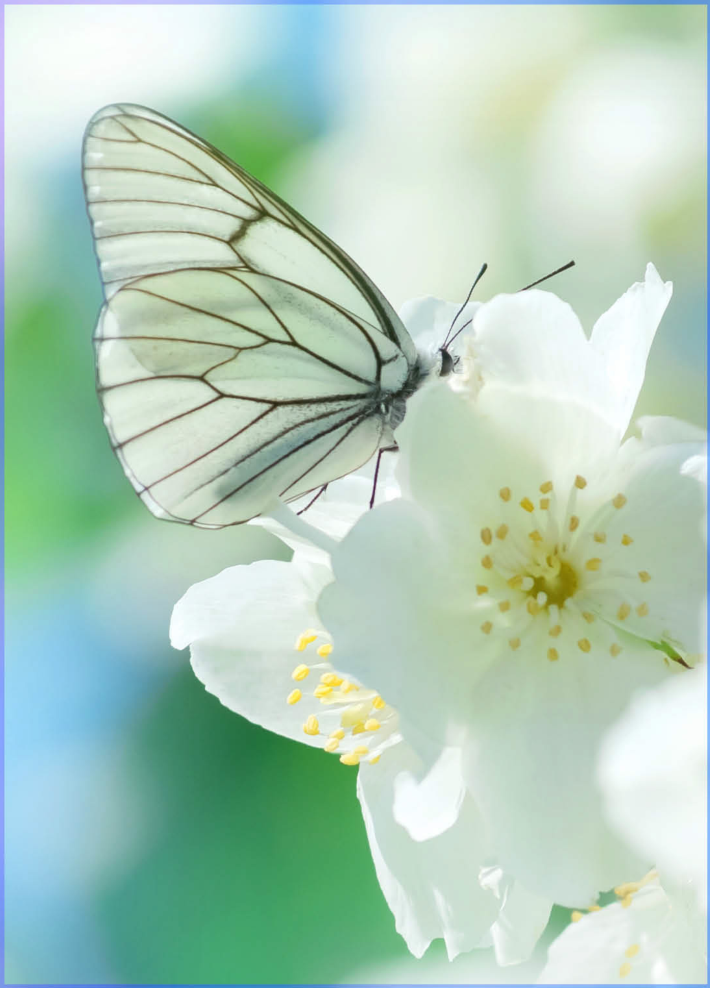
June 2023 SAPWG Call

Issues & Trends



SAPWG reexposed revisions to INT 23-01 to update guidance for negative IMR.

August 2023

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Contents

Negative interest maintenance reserve

Action: The Statutory Accounting Principles Working Group (SAPWG) reexposed revisions to INT 23-01 to update guidance for a negative interest maintenance reserve (IMR).[1] Comments were due July 21, 2023.

The proposed revisions were based on comments from regulators and interested parties and included:

- allowing an insurer to admit negative IMR up to 10% of adjusted capital and surplus when its RBC is greater than 300% after adjustment to remove admitted positive goodwill, EDP equipment and operating system software, deferred tax assets (DTA) and admitted IMR;
- instructing insurers to first apply the negative IMR to the general account (GA); then if all negative IMR in the GA is admitted and the percentage limit is not reached, apply it to separate account proportionately between insulated and non-insulated accounts and disclose:
  - net negative IMR in aggregate and allocated between the general account, insulated separate accounts and non-insulated accounts;
  - amounts of negative IMR admitted in the general account and reported as an asset in the separate account insulated and non-insulated blank;
  - the calculated adjusted capital and surplus; and
  - the percentage of adjusted capital and surplus that the admitted net negative (disallowed) IMR represents (including what is admitted in the general account and what is recognized as an asset in the separate accounts).
- including application guidance for admitting IMR in both the general and separate accounts;

[1] INT 23-01, Net Negative (Disallowed) Interest Maintenance Reserve

- allowing derivative losses to be included in negative IMR if the insurer can demonstrate a historical practice in which realized gains from derivatives were also included in IMR (as liabilities) and amortized; and
- adding new disclosures to attest to that:
  - fixed income investments generating IMR losses comply with the insurer's documented investment or liability management policies;
  - IMR losses for fixed income related derivatives are in accordance with prudent and documented risk management procedures, in accordance with the insurer's derivative use plans and reflect symmetry with historical treatment in which unrealized derivative gains were reversed to IMR and amortized;
  - any deviation to from the insurer's documented investment or liability management policies was either because of a temporary and transitory timing issue or related to a specific event; and
  - asset sales were not compelled by liquidity pressures.

The INT would be effective through December 31, 2025 but could be nullified earlier or extended based on SAPWG's actions to establish specific guidance on negative IMR.

On its call on June 28, SAPWG discussed comments received on the previous exposure of the INT, including:

- **RBC sensitivity and surplus guardrails** - Interested parties proposed to increase the amount of negative IMR to be admitted from 5% to 10% of surplus. Although many regulators agreed with the increased limit, they requested that the percentage be applied to surplus adjusted to remove items such as net positive goodwill, EDP equipment and operating system software and net DTAs. Interested parties asserted that such adjustments were not necessary.
- **Exclusion of fair value derivatives from admitted negative IMR** – Interested parties suggested that negative IMR losses related to interest rate risk of derivatives that are effective hedges be eligible to be admitted. Interested parties commented that the inclusion of derivatives within IMR is a longstanding practice consistently applied by insurers and aligns with prior guidance from regulators. Regulators stated it would be disruptive to change the accounting of gains and losses related to effective hedges. They agreed that if an insurer historically amortized derivative gains through IMR, losses reflected in IMR related to effective hedges should be eligible to be admitted.
- **Recognizing and reporting IMR in separate and special surplus accounts** - Interested parties commented that current IMR rules appropriately recognize net negative IMR in separate accounts as relevant to the overall IMR position of the insurer. Contributions to the IMR calculation are produced by both insulated and non-insulated separate accounts. They recommended that negative IMR related to relevant insulated and non-insulated book value guaranteed separate accounts be admissible. Regulators did not oppose to the proposal and

discussed the order in which the negative admitted IMR would be applied between the general accounts and the separate accounts.

- **Reinvestment guardrails** - Interested parties and regulators agreed that some macro-level proof of reinvestment is needed. Interested parties suggested the proof should be designed to be practical and not to disincentivize prudent investment. They also commented that asset adequacy testing plays a role in ensuring the returns are being reinvested appropriately and could be used as an additional guardrail.
- **Effective duration date** - SAPWG proposed the INT be effective for three year-ends to allow time for a long-term solution to be adopted. Interested parties agreed with this timeframe.

The Life Actuary Task Force (LATF) commented that any decision to admit or non-admit negative IMR should not rely on asset adequacy testing (AAT). LATF clarified that AAT is not formulaic, but rather heavily judgment-based, and generally does not include prescriptive guardrails on those judgments, such as the reinvestment guardrail. Therefore, LATF confirmed it would not be appropriate to admit negative IMR if doing so was dependent on AAT as the sole or primary safeguard for any related solvency concerns.

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Acknowledgments

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