# NAIC Spring Meeting

## Issues & Trends

We report on the latest actions by the NAIC, including adoption of a redesigned climate risk survey, exposure of related party guidance, hedge effectiveness guidance and an actuarial guideline focusing on modeling of complex or high-yield assets in asset adequacy testing. This Issues & Trends summarizes these topics and more.

**May 2022**

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# Meeting highlights

During its Spring meeting and on calls through April 8, 2022, the National Association of Insurance Commissioners (NAIC) **adopted** the following guidance.

— A proposal to add a new general interrogatory to the Annual Statement to require disclosure when cryptocurrencies are directly held or accepted for the remittance of premiums.
— A redesigned climate risk disclosure survey.

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

— SSAP Nos. 25 and 43R to clarify the identification and reporting of affiliated transactions and add annual statement disclosures to identify investments held that involve related parties.
— SSAP No. 86 to expand effective hedge relationships consistent with ASU 2017-12.
— A proposal for reflecting all future hedging strategies in VM-20 and VM-21.
— Actuarial guideline on modeling of complex and high-yield assets in asset adequacy testing.
— A proposal to require insurers to report various analytical measures about each security reported on Schedule D, Part 1, including metrics such as its current market yield, interest rate sensitivity, spread relative to risk-free securities such as US Treasuries, and average remaining life.

| Accounting highlights – Page 7 | |
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| **Conceptual Framework** | Statutory Accounting Principles Working Group (SAPWG) exposed revisions to the Preamble and SSAP Nos. 4 and 5R to incorporate updates from the FASB conceptual framework in the definition of an asset and a liability.[1]<br><br>Comments are due June 3, 2022. |
| **Leasehold improvements after lease termination** | SAPWG discussed comments received on proposed revisions to SSAP Nos.19 and 73 to clarify that when a lease terminates early, the amortization of leasehold improvements should cease, and any remaining unamortized leasehold improvement balance should be expensed.[2]<br><br>It directed NAIC staff to work with interested parties on the proposed revisions for future reexposure. |
| **Government assistance** | SAPWG exposed revisions to SSAP No. 24 to include certain government assistance disclosures from ASU 2021-10.[3]<br><br>Comments are due June 3, 2022. |
| **Related party reporting** | SAPWG reexposed revisions to SSAP Nos. 25 and 43R to clarify the identification and reporting of affiliated transactions and add Annual Statement disclosures to identify investments held involving related parties.[4]<br><br>Comments are due May 6, 2022. |
| **Proposed bond definition (43R project)** | SAPWG received comments on the proposed discussion draft to revise Schedule D, Part 1 reporting. |
| **Financial modeling** | SAPWG adopted revisions to SSAP No. 43R to update NAIC designation and designation category guidance for residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS). |

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

4 SSAP No. 25, Affiliates and Other Related Parties; SSAP No. 43R, Loan-backed and Structured Securities

| Accounting highlights – Page 7 | |
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| **Alternative valuation of minority ownership interests** | SAPWG exposed a proposal for SSAP No. 48 to either eliminate the audited US tax basis equity valuation exception or clarify that the audit of US tax basis financial statements should occur at the investee level.[5]<br><br>Comments are due June 3, 2022. |
| **Derivatives** | SAPWG exposed revisions to SSAP No. 86 adopting, with modification, US GAAP guidance on determining hedge effectiveness by including a new Exhibit A, Assessment of Hedging Effectiveness and revising measurement methods required for excluded components in hedging instruments.[6] Exhibit A would replace existing Exhibits A and B of SSAP No. 86.<br><br>Comments are due June 3, 2022. |
| **Share-based payments** | SAPWG exposed 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.[7]<br><br>Comments are due June 3, 2022. |
| **Supplemental reporting** | SAPWG adopted an agenda item to support the Blanks Working Group proposal for supplemental reporting of investments in subsidiary, controlled and affiliated (SCA) entities reported on Schedule D, Part 6-1. |
| **Cryptocurrency general interrogatory** | SAPWG adopted a proposal to add a new general interrogatory to the Annual Statement to require disclosure when cryptocurrencies are directly held or accepted for the remittance of premiums. |
| **Freddie Mac When-Issued K-Deal Certificates** | SAPWG exposed INT 22-01 to clarify that Freddie Mac When-Issued K-Deal Certificates should be included in the scope of SSAP No. 43R from initial acquisition of the investment rather than accounted for as a derivative forward contract.[8]<br><br>Comments are due May 6, 2022. |

[5] SSAP No. 48, Joint Ventures, Partnerships and Limited Liability Companies

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

[7] 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

[8] INT 22-01, Freddie Mac When-Issued K-Deal (WI Trust) Certificates

| Actuarial highlights - Page 13 | |
|---|---|
| **Non-variable annuities** | The VM-22 Subgroup reported on its plans to address comments received on the previously exposed VM-22 document.[9] |
| **Index-linked variable annuities** | The Index-Linked Variable Annuity (ILVA) Subgroup exposed 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.[10]<br><br>Comments were due May 2, 2022. |
| **Economic scenario generator** | Before the Spring meeting, the Life Actuarial Task Force (LATF) exposed recommended models for Economic Scenario Generator (ESG) field testing.<br><br>Comments were due on April 7, 2022. |
| **Actuarial guideline for modeling of complex assets** | After the Spring meeting, LATF reexposed the actuarial guideline on modeling of complex and high-yield assets in asset adequacy testing. The guideline would be effective December 31, 2022.<br><br>Comments were due May 2, 2022. |
| **Clearly defined hedging strategy** | LATF reexposed a proposal to reflect all future hedging strategies in VM-20 and VM-21, including the use an increased E factor or residual risk when future hedging strategies are not clearly defined.[11]<br><br>Comments were due April 29, 2022. |
| **Mortality** | LATF heard an update from the Society of Actuaries (SOA) on various mortality studies, including the US population mortality observations, updated with 2020 experience. |
| **Life PBR exemption** | The Blanks Working Group adopted a change to the Life, Accident and Health/Fraternal instructions, as recommended by LATF, to align with the instructions in VM-20 for the Life Principle Based Reserving (PBR) exemption. |

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

[10] NAIC Model 805, Standard Nonforfeiture Law for Individual Deferred Annuities

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

| Group capital calculation – Page 18 | |
|---|---|
| **Modifications to group capital calculation** | Before the Spring meeting, the Group Capital Calculation Working Group (GCCWG) exposed 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 – Page 19** | |
| **Life RBC – C-2 mortality factors** | The Life Risk Based Capital (RBC) Working Group discussed comments on the proposed structural updates to the C-2 mortality factors. |
| **RBC Investment Risk and Evaluation Working Group** | The RBC Investment Risk and Evaluation Working Group discussed its goals. It heard from representatives of SAPWG and the Valuation of Securities Task Force (VOSTF) about projects for the Working Group to consider. |
| **Wildfire peril** | The Property and Casualty RBC Working Group adopted a proposal to add wildfire as one of the catastrophe perils in the Rcat component. This requirement is for informational purposes only. |
| **Valuation of Securities Task Force – Page 21** | |
| **Working capital finance investments** | VOSTF adopted amendments to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (PPM) to allow the Securities Valuation Office (SVO) the discretion to notch down ratings for an unrated and unguaranteed subsidiary in a Working Capital Finance Investment (WCFI) program from the parent entity’s rating, as deemed appropriate. |
| **Principal protected securities** | VOSTF discussed comments received on the proposed revisions to the PPM to amend the definition of principal protected securities to account for alternate structures that pose similar risks as those currently defined. |
| **Designation of Schedule BA assets with fixed income characteristics** | VOSTF discussed comments received on the proposed revisions to the PPM to include guidance related to the assignment of NAIC designations to Schedule BA assets with underlying characteristics of bonds or fixed income instruments. |

| Valuation of Securities Task Force – Page 21 | |
|---|---|
| **Analytical measures for bond investments** | VOSTF exposed a proposal to require insurers to report various analytical measures about each security reported on Schedule D, Part 1, including metrics such as its current market yield, interest rate sensitivity, spread relative to risk-free securities such as US Treasuries, and average remaining life.<br>Comments are due by May 20, 2022. |
| **Financial Stability Task Force – page 23** | |
| **Macroprudential working group** | The Financial Stability Task Force adopted the macroprudential risk assessment process aimed at helping regulators monitor macroprudential industry trends. |
| **Private equity owned insurers** | The Macroprudential Working Group reported on the status of its discussions and recommendations of regulatory considerations applicable, but not exclusive, to private equity owned insurers. |
| **Climate risk – Page 25** | |
| **Catastrophe modeling center of excellence** | The Climate and Resiliency Task Force adopted a proposal to create a catastrophe modeling center of excellence. |
| **Climate risk disclosure survey** | The Climate and Resiliency Task Force adopted a redesigned climate risk disclosure survey. |

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# Accounting highlights

## Conceptual Framework

**Action.** SAPWG exposed revisions to the Preamble and SSAP Nos. 4 and 5R to incorporate updates from the FASB conceptual framework in the definition of an asset and a liability. Comments are due June 3, 2022.

The revisions include:

— removing the term 'probable' and phrases 'future economic benefit' and 'past transactions or events' in the definition of an asset;
— 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 an asset on a present right to an economic benefit and primary characteristics of a liability on a present obligation to transfer an economic benefit.

## Leasehold improvements after lease termination

SAPWG discussed comments received on proposed revisions to SSAP No's.19 and 73 to clarify that when a lease terminates early, the amortization of leasehold improvements should cease, and any remaining unamortized leasehold improvement balance should be expensed.

These proposed revisions are in response to questions received by the NAIC staff about the treatment of leasehold improvements when a lessee purchases the leased property during the lease term.

Interested parties agreed that in most cases, unamortized leasehold improvements should be immediately expensed when the lease terminates. However, they expressed concern that immediately expensing unamortized leasehold improvements may not be appropriate when an insurer purchases a property that it previously leased.

SAPWG acknowledged interested parties' concerns and identified several items it would like to discuss, including:

— language proposed by interested parties that may suggest allowing insurers to move leasehold improvement assets from being nonadmitted to being included in the building cost and reflected as an admitted asset under SSAP No. 40R;[12]
— treatment of lease agreements that do not include provisions for repurchase options at the time the lease is signed; and
— accounting for situations where the intent is to not include the leasehold improvement asset in the purchase price of the building.

**Next Step:** SAPWG directed NAIC staff to work with interested parties on the proposed revisions for future reexposure.

[12] SSAP No. 40R, Real Estate Investments

## Government assistance

**Action.** SAPWG exposed revisions to SSAP No. 24 to include certain government assistance disclosures from ASU 2021-10. Comments are due June 3, 2022.

The goal of the proposed revisions is to increase the 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.

## Related party reporting

**Action.** SAPWG reexposed revisions to SSAP Nos. 25 and 43R to clarify the identification and reporting of affiliated transactions and add Annual Statement disclosures to identify investments held involving related parties. Comments are due May 6, 2022.

This proposal is a result of discussions with the regulators about reporting and disclosures for investments with related parties. The proposed revisions:

- clarify reporting of affiliates within existing reporting lines in the investment schedules; and
- add reporting requirements for investment transactions with related parties, regardless of whether the related party meets the definition of an affiliate under Model #440.[13]

Interested parties agreed that the information requested by the proposal would be useful to regulators. However, they stated that it is critical to differentiate investments where there is direct credit exposure to an affiliate from those investments and others that are only managed by affiliates. Their suggestions included:

- removing references to US GAAP from SSAP No. 25;
- adding a paragraph to SSAP No. 25 with guidance on evaluating whether an entity is an affiliate;
- revising SSAP No. 43R to include guidance on investments in securitization vehicles where the underlying assets of the securitization predominately relate to assets with credit exposure to affiliates or related parties of the insurer;
- revising SSAP No. 43R to clarify that investments managed by affiliates are viewed as affiliated even if the underlying assets in the structure do not have credit exposure to an affiliate; and
- adding an electronic-only column to the investment schedules in the Annual Statement to identify investments involving related parties.

The reexposed revisions, with suggested revisions from interested parties, would require insurers to identify the role of the related party in the investments using

[13] Model 440, Insurance Holding Company System Regulatory Act

specific codes in the electronic-only column in investment schedules in the Annual Statement beginning with year-end 2022 reporting.

## Proposed bond definition

SAPWG received comments on the proposed discussion draft to revise Schedule D, Part 1 reporting. The goal of the discussion draft is to incorporate transparency and granularity in reporting investments under the bond proposal project, including:

- potential changes in reporting lines in Schedule D that would replace the ‘general categories’ with alternate reporting lines based on the type of investment;
- a new sub-schedule D, Part1 that would include information on certain asset-backed securities; and
- other potential changes to the columns and reported information in Schedule D, Part1.

Interested parties did not object to the proposed removal of the ‘general categories’ within Schedule D. Their suggestions included:

- ensuring clarity in the instructions for the investment categories;
- clarifying the unaffiliated and affiliated split of certain lines in the proposal;
- adding lines to the Asset Backed Securities (ABS) section for Government National Mortgage Association investments;
- adding a new category in ‘Issuer Credit Obligation’ for investments in surplus notes; and
- including the reporting of ‘Other Asset-Backed Securities’ on Schedule D, Part1 with electronic-only columns with respective categories rather than developing a new sub-schedule D, Part 1.

Interested parties also commented on the additional information that could be required for the ABS section.

**Next steps.** SAPWG directed NAIC staff to work with interested parties on comments provided and proceed with developing a more robust illustration of the reporting proposal with the goal of exposing it in May 2022.

## Financial modeling

**Action.** SAPWG adopted revisions to SSAP No. 43R to update NAIC designation and designation category guidance for RMBS and CMBS.

The revisions retain the existing guidance in SSAP No. 43R with updates to reflect recent changes to the PPM. Interested parties supported this option because as it provides a holistic view of how securities are treated in one place without reference the PPM.

## Alternative valuation of minority ownership interests

**Action.** SAPWG exposed a proposal for SSAP No. 48 to either eliminate the audited US tax basis equity valuation exception or clarify that the audit of US tax basis financial statements should occur at the investee level. Comments are due June 3, 2022.

The proposed revisions are a result of questions about whether US tax basis financial statements are used as an alternative when audited US GAAP financial statements are not available. The NAIC's AICPA Task Force commented that they were unaware of insurers using a tax basis audit opinion as an alternative to audited US GAAP financial statements.

The exposure includes two options to clarify SSAP No. 48:

**Option 1** - Remove audited US tax basis equity as a permissible valuation method.

**Option 2** - Clarify that the audit of US tax basis financial statements should occur at the investee level.

## Derivatives

**Action.** SAPWG exposed revisions to SSAP No. 86 adopting, with modification, US GAAP guidance on determining hedge effectiveness by including a new Exhibit A, Assessment of Hedging Effectiveness and revising measurement methods required for excluded components in hedging instruments. Exhibit A would replace existing Exhibits A and B of SSAP No. 86.Comments are due June 3, 2022.

SAPWG previously adopted revisions to SSAP No. 86 to align US GAAP and statutory guidance for derivative hedge documentation requirements. However, it received requests from both regulators and interested parties to consider aligning SSAP No. 86 with ASU 2017-12 when determining effective hedge relationships. At the Fall 2021 meeting, SAPWG also exposed an agenda item summarizing key changes in ASU 2017-12 to reduce complexity and align hedge accounting with risk management activities. The revisions proposed at this meeting would align the hedge effectiveness determination between SSAP No. 86 and US GAAP.

Interested parties suggested changes to make US GAAP and SSAP No. 86 guidance consistent including:

- clarification of accounting of forward points as an excluded component for foreign exchange forwards;
- cross-currency basis spread as an excluded component;
- ability to designate partial-term for fair value hedges;
- alternative to use the benchmark interest rate component of contractual cash flows to calculate the change in the fair value of the hedged item in fair value hedges;
- last-of-layer or portfolio layer method for fair value hedges; and
- hedges of interest rate risk when the hedged item can be settled before the scheduled maturity.

NAIC staff agreed with interested parties' suggestions but stated that more robust changes to SSAP No. 86 and Exhibit A and B were needed to eliminate confusion and better align SSAP No. 86 with US GAAP.

## Share-based payments

**Action.** SAPWG exposed revisions to SSAP No. 104R to incorporate the practical expedient in ASU 2021-07 when determining the current price input in option-pricing models utilized to estimate the fair value of share-based payments. Comments are due June 3, 2022.

The proposal would allow insurers to use a practical expedient when it is unable to reasonably estimate the current share price (fair value) to determine the current price input using a reasonable valuation method. Insurers would 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; and
— 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.

## Supplemental reporting

**Action.** SAPWG adopted an agenda item to support the Blanks Working Group proposal for supplemental reporting of investments in SCA entities reported on Schedule D, Part 6-1.

Blanks Working Group proposed adding new electronic columns in schedule D, Part 6-1. These columns would assist the regulators in understanding and reconciling the reporting of SCA entities and:

— include incremental columns added to Schedule D, Part 6-1 to capture the submission status of other required NAIC filings; and
— indicate whether NAIC approved values vary significantly from the value reported on Schedule D, Part 6-1.

This change does not affect statutory accounting.

## Cryptocurrency general interrogatory

**Action.** SAPWG adopted a proposal to add a new general interrogatory to the Annual Statement when cryptocurrencies are directly held or accepted for the remittance of premiums.

These revisions are in response to the observation that some insurers are holding cryptocurrencies that are not always easy to identify within the statutory financial statements. The revisions affect only the Annual Statement and do not change the statutory accounting for cryptocurrencies.

## Freddie Mac When-Issued K Deal Certificates

**Action.** SAPWG exposed INT 22-01 to clarify that Freddie Mac When-Issued K-Deal Certificates are in the scope of SSAP No. 43R. Comments are due May 6, 2022.

Freddie Mac When-Issued K-Deal certificates are backed by an asset pool held in trust, but those assets do not initially include any mortgages or mortgage-backed assets. These assets include cash from the sale of the certificates and a commitment by Freddie Mac to deliver one or more structured pass-through certificates in exchange for the When-Issued trust's cash within approximately 90 days of settlement.

The proposed INT 22-01 addresses questions from industry about how to account for investments in the When-Issued program during the 90-day period after settlement, before the receipt of the structured pass-through certificates. It states that these instruments should be captured in the scope of SSAP No. 43R and are not considered derivative forward contracts.

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# Actuarial highlights

## Non-variable annuities

The VM-22 Subgroup reported on its plans to address comments received on the previously exposed VM-22 document. It stated that it will take a tiered approach.

The first tier will focus on:

— 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.

Once tier one comments are addressed, the VM-22 Subgroup will move to addressing highly substantive comments that include items such as longevity reinsurance, the transition period and scope of the exclusion test. The third tier of comments will focus on moderately substantive or highly technical comments, and the last tier will address editorial and noncontroversial comments.

The VM-22 Subgroup stated that it will also:

— continue its work to develop a standard projection amount;
— conduct a VM-22 field test in the upcoming year; and
— develop mortality assumptions for annuities covering the non-US population.

## Index-linked variable annuities

**Action.** The Index-Linked Variable Annuity Subgroup exposed 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 May 2, 2022.

The proposed guideline addresses non-unitized annuity products with credits based on the performance of an index with caps on returns, participation rates, spreads or margins, or other crediting elements with limitations on loss but may reflect negative index returns. It is based on the following principles:

— a package of derivative assets exists that replicate the index credits provided by an index strategy at the end of an index term;
— value of the package of derivative assets can be determined daily using assumptions consistent with observable market values; and
— interim values defined in the contract provide equity to both the contract holder and the insurer where the interim values are consistent with the value of the hypothetical portfolio over the index term.

On calls before the Spring meeting, the Index-Linked Annuity Subgroup discussed the draft proposal focusing on methods to determine interim values. Interested parties expressed concern that the proposed guideline does not accommodate a product design that credits the full index performance, subject to a cap and floor. They also stated that the guideline may cause potential market disruption if products that currently provide pro-rata interim values are not accommodated. Some also suggested that the guideline not be applied to existing contracts.

## Economic scenario generator

**Action.** Before the Spring meeting, LATF exposed recommended models for ESG field testing. Comments were due on April 7, 2022.

The field test is planned from June through September 2022. Results are expected to be presented to the public by November.

The NAIC staff recommended models for field testing included:

— Treasury model - two Conning GEMS® models:
  - Conning calibration and generalized fractional floor, which uses a threshold of 40 BPs and a factor of 20% to reduce the frequency and severity of negative interest rates, while ensuring regulator objectives are met; and
  - alternative calibration and shadow floor, which introduces a floor rate believed to preserve the arbitrage-free property of the scenarios.

— Equity model – GEMS® equity model with equity-treasury linkage based on the short treasury rate for field testing, with the following calibration updates:
  - equity model calibrations to account for changes made to the treasury model; and
  - application of a Sharpe-ratio approach with a 5% corridor to represent international equity indices.

— Corporate model – GEMS® corporate model with calibration updated for consistency with other generated returns on a risk/reward basis.

The American Academy of Actuaries (the Academy) provided an update on its model office developed for universal life with secondary guarantees and variable annuities. The model office is used to test the effect of selected economic scenario sets on statutory reserves and capital. The Academy presented results for selected economic scenario sets. The Academy's preliminary conclusions on universal life with secondary guarantees included that:

— the Conning ESG scenarios are expected to have a large effect on reserves because:
  - the low-for-long requirements of ESG are not present in the current Academy Interest Rate Generator (AIRG);
  - the high premiums used in the AIRG are conservative and limit the value of the secondary guarantee; and
  - the lower premiums strengthen the secondary guarantee and make the product riskier, producing greater effects.

— Conning's unfloored scenarios produce some extreme scenario reserves, primarily due to discounting deficiencies at 105% of the 1-year US Treasury, that can be negative.

Similarly, the Academy's preliminary conclusions for variable annuities included that:

- under the three Conning ESG scenario sets, reserves would be significantly larger relative to the current AIRG model;
- the reserves and total asset requirement (TAR) for the Conning scenario sets were higher due to low-for-long interest rate requirements; and
- the low equity return scenario may be more of a driver of large reserve and TAR effects than the low-for-long interest rate scenarios for this product.

Interested parties expressed concerns over the use of the Conning GEMS® treasury and equity models for life insurance reserving and suggested that other alternatives be explored. LATF determined that field testing should proceed and it will evaluate the results to determine next steps.

## Actuarial guideline for modeling of complex assets

**Action:** After the Spring meeting, LATF reexposed the actuarial guideline on modeling of complex and high-yield assets in asset adequacy testing. The guideline would be effective December 31, 2022. Comments were due May 2, 2022.

The proposed guideline intends to provide guidance for the appropriate support of certain assumptions for asset adequacy testing including:

- clarifying how margins for uncertainty would be established so that higher uncertainty results in higher margins and reserves;
- 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;
- identifying expectations for the valuation of complex assets; and
- requiring sensitivity testing for complex assets that support life insurance products;
- establishing a process for researching and monitoring the risk associated with complex assets; and
- requiring additional documentation of investment fee income relationships with affiliated entities or entities close to the insurer.

Discussion primarily focused on:

- whether or not the actuarial guideline should include a guardrail on the assumed individual asset net yield for certain assets; and
- the effect requiring an insurer to perform asset adequacy testing on the business that includes ceded reserves could have on the Covered Agreement.

The actuarial guideline proposed that beginning with reserves reported as of December 31, 2023, the assumed individual asset net yield for both current and projected reinvestment assets would not exceed the net yield of public non-callable corporate bonds with spreads and costs consistent with a PBR credit rating of 10. Many interested parties were opposed to including a specific guardrail and stated that having a sensitivity test would be more appropriate. They stated that a guardrail is very prescriptive and could have unintended consequences. However, other interested parties expressed support for a guardrail.

A majority of regulators supported further study of guardrails and recommended only including sensitivity testing covering both current and projected reinvestment assets. They stated that the sensitivity testing would provide information on outliers and potential undesirable results that can be reviewed to determine if a guardrail is needed in future years.

The proposed reinsurance modeling provision would require an insurer that cedes a material amount of reserves to a reinsurer that does not file a VM-30 report or where reinsurance counterparty risk is material, to perform asset adequacy testing on the business that includes the ceded reserves.[14] Certain regulators and interested parties expressed concerns that the requirement may be in conflict with the Covered Agreement signed between the EU, the UK and the US. The Covered Agreement eliminates collateral and host country physical presence requirements for reinsurers operating on a cross-border basis. It also enables jurisdictions to recognize each other's system of solvency and market conduct regulations. The NAIC staff stated that the requirement to perform asset adequacy testing may indirectly cause an increase to collateral requirements for reinsurers subject to the Covered Agreement. They said that the Covered Agreement includes not only a direct provision to eliminate collateral but it also prevents new requirements that may indirectly cause a reinsurer subject to the Covered Agreement to have increase collateral requirements. Interested parties proposed that until more research is done, the actuarial guideline should refer to ASOP 11 and not require separate asset adequacy testing. Regulators agreed with this proposal.[15]

## Clearly defined hedging strategy

**Action**. LATF reexposed a proposal to reflect all future hedging strategies in VM-20 and VM-21, including the use an increased E factor or residual risk when future hedging strategies are not clearly defined. Comments were due April 29, 2022.

The proposal includes a consistent definition of clearly defined hedging strategies (CDHS) to be used in VM-20 and VM-21. It also defines future hedging strategy and adds a definition for hedging transactions that is slightly modified from the definition currently used in the Accounting Practices and Procedures Manual. Significant changes from the prior proposals include:

- removing optionality for liquidating currently held hedges if the insurer does not have a future hedging strategy; and
- allowing the use of 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.

LATF discussed comments received from interested parties that it incorporated into the proposal. The Academy stated that it agrees with the general principals of the proposal but suggested that the VM-21 approach should be revised consistent with the approach for VM-20 and move away from the use of E factors. LATF stated that this proposed revision is beyond the scope of the current proposal and would require a larger structural change.

## Mortality

LATF heard an update from the SOA on various mortality studies including the US population mortality observations, updated with 2020 experience included the following:

[14] VM-30, Actuarial Opinion and Memorandum Requirements

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

— 3.4 million deaths, the highest in history
— increase of 16.8% in the age-adjusted mortality rate over 2019; and
— increase of mortality by 4.9% from 2019, highest since 1936, without effects of the COVID-19 pandemic.

One study also showed that there were significant increases in mortality reported in the third quarter of 2021 between the ages of 25 and 64.

## Life PBR exemption

**Action.** The Blanks Working Group adopted a change to the Life, Accident and Health/Fraternal instructions, as recommended by LATF, to align with the instructions in VM-20 for the Life PBR exemption.

The revisions include:

— adding disclosure of the year that the Life PBR exemption was actively filed;
— confirming the eligibility criteria in the case of ongoing exemptions;
— correcting references to a state 'granting' an exemption; and
— adding instructions on how to respond if the insurer is using the ongoing exemption.

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# Group capital calculation

## Modifications to group capital calculation

**Action.** Before the Spring meeting, the GCCWG exposed changes to the GCC template and instructions based on both the GCC trial implementation and comments received from interested parties. Comments were due March 13, 2022.

The proposed changes include:

- eliminating the stress scenario included in the trial implementation;
- eliminating sensitivity test related to 'other debt' which tested the sensitivity of 'other debt' as compared 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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# Risk-based capital

## Life RBC – C-2 mortality factors

The Life RBC Working Group discussed comments on the proposed structural updates to the C-2 mortality factors.

On calls before the Spring meeting, the Academy presented two options for the C-2 mortality factor including its recommendations to apply one of three factors to each category (first $500 million, next $24,500 million and over $25,000 million).

**Option 1** categorizes in-force policies as universal life with secondary guarantees, term life, and all other life policies. This option is more closely aligned to information available in the Annual Statement.

**Option 2** categorizes polices as life policies with pricing flexibility in force, term life policies without pricing flexibility in force, and permanent life policies without pricing flexibility in force and is a more principle-based approach.

Interested parties and regulators suggested that:

- additional sensitivity testing over the categories should be performed;
- a tiered approach, where higher risk charges are considered first to create a more objective measure, should be implemented; and
- the Annual Statement should be updated in future periods to allow more information used in the C-2 factors to be pulled directly from the Annual Statements under either approach.

On a call after the Spring meeting, the Academy presented results of initial sensitivity testing for certain components of the C-2 charge in response to a request from LATF including that:

- Impact on C-2 factors assuming zero expected mortality improvement – there was minimal impact to the factors with this change, the Academy continued to suggest the use of the 2017 mortality improvement scale and the evaluation of trend risk versus this expectation.
- Sensitivity of unknown sustained risk likelihood and severity in the catastrophe risk component – while an increased likelihood or severity has some impact to the factors, with more significant impact for the longer exposure periods, the Academy continued to recommend conservatively setting both the likelihood and impact of an unknown sustained risk event.
- Pandemic risk likelihood and severity that measures the impact of a one-year increase in mortality from a new pandemic – since the likelihood of future pandemics is uncertain, and there is a possibility of overreacting to current events, the Academy maintained its suggestion to include a distribution of potential outcomes providing for excess mortality at least as severe as the COVID-19 pandemic.
- Five-year risk exposure period for products with pricing flexibility – after considering four models that directly simulate pricing flexibility to respond to emerging mortality experience, the Academy maintained its suggestions to assign products with inforce pricing flexibility to the five-year risk exposure period category.

## RBC Investment Risk and Evaluation Working Group

The RBC Investment Risk and Evaluation Working Group discussed its goals. It heard from representatives of SAPWG and VOSTF about projects for the Working Group to consider including:

- review of charges for:
  - structures where an insurer holds an entire stack from a securitization, also referred to as stapling of investments; and
  - residual tranches;
- collaboration on project to review ratings from various credit rating providers.

The chair of the RBC Investment Risk and Evaluation Working Group stated that the intent of the Working Group is to align RBC charges with the related investment risk, removing RBC as a factor when insurers make investment decisions. He stated that the Working Group will not focus on identifying weakly capitalized insurers. Instead, it will focus on a more granular breakdown of investment risk including:

- creating a framework that can be easily updated for future investment factors; and
- ensuring the risk RBC is addressing is commonly understood.

Some interested parties commented that it is important to start with a holistic approach and for RBC to recognize that different asset classes have different loss severity after defaults occur and different default patterns. Others suggested a phased approach, with:

- phase 1 focusing on collateral loan obligations because they can be addressed quickly using existing C1 bond factors; and
- phase 2 dealing with more difficult ABS structures including assessing adequacy and consistency across modelled categories, defining alternative approaches such as bottom-up underwriting, and situations where collateral does not have a well-established RBC.

## Wildfire Peril

**Action.** The Property and Casualty RBC Working Group adopted a proposal to add wildfire as one of the catastrophe perils in the Rcat component. This requirement is for informational purposes only.

The Catastrophe Risk Subgroup identified wildfires as one of the major drivers of US insured losses. It recommended that the wildfire peril be added as one of the catastrophe risks in the Rcat component to gather data on models currently used and inform future decisions on capital requirements related to wildfires. Interested parties supported reporting wildfire information for information purposes only until concerns about models are addressed before incorporating into RBC. Interested parties stated that wildfire models are still in the new stage of development and are more prone to yielding inconsistent results.

# 6 Valuation of Securitites Task Force

## Working capital finance investments

**Action.** VOSTF adopted amendments to the PPM to allow the SVO the discretion to notch down ratings for an unrated and unguaranteed subsidiary in a WCFI program from the parent entity's rating, as deemed appropriate.

The amendments are in response to the SVO receiving requests from interested parties to assign NAIC designations to a WCFI with unguaranteed and unrated obligors based on the implied support of its NAIC Credit Rating Provider rated parent. VOSTF indicated that it would like the SVO to retain discretion to notch down ratings, based on its assessment of the parent or subsidiary relationship.

These amendments clarify that if the SVO notches the NAIC designation below a NAIC 2 rating, the WCFI program would be ineligible for an NAIC designation because it would no longer meet the definition of an eligible obligor under SSAP No. 105R.[16] In past exposures, SAPWG commented that in order for SSAP No. 105R to maintain its original intent, additional guardrail provisions would be required if the SVO granted NAIC designations to a WCFI with unguaranteed and unrated obligors.

## Principal protected securities

VOSTF discussed comments received on the proposed revisions to the PPM to amend the definition of principal protected securities to account for alternate structures that pose similar risks as those currently defined.

Interested parties agreed with the substance of the proposed amendment but proposed to include principal protected securities as one of the illustrations under Subscript S because these securities are already not eligible for filing exemption. Interested parties suggested that this approach would improve the clarity and usability of the PPM.

In 2020 the SVO added principal protected securities as a security type ineligible for the filing exempt process. Recently, the SVO received a proposal 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. As such, the SVO proposed revising the definition of principal protected securities to include alternate structures that pose similar risks.

**Next Steps.** VOSTF directed NAIC staff to work with interested parties on revisions to the current proposal.

[16] SSAP No. 105R, Working Capital Finance Investments

## Designation of Schedule BA assets with fixed income characteristics

VOSTF discussed comments on the proposed revisions to the PPM to include guidance on the designation of Schedule BA assets with underlying characteristics of bonds or fixed income instruments.

The proposed revisions would include Schedule BA assets on the non-filing exempt list within the PPM and allow the SVO to assign NAIC Designations to Schedule BA assets that are not specifically covered by other sections of the PPM. The proposed revision could make various types of currently ineligible assets eligible for an NAIC designation. However, each Schedule BA asset would need to be individually assessed by the SVO for bond or fixed income characteristics.

Interested parties supported the SVO providing designations for Schedule BA assets with fixed income characteristics, but expressed concerns about adding Schedule BA assets to the non-filing exempt list in the PPM because:

- the non-filing exempt list within the PPM is for bonds within the scope of SSAP No. 26R and SSAP No. 43R, which generally does not include Schedule BA assets; and
- certain securities, such as surplus notes, do not require NAIC designations and are currently reported on Schedule BA.

**Next Steps.** VOSTF directed NAIC staff to work with interested parties on revisions to the current proposal.

## Analytical measures for bond investments

**Action.** VOSTF exposed a proposed referral to the Blanks Working Group to add fixed income analytical risk measures to investments reported on Schedule D, Part 1. Comments are due by May 20, 2022.

The proposal is 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. Based on a sample of privately rated securities, the SVO reported that for some securities the risk assessments for the sampled securities were materially different – between three to six and more notches higher than the SVO's estimates.

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 insurers to report various analytical measures about each security reported on Schedule D, Part 1. It suggested collecting information, such as its current market yield, interest rate sensitivity, spread relative to risk-free securities such as US Treasuries, and average remaining life.

# 7 Financial Stability Task Force

## Macroprudential Working Group

**Action.** The Financial Stability Task Force adopted the macroprudential risk assessment process aimed at helping regulators monitor macroprudential industry trends.

The Macroprudential Working Group stated that the macroprudential risk assessment process will have both quantitative and qualitative factors to facilitate the identification of key risk exposures. Quantitative factors may be used to track and measure risk exposures by establishing key risk indicators for ongoing monitoring and objective assessment. Qualitative factors may be used to supplement the risk indicators by incorporating information from a broader range of sources into the risk assessment process to identify emerging issues and industry trends for consideration.

The Macroprudential Working Group stated that interested parties were supportive of the macroprudential risk assessment process and comments received were consistent with the Working Group's goal. The Working Group discussed changes made to the document, stating that all changes were clarifying in nature and did not change the substance of the risk assessment. The Working Group acknowledged that some comments did not warrant a change to the risk assessment because they were viewed as prescriptive and would not allow for regulatory flexibility.

## Private equity owned insurers

The Macroprudential Working Group reported on the status of their discussions and recommendations of regulatory considerations applicable, but not exclusive to, private equity owned insurers.

The Working Group developed a list of tools available to the regulators to use when approving acquisitions involving a private equity company and identified concerns that may require additional conditions or guidance. It also provided its recommendations on the first six considerations including recommended referrals of the identified concerns to other working groups including:

- **NAIC Group Solvency Issues Working Group** for work to ensure:
  - Obtaining 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 the acquisition.
  - Understanding of control and conflict of interest for owners with less than 10% ownership. The Macroprudential Working Group suggested

considering ways of better targeting pertinent agreements by adding a list of questions about owners with less than 10% interest who may have significant influence.

- **Risk-Focused Surveillance Working Group** for work to ensure:
  - Understanding the effects of investment management agreements and whether they are arm's length or 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 potentially focus on short-term results rather than alignment with the long-term nature of liabilities in life products. The Macroprudential Working Group suggested guidance for some insurers to provide capital maintenance agreements and considering ways to make the agreements stronger.

The Working Group also discussed the concern over operational, governance and market conduct practices being affected by the different priorities and level of insurance experience possessed by entrants into the insurance market without prior insurance experience. It decided to continue working on more specific suggestions to address this topic. It also determined to not develop a definition of private equity because considerations are activity based and could apply beyond private equity owners.

**Next Step.** The Macroprudential Working Group will continue discussions about the remaining concerns outlined in the Regulatory Considerations Applicable, But Not Exclusive, to Private Equity Owned Insurers proposal and will expose it after each item has been considered.

# 8 Climate risk

## Catastrophe modelling center of excellence

**Action.** On a call before the Spring meeting, the Climate and Resiliency Task Force adopted a proposal to create a Catastrophe Modeling Center of Excellence. The center will:

— facilitate access to catastrophe modeling documentation for insurance regulators and provide assistance in understanding information received;
— provide education and training materials about the mechanics of commercial models and treatment of perils and risk exposures; and
— conduct research using various model platforms to proactively consider questions that may need to be addressed for regulatory resilience priorities.

## Climate risk disclosure survey

**Action.** On a call before the Spring meeting, the Climate and Resiliency Task Force adopted a redesigned Climate Risk Disclosure Survey (the Survey). During the meeting of the Executive Committee and Plenary, regulators determined that a vote is not needed because the participation in the Survey is voluntary.

The Survey was redesigned to more closely align with the framework put forth by the Task Force on Climate-related Financial Disclosures (TCFD) to reduce redundancy in reporting requirements. The Task Force asserted that there has been growing support, both domestically and internationally, to use the TCFD framework.

The Survey includes narrative questions consistent with the requirements of the TCFD and additional close-ended questions that allow for a timelier analysis of the survey results.

Interested parties expressed concerns about the survey, including:

— responding to closed-ended questions
— the scope of the Survey; and
— deadlines for completion.

After discussion, the regulators determined to make responses to closed-ended questions voluntary for the 2022 reporting year. The Survey allows state regulators for participating states to opt out of requiring responses to these questions.

The scope of Survey includes all insurers with countrywide written premium ]of at least $100 million, licensed to write in any of the participating states. Interested parties' concerns focused on the requirement to participate in the Survey in the year that an insurer exceeds the $100 million premium written threshold and whether insurers would have an appropriate amount of time and resources to thoughtfully respond to the Survey. The Task Force responded that in an effort to alleviate these concerns during transition, the Survey includes language that encourages state regulators to work closely with insurers to provide as much flexibility as possible for responding to the Survey.

The Task Force also acknowledged interested parties concerns about the timing to file the survey and allowed additional time for insurers to move to the new reporting structure, by moving submission deadlines from August 31 to November 30. The Survey also allows the state that initiated the request or the lead state, for group filing, to grant an insurer an extension.

The Task Force stated that currently 15 states participate in the survey, accounting for approximately 80% of the insurance market, based on direct premium written. It expects that the Survey will remain voluntary but hopes that the alignment with the TCFD will increase participation by the states.

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