equity owned insurers. The Working Group developed 13 regulatory considerations it referred to various other NAIC Working Groups and Task Forces.
Climate risk >>	
Solvency workstream	Before the Summer meeting, the Solvency Workstream of the Climate and Resiliency Task Force suggested modifications or enhancements to the NAIC's Financial Analysis Handbook, the NAIC's Financial Condition Examiners Handbook and the ORSA Guidance Manual.

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Accounting highlights

Conceptual framework

Action. SAPWG adopted revisions to the Preamble and SSAP No. 4 to incorporate updates from the FASB conceptual framework in the definition of an asset and reexposed revisions to SSAP No. 5R to incorporate updates in the definition of a liability. Comments are due October 7, 2022.

The revisions to the definition of an asset would include:

- removing the term ‘probable’ and phrases ‘future economic benefit’ and ‘past transactions or events’ from the definition of an asset; and
- focusing the primary characteristics of an asset on a present right to an economic benefit.

The revisions to the definition of a liability would include:

- removing the term ‘probable’ and the phrase ‘in the future as a result of past transactions or events’ in the definition of a liability; and
- focusing the primary characteristics of a liability on a present obligation to transfer an economic benefit.

Interested parties expressed concern that changing the definition of a liability may expand the population of liabilities and requested an analysis of the revisions’ effect be performed for each SSAP. SAPWG stated that it is important that statutory accounting principles are as conservative or more conservative than FASB in defining liabilities; however, it agreed to allow interested parties the opportunity to identify specific situations where a new liability would be reported at adoption of the proposed revisions.

Leasehold improvements after lease termination

Action. SAPWG reexposed revisions to SSAP Nos. 19 and 73 to clarify that when a lease terminates early, the amortization of leasehold improvements would cease, and any remaining unamortized leasehold improvement balance would be expensed. There would be an exclusion for health care delivery assets. Comments are due October 7, 2022.

The proposed revisions are a result of questions received by the NAIC staff about the treatment of leasehold improvements when a lessee purchases the leased property during the lease term and reflect changes based on comments from interested parties to exempt insurers that provide direct healthcare. The updated revisions to SSAP No. 73 state that a real estate lease agreement with a purchase option that allows leasehold improvements necessary for the functionality of specific health care delivery assets, would be excluded from the purchase cost of the real estate. On acquisition, such leasehold improvements necessary for the functionality of

healthcare delivery assets would follow the guidance for health care delivery assets in SSAP No. 73.

Collateral loans

Action. SAPWG exposed revisions to SSAP No. 21R to clarify that an asset pledged as collateral must qualify as an admitted asset for a collateral loan to be admissible. Comments are due October 7, 2022.

Revisions were proposed to address the inconsistency between SSAP No. 20 and SSAP No. 21R related to collateral loans.¹⁶ SSAP No. 20 states that the investment asset collateral must qualify as an admitted asset. Although SSAP No. 21R references guidance in SSAP No. 20, it does not make the same explicit statement. Based on discussion with regulators, SAPWG decided that it would be beneficial to add specific guidance to SSAP No. 21R that the collateral has to qualify as an admitted invested asset.

Government assistance

Action. SAPWG adopted revisions to SSAP No. 24 to include certain government assistance disclosures from ASU 2021-10.

The revisions increase transparency of unusual or infrequent items that result from government assistance by requiring disclosure of:

- a general description of the transactions;
 - the form in which the assistance has been received; and
 - information about significant terms and conditions of the transactions, including, when applicable, the duration or period of the agreement, and commitments made by the insurer, provisions for recapture, or other contingencies.
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Related party

Action. SAPWG exposed revisions to SSAP Nos. 25 and 97 to add foreign open-end investment funds to the list of investments where the ownership percentage does not reflect control unless the insurer controls the fund with the power to direct or cause the direction of management of an underlying company. Comments are due October 7, 2022.

The exposed proposal reflects a request from interested parties for the previously adopted exemption in SSAP No. 25 be extended to foreign open-ended investment funds governed and authorized under regulations established by the applicable jurisdiction.

¹⁶ SSAP No. 20, Nonadmitted Assets

Proposed bond definition

Action. SAPWG exposed revisions to SSAP Nos. 26R and 43R that would define investments eligible to be reported as a bond on Schedule D-1. The exposure also includes a revised bond definition and related issue paper. Comments are due October 7, 2022.

The bond definition was revised based on comments received before the Summer meeting and included:

- clarification about US Treasury Inflation Protected Securities stating that:
 - securities with plain-vanilla inflation adjustment mechanisms are not intended to be captured within the provisions that restrict bond classification due to varying principal or interest payments; and
 - other variances in contractual amounts due to reference variables (and not just equity interests) are intended to be precluded from bond treatment;
- description of substantive credit enhancements, particularly the reference to the first loss tranche as the first loss position and clarification that securitization tranches that do not have contractual principal and interest payments, along with substantive credit enhancement, do not qualify as a Schedule D Bond and should be reported on Schedule BA.

Before the Summer meeting, interested parties also provided comments on areas that SAPWG decided not to revise, including proposals to:

- identify non-bond items that are specifically scoped into the bond-definition in SSAP No. 26R;
- limit guidance that requires the consideration of all returns to equity-backed asset backed securities (ABS);
- report ABSs as cash equivalents or short-term investments if acquired within those timeframes; and
- capture securities as issuer credit obligations if they pass through cash flows unaltered (such as with certain lease-backed structures) and are supported primarily by a single rated credit payor, though principal repayment is not fully supported by the obligation of that payor.

The issue paper was updated to include discussion of feeder funds, stating that:

- feeder fund structures would not automatically be assumed to qualify for bond classification, nor be automatically precluded bond classification; and
- the substance of the investment is the determining factor, specifically whether the structure ensures the pass-through of the underlying cash flows, or whether uncertainty as to the timing or amount of cash flows is introduced by the structure.

The revisions to SSAP No. 26R included:

- updating the scope guidance and exclusions to identify credit issuer obligations as the focus of SSAP No. 26R and name specific investments captured in the scope;
- including guidance for investments acquired with a maturity date of one year or less from the date of acquisition;
- adding guidance from the principles-based definition;
- eliminating the general reporting categories;
- expanding Exhibit A and the glossary, to include more key terms; and
- adding Exhibit B with information from the Appendix of the principles-based bond definition on structures that do not represent creditor relationships.

The revisions to SSAP No. 43R included:

- updating the scope guidance and exclusion, specifically identifying ABS as the focus of SSAP No. 43R and naming specific investments captured in the scope;
- renaming SSAP No. 43R to Asset Backed Securities;
- adding guidance from the principles-based reserving definition;
- revising the structure of the SSAP for readability;
- capturing all guidance for the assessment of cash flows and for the accretable yield or changes to the effective yield together rather than dividing it between whether cash flows are or are not probable; and
- including guidance from the principles-based bond definition examples in Appendix A.

SAPWG also stated that additional revisions are expected to SSAP Nos. 2R and 103R to make corresponding edits in line with the revised guidance in SSAP No. 43R.¹⁷ It also said that a January 1, 2024 effective date will be difficult, and anticipate a 2025 effective date.

Troubled debt restructuring

Action. SAPWG exposed revisions to SSAP No. 36 to reject ASU 2022-02. The ASU eliminates previous US GAAP guidance for a troubled debt restructuring by creditors and requires an entity to evaluate whether the modification represents a new loan or a continuation of an existing loan. Comments are due October 7, 2022.

The US GAAP guidance for troubled debt restructuring is being eliminated because these losses would be captured in the current expected credit losses (CECL) standard. However, since CECL has not been adopted for statutory accounting, the proposal would retain existing statutory guidance for a troubled debt restructuring. These revisions would result in a difference between US GAAP and statutory accounting.

¹⁷ SSAP No. 2R, Cash, Cash Equivalents, Drafts, and Short-Term Investments; SSAP No. 103R, Transfers and Servicing of Financial assets and Extinguishments of Liabilities.

Alternative valuation of minority ownership interests

Action. SAPWG adopted revisions to SSAP No. 48 to clarify that the audit of US tax basis financial statements should occur at the investee level when used as an alternative valuation method for a minority ownership interest.

The revision retains audited US tax equity financial statements as an alternative to audited US GAAP financial statements for valuation of minority ownerships and clarifies the level at which the financial statements occur. Interested parties supported this option over the removal of this alternative valuation basis because some insurers use this approach for investments in partnerships.

Derivatives – Hedge effectiveness

Action. SAPWG adopted revisions to SSAP No. 86 adopting, with modification, US GAAP guidance to determine hedge effectiveness. Revisions are effective January 1, 2023 with early adoption permitted.

The revisions:

- add a new Exhibit A to SSAP No. 86 with guidance for the assessment of hedging effectiveness that replaces previous Exhibits A and B; and
- align statutory accounting to US GAAP for hedge effectiveness by incorporating what is permitted to be an excluded component and revising the measurement methods for excluded components.

These revisions are in response to requests from both regulators and interested parties to align SSAP No. 86 with ASU 2017-12 when determining effective hedge relationships and reduce complexity.

Derivatives – Portfolio layer method

Action. SAPWG exposed revisions to SSAP No. 86 to adopt, with modification, US GAAP guidance about portfolio and partial-term fair value hedges. Comments are due October 7, 2022.

The proposed revisions are part of an ongoing effort to align SSAP No. 86 with US GAAP and include:

- adding criteria for portfolio and partial-term hedges;
- adding a requirement to disclose circumstances that lead to the breach of portfolio method hedges; and
- adopting, with modification, guidance for partial-term hedges from ASU 2017-12 for hedged assets.

SAWPG considered how the alignment to US GAAP could affect hedge basis adjustments. The portfolio layer method will have a basis adjustment impact only at the time of designation because an amortized cost approach is used for interim adjustments. However, the proposed revisions limit partial term hedging to recognized assets, and not liabilities, to reduce the effect on

basis adjustments. This treatment will be different from US GAAP, which applies to both hedged assets and liabilities.

Next step. SAPWG directed NAIC staff to prepare an issue paper with the recent and upcoming derivative revisions.

Share-based payments

Action. SAPWG adopted revisions to SSAP No. 104R to incorporate the practical expedient in ASU 2021-07 when determining the current price input in option-pricing models used to estimate the fair value of share-based payments.

The revisions allow insurers to use a practical expedient when they are unable to reasonably estimate the current share price (fair value) to determine the current price input using a reasonable valuation method. Insurers will consider the following factors under a reasonable valuation method:

- the value of tangible and intangible assets;
 - the present value of future cash flows;
 - the market value of stock or equity interest in similar entities for which the stock is to be valued;
 - any recent arm's length transactions involving the sale or transfer of equity interests;
 - other relevant factors such as control premiums or discounts or lack of marketability and whether the valuation method is used for other purposes that have a material economic effect on the insurer, its stockholders, or its creditors; and
 - consistency of use of the valuation method.
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Intercompany pooling

Action. SAPWG exposed its intent to nullify INT 03-02 to eliminate inconsistent guidance with SSAP No. 25 for economic and non-economic related party transaction guidance. Comments are due October 7, 2022.

INT 03-02 states that transfers of assets and liabilities among affiliates, in connection with a new reinsurance agreement, that serve to substantively modify an existing intercompany pooling arrangement should be done at book value. However, SSAP No. 25 requires economic transactions to be recorded at fair value. Recording transfers of assets at book value instead of fair value could result in significantly different economic effects. The NAIC staff stated that there is not a compelling need for different accounting if assets are transferred instead of cash for intercompany reinsurance.

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Actuarial highlights

Non-variable annuities

Action. On a call before the Summer meeting, the VM-22 Subgroup exposed a proposal to treat longevity reinsurance as a third reserving category and limit loading on recurring gross premiums from being reflected in the stochastic reserve. Comments were due August 12, 2022.

At the Summer meeting, the VM-22 Subgroup reported on its progress addressing comments received on the previously exposed VM-22 document. It divided the comments into four tiers with the first focusing on comments on highest priority issues such as:

- the scope and definitions of VM-22 requirements;
- reinvestment guardrail for the mix of credit qualities;
- definitions of reserve categories for product aggregation; and
- the need for a small company exemption.

The Subgroup decided to:

- define the pay-out reserving category consistent with the current scope of VM-22, listing specific products to restrict stochastic reserve aggregation between pay-out and accumulation annuities;
- develop a small company exemption, similar to the Life PBR exemption that exists in VM-20;
- allow single premium index annuities below a certain duration threshold to automatically pass the exclusion test;
- prohibit risk transfer from the certification method exclusion test;
- limit aggregation for contracts with significantly different risk profiles and restrict future premiums from the denominator of the ratio test in the exclusion testing; and
- permit only prescribed tables to be used for pension risk transfer and longevity reinsurance mortality with limited or no experience.

Next step. After addressing remaining comments, the Subgroup plans to reexpose the VM-22 draft proposal and work on the standard projection amount, including whether it will be a disclosure or a floor. A VM-22 field test is planned for Spring 2023 with a target effective date of January 1, 2025, with a three-year transition period for implementation.

Index-linked variable annuities

Action. Before the Summer meeting, the ILVA Subgroup reexposed Actuarial Guideline ILVA specifying the conditions under which an index-linked variable annuity would be exempt from NAIC Model 805 as well as the nonforfeiture requirements. Comments were due August 23, 2022.

The goal of the Actuarial Guideline is to:

- provide guidance for how ILVA products can be considered variable products; and
- avoid designs where when the index goes down over the interim, the contract holder bears losses and but does not benefit when the index goes up.

The Guideline principles are that Interim Values:

- as defined in the contract provide equity between the contract holder and the insurer; and
- are consistent with the value of the hypothetical portfolio over the index strategy term.

On calls before the Summer meeting, the ILVA Subgroup discussed comments on previous exposures of the Actuarial Guideline with a majority of the discussion focusing on comments about the clarification or modification of the treatment of market value adjustments (MVAs). Interested parties requested that the definition of fixed income asset Proxy permit MVAs and that the Actuarial Guideline allow insurers to apply MVAs either at the asset level, the contract level, or some combination of the two. Interested parties stated that this would allow the MVAs to align with the insurer's investment strategy. One regulator proposed redefining the fixed asset proxy so the duration of the asset is commensurate with the actual assets the insurer holds. Therefore, the initial value of the asset would be equal to the strategy base minus the option value, and the asset value at the end of the term would be equal to the strategy base.

Economic scenario generator – field test

LATF heard an update about the status of the Economic Scenario Generator field test currently in process with 29 insurance groups and 42 legal entities. The field test includes:

- Two calibrations of the Treasury model:
 - a Conning calibration developed according to regulator's acceptance criteria and a generalized fractional floor that reduces the severity frequency of negative interest rates; and
 - an alternative calibration developed by the Academy that meets regulator's acceptance criteria as well as places additional emphasis on term premium and shadow floor, and that preserves reduced severity and frequency of negative interest rates while preserving the arbitrage-free nature of Treasury scenarios.
- Three calibrations of the Equity model:
 - a baseline calibration that preserves base functionality of the GEMS equity model while partially mitigating the impact of the equity-Treasury linkage;

- an original Conning equity calibration that assumes that the equity risk premium over Treasuries has a constant mean in every projection period; and
- a calibration developed by the American Counsel for Life Insurers that assumes a constant mean equity return independent of the starting Treasury rates.
- Corporate model that captures the complex dynamics of bond fund returns.

Field test participants are required to complete seven reserve runs and five optional runs. The NAIC expected submission of close to 600 field test templates with information covering VM-20, VM-21/C3 Phase II and C3 Phase I reserve and capital frameworks by August 31, 2022.

The NAIC also engaged Oliver Wyman to build and deliver an AXIS model office to support the Economic Scenario Generator Field Test. The model office will include:

- an inforce variable annuity product that will include:
 - guaranteed minimum death benefits and a variety of guaranteed living benefits with different levels of richness that are commonly seen on inforce products throughout the industry; and
 - different levels of in-the-moneyness at valuation;
- new-business ILVA product with a buffer crediting strategy (consistent with common industry practice) and different levels of buffer, varying from 5% to 10%.

Next step. Consolidated results of the field test are expected to be presented from September through November of 2022. If field test results show that modifications are needed for the Economic Scenario Generator, Conning will make changes as directed by regulators with a follow-up field test in early 2023. The goal is for the Economic Scenario Generator to be effective for the 2024 Valuation Manual; however, LATF acknowledged the timeline is challenging and may be extended because of the number of field test results requiring review.

Actuarial guideline for modeling of complex assets

Action: LATF and its parent committees adopted the actuarial guideline on modeling of complex assets in asset adequacy testing (AG AAT). The guideline is effective December 31, 2022.

The guideline provides guidance for the appropriate support of certain assumptions for asset adequacy testing including:

- identifying reserve adequacy and claims-paying ability in moderately adverse conditions, including conditions negatively impacting cash flows from complex assets;
- clarifying elements to consider in establishing margins on asset-related assumptions;

- recognizing that higher expected gross returns from assets would be associated with higher risk, and that assumptions should fit reasonably within the risk-return spectrum;
- requiring sensitivity testing for complex assets that support life insurance products;
- identifying expectations for the valuation of complex assets;
- focusing the analysis requirements on complex assets with a higher uncertainty about timing and amount of cash flows than more traditional investments; and
- requiring additional documentation of investment fee income relationships with affiliated entities or entities close to the insurer.

In response to comments received, the adopted AG AAT:

- added nonconvertible, noncallable public corporate bonds to the list of non-complex assets that are exempt;
- clarified that the guideline excludes policy loans;
- required insurers to perform sensitivity testing rather than establishing guardrails; and
- eliminated reinsurance modeling provisions and added a reference to ASOP No. 11.¹⁸

Action. Before the Summer meeting, LATF exposed templates intended to serve as standardized formats for submitting sensitivity testing, attribution, and disclosure requests for the AG AAT on modeling complex assets, consistent with Section 6 described within that Guideline. Comments were due August 19, 2022.

LATF's objective for these templates is to provide results associated with the actuarial guideline in an easy-to-digest manner, with the intention of educating regulators on the yield or spread assumptions, if applicable, reflected for each asset class for asset adequacy testing purposes.

Clearly defined hedging strategy

Action. LATF adopted revisions to VM-20 and VM-21 to reflect all future hedging strategies in VM-20 and VM-21, including the use of an increased E factor or residual risk when future hedging strategies are not clearly defined.

The proposal includes:

- a consistent definition of clearly defined hedging strategies (CDHS) to be used in VM-20 and VM-21;
- a definition of a future hedging strategy;
- a definition for hedging transactions that is slightly modified from the definition currently used SSAP No. 108 in the Accounting Practices and Procedures Manual;

¹⁸ ASOP 11, Treatment of reinsurance or similar risk transfer programs involving life insurance, annuities or health benefit plans in financial reports

- a prohibition on optionality for liquidating currently held hedges if the insurer does not have a future hedging strategy; and
 - the ability to use a 0.3 E factor, rather than a revised E factor of 1.0, for new hedging strategies backing a newly introduced or newly acquired product or block of business.¹⁹
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Mortality improvement

The Academy presented their recommendations for the HMI and FMI scales that included the effect of COVID-19. It stated that the proposed approach to address COVID-19 mortality in the FMI scale is balanced, because it is based on historic experience with appropriate margins for uncertainty. Similarly, the HMI scale reflects a reasonable approach to differentiate the mortality risk covered by reserves rather than capital. The recommendation was developed based on the principle that the valuation mortality assumption should present the expected ongoing mortality level over the full period of the reserve projection. Therefore, the basic valuation mortality and mortality improvement assumptions would not reflect the full initial shock of the COVID-19 pandemic on mortality as an ongoing event but would focus on the expected ongoing impacts.

The Academy recommended:

- for HMI, applying the standard methodology with the full COVID-19 impact for 2020; and
- for FMI, applying an approved methodology with an additional temporary COVID-19 margin of 25%, grading down to zero over five years.

The Academy stated that it will present updated information showing the reserve effect of applying both HMI and FMI recommendations, but stated it expects to have a slight reserve increase of approximately one to five percent.

Some regulators questioned whether the FMI improvement was appropriate and wanted to see the effect on reserves if FMI is set to zero. The Academy stated it will work on providing that information for the recommendation to be considered for exposure on a future LATF call.

Short-term and long-term swap rates

Action. LATF adopted a proposal to transition from LIBOR to SOFR for the purpose of calculating short-term and long-term swap rates prescribed for PBR valuations beginning in 2023.

Two options were considered:

¹⁹ SSAP No. 108, Derivatives Hedging Variable Annuity Guarantees

Option A

- for current swap spreads, Option A would require insurers to obtain swap spreads from a nationally recognized source; and
- for long-term swap spreads, Option A would allow the NAIC to obtain data from a single source, applying the required method and publishing the rates.

Option B

- for current swap spreads, Option B would require the NAIC staff to obtain the swap rates and subtract the corresponding US Treasury rates to obtain current swap spreads before publishing them; and
- for long-term swap spreads, Option B would require averaging of long-term swap data from at least two nationally recognized sources, applying the required method, and publishing the rates.

For current swap spreads, the NAIC was concerned that small insurers may not have the resources to obtain the swap spreads from a nationally recognized source. It also recommended the use of Option B for long-term swap spreads to ensure that the supplier data that is posted on the NAIC website cannot be reverse engineered. The Academy stated that it prefers Option A, but believes that results from using that option would not be significantly different than using Option B.

The adopted proposal reflects the use of Option B for both current and long-term swap spreads.

4

Group capital calculation

Modifications to group capital calculation

Action. Before the Summer meeting, the GCCWG adopted changes to the GCC template and instructions based on both the GCC trial implementation and comments received from interested parties.

The changes include:

- eliminating the stress scenario included in the trial implementation;
 - eliminating the sensitivity test related to 'other debt' that compared the other debt to senior and hybrid debt instruments; and
 - revising the current treatment of applying a capital charge of 100% of available capital to 50% of available capital with an option to calculate an insurer's capital requirement using RBC.
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5

Risk-based capital

Affiliated investments

Action. The Capital Adequacy Task Force exposed revisions to the affiliated investment instructions for Life, Health, and Property and Casualty instructions. Comments are due October 10, 2022.

The proposed changes improve consistency between the Life, Health and Property and Casualty filings and were previously exposed by the respective Working Groups, Life RBC, Health RBC, and Property and Casualty. The proposed changes allow state insurance regulators to identify and explain discrepancies more easily and also align with the group capital calculation. Interested parties suggested that since the revised instructions include affiliates and subsidiaries that are non-admitted, statutory accounting should be aligned with this RBC treatment.

Life RBC – C-2 mortality factors

Action. On calls before the Summer meeting, the Life RBC Working Group adopted changes to the C-2 mortality factors, categories to which these factors will be applied and instructions that will be effective for year-end 2022. The adoption of these new factors will be phased-in.

The new factors will apply to categories that were developed using a principles-based approach. The categories include life policies with pricing flexibility in force, term life policies without pricing flexibility in force, and permanent life policies without pricing flexibility in force. The intent of this structure is to better match capital requirements to the type of product. One of three factors will apply to each category (first \$500 million, next \$24,500 million and over \$25,000 million).

Interested parties requested a delay in the implementation of the new structure and factors and also a broader definition of pricing flexibility, with the removal of references to specific products. They also expressed concern about:

- unintended outcomes related to non-guaranteed yearly renewable reinsurance or similar structures; and
- lack of opportunity for insurers to process the potential ramifications of this change that may require a significant amount of work to determine if reinsurance treaty products have pricing flexibility.

Next step. The Life RBC working group will continue to work with the Academy to provide guidance on the new structure and future updates to the instructions.

RBC Investment Risk and Evaluation Working Group

The RBC Investment Risk and Evaluation Working Group discussed its working agenda and coordination with SAPWG and VOSTF. The chair stated that one of the Working Group's first priorities will be to determine risk-based capital charges for all tranches of CLOs. This will include removing CLOs from the filing exempt process and utilizing a modeling process. Although this may be a long-term solution, in the interim, the Working Group plans to address concern about potential arbitrage through the structuring of CLOs. The goal of the interim solution is to eliminate an insurer's ability to take a risk, repackage it and come up with a different RBC charge.

6

Valuation of Securities Task Force

Principal protected securities

Action. VOSTF adopted revisions to the PPM to amend the definition of principal protected securities to account for alternate structures that pose similar risks as those previously defined.

The VOSTF stated that it worked with interested parties on technical modifications to the original proposed language and that interested parties supported the revised amendment. The revisions included:

- updating the definition of principal protected securities to include alternative structures that pose similar risk; and
- adding an example of a structure where the issuer of notes is an operating entity and not a special purpose vehicle but meets the definition of principal protected securities.

The revisions are in response to a proposal received by the Securities Valuations Office (SVO) for a security that posed many of the same risks as a principal protected security but was structured in a way that did not fit the definition of a principal protected security in the PPM.

Analytical measures for bond investments

Action. VOSTF exposed a memorandum on alternatives to add fixed income analytical risk measures to investments reported on Schedule D, Part One. Comments are due September 12, 2022.

The project began in response to concerns raised by the SVO about inconsistencies between NAIC designations determined by the SVO when compared to spread implied ratings using ratings from nationally recognized statistical ratings organizations. The goal of the project is to develop additional or alternative ways to measure risk and to use those risk measures to lessen reliance on credit rating agencies. The SVO stated that although it continues to rely on credit rating providers, one step towards introducing alternative ways to measure a security's risk would be to require various analytical measures for each security reported on Schedule D, Part 1. It suggested collecting information, such as the investment's current market yield, interest rate sensitivity, spread relative to risk-free securities such as US Treasuries, and the average remaining life.

On a call before the Summer meeting, interested parties commented that:

- they want to provide meaningful data to the regulators, but are concerned about the operational burden the current request may place on insurers; and
- there could be issues in applying public bond spreads or prices as an indicator for the credit rating to private investments for which there are other factors that could influence pricing.

Interested parties stated that they wanted to work with the Task Force on the best way to achieve the goal of the project. The Task Force agreed to work with interested parties on the best way to operationalize the project.

At the Summer meeting, VOSTF exposed a memorandum that outlines two approaches for data collection. It stated that collecting additional market-data from each insurer would be beneficial because it would:

- identify credit rating provider ratings that are inconsistent with the security's risk;
- increase transparency into risk characteristics of insurer investments;
- incorporate investment portfolio analysis into the examination process;
- increase availability of Level 1 and Level 2 inputs for Automated Valuation Services pricing data;
- allow regulators to assess the capabilities of an insurer's investment management or risk management process; and
- provide the NAIC staff with the capability to run cash flow simulations on an insurer's investments.

The first approach for data collection is for the SVO to produce the analytical elements requested by this proposal. The benefits of this approach would include providing consistency in the production of information, increasing transparency, giving NAIC staff the ability to model cash flows for any bond, and decreasing the cost to insurers. However, this approach would require enhancements to SVO's systems, additional NAIC staff, and new data feeds and databases.

The second approach would be for insurers to produce the data individually. The memorandum asserts that most insurers should have the data as part of their investment management and data collection could be implemented faster, with less upfront work from the NAIC. However, this approach would increase the burden and cost to individual insurers by requiring the implementation of new interfaces and could result in a higher degree of variability in the data produced.

The SVO stated that these market data fields are an important first step in finding alternative ways to measure an insurer's investment risk and reducing the NAIC reliance rating agency ratings. It also expressed a preference for the first approach because it would provide standardized data and utility to regulators, the SVO, and other NAIC groups.

Collateralized loan obligation

Action. VOSTF exposed the SSG report on the IAC issue paper about the risk assessment of CLOs that included responses to comments received on the recommendation to permit SSG to model CLOs. Comments are due September 12, 2022

On a call before the Summer meeting, VOSTF discussed a memo from SSG that identified opportunities for RBC arbitrage and incentives for CLO structures when an insurer owns every tranche of a CLO. It was concerned that an insurer may take a pool of assets with a lower rating, put them in the CLO, and that action could in a significant regulatory arbitrage when the total RBC on every tranche is calculated. The SSG recommended that the capital requirement when holding all tranches of a structured security should be consistent with the capital requirement when holding all of the underlying collateral. The IAO staff recommended permitting SSG to model CLO investments and requested that the RBC Investment Risk and Evaluation Working Group consider adding NAIC Designation Categories, for example 6.A, 6.B and 6.C with RBC factors, 30%, 75% and 100% to account for the tail risk in any structured finance tranche.

At the Summer meeting, VOSTF stated that it received some supportive responses from interested parties, with caveats, but most responses expressed concern with the proposal or its implications. Main comments included:

- concern about the timeline of the proposal and opportunity for comment;
- importance of CLOs to the financial markets and the potential effect of this proposal on the asset class;
- transparency; and
- methodology.

VOSTF stated that the goal of the proposal is to balance risks to ensure that CLOs continue to be an investment option for insurers. Responses to the comments included:

- acknowledgement of the role of insurers and their investments in the US economy and financial markets, but stated that the priority of state insurance regulation is to ensure the protection of policyholders through prudent financial solvency policies;
- statement of intention for the process to be transparent with market participants being able to replicate results; and
- outline of a potential timeline expected to have ample opportunity for comment from interested parties and regulators, with earliest implementation being December 31, 2023 and December 31, 2024 as the most likely.

7

Group solvency

Own risk and solvency assessment

Action. The Group Solvency Working Group adopted changes to the ORSA Guidance Manual to incorporate the ComFrame elements deemed appropriate for the US system of solvency regulation.

The revisions include enhancements related to:

- the treatment and disclosure of liquidity and business strategies in the ORSA Guidance Manual; and
- additional considerations relevant to IAIGs as outlined in the ComFrame.

Although most revisions only apply to IAIGs, the following apply to all ORSA filers:

- clarification that non-insurance operations that present material and relevant risks to the insurer should be included in the scope of the ORSA Summary Report;
- clarification that the ORSA Summary Report should cover the main goals and objectives of the insurer's business strategy; and
- additional expectations for the insurer to assess its resilience to liquidity stresses, as well as a description of policies and procedures in place to manage liquidity risks.

Revisions related only to IAIGs included:

- indicating that one ORSA Summary Report should be provided to the US groupwide supervisor covering all material groupwide insurance operations;
 - adding a new section on additional expectations for an IAIG that identifies the enterprise risk management expectations applying to an IAIG's ORSA that should be discussed in the ORSA Summary Report, including:
 - enhanced liquidity considerations,
 - expectations for integration between legal entity and group risk exposure
 - economic capital model expectations; and
 - summary of the recovery options available for severe scenarios.
 - adding definition for IAIG and reserve stress test.
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8

Financial Stability Task Force

Private equity owned insurers

On a call before the Summer meeting, the Macroprudential Working Group completed their discussion of topics related to private equity owned insurers. The Working Group developed 13 regulatory considerations it referred to various other NAIC Working Groups and Task Forces. These considerations were developed with an activities-based focus on private equity owned insurers but recognized that any ownership type or corporate structures could participate in these activities. The consideration include:

- **Holding company structure:** Obtain a clear picture of risk when holding companies may structure contractual agreements in a manner to avoid regulatory disclosure and requirements. The Macroprudential Working Group suggested considering an optional disclosure requirement that can be used when unresolved regulatory concerns exist with an acquisition.
- **Ownership and control:** Understand control and conflict of interest for owners with less than a 10% interest. The Macroprudential Working Group suggested considering better ways to target pertinent agreements by adding a list of questions about owners with less than a 10% interest who may have significant influence.
- **Investment management agreements:** Understand the effects of investment management agreements and whether they are arm's length or may include conflicts of interest. The Macroprudential Working Group suggested coordination with VOSTF or the SVO on the topic of bespoke agreements and SAPWG on surplus notes, specifically whether floating rates are appropriate.
- **Owners of insurers:** Address concern about owners of insurers potentially focusing on short-term results rather than alignment with the long-term nature of liabilities in life products. The Macroprudential Working Group suggested guidance for when certain insurers would obtain capital maintenance agreements and ways to make the agreements stronger.
- **Operational, governance, and market conduct practices:** Address concern over the operational, governance and market conduct practices affected by the different priorities and level of insurance experience possessed by new entrants into the insurance market. The Macroprudential Working Group decided to continue working on more specific suggestions to address this topic.

- **Defining private equity:** The Macroprudential Working Group decided not to develop a definition of private equity because considerations are activity based and could apply beyond private equity owners.
 - **Related party originated investments:** Obtain more visibility into related party-originated investments as there may be conflicts of interest and hidden or excessive fees in portfolio structures. The Macroprudential Working Group stated that SAPWG's recently adopted proposal to add related-party identification codes is a good first step.
 - **Identifying underlying affiliated or related party investments including CLOs:** Enhance affiliated disclosures to improve visibility of affiliated and related party investments. The Macroprudential Working Group also suggested asking for monthly CLO collateral reports when there is concern over exposure in affiliated CLOs and working to obtain more information from CLO managers.
 - **Asset manager affiliations and disclaimer of affiliation:** Recognize that while Schedule Y, Part 3 identifies all entities with greater than 10% ownership, regardless of disclaimers of affiliation of control, the Macroprudential Working Group would like to see if the Schedule D project lead by SAPWG will help provide further disclosures that will assist with this consideration.
 - **Privately structured securities:** Understand whether the risk of privately structured securities is appropriately included in insurers' results and whether insurers have appropriate governance and controls over these investments. The material increases in and lack of transparency around privately structured securities increase credit risk or introduce other risk. Regulators stated there is a need to determine whether insurers have appropriate controls and disclosures over these risks. The Macroprudential Work group stated that there are currently ongoing projects to address this consideration, including LATF's adoption of actuarial guideline for modeling complex assets (AG AAT) and VOSTF's project to add market data fields for private securities.
 - **Reliance on rating agencies:** Monitor VOSTF's work on the level of reliance on rating agency ratings.
 - **Pension risk transfers (PRT):** Support for PRT business may increase the need for more complex investments. This may result in the need for disclosures about the risk to the general account from the separate account PRT business for guarantees and for reporting and tracking when the separate account is unable to support its own liabilities. The need for disclosures relates to an insurer's ability to support the liabilities and the difference between buy in and buy out transactions.
 - **Offshore and complex reinsurance:** Understand why insurers are using offshore reinsurers and complex sidecar vehicles. The Macroprudential Working Group stated it does not have a specific action for this consideration at this time but wants to understand the economics of the transactions so they can effectively perform solvency monitoring.
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9

Climate risk

Solvency workstream

Before the Summer meeting, the Solvency Workstream of the Climate and Resiliency Task Force suggested modifications or enhancements to the NAIC's Financial Analysis Handbook, the NAIC's Financial Condition Examiners Handbook and the ORSA Guidance Manual. These recommendations included updates to the:

- Financial Examiners Handbook to include climate risk in the planning and fieldwork phase of examinations, including:
 - gaining an understanding of insurer's exposure to and management of climate risk;
 - adding sample interview questions for the various executives and board members;
 - considering enhancements to repository of risks for investment portfolios and strategy, the underwriting process and both assumed and ceded reinsurance;
- Financial Analysis Handbook to include procedures for using:
 - the Property and Casualty RBC Cat reporting data;
 - any investment stress scenario results available from the NAIC Capital Markets Bureau; and
 - Climate Risk Exposure Survey results, if available.
- ORSA Guidance Manual to provide guidance for insurers to include discussion of topics including:
 - how climate change is addressed through their risk management framework;
 - quantitative and qualitative assessments of exposure of assets and liabilities to transition or physical risk if climate change has the potential to materially affect insurer's asset portfolio or insurance liabilities; and
 - qualitative assessments of material medium and long-term effect of climate change risk on insurer's risk appetite and business strategy.

These recommendations are a result of public panels focused on topics that included a high-level summary of existing regulatory tools and feedback provided to questions asking for potential enhancements to these tools.

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