NAIC Fall Meeting

Issues & Trends

Latest actions include adoption of guidance about portfolio and partial-term fair value hedges, plus Schedule D-1 reporting and the Principles-Based Bond Definition issue paper, in connection to the principles-based bond project and treatment of negative interest maintenance reserve.

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Meeting highlights

During its Fall meeting and on calls before it, the National Association of Insurance Commissioners (NAIC) **adopted** the following guidance.

- SSAP Nos. 19 and 73 to clarify that when a lease terminates early, the amortization of leasehold improvements will cease, and any remaining unamortized leasehold improvement balance will be expensed. The revisions include an exclusion for health care delivery assets.
- SSAP No. 86 to adopt, with modification, US GAAP guidance about portfolio and partial-term fair value hedges.
- INT 22-02 to provide an exception to insurers from assessing the effects on the insurer's valuation allowance and deferred tax assets from the Corporate Alternative Minimum Tax (CAMT) through the first quarter of 2023. It also provides subsequent event exceptions.

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

- Treatment of negative interest maintenance reserve (IMR), specifically related to current guidance on the nonadmission of negative IMR.
- SSAP No. 21R to clarify that an asset pledged as collateral must qualify as an admitted asset for a collateral loan to be admissible.
- New or revised SSAP No. 93 to expand current guidance to capture all tax equity investments that qualify under specified criteria and provide general federal business tax credit or state premium tax credit.
- Nullification of INT 03-02 to eliminate inconsistent guidance with SSAP No. 25 for economic and non-economic related party transactions.
- Schedule D-1 reporting and the Principles-Based Bond Definition issue paper, in connection to the principles-based bond project

The NAIC **discussed** the following guidance:

- Qualitative responses to the Economic Scenario Generator field test.
- Risk-Based Capital (RBC) charges for collateral loan obligations (CLOs).

Accounting highlights >>	
Conceptual Framework	SAPWG reexposed revisions to SSAP No. 5R to incorporate updates from the FASB conceptual framework to define a liability.[1] Comments were due February 10, 2023.
Negative interest maintenance reserve	SAPWG exposed an agenda item about the treatment of negative IMR, specifically related to current guidance on the nonadmission of negative IMR. Comments were due February 10, 2023.
Leasehold improvements after lease termination	SAPWG adopted revisions to SSAP Nos. 19 and 73 to clarify that when a lease terminates early, the amortization of leasehold improvements will cease, and any remaining unamortized leasehold improvement balance will be expensed.[2] The revisions include an exclusion for health care delivery assets.
Collateral loans	SAPWG reexposed 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] Comments were due February 10, 2023.
Related party	SAPWG adopted 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.[4]
Affiliated investments	SAPWG exposed revisions to SSAP No. 25 to clarify the definition of an affiliated investment. Comments were due February 10, 2023.

1 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. 25, Affiliates and Other Related Parties; SSAP No. 97, Investments in Subsidiary, Controlled and Affiliated Entities

Accounting highlights >>	
Proposed bond definition – Schedule D reporting	SAPWG exposed proposed revisions to Schedule D-1 reporting and the Principles-Based Bond Definition issue paper, in connection to the principles-based bond project. Comments were due February 10, 2023.
Interest income disclosures	SAPWG exposed revisions to SSAP No. 34 to add disclosures for interest income due and accrued and a disclosure for paid-in-kind (PIK) interest included in the current principal balance.[5] Comments were due February 10, 2023.
Troubled debt restructuring	SAPWG adopted revisions to SSAP No. 36 to reject ASU 2022-02.[6] The ASU eliminates previous US GAAP guidance for a troubled debt restructuring (TDR) by creditors.
Derivatives – Portfolio layer method	SAPWG adopted revisions to SSAP No. 86 to adopt, with modification, US GAAP guidance about the portfolio layer method and partial-term fair value hedges.[7] Revisions are effective January 1, 2023, with early adoption permitted. SAPWG also exposed a new issue paper that documents previous adoptions in connection with the review of ASU 2017-12.[8] Comments were due February 10, 2023.
New market tax credits and tax equity investments	SAPWG exposed a proposal for a new or revised SSAP No. 93 to expand current guidance to capture all tax equity investments that qualify under specified criteria and provide general federal business tax credits and state tax credits, including state premium tax credit programs.[9] Comments were due February 10, 2023.

5 SSAP No. 34, Investment income due and accrued

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

7 SSAP No. 86, Derivatives

8 ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted improvements to Accounting for Hedging Activities

9 SSAP No. 93, Low-Income Housing Property Tax Credits

Accounting highlights >>	
Fair value measurement of restricted securities	SAPWG exposed revisions to SSAP No. 100R to adopt, with modification, ASU 2022-03.[10] Comments were due February 10, 2023.
Intercompany pooling	SAPWG reexposed its intent to nullify INT 03-02 because it is inconsistent with SSAP No. 25.[11] Comments were due February 10, 2023.
Inflation Reduction Act	SAPWG adopted revisions to INT 22-02 to provide an exception to insurers from assessing the effects on the insurer's valuation allowance and deferred tax assets from the CAMT through the first quarter of 2023. It also provides subsequent event exceptions.[12] This INT will be nullified on June 15, 2023.
Actuarial highlights >>	
Non-variable annuities	On a call after the Summer meeting, the VM-22 Subgroup reexposed VM-22 principles-based requirements.[13] Comments were due January 2, 2023.
Index-linked variable annuities	At the Fall meeting, the Life Actuarial Task Force (LATF) adopted Actuarial Guideline Index-Linked Variable Annuity (ILVA) specifying the conditions under which an index-linked variable annuity would be exempt from NAIC Model 805, and include the nonforfeiture requirements consistent with variable annuities.[14] The guideline is effective for all contracts issued on or after July 1, 2024.
Economic scenario generator – Field test	LATF heard a summary presentation about participant responses to the economic scenario generator field test that provided qualitative information to help interpret results. It is expected that a second field test will be performed, resulting in an expected effective date for the economic scenario generator being no earlier than 2025.

10 SSAP No. 100R, Fair Value; ASU 2022-03 - Fair Value Measurement (Topic 820): Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions

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

12 NT 22-02, Third Quarter 2022 through First Quarter 2023 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax

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

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

Mortality improvement	On a call before the Fall meeting, LATF adopted the American Academy of Actuaries' (the Academy) recommendations for the historical mortality improvement (HMI) and future mortality improvement (FMI) scales.
Short-term and long-term swap rates	LATF adopted a proposal to replace the London Interbank Offered Rate (LIBOR) with the Secured Overnight Financing Bank (SOFR) effective December 31, 2022.
Negative interest maintenance reserve	LATF adopted a recommendation about the treatment of a negative interest maintenance reserve (IMR) in reserves under VM-20, VM-21 and VM-30.[15]
Risk-based capital >>	
Affiliated investments	The Capital Adequacy Task Force referred a proposal with revisions to the affiliated investment instructions and restructure for all lines used to calculate RBC charges for affiliated investments to SAPWG and the Blanks Working Group.
Life RBC – C-2 mortality factors	After the Fall meeting, the Life RBC Working Group adopted the instruction supplement for applying the newly adopted Life Insurance C-2 mortality instructions.
RBC Investment Risk and Evaluation Working Group – Collateralized loan obligations	The RBC Investment Risk and Evaluation (IRE) Working Group exposed a presentation from the Academy on CLOs. Comments were due January 27, 2022.
RBC IRE interim proposal to address arbitrage	The RBC IRE Working Group exposed a proposal to create or break out risk-based capital factors for three new NAIC 6 designation categories. Comments were due January 27, 2022.

15 VM-20, Requirements for Principle-Based Reserves for Life Products; VM-21, Requirements for Principle-Based Reserving for Variable Annuities; VM-30, Actuarial Opinions and Memorandum Requirements

Valuation of Securities Task Force >>	
Collateralized loan obligation	The Valuation of Securities Task Force (VOSTF) exposed the CLO modeling methodology. Comments were due February 13, 2023.
Race and Insurance >>	
Workstream One proposed recommendations	The Special Committee on Race and Insurance adopted recommendations of Workstream One that focused on diversity within the insurance industry and access to insurance products.
Mechanisms to resolve disparities	The Special Committee on Race and Insurance adopted the report of the Health Innovations Working Group on mechanisms to resolve disparities through improved access to care.

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Accounting highlights

Conceptual framework

Action. SAPWG reexposed revisions to SSAP No. 5R to incorporate updates from the FASB conceptual framework to define a liability. Comments were due February 10, 2023.

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 proposed additional language to clarify that the guidance would apply only if there were no contradictory guidance in other existing statements. NAIC staff proposed alternative language; however, after discussion, SAPWG directed NAIC staff to work with interested parties to clarify application of the asset and liability definitions.

Negative interest maintenance reserve

Action. SAPWG exposed an agenda item about the treatment of negative IMR, specifically related to current guidance on the nonadmission of negative IMR. Comments were due February 10, 2023.

The rising interest rate environment has created an increased likelihood for insurers to be in a negative IMR position, which is reported as a nonadmitted asset and amortized to income over time. Interested parties expressed concern that this requirement has negative ramifications for insurers including:

- In general, rising interest rates are favorable to the financial health of insurers and policyholders. However, with negative IMR, there is an inappropriate perception of decreased financial strength through lower surplus and risk-based capital.

- Negative IMR could affect a rating agency's views towards the industry or incentivize insurers to avoid prudent investment transactions necessary to avoid mismatches between assets and liabilities. In either scenario, negative IMR encourages short-term non-economic activity that is not in the best long-term interest of an insurer's financial health or its policyholders.

Some regulators expressed concern over allowing negative IMR to be recorded as an admitted asset, stating that some guardrails would be needed. Examples of guardrails discussed included:

- requiring bond reinvestment;

- limiting the admitted net negative IMR to a specific percentage of surplus or other relevant metrics; and
- limiting the net negative IMR amortization period.

With the exposure, the regulators asked interested parties to propose potential guardrails and details on unique considerations.

Leasehold improvements after lease termination

Action. SAPWG adopted revisions to SSAP Nos. 19 and 73 to clarify that when a lease terminates early, the amortization of leasehold improvements ceases, and any remaining unamortized leasehold improvement balance is expensed. The revisions include an exclusion for health care delivery assets.

Interested parties commented that in the situation where an insurer purchases a previously leased property, expensing of any unamortized leasehold improvement balance may not be appropriate in all circumstances because leasing and purchasing of assets is a complex business activity and takes many forms and structures. They suggested revisions that would direct insurers to add unamortized leasehold improvements to the cost basis of the acquired real estate when the insurer can demonstrate, through appraisals or other means, that the lessee owned leasehold improvements are not included in the purchase price of the acquired leased real estate.

The adopted revisions did not include changes proposed by interested parties. SAPWG stated that:

- in an arm's length transaction, the seller is obligated to get the best sales price possible based on the true condition of the asset, including the leasehold improvements; and
- allowing a leasehold improvement to remain an asset after a lessee has purchased the real estate would overstate the value of the reported assets because the book value of the real estate would be the fair value of the real estate plus the leasehold improvement.

Collateral loans

Action. SAPWG reexposed 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 were due February 10, 2023.

Revisions were proposed to address the inconsistency between SSAP Nos. 20 and 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 have the same explicit statement.

[16] SSAP No. 20, Nonadmitted Assets

Interested parties stated that for collateral in the form of equity investments in a joint venture, partnership, or LLC, the fair value assessment is more relevant valuation information than the audited financial statements. They recommended SAPWG add a footnote clarifying that for this type of collateral, a fair value assessment would be required to support recording the collateral as an admitted asset. In the event of foreclosure, the collateral asset would be owned directly and recorded as an admitted asset. A US GAAP audit would be required on an annual basis to continue recording the asset as admitted.

Some regulators expressed concern with the interested parties' recommendation, specifically with having unaudited partnerships, joint ventures or LLCs that are pledged as collateral for an admitted collateralized asset. SAPWG agreed that additional work is needed to finalize this guidance.

Related party

Action. SAPWG adopted 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.

These revisions reflect 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.

Affiliated investments

Action. SAPWG exposed revisions to SSAP No. 25 to clarify the definition of an affiliated investment. Comments were due February 10, 2023.

The proposed revisions clarify that an invested asset held by an insurer that is issued by an affiliated entity, or that includes the obligation of an affiliated entity is an affiliated investment. This change is in response to interested parties' comments to revisions clarifying the application of the existing affiliate definition and new disclosures requirements. Those disclosures required insurers to include a specific designation for investments acquired through, or in, related parties regardless of if they meet the affiliate definition.

Proposed bond definition – Schedule D reporting

Action. SAPWG exposed proposed revisions to Schedule D-1 reporting and the Principles-Based Bond Definition issue paper, in connection to the principles-based bond project. Comments were due February 10, 2023.

The proposed revisions to the general instructions, Schedule D-1-1, Schedule D-1-2 would address interested parties' comments discussed during previous SAPWG calls and meetings.

Proposed revisions to the general instructions include:

- clarifying that convertible bonds are included with corporate bonds, with the exception of mandatory convertible bonds, that are in a separate category;
- identifying the lines for which affiliated investments are not reported, including government jurisdictions, Securities Valuation Office (SVO) – Identified Bond Exchange Traded Funds and Certificates of Deposit;
- expanding the definition of financial asset-backed securities (ABS) that are not-self-liquidating to include all financial ABS with a structure that does not represent a design where the terms of the underlying collateral has contractual principal and interest that results with a conversion into cash over a period of time (e.g. receivables or other such assets); and
- clarifying the practical expedient in SSAP No. 43R regarding the determination of when the 'meaningful' criteria may be used.[17]

Proposed revisions to Schedules D-1-1 and D-1-2 include:

- adding example references to the retrospective and prospective methods instead of defining the two approaches in the instructions;
- eliminating investment characteristic that identifies whether an asset is bifurcated between an insulated and non-insulated separate account;
- limiting the current overcollateralization percentage column to financial asset backed securities that are not self-liquidating and non-financial ABS that require a full analysis;
- clarifying terminology; and
- revising description of paid-in-kind (PIK) interest due and accrued to reflect the cumulative amount of PIK interest included in the current principal balance.

The proposed revisions to the issue paper include changes from the last exposure and the updated SSAP guidance exposed on the November 2022 call. The issue paper was also revised to clarify the guidance for feeder funds based on discussions with interested parties including examples of various structures.

[17] SSAP No. 43R, Loan-Backed and Structured Securities

Interest income disclosure

Action. SAPWG exposed revisions to SSAP No. 34 to add disclosures for interest income due and accrued and for PIK interest included in the current principal balance. Comments were due February 10, 2023.

The revisions would require disclosure of:

- the gross, nonadmitted and admitted amounts for interest income due and accrued; and
- the aggregate deferred interest and cumulative amounts of PIK interest included in the current principal balance.

These revisions are in response to interested parties' comments received in connection with the principles-based bond definition project and include suggested enhancements to the reporting of interest income on Schedule D-1-1 and consideration of whether those changes should be added to other schedules.

Troubled debt restructuring

Action. SAPWG adopted revisions to SSAP No. 36 to reject ASU 2022-02. The ASU eliminates previous US GAAP guidance for a troubled debt restructuring by creditors.

The US GAAP guidance for TDRs is being eliminated because these losses are captured in the current expected credit losses (CECL) standard. As a result, debt modifications are no longer evaluated as TDRs but are assessed to determine if the modified instrument is a new loan or a continuation of an existing loan. However, since CECL has not been adopted for statutory accounting, the proposal retains existing statutory guidance for a troubled debt restructuring. These revisions result in a difference between US GAAP and statutory accounting.

Derivatives – Portfolio layer method

Action. SAPWG adopted revisions to SSAP No. 86 to adopt, with modification, US GAAP guidance about the portfolio layer method and partial-term fair value hedges. Revisions are effective January 1, 2023, with early adoption permitted.

SAPWG also exposed a new issue paper that documents previous adoptions in connection with the review of ASU 2017-12. Comments were due February 10, 2023.

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

- additional criteria for the portfolio layer method and partial-term hedges;
- additional requirement to disclose circumstances that lead to the breach of portfolio layer method hedges; and

- adoption, with modification, guidance for partial-term hedges from ASU 2017-12 for hedged assets.

The issue paper documents historical discussions, considerations, and changes made as a result of ASU 2017-12, including:

- documentation and initial assessment of hedge effectiveness;
- determination of hedge effectiveness and measurement of excluded components; and
- application of portfolio layer method and partial-term fair value hedges.

New market tax credit and tax equity investments

Action. SAPWG exposed a proposal for a new or revised SSAP No. 93 to expand current guidance to capture all tax equity investments that qualify under specified criteria and provide general federal business tax credits and state tax credits including state premium tax credit programs. Comments were due February 10, 2023.

The proposal includes a discussion document with questions on general concepts to consider in developing a revised or new SSAP that would supersede SSAP No. 93 and could subsequently revise SSAP No. 94.[18] The proposed guidance would address the new market tax credits (NMTC) as well as other qualifying tax equity investments. It would consider the proposed FASB guidance as well as admittance and impairment provisions, recognizing that tax credits cannot be used to provide direct payment to policyholders, but rather are meant to affect a reporting entity's tax liability.

NMTC permits individual and corporate taxpayers to receive a non-refundable tax credit against federal income taxes for making equity investments in financial intermediaries known as Community Development Entities. The FASB has a current Emerging Issues Task Force project to assess whether the proportional amortization method of accounting, which is used for Low-Income Housing Tax Credits (LIHTC), should be expanded to investments in tax credit structures beyond LIHTC.

Fair value measurement of restricted securities

Action. SAPWG exposed revisions to SSAP No. 100R to adopt, with modification, ASU 2022-03. Comments were due February 10, 2023.

The revisions add guidance for equity securities subject to contractual sale restrictions including:

- the effect on a fair value measurement arising from a restriction on the sale or use of an asset by an insurer will be different depending on whether the restriction would be taken into account by market participants when pricing the asset;

[18] SSAP No. 94, Transferable and Non-Transferable State Tax Credits

- an equity security that an insurer cannot sell on the measurement date because of a contractual sale restriction would be measured at fair value on the basis of the price in the principal (or most advantageous) market. A contractual sale restriction is not a characteristic of the equity security and is not considered in measuring the fair value of an equity security;
- an equity security with sale restrictions will be considered a restricted equity security and subject to admissibility guidance in SSAP No. 4;[19] and
- Insurers would disclose the fair value of equity securities subject to contractual sale restrictions.

Intercompany pooling

Action. SAPWG reexposed its intent to nullify INT 03-02 because it is inconsistent with SSAP No. 25. Comments were due February 10, 2023.

Interested parties expressed concern about the proposed nullification of the intercompany pooling arrangement guidance in INT 03-02. Their comments included observations that:

- nullification would create inconsistency in the basis used to transfer assets, if assets transferred at fair value under SSAP No. 25, and liabilities transferred at book value, because the insurer still has continuing involvement resulting in the asset transfer being deemed a non-economic transaction;
- the use of market value to transfer bonds in a transaction where statutory book value is used in the transfer of underwriting and claim assets and liabilities would create an opportunity to recognize a gain in surplus;
- the guidance in SSAP No. 68 on statutory mergers is consistent with US GAAP that treats transfers of assets and liabilities between entities under common control as non-economic transactions;[20]
- the modification of the intercompany pooling arrangement could result in a gain in surplus and would not qualify for prospective reinsurance accounting;
- generation of internal gains/losses on the transfer of bonds used to settle changes in intercompany pooling arrangements, in the context of a combined group operating as a single entity, would be contrary to the concept of an economic transaction with an independent third party; and
- The use of market value for bonds still held within the combined intercompany pool would be inconsistent with the statutory accounting

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

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

valuation guidance for NAIC rated 1 or 2 bonds that are generally held until maturity.

NAIC staff acknowledged interested parties' concerns and responded to some of the key points but still recommend nullification of INT 03-02. NAIC staff also responded to interested parties' comments including the following:

- actual cash value of obligations when they are extinguished are a relevant measure to the value of the transaction;
- using book value for measurement of payments between affiliates can result in either unrecognized dividends (in effect) or losses;
- in noneconomic transactions at the ultimate parent level, the transfers of assets may result in a deferred gain but losses would not be deferred; and
- the statutory accounting objective is to provide a different treatment for retroactive reinsurance contracts if there is a gain to the ceding entity and not to obscure that gain, which can happen in the event that the assets used in payment are not measured correctly.

SAPWG requested that interested parties' comments include:

- specific examples where nullifying the INT would be of concern;
- effective date of the nullification; and
- observations provided by the NAIC staff.

Inflation Reduction Act

Action. SAPWG adopted revisions to INT 22-02 to provide an exception to insurers from assessing the effects on the insurer's valuation allowance and deferred tax assets from the CAMT through the first quarter of 2023. It also provides subsequent event exceptions. This INT will be nullified on June 15, 2023.

The Inflation Reduction Act (IRA) was enacted on August 16, 2022 and included a new CAMT. The IRA, including the CAMT, are effective for tax years beginning after 2022.

INT 22-02 states that a reasonable estimate is not determinable for both year-end 2022 and the first quarter of 2023. Therefore, reporting the effects related to CAMT are not required in those financial statements. It also includes an exception to Type I subsequent event requirements under SSAP No. 9 for events that occur before the date the audited financial statements are issued or available to be issued.[21]

INT 22-02 requires insurers to disclose:

- that the CAMT was enacted during the reporting period;

[21] SSAP No. 9, Subsequent Events

- a statement about whether the insurer, or the controlled group of corporations of which the insurer is a member, has determined if it expects to be liable for CAMT in 2023; and
- if, based on information regarding the projected adjusted financial statement income for 2023, the insurer or the controlled group of corporations of which the insurer is a member has determined if it is an ‘applicable corporation’ to determine if CAMT exceeds the regular federal income tax payable.

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Actuarial highlights

Non-variable annuities

Action. On a call after the Summer meeting, the VM-22 Subgroup reexposed VM-22 principles-based requirements. Comments were due January 2, 2023.

The revised VM-22 included the following decisions:

- including annuity principle-based reserving (PBR) exemption with a threshold based on prior-year fixed annuity reserves in the Annual Statement and excluding products with guaranteed living benefits from the exemption. To be exempt, an insurer would need to have:
  - less than $0.5 billion of exemption reserves which include fixed annuities, indexed annuities and life contingent payout annuities for both individual and group policies; or
  - less than $6 billion of fixed annuity reserves for insurers that are a member of an NAIC group that includes other life insurers; or
  - all new contract or certificates that would otherwise be subject to VM-22 being issued or assumed by the insurer result from an election of contract benefits or features from existing contracts or certificates valued and the insurer was exempted from, or otherwise not subject to, the requirements of VM-22 in the prior year;
- clarifying the scope to:
  - include principles describing which business is in scope with elements related to the applicability of nonforfeiture limits and a guarantee on the return of principal; and
  - state that index-linked variable annuities products should be measured under VM-21 requirements;
- using a modified approach to allocate statutory reserves in excess of the cash surrender values to all non-variable annuity products, including life contingent payout, non-life contingent payout, and accumulation annuities;
- updating the longevity reinsurance proposal to:
  - include expenses in determining a k-factor to set premiums for the reserve calculation; and
  - treat longevity reinsurance as a separate reserving category for aggregation purposes;
- adding new section called “VM-V” that includes the current VM-22 requirements related to the maximum valuation rate for formulaic reserves on payout annuities.

Next step. A VM-22 field test is being targeted for 2023. If completed in 2023, the target effective date would be January 1, 2025, with a three-year transition period for implementation.

Index-linked variable annuities

Action. At the Fall meeting, LATF adopted Actuarial Guideline ILVA specifying the conditions under which an index-linked variable annuity would be exempt from NAIC Model 805 and include the nonforfeiture requirements consistent with variable annuities. The guideline is effective for all contracts issued on or after July 1, 2024.

This guideline applies to an index-linked annuity exempt from NAIC Model 805 on the basis that it is a variable annuity and includes an index-linked crediting feature that is built into the contract (with or without unitized subaccounts) or added to the contract by a rider, endorsement, or amendment. It establishes principles and requirements for determining values, including death benefits, withdrawal amounts, annuitization amounts or surrender values, resulting in an ILVA being considered a variable annuity and thereby exempt from NAIC Model 805.

The guideline's principles are that interim values, which are values attributed to the index strategy used to determine the value of death benefits, withdrawal amounts, annuitization amounts or surrender values at any time other than the start and the end date of the index strategy term:

- 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 Fall meeting, LATF 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). The regulators could not reach consensus on whether MVAs should be allowed. As such, the ILVA guideline was updated to allow states more discretion to consider the value of the supporting assets and whether MVAs are appropriate to define the interim nonforfeiture value.

Economic scenario generator – Field test

LATF heard a summary presentation about participant responses to the economic scenario generator field test. The purpose of the presentation was to provide qualitative information that may help regulators and interested parties to understand and interpret quantitative field test results, which will be presented at a future date. The summary of participant comments included discussion about sensitivity tests and custom scenarios, scenario subset selection methodology, linkage between interest rates and equity returns, stochastic exclusion ratio test scenarios, economic scenario generator interest rate calibration and the calibration of the equity model.

Although most of the quantitative results have been compiled, they are under review. Before presenting these results, the NAIC staff will:

- follow-up with participants about any template completion issues and outlier results; and
- provide participants information about how their results will be aggregated.

The NAIC staff expects to have aggregated results for VM-21 and C3 Phase 2 first, followed by results for VM-20 and C3 Phase 1. It is expected that a second field test will be performed, resulting in the expected effective date of being no earlier than 2025.

Mortality improvement

Action. On a call before the Fall meeting, LATF adopted the Academy's recommendations for the HMI and FMI scales.

The recommendations included:

- an HMI approach that is based on data from 2010–2020 but sets the 2020 mortality equal to the 2019 level to remove the effect of COVID-19; and
- an FMI approach that includes mortality deterioration in 2023 and 2024 and no improvement in 2025, to account for the effect of COVID-19 on mortality, and then grades to long-term mortality improvement levels at projection year 10.

Some regulators continued to state that a rate of zero was appropriate for FMI because of the effects of COVID-19 and other factors, including individuals forgoing medical care during the COVID-19 pandemic. They also expressed a view that a principle-based reserving framework has greater uncertainty that calls for greater margin.

Short-term and long-term swap rates

Action. LATF adopted a proposal to replace LIBOR with SOFR effective December 31, 2022.

The proposal also included the approach for calculating current and long-term swap spread curves as of December 31, 2022 and technical implementation details as recommended by the Academy. These recommendations are consistent with previously adopted changes that are effective for the 2023 Valuation Manual.

Negative interest maintenance reserve

Action. LATF adopted a recommendation about the treatment of a negative IMR in reserves under VM-20,VM-21and VM-30.

The recommendation states that insurers are not required to allocate the non-admitted portion of IMR for the purposes of VM-20, VM-21 and VM-30. However, if an insurer is granted a permitted practice to admit negative IMR as an asset, then it should allocate the portion of negative IMR permitted to be admitted.

The rising interest rate environment has created an increased likelihood for insurers to be in a negative IMR position. This recommendation was a result of interested parties' comments requesting additional guidance on the appropriate practice for allocating IMR for asset adequacy testing and PBR. Interested parties expressed concern that without additional guidance there is a potential to double count losses through the nonadmission of negative IMR on the balance sheet and a related reserve deficiency caused by allocating negative IMR in VM-20, VM-21 and VM-30.

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Risk-based capital

Affiliated investments

The Capital Adequacy Task Force referred a proposal with revisions to the affiliated investment instructions and restructure for all lines used to calculate RBC charges for affiliated investments to SAPWG and the Blanks Working Group. The proposal would revise RBC formulas and provide consistent treatment of affiliates for all lines of business.

The referral was in response to a request by interested parties because the revisions would require insurers to apply RBC charges to non-admitted affiliates and subsidiaries. Interested parties suggested that statutory accounting should be aligned with RBC treatment.

Life RBC – C-2 mortality factors

Action. After the Fall meeting, the Life RBC Working Group adopted the instruction supplement for applying the newly adopted Life Insurance C-2 mortality instructions.

The supplement will help insurers complete the new structure for life mortality risks and is written in a question-and-answer format including several examples. The Working Group will consider including it as an appendix to the instructions in future years.

Interested parties' comments included clarifying questions as well as broader questions about the inconsistency of guidance within the supplement about pricing flexibility and the principles in the development of the factors. They also requested additional examples for determining pricing flexibility and ceded versus direct tiers. The Academy responded to interested parties' comments but did not think that additional examples were needed. The Academy stated that insurers could use the forecast template to model different scenarios and it is up to each insurer to demonstrate and support their approach for determining pricing flexibility.

RBC Investment Risk and Evaluation Working Group – Collateralized loan obligations

Action. The RBC IRE Working Group exposed a presentation from the Academy on CLOs. Comments were due January 27, 2022.

The Academy has been investigating CLOs to understand the risk they pose to life insurers' statutory capital and considerations for establishing capital requirements. The Academy observed that CLOs do not currently present a material risk to the aggregate solvency of the life insurance industry. When comparing CLO factors to C-1 factors for corporate bonds and common stock, the Academy commented that:

- for the higher CLO debt traches, the bond charges are probably too high;
- for the lower CLO tranches, the bond charges are probably too low; and
- it is uncertain where the crossover point is between higher and lower tranches.

It also observed that:

- while a CLO's total collateral and a vertical slice of its tranches have the same risk at a point in time, it does not follow that it must have the same total C-1 requirement;
  - each of corporate bonds, bank loans, and CLOs have unique structures and risk profiles;
  - C-1 corporate bond factors are not appropriate for bank loans or for CLOs due to different assumptions and models (e.g. secured vs. unsecured, time horizon, etc.); and
  - it would not be appropriate to force equivalence using the current C-1 corporate bond factors.
- while structure does not reduce aggregate risk at any given moment, it does transform risk; and
- junior tranches are more likely to experience losses at that level.

The Academy also stated that they have not seen specific evidence to support the use of a 30% capital charge for residual tranches and have not concluded that sub-categories of NAIC-6 are needed. Establishing a CLO residual tranche charge or new sub-categories of NAIC 6 will require substantial analysis.

RBC IRE interim proposal to address arbitrage

Action. The RBC IRE Working Group exposed a proposal to create or break out risk-based capital factors for three new NAIC 6 designation categories. Comments were due January 27, 2022.

The proposal recommends adding NAIC Designation Categories, for example 6.A, 6.B and 6.C with RBC factors, 30%, 75% and 100% respectively to eliminate RBC arbitrage and potential financial solvency risk. The proposal asserts that the aggregate risk of owning all the underlying corporate loans held by a CLO structure should be the same as owning all of the CLOs tranches resulting in an equivalent RBC effect on both, if it is free from any RBC arbitrage. It also identified that there is a regulatory issue with the insurer's ability to potentially materially reduce C-1 capital requirements by securitizing a pool of assets into a CLO.

The Structured Securities Group (SSG) previously 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 result in a significant regulatory arbitrage when the total RBC on every tranche is calculated. The SSG recommended that the capital requirement when holding all traches of a structured security should be consistent with the capital requirement when holding all of the underlying collateral.

5 Valuation of Securities Task Force

Collateralized loan obligation

Action. VOSTF exposed the CLO modeling methodology. Comments were due February 13, 2023.

The proposed modeling methodology is based on SSG's annual CLO stress test produced by the NAIC Capital Markets Bureau that monitors developments in the capital markets globally and analyzes their potential impact on the investment portfolios of U.S. insurers. The methodology does not include scenarios or probabilities, including the default and recovery rate assumptions that would be used.

VOSTF requested interested parties to comment on whether:

- there are assumptions other than default or recovery rate that would allow market participants to completely replicate the work of the NAIC for broadly syndicated loan CLOs;
- assumptions are reasonable; and
- there are any other issues that should be brought to the attention of the Task Force's attention.

VOSTF also asked that for assumptions deemed unreasonable, interested parties provide:

- actionable alternatives that can be replicated by the NAIC and market participants;
- quantitative justification for alternatives, based on all available historical data; and
- references on whether such alternatives are used by rating agencies in their public published methodologies and whether it contemplates a trade-off, for example, between the timing of recovery and the amount recovered.

6 Race and Insurance

Workstream One proposed recommendations

Action. The Special Committee on Race and Insurance adopted recommendations of Workstream One that focused on diversity within the insurance industry and access to insurance products.

Its recommendations included:

- the NAIC in collaboration with trade organization to make resources available to insurers to use in hosting programs introducing students from local colleges and graduate schools to careers in insurance;
- insurance trade associations to make available to their members diversity, equity, and inclusion (DEI) resources and best practices for student internships, grants, or similar programs, and resources for recruiting talent from non-traditional channels;
- insurance trade associations to assess DEI and DEI efforts at all levels of their organizations as well as among producers and third-party suppliers to identify opportunities for improvement and to measure changes in diversity over time. As part of the assessment, trade associations are encouraged to share information collected from their members in a way that facilitates evaluation across business lines;
- the insurance industry to assess DEI efforts at all levels of its organizations, as well as among producers and third-party suppliers, and identify opportunities for improvement and measure changes over time; and
- state regulators to discuss insurers' efforts relating to talent recruitment and retention, including the effect of DEI initiatives;
- NAIC to provide updates on DEI initiatives to federal counterparts and the International Association of Insurance Supervisors.

Workstream One also said that these recommendations should be periodically evaluated to determine whether revisions are appropriate.

Mechanisms to resolve disparities

Action. The Special Committee on Race and Insurance adopted the report of the Health Innovations Working Group on mechanisms to resolve disparities through improved access to care.

The report focuses on telehealth services and alternative payment models (APMs). It did not provide explicit recommendations, rather, its goal was to inform the Special Committee and allow the committee to determine next steps. Key findings of the report included:

- physical access to care is the most substantial and pervasive obstacle that could be alleviated with increased use of telehealth that can connect isolated people with culturally competent health practitioners and reduce the need for transportation.

- to help ensure that telehealth decreases disparities, regulators may:

  - support increased access to telehealth by requiring it to be covered or offered with favorable cost sharing; and
  - consider steps to increase digital literacy and access to technology for patients to ensure disparities are not exacerbated.

- APMs and value-based payments (VBPs):

  - have incentives that could exacerbate health disparities; and
  - could potentially reduce health disparities because these same patients present the greatest opportunities to realize savings.

- providers could seek to better manage high-cost conditions that could reduce health disparities or avoid treating such populations increasing health disparities. To help APMs reduce disparities regulators could:

  - closely monitors health insurers' use of APMs and VBPs;
  - seek to better understand how regulatory tools can encourage models that promote better provider engagement with disadvantaged communities; and
  - promote the testing and implementation of more effective risk adjustment mechanism for APMs.

The Working Group was also asked to research programs to improve access to historically underserved communities and will provide an additional report once the work advances.

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