NAIC Fall Meeting and January 2024 SAPWG Call

Issues & Trends

Latest actions include adoption of guidance related to reinsurance recoverable from the estate of Scottish Re, allocation of non-interest related losses to asset valuation reserve, and further restriction of cash equivalents or short-term investment classifications.

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Meeting highlights

During its Fall meeting, on calls before it and the January 2024 Statutory Accounting Principles Working Group (SAPWG) call, the National Association of Insurance Commissioners (NAIC) **adopted** the following guidance.

- Revisions to SSAP No. 2R to further restrict investments reported as cash equivalents or short-term investments.
- Revisions to the Annual Statement Instructions to remove guidance permitting the allocation of non-interest related losses to Interest Maintenance Reserve (IMR).
- Revisions to SSAP No. 54R to clarify that a gross premium valuation under Appendix A-010 and cash flow testing under AG 51 are both required.
- INT 23-04 to provide accounting and reporting guidance for ceding entities with reinsurance balances to or from Scottish Re in liquidation.
- A model bulletin in response to the need for a framework around the use of artificial intelligence (AI) systems in insurance.

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

- SSAP No. 21R to add a disclosure to expand the reporting lines on Schedule BA to report collateral loans by the type of collateral that secures the loan, effective for year-end 2024 reporting.
- SSAP No. 93 to update guidance for tax credit investments and SSAP No. 94 to clarify the scope.
- Purposes and Procedures Manual (PPM) of the NAIC Investment Analysis Office to update the definition of an NAIC designation.
- PPM of the NAIC Investment Analysis Office authorizing the procedures for the Security Valuation Office's (SVO's) discretion over NAIC designations assigned through the filing exemption (FE) process.

The NAIC **discussed** the following guidance:

Intent to nullify INT 03-02 because it is inconsistent with SSAP No. 25 for economic and non-economic related party transactions.

Accounting highlights >>	
Short-term investments	SAWPG adopted revisions to SSAP No. 2R to further restrict the investments that are reported as cash equivalents or short-term investments, effective January 1, 2025.[1]
Asset valuation reserve and interest maintenance reserve	SAPWG established a long-term project to include additional accounting guidance for the asset valuation reserve (AVR) and IMR within SSAP No. 7.[2]
IMR and AVR specific allocations	SAWPG adopted revisions to the Annual Statement Instructions to remove guidance that permits the allocation of non-interest related losses to IMR and to clarify these non-interest related losses should be allocated to AVR. The changes are effective January 1, 2024.
IMR / AVR for preferred stock	SAWPG exposed revisions to the Annual Statement Instructions to clarify that realized gains and losses on perpetual preferred stocks, regardless of NAIC designation, are allocated to AVR, not IMR. Comments are due February 9, 2024.
Collateral loan reporting	SAPWG exposed revisions to SSAP No. 21R to add a disclosure of the total amount of collateral loans and collateral loans admitted and nonadmitted by qualifying investment type and to Schedule BA to expand the reporting lines to report collateral loans by the type of collateral that secures the loan, effective for year-end 2024 reporting.[3] Comments were due January 22, 2024.
Principles-based bond definition	SAPWG reexposed revisions for residuals in the scope of SSAP 21R, to incorporate the effective yield with a cap method to measure residuals, with a practical expedient that allows the use of the cost recovery method. Comments were due January. 22, 2024.

[1] SSAP No. 2R, Cash, Cash Equivalents, Drafts and Short-Term Investments

[2] SSAP No. 7, Asset Valuation Reserves and Interest Maintenance Reserves

[3] SSAP No. 21R, Other Admitted Assets

Accounting highlights >>	
Bond Definition – debt securities issued by funds	SAPWG exposed revisions to SSAP No. 26R incorporating the principles-based bond definition to clarify that debt securities issued by funds that represent operating entities are issuer credit obligations. Comments are due February 9, 2024.
Residuals in preferred stock and common stock	SAPWG adopted revisions to SSAP No. 30R and SSAP No. 32R to clarify that investments that are in substance residual interests are reported on the dedicated reporting line for residuals in Schedule BA. This revision is effective for 2023 year-end reporting.[4]
C-2 mortality risk disclosure	SAWPG disposed of agenda item to consider revisions to SSAP Nos. 51R, 59, and 61R to add detailed disclosures for the net amount at risk to support updates to the life RBC C-2 mortality risk charges.[5]
Actuarial Guideline 51	SAPWG adopted revisions to SSAP No. 54R to clarify that a gross premium valuation under Appendix A-010 and cash flow testing under AG 51 are both required.[6]
Schedule BA reporting categories	SAPWG reexposed revisions to the Schedule BA instructions to further define examples of investments that are reported by type of investment on Schedule BA based on underlying characteristics of assets. Comments were due January 22, 2024.
Mortgage guaranty insurance	SAPWG exposed its intent to review Model 630 for incorporation into SSAP No. 58 and Appendix A-630.[7] The proposed effective date is January 1, 2025 or later.

4 SSAP No. 30R, Unaffiliated Common Stock; SSAP No. 32R, Preferred Stock

5 SSAP No. 51R, Life Contracts; SSAP No. 59, Credit Life and Accident and Health Insurance Contracts; SSAP No. 61R, Life, Deposit-Type and Accident and Health Reinsurance

6 SSAP No. 54R, Individual and Group Accident and Health Contracts; Appendix A-010, Minimum Reserve Standards for Individual and Group Accident and Health Insurance Contracts; Actuarial Guideline 51, The Application of Asset Adequacy Testing to Long-Term Care Insurance Reserves

7 SSAP No. 58, Mortgage Guarantee Insurance; Appendix A-630, Mortgage Guarantee Insurance

Accounting highlights >>	
New market tax credits and tax equity investments	SAPWG reexposed revisions to SSAP No. 93 to update guidance for tax credit investments, to SSAP No. 94 to clarify its scope, and to SSAP Nos. 34 and 48 to ensure consistency with SSAPs No. 93 and 94.[8] The proposed effective date is January 1, 2025. Comments are due February 9, 2024.
Intercompany pooling	SAPWG deferred action related to INT 03-02 allowing time to work with interested parties on a revised proposal for discussion at the 2024 Spring National Meeting.[9]
Investments in downstream holding companies	SAWPG exposed revisions to SSAP No. 97 to align guidance within the SSAP on the admissibility requirements of investments in downstream holding companies.[10] Comments are due February 9, 2024.
Scottish Re Life Reinsurance liquidation questions	SAPWG adopted INT 23-04 to provide accounting and reporting guidance for ceding entities with reinsurance receivables from the estate of Scottish Re in liquidation effective for 2023 reporting.[11]
Measurement of credit losses	SAPWG adopted revisions to reject ASU 2016-13, and five other ASUs related to the current expected credit loss (CECL) method for impairment recognition.[12]

[8] SSAP No. 93, Investments in Tax Credit Structures; SSAP No. 94R, State and Federal Tax Credits; SSAP No. 38, Acquisition, Development and Construction Arrangements; SSAP No. 48, Joint Ventures, Partnerships and Limited Liability Companies

[9] SSAP No. 25, Affiliates and Other Related Parties; INT 03-02, Modifications to an Existing Intercompany Pooling Arrangement

[10] SSAP No. 97, Investments in Subsidiary, Controlled or Affiliated Entities

[11] INT 23-04, Scottish Re Life Reinsurance Liquidation Questions

[12] ASU 2016-13, Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19, Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04, Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments, (collectively referred to as CECL)

Actuarial highlights >>	
Non-variable annuities	On a call before the Fall meeting, the VM-22 Subgroup exposed requirements for VM-31 for non-variable annuities.[13] Comments are due February 14, 2024.
Modeling of complex assets	The Life Actuarial Task Force (LATF) reexposed revisions to VM-01 to add a term “equity-like instruments” and VM-30 to clarify regulatory expectations about equity return assumptions in cash-flow testing.[14] Comments were due January 29, 2024.
Interest maintenance reserve template	On a call before the Fall meeting, LATF adopted an optional template to gather information about how insurers report IMR.
Risk-based capital >>	
Structured securities	The Risk-Based Capital Investment Risk and Evaluation (RBC IRE) Working Group heard a presentation from the American Academy of Actuaries (the Academy) about proposed principles for RBC for structured securities. These principles included criteria for when an asset class would require a new model and if the securities within an asset class should be modeled individually to determine their C-1 factors.
Valuation of Securities Task Force >>	
NAIC designation definition	The Valuation of Securities Task Force (VOSTF) reexposed an amendment to the PPM of the NAIC Investment Analysis Office to update the definition of an NAIC designation. Comments were due January 26, 2024.
NAIC designations	VOSTF reexposed an amendment to the PPM of the NAIC Investment Analysis Office authorizing the procedures for the SVO’s discretion over NAIC designations assigned through the FE process. Comments were due January 26, 2024.

13 VM-22, Statutory Maximum Valuation Interest Rates for Income Annuities; VM-31, PBR Reporting Requirements for Business Subject to a Principle-Based Reserve Valuation

14 VM-01, Definitions for Terms in Requirements; VM-30, Actuarial Opinion and Memorandum Requirements

Other developments >>	
Use of algorithms, predictive models, and artificial intelligence systems	The Innovation, Cybersecurity, and Technology Committee adopted a NAIC Model Bulletin to provide a framework around the use of artificial intelligence (AI) systems in insurance.[15]

[15] NAIC Model Bulletin: Use of Artificial Intelligence Systems by Insurers

2 Accounting highlights

Short-term investments

Action. SAWPG adopted revisions to SSAP No. 2R to further restrict the investments that are reported as cash equivalents or short-term investments, effective January 1, 2025.

The following investments are added to the exclusions from being reported as short-term investments or cash equivalents:

- investments that are reported on Schedule BA, including but not limited to:
  - collateral or non-collateral loans in the scope of SSAP No. 21R;
  - surplus notes in the scope of SSAP No. 41R;
- mortgage loans in the scope of SSAP No. 37.[16]

An example of securities with predefined reset dates is an auction-rate security that has a long-term maturity and an interest rate that is regularly reset through a Dutch auction. These instruments are accounted for based on the contractual maturity at the date of acquisition, except where other specific rules within the statutory accounting framework currently exist.

Asset valuation reserve (AVR) and interest maintenance reserve (IMR)

Action. SAPWG adopted a proposal to establish a long-term project to include additional accounting guidance for AVR and IMR in SSAP No. 7.

The long-term project will be focused on relocating AVR/IMR guidance currently in the Annual Statement Instructions to SSAP No. 7. Currently SSAP No. 7 references the Annual Statement instructions but as the SSAPs are the highest level of guidance in the hierarchy, it was determined that the guidance should be in the SSAPs.

An ad-hoc group has been established to provide recommendations to SAPWG on any necessary revisions to SSAP No. 7 as part of the normal exposure process.

IMR and AVR specific allocations

Action. SAPWG adopted revisions to the Annual Statement Instructions to remove guidance that permits the allocation of non-interest related losses to IMR. The changes are effective January 1, 2024.

[16] SSAP No. 41R, Surplus Notes: SSAP No. 37, Mortgage Loans

Based on the comments from interested parties on the previous exposure, SAPWG made further revisions to

- adopt the mortgage loan guidance as originally exposed; and
- incorporate guidance for debt securities that directs AVR reporting if, between the purchase and sale date, there is an acute credit event (known event) negatively affecting the price of the security that has not yet been reflected in the credit rating provider (CRP) ratings / SVO feed at the time of the sale where the resulting gain/loss was predominantly credit related.

Although the NAIC staff supported the modified revisions suggested by interest parties to allow for timely implementation of key changes for 2024, the NAIC staff supported continued discussion on the allocation between IMR and AVR for debt instruments as part of the long-term IMR project.

The adopted changes will subsequently be included in SSAP No. 7 as part of the long-term project for IMR and AVR. However, SAPWG made these clarifying edits immediately in the Annual Statement Instructions because that is where the guidance currently resides.

IMR / AVR preferred stock

Action. SAWPG exposed revisions to the Annual Statement Instructions to remove the guidance that directs all realized gain/loss on perpetual preferred stock to be allocated between IMR and AVR based on NAIC designation. Comments are due February 9, 2024.

The proposed revisions:

- clarify that realized gains and losses on perpetual preferred stock would not be included in IMR, regardless of NAIC designation;
- direct insurers to follow the same concepts for perpetual preferred stock as for common stock. With this approach, all unrealized gains or losses on perpetual preferred stock would be reversed to realized gains or losses in the AVR formula;
- indicate that if the NAIC designation for redeemable preferred stock was a 4 to 6 at any time during the holding period, the realized gain or loss would go to AVR; and
- clarify that SVO-Identified Preferred Stock ETFs would be treated as equity investments, with gains and losses excluded from IMR, consistent with guidance in SSAP No. 32R for perpetual preferred stocks.

Statutory accounting revisions effective in 2021 revised the measurement method for perpetual preferred stock to be fair value, not to exceed any currently effective call price, regardless of NAIC designation. At the time of this measurement method change, corresponding revisions to the IMR/AVR instructions were not reflected. These revisions are intended to make the

Annual Statement Instructions for IMR/AVR consistent with the accounting and reporting guidance in SSAP No. 32R.

Collateral loan reporting

Action. SAPWG exposed revisions to SSAP No. 21R to add a disclosure to expand the reporting lines on Schedule BA to report collateral loans by the type of collateral that secures the loan, effective for year-end 2024 reporting. Comments were due January 22, 2024.

The proposed revisions would require that collateral loans be reported based on the type of qualifying investment that secures the loan and would add a disclosure to identify:

- total amount of collateral loans; and
- the collateral loans admitted and nonadmitted by qualifying investment type.

Proposed revisions also include:

- changes to Schedule BA that would require collateral loans to be reported based on the qualifying investment collateral that secures the loan, including short term investments, bonds, asset backed securities, preferred stocks, common stocks, mortgage loans, real estate, joint ventures, subsidiaries, and other qualifying investments for both unaffiliated and affiliated entities;
- clarification that collateral loans would be classified based on the type of collateral held; and
- inclusion of a data capture disclosure that would identify the admitted and nonadmitted collateral loans by type of collateral that secures the loan.

These revisions are in response to comments that the current reporting detail on Schedule BA does not provide sufficient clarity on the type of collateral used to support the admittance of collateral loans.

Principles-based bond definition

Action. SAPWG reexposed revisions for residual tranches or interests from securitization tranches, beneficial interests and loss positions (residuals) in the scope of SSAP 21R, to incorporate the effective yield with a cap method to measure residuals, with a practical expedient that would allow the use of the cost recovery method. Comments were due January. 22, 2024.

Proposed revisions include guidance to:

- report residuals initially at acquisition cost and, subsequent to acquisition, at the lower of book adjusted carrying value (BACV) or fair value;

- at acquisition date, estimate the allowable earned yield based on the initial best estimate of the residual's cash flows relative to the acquisition cost;
- subsequently measure BACV using the effective yield method with a cap, where BACV would be reduced for cash flows received in excess of the allowable earned yield and interest income would be recognized for cash flows received equal to or less than the allowable earned yield;
- allow a policy election for all residuals held to use the return of cost basis approach as a practical expedient where all cash flows received from residual tranches would reduce the BACV until zero, then subsequent cash flows received would be recognized as interest income;
- report temporary reductions in fair value as unrealized losses;
- reclassify and account for the investment under applicable SSAP if the investment no longer meets the definition of a residual and structure is expected to continue for more than 12 months;
- evaluate and record other than temporary impairment (OTTI) consistent with SSAP No. 43R including guidance to:
  - consider OTTI to have occurred if the present value of expected cash flows discounted by the allowable earned yield is less than the BACV; and
  - recognize a realize loss equal to the difference between the BACV and the present value of expected cash flows, with present value of expected cash flows becoming the new BACV.

SAPWG stated that the previously proposed cost recovery method does not recognize income from the investment holding until the cost basis is recovered, which is an approach that is not followed for most investment holdings.

The proposed effective yield method includes a cap that:

- eliminates the practice in which the BACV for residuals increases unless there is a subsequent investment; and
- incorporates a process that allows interest income to be recognized based on the calculated effective yield.

The cost recovery method was included as a practical expedient to address concerns by some interested parties about the extensive work and non-automation that would be required to apply the effective yield with a cap method.

Bond definition – debt securities issued by funds

Action. SAPWG exposed revisions to SSAP No. 26R incorporating the principles-based bond definition to clarify that debt securities issued by funds that represent operating entities are issuer credit obligations. The revisions would be effective January 1, 2025.

The revisions are intended to eliminate inconsistent application between similar funds and to better align with the recently adopted definition of residual tranches, including updating guidance previously addressing 1940 Act[17] registered business development corporations, closed-end funds, or similar operating entities. This would allow consistent treatment of similar funds regardless of SEC registration status. Guidance is also proposed to assist with distinguishing whether a fund represents an operating entity or a securitization vehicle. Comments are due February 9, 2024.

Residuals in preferred stock and common stock

Action. SAPWG adopted revisions to SSAP Nos. 30R and 32R to clarify that investments that are in substance residual interests are reported on Schedule BA on the dedicated reporting line for residuals. This revision is effective for 2023 year-end reporting.

SAPWG stated that common stock and preferred stock typically would not be construed to be in-substance residual interests or residual security tranches. However, SAPWG received information that investments categorized as preferred stock are being created to repackage potential additional interest or performance coupons separately from debt instruments.

Interested parties requested that these revisions be effective beginning March 31, 2024, due to the proximity of this guidance to the year end and the additional effort required to identify these additional items. However, SAPWG did not think that extensive work will be required to identify residuals in these structures.

C-2 mortality risk disclosure

Action. SAPWG disposed of the agenda item to consider revisions to SSAP Nos. 51R, 59 and 61R to add detailed disclosures for the net amount at risk to support updates to the life RBC C-2 mortality risk charges.

SAPWG stated that revisions to the SSAPs are no longer needed because disclosures about certain product characteristics used to calculate the net amount at risk for the new mortality risk charge are being addressed by the Blanks Working Group with a proposal to add a general interrogatory to the Annual Statement instead of a financial statement note.

[17] Investment Company Act of 1940

Actuarial Guideline 51

Action. SAPWG adopted revisions to SSAP No. 54R to clarify that a gross premium valuation under Appendix A-010 and cash flow testing under AG 51 are both required if indicated.

The revisions:

- clarify an insurer's accident and health reserves in total must be adequate under a gross premium valuation;
- state that:
  - requirements of AG 51 provide a test that indicates whether reserves in addition to the requirements of A-010 are needed; and
  - AG 51 does not change the base requirements of A-010; and
- include exhibits illustrating interaction between SSAP No. 54R, A-010 and AG 51.

These revisions are a result of diversity in practice across insurers of long-term care insurance in applying guidance in AG 51 for the additional reserve determination and guidance for accident and health insurance reserve adequacy in SSAP 54R and Appendix A-010.

Schedule BA reporting categories

Action. SAPWG reexposed revisions to further define examples of investments that are reported by type of investment on Schedule BA based on underlying characteristics of assets. Comments were due January 22, 2024.

The proposed revisions include modifications proposed by interested parties but combines the reporting lines for non-registered private funds with those for joint ventures, partnerships and limited liability company interests. The SAPWG stated that:

- there is no SSAP for non-registered private funds and that they are captured in SSAP No. 48; and
- there is no clear distinction on what would be captured as a non-registered private equity fund and not a joint venture.

SAPWG also observed that some of the descriptions proposed by interested parties are broad and requested that comments be provided about whether more specification is needed.

The proposed revisions clarify the classification of investments in Schedule BA reporting categories by reporting lines and related characteristics of underlying assets for the following:

- joint venture, partnership or limited liability interests with characteristics of:
  - fixed income instruments include investments with underlying collateral, including contractual principal and/or interest payments,

excluding mortgage loans; and
  - common stocks include venture capital funds or other underlying equity investments.

- residual tranches or interests with underlying assets having the characteristics of:
  - fixed income instruments include investments with underlying collateral, such as contractual principal or interest payments, excluding mortgage loans;
  - common stocks include investments with underlying collateral, which are securities that represent a subordinate equity ownership;
  - preferred stocks include investments with underlying collateral, which is a security that represents ownership of a corporation and gives the holder a claim prior to the claim of common stockholders on earnings and generally on assets in the event of liquidation;
  - real estate includes investments with underlying collateral, defined as directly owned real estate properties and single real estate property investments that are directly and wholly owned through a limited liability company; and
  - mortgage loans include investments with underlying collateral, secured by a mortgage on real estate.

SAPWG stated key industry representatives identified that there is a current industry interpretation in which warehouse loans are being reported in the non-registered private equity fund category. It was noted that these warehouse loans are not in the scope of SSAP No. 48. The industry representatives view was that reporting these instruments as non-registered private funds allows them to be classified by the underlying interests and apply an RBC charge that is consistent with mortgage loans.

SAPWG had the initial impression that these warehouse loans are collateral loans and thus should be reported under SSAP No. 21R in the collateral loan reporting line. They proposed a new agenda item to address collateral loans reporting by type of collateral.

Mortgage guaranty insurance

Action. SAPWG exposed its intent to review Model 630 for incorporation into SSAP No. 58 and Appendix A-630.The proposed effective date is January 1, 2025 or later.

At the 2023 Summer meeting, the NAIC adopted Model 630, which is referenced in SSAP No. 58. Excerpts from Model 630 related to contingency reserves are also included in SSAP No. 58. The review of the model is expected to focus on accounting and reporting items incorporated in SSAP No 58 or Appendix A-630. SAPWG stated that although the model was expanded, most of the key accounting related provisions have minor updates.

New market tax credits and tax equity investments

Action. SAPWG reexposed revisions to SSAP No. 93 to update guidance for tax credit investments, to SSAP No. 94 to clarify the scope, and to SSAP Nos. 34 and 48 to ensure consistency with the proposed updates to SSAP Nos. 93 and 94. Their proposed effective date is January 1, 2025. Comments are due February 9, 2024.

The proposed revisions to SSAP No. 93 include:

- changes to the admittance test to clarify technical aspects of the assessment;
- addition of a Glossary of key terms at the end of the SSAP;
- revised effective date to January 1, 2025, applied prospectively without option to early adopt;
- added paragraph to the Impairment of Tax Credit Investments section to provide guidance on tax credit programs which allocate variable amounts of tax credits;
- clarified that tax credit strips derived from tax equity investments are not an example of an investment structure exempt from the annual financial statement audit requirement; and
- added disclosures for unused tax credits allocated from tax credit investments as these tax credits would not be within the scope of SSAP No. 94R disclosures.

Proposed revisions to SSAP 94R include:

- revised effective date to be January 1, 2025 with early adoption permitted;
- added language to clarify that awarded tax credits (neither purchased nor allocated from an investment) are not within the scope of SSAP No. 94R; and
- added a requirement to disclose any commitment or contingency to purchase tax credits.

Newly proposed revisions to other SSAPs include clarifications that:

- tax credits earned or purchased are not within the scope of SSAP No. 34; and
- investments in joint ventures, partnerships and limited liability companies that invest in tax credit programs are not within the scope of SSAP No. 48.

The proposed revisions were made in response to comments received from interested parties. SAPWG stated that it did not make revisions recommended by interested parties to narrow the scope of the admittance test to only tax credit investments which allocate non-transferable tax credit and prohibit the sale of ownership interests, but it intends to continue working with interested parties to address their concerns that some previously admitted tax credit investments could be non-admitted under the reexposed guidance.

Intercompany pooling

SAPWG deferred action related to INT 03-02 allowing time to work with interested parties on a revised proposal for discussion at the 2024 Spring National Meeting.

SAPWG previously proposed to nullify the INT because it is inconsistent with SSAP No. 25 for economic and non-economic related party transactions. However, interested parties continued to express concerns with the nullification because it would create inconsistencies with other guidance.

In response to SAPWG's request, interested parties provided examples of the two most common modifications that would create inconsistencies:

- the combination of two intercompany pooling arrangements following the acquisition by an insurance group of another insurance company or group of companies; and
- the removal of an insurance subsidiary from an intercompany pooling arrangement in preparation for the sale of the subsidiary.

SAPWG stated that discussions with interested parties have highlighted that:

- regulators and interested parties share the intent that the prior guidance in INT 03-02 should have a very limited scope;
- differences in pricing exists for some intercompany pooling contracts; and
- regulators and interested parties agree that the guidance is not intended to require members of the same intercompany pool to account for the contract differently.

Next step. NAIC staff will work with interested parties to develop recommendations for discussion at the 2024 Spring National Meeting.

Investments in downstream holdings companies

Action. SAWPG exposed revisions to SSAP No. 97 to revise admissibility guidance to better align it with guidance on the look-through methodology. Comments are due February 9, 2024.

The proposed previsions clarify that, if the downstream noninsurance holding company does not meet the requirements to apply the look-through methodology to determine admissibility of downstream investments in subsidiary, controlled and affiliated entities (SCAs), audited GAAP financial statements are required in order for the investment in the downstream noninsurance holding company or individual SCAs to be admitted. This clarification was made in paragraph 24 of SSAP No. 97 to better align the admissibility guidance to the look-through methodology.

Scottish Re Life Reinsurance liquidation questions

Action. SAPWG adopted INT 23-04 to provide accounting and reporting guidance for ceding entities with reinsurance receivables from the estate of Scottish Re in liquidation. This INT is effective for year-end December 31, 2023.

Due to the 2023 liquidation order of Scottish Re, a US life reinsurance entity, life industry cedents requested an interpretation to address the accounting and reporting requirements for reinsurance receivables from the reinsurer's estate.

The interpretation is effective for year-end 2023 reporting and addresses the following areas for reinsurance contracts with Scottish Re cancelled pursuant to the 2023 liquidation order:

(1) Commutation or recapture of a life reinsurance contract – follow existing guidance for life reinsurance recaptures and commutations in SSAP No. 61R.

(2) Impairment of reinsurance recoverables – follow existing guidance on impairment in SSAP No. 61R, which does not permit a valuation allowance.

(3) Reporting of reinsurance recoverables –report reinsurance payables separately as amounts payable on reinsurance (line 9.3); report amounts related to paid claims and unpaid claims prior to contract cancellation as amounts recoverable from reinsurers (line 16.1) and other amounts receivable under reinsurance contracts (line 16.3), respectively; and report any reinsurance recoverable amounts remaining after an impairment assessment as aggregate write-in for other than invested assets (line 25).

(4) Admissibility of reinsurance recoverables – allows amounts reported on line 16.1, which remain after an impairment review and are not in dispute, to be admitted and allows reinsurance recoverable amounts which remain after an impairment review that are (i) secured by a collateral in a trust that is compliant with Appendix A-785[18], (ii) collateral is sufficient and (iii) amounts are not in dispute to be admitted. Other reinsurance recoverables are required to be non-admitted.

(5) Disclosures –existing relevant disclosures continue to apply. Also provides an additional disclosure of information necessary to obtain an understanding of the impact to the Scottish Re counterparties in liquidation, including information regarding the status and fair value of any collateral, individual components of recoverable amounts presented in the financial statements, and description of measurement, impairment and collectability of reinsurance recoverables as well as timing of expected payments, and nonadmitted amounts.

There is a continuing concern from interested parties that the approach to determining the admissible amounts is too conservative as there are certain

[18] Appendix A-785, Credit for Reinsurance

contracts that, based on information received from the trustee and determined as part of the Company's impairment analysis, are expected to be recoverable but would not be admissible under this INT. Interested parties suggested a mechanism to have companies obtain approval from their state regulator to admit other recoverables in certain facts and circumstances. Due to concerns about the approach proposed by interested parties, including uncertainty in the ultimate resolution and timing of amounts due from the estate of Scottish Re, SAPWG decided not to further revise the proposed admissibility guidance. The NAIC staff did discuss that individual insurers could seek a permitted practice from their state regulator to admit other recoverables related to Scottish Re.

Measurement of credit losses

Action. SAPWG adopted revisions to reject ASU 2016-13, and five other ASUs related to the current expected loss (CECL) method for impairment recognition.

The revisions affect multiple SSAPs and INT 06-07: Definition of Phrase "Other than Temporary" and clarifies that existing statutory accounting guidance continues to apply, which typically reflects relevant US GAAP guidance prior to the CECL method. Existing guidance will be evaluated to determine if US GAAP guidance prior to the CECL method should be incorporated more clearly in the statutory impairment guidance.

SAPWG stated that the statutory framework has included concepts that incorporate a prospective view of future credit risk that historical GAAP has not through:

- AVR;
- the requirement for insurers that do not maintain AVR to report bonds at fair value if the bond is not considered high-quality; and
- the application of RBC formula factors in the credit risk of each individual asset to calculate the amount of required capital.

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Actuarial highlights

Non-variable annuities

Action. On a call before the Fall meeting, the VM-22 Subgroup exposed requirements for VM-31 for non-variable annuities. Comments are due February 14, 2024.

The revisions:

- build on the current variable annuity disclosure requirements, with the same VM-31 sections applying to both variable and non-variable annuities; and
- add disclosure requirements sections related to non-guaranteed elements, VM-22 exclusion testing, and riders or supplemental benefits.

The exposure also included a VM-22 Supplement Blank for the Annual Statement, as well as edits to VM-G.[19]

At the Summer meeting, the VM-22 Subgroup reported to LATF that it has been focusing on the standard projection amount methodology, liability assumptions and VM-31 disclosure requirements. The Subgroup expects that that the Society of Actuaries will present proposed mortality and policyholder behavior assumptions for the VM-22 SPA in early 2024, that will then be exposed for public comment.

The Subgroup is targeting a field test for July 2024, with results presented by early February 2025.The goal is to adopt VM-22 in July 2025 with an effective date of January 1, 2026 for new business going forward, with an optional three-year implementation.

Modeling of complex assets

Action. LATF reexposed revisions to VM-01 to add a term "equity-like instruments" and VM-30 to clarify regulatory expectations about equity return assumptions in cash-flow testing. Comments were due January 29, 2024.

The revisions:

- state that for cash-flow testing, investment return assumptions for equity-like instruments should not only project the anticipated long-term average return, but also account for the volatility of such returns that may be expected in moderately adverse conditions;
- include multiple approaches that can be used to account for volatility; and

[19] VM-G, Appendix G Corporate Governance Guidance for Principle-Based Reserves

- require a qualitative description of why the equity return scenario used in asset adequacy analysis is moderately adverse in light of the insurer's portfolio.

Interested parties supported the proposal; however, some were concerned that including prescriptive requirements about approaches to be used in the Valuation Manual would diminish the value of the Actuarial Opinion. They proposed regulators consider requesting the Academy to include approaches for equity volatility in a Practice Note. Interested parties also requested that the definition of equity-like instruments exclude surplus notes, bond ETFs and preferred stock ETFs.

LATF also heard an update about interactions between the NAIC, insurers and their domestic regulators as it relates to findings identified during review of Actuarial Guideline 53 reports as well as observations about investment expense assumptions and attribution analysis. The regulators stated that they analyzed two aspects of investment expenses, accuracy of the assumptions and reasonableness of the expense amount and are looking for:

- commentary about how investment expense assumptions are commensurate with the expected expenses in light of the complexity of the assets; and
- explanation, where relevant, of why complex assets are not leading to higher investment expenses than less complex assets.

With respect to attribution analysis regulators are looking for:

- an explanation of the source that the insurer's actuary believes drives any excess spreads beyond the benchmark;
- reflection of considerable thought in the attribution related to the range of risks, especially to the extent assumed excess spreads are higher; and
- rigor of the model that captures the specific risks of complex assets, or additional conservatism in assumptions.

A guidance document for year-end 2023 has been finalized to clarify and fill in gaps identified during reviews of the year-end 2022 filings, including:

- sensitivity test for currently held equities;
- allocation of higher-yielding assets over the projection;
- structured asset information by tranche and related payments in-kind; and
- reinsurance collectability.

Next steps. Regulators will be performing coordinated review of investment expense assumptions and reasonability.

Interest maintenance reserve template

Action. On a call before the Fall meeting, LATF adopted an optional template to gather information about how insurers report IMR.

The focus of the template is on insurers that have a total negative IMR balance but could also be useful for insurers with positive balances. The template is optional and completed at the request of the regulators.

4

Risk-based capital

Structured securities

The RBC IRE Working Group heard a presentation from the Academy with revised proposed RBC principles for structured securities. These principles included criteria for when an asset class would require a new model and if the securities within an asset class should be modeled individually to determine their C-1 factors. These principles were revised based on feedback received after the Summer NAIC meeting where they were initially presented.

In their initial presentation, at the Summer NAIC meeting, the Academy stated that for an asset class to be considered for a new C-1 factor it should first meet the following attributes:

- material or likely material in the future across the industry;
- the modeled risk needs to be incorporated in C-1, for example, liquidity alone would not be sufficient justification because C-1 does not measure liquidity risk; and
- expected benefits of a more precise calculation outweighs the expected cost of building and using a new model.

If the above criteria are met, a flowchart would be used to determine if existing C-1 factors can be used or if new factors would need to be developed. The Academy stressed that preference is given to a simpler solution: if an existing factor can be used, it should be used. Based on the flowchart presented, a new factor would be developed when an asset class does not have similar risks to an existing C-1 asset class (for example, structured securities may not be considered similar to corporate bonds because their tail risk increases more quickly) and there is sufficient data available to create a new model. If an asset class for which a new factor is being considered has comparable attributes, (for example, can be grouped by similar risks based on CRP ratings) a new C-1 factor should be created. The Academy stated that individual assets should only be modeled when the asset class does not have comparable attributes and it is practical to model the securities individually.

The Academy proposed the following six candidate principles to govern the process of creating new C-1 factors (revised from the original seven principles):

- the purpose of RBC is to help regulators identify potentially weakly capitalized insurers, therefore changes that have a small impact on RBC requirements may not justify a change to the RBC formula;
- emerging investment risks create concerns for regulators, and existing regulatory tools can be considered alongside RBC for addressing these new risks, but RBC needs to be considered when there are material solvency issues;

- C-1 requirements reflect the effect of risk on statutory surplus. Changes in accounting treatment will affect RBC;
- C-1 requirements for a given tranche should align with that tranche's risk, to the extent practical;
- C-1 requirements on ABS should treat the collateral as a dynamic pool of assets, incorporating future trading activities that are reasonable and vary appropriately by economic scenario; and
- each C-1 factor is based on the asset class's risk profile. However, the risk profile for ABS differs from the risk profile for bonds. Therefore, C-1 requirements for ABS should be calibrated to different risk measure where appropriate.

Next Step. The regulators directed the Academy to use these factors in their work.

5

Valuation of Securities Task Force

NAIC designation definition

Action. VOSTF reexposed an amendment to the PPM of the NAIC Investment Analysis Office to update the definition of an NAIC designation. Comments were due January 26, 2024.

VOSTF discussed the revised proposal to update the definition of an NAIC designation in the PPM, originally discussed at the NAIC Summer meeting.

The revisions, which reflect actionable comments received from Task Force members and interested parties, include:

- creation of a concise definition of an NAIC Designation which reflects credit quality:
- any inconsistencies with the existing regulatory assumption that a fixed income instrument requires schedule payments of interest and full repayment of principal on a date certain;
- loss given default and/or “tail” risk, where appropriate; and
- removal of the application of Subscript S for other non-payment risks.

NAIC designations

Action. VOSTF reexposed an amendment to the PPM of the NAIC Investment Analysis Office authorizing the procedures for the SVO’s discretion over NAIC designations assigned through the FE process. Comments were due January 26, 2024.

VOSTF discussed the revisions which reflect actionable comments received from Task Force members and interested parties.

SVO outlined the revised proposed process as follows:

- Notice Period: If a state insurance regulator notifies the Investment Analysis Office (IAO) or IAO staff believes that the NAIC Designation assigned is not a reasonable assessment of risk for regulatory purposes, IAO will publish a notice on the NAIC's AVS+ product, indicating that the security is under review. This notice will remain open for 120 days.

- Appeal by Insurer: During the notice period, the insurer that owns the security can submit an appeal of the indicative NAIC Designation Category determined by the IAO. The insurer must follow the operational steps outlined in the Appeals of SVO Determinations in the manual.

- IAO Review: The IAO will consider the appeal and conduct a review of the security. They may request additional documentation and data as necessary. The IAO will make a determination of the Eligible NAIC CRP Credit Rating or security filing exemption status within 120 days from the initial notice or at the conclusion of any outstanding insurer appeal.
- Final Determination: After the review and appeal process, the IAO Credit Committee, in consultation with the applicable state insurance regulator(s) if requested, will make a final determination. If the NAIC Designation Category remains unchanged, the Eligible NAIC CRP Credit Rating or security will remain eligible for filing exemption. If the IAO determines that the security should be removed from filing exemption eligibility, the insurer will be notified, and the security will no longer be eligible for filing exemption.
- Reinstatement: If an insurer wants the IAO to re-evaluate an Eligible NAIC CRP Credit Rating or security that was removed from filing exemption eligibility, they can submit a request for reinstatement in a subsequent filing year.
- Reporting: The Chair of VOSTF may request a confidential, regulator-only report from the IAO Director(s) summarizing the Eligible NAIC CRP Credit Ratings and securities removed from filing exemption eligibility over the prior calendar year and the reason for the removal. This report will be presented annually to VOSTF members.

SVO stated that the proposal allows sufficient notice period to let the insurer decide whether or not it wants to appeal and provide additional information before any action is taken. It further stated that it could take up to a year for the actual rating to change.

Interested parties expressed concern with the revised proposal. Their comments included:

- Concern around how the SVO can determine that something is three notches off where it should be. They noted that the tests specified presently are unproven and vague, noting that the SVO has the authority under the proposal to declare if something is off three notches for any reason it feels appropriate.
- The third-party appeal process would have a confidentiality issue. They stated that a lot of these issues are private placements in which the information is confidential to those in the deal. They also stated concern with the third party not having access to the other information, specifically, rating agency materials that detail what the rating agency has done and the materials that determine how the SVO performed their own credit rating. It was suggested the third-party could evaluate the work of the rating agency if the confidentiality concerns can be overcome.
- It was noted that one item missing from the memo is that nothing requires the SVO to produce a report explaining its analytical process to

the investor, like what the rating agencies currently have done. Without that information, it is hard to understand how an appeal could be effective without knowing the steps of the analysis.

VOSTF noted that issuing reports from the SVO could be problematic when the NAIC does not have the same engagement letter and provisions that exist for those insurers to demand confidentiality of the process, especially when there are multiple insurers that are invested in a deal, and one chooses to reveal that information when others choose not to. VOSTF also noted there should be no expectation that the insurer will not have full visibility into the analysis that has been done or the methodologies used. They believe there is absolute transparency in the process built into the proposal.

VOSTF asked NAIC staff to continue working with interested parties in response to their comments.

6

Other developments

Use of algorithms, predictive models, and artificial intelligence systems

Action. The Innovation, Cybersecurity, and Technology Committee adopted an NAIC Model Bulletin: Use of Artificial Intelligence Systems by Insurers. The Committee developed this bulletin in response to the need for a framework around the use of artificial intelligence (AI) systems in insurance.

The bulletin was originally exposed on July 17, 2023 and discussed during the Summer NAIC meeting in August. The bulletin was reexposed after the August meeting with comments due in early November. The adopted bulletin reflects changes from comments received during the exposure period.

The bulletin provides regulatory guidance and expectations about how insurers should govern their development and use of AI systems. It also discusses information and documentation that insurers can expect to provide to the regulator when evaluating the insurer's development and use of these systems, organized into four sections:

- introduction, background and legislative authority;
- definitions of terms such as algorithm, artificial intelligence, generative AI, and machine learning;
- regulatory guidance and expectations that establishes general guidelines, guidelines for governance, risk management and internal controls, third-party AI systems; and
- regulatory oversight and examination considerations.

Interested parties agreed with the principle-based approach of the bulletin; however, there were still some concerns with the bulletin, which included:

- whether the word 'bias' should be included in the bulletin as it is not a term defined in existing guidance; and
- the additional risks presented from third parties. There could be challenges with transparency and accountability of the third parties, given the third parties' need to ensure proprietary information is protected. Additionally, these third parties may introduce additional risks in the form of data security, potential bias in algorisms and operational risks.

It was agreed that the concerns of the interested parties would be discussed as the group works towards specific implementation of the principles outlined in the bulletin.

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Kathy Bachman

Maureen Downie

Lauren Lokensgard

Robert Antolini

Olga Roberts

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