

Interpretation of the Statutory Accounting Principles (E) Working Group

2023 Net Negative (Disallowed) Interest Maintenance Reserve

INT 23-01T Dates Discussed

March 22, 2023

INT 23-01 References

Current:

*SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve
Annual Statement Instructions*

INT 23-01T Issue

1. The statutory accounting guidance for interest maintenance reserve (IMR) and the asset valuation reserve (AVR) is within *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*, but the guidance within *SSAP No. 7* is very limited. It provides a general description, identifies that IMR/AVR shall be calculated and reported per the guidance in the applicable SSAP, and if not explicit in the SSAP, in accordance with the annual statement instructions. The SSAPs most often simply direct allocation to (or between) IMR and AVR, with the bulk of the guidance residing within the annual statement instructions.
2. As detailed in *SSAP No. 7*, paragraph 2, the guidance for IMR and AVR applies to life and accident and health insurance companies and focuses on IMR and AVR liability recognition and distinguishing between IMR and AVR:
 2. Life and accident and health insurance companies shall recognize liabilities for an AVR and an IMR. The AVR is intended to establish a reserve to offset potential credit-related investment losses on all invested asset categories excluding cash, policy loans, premium notes, collateral notes and income receivable. The IMR defers recognition of the realized capital gains and losses resulting from changes in the general level of interest rates. These gains and losses shall be amortized into investment income over the expected remaining life of the investments sold. The IMR also applies to certain liability gains/losses related to changes in interest rates. These gains and losses shall be amortized into investment income over the expected remaining life of the liability released.
3. The IMR guidance in the annual statement instructions provides information on the net balance. A positive IMR represents net interest rate realized gains and is reported as a liability on a dedicated reporting line. A negative disallowed IMR represents net interest rate realized losses and is reported as a miscellaneous other-than-invested write-in asset in the general account and nonadmitted.
4. IMR balances between the general account and separate accounts are separate and distinct. Meaning, a net negative IMR in the general account only represents activity that occurred in the general account that was allocated to IMR. However, the net positive or negative balance of the general account influences how the net positive or negative balances are reported in separate account statements (and vice versa). (A net negative IMR balance in the general account may not be disallowed if there is a covering net positive IMR in the separate account. Negative IMR that is not disallowed is reported as a contra-liability.) The instructions for reporting the net negative and positive balances are detailed in the annual statement instructions:

Line 6 – Reserve as of December 31, Current Year

Record any positive or allowable negative balance in the liability line captioned "Interest Maintenance Reserve" on Page 3, Line 9.4 of the General Account Statement and Line 3 of the Separate Accounts Statement. A negative IMR balance may be recorded as a negative liability in either the General Account or the Separate Accounts Statement of a company only to the extent that it is covered or offset by a positive IMR liability in the other statement.

If there is any disallowed negative IMR balance in the General Account Statement, include the change in the disallowed portion in Page 4, Line 41 so that the change will be appropriately charged or credited to the Capital and Surplus Account on Page 4. If there is any disallowed negative IMR balance in the Separate Accounts Statement, determine the change in the disallowed portion (prior year less current year disallowed portions), and make a direct charge or credit to the surplus account for the "Change in Disallowed Interest Maintenance Reserve" in the write-in line, in the Surplus Account on Page 4 of the Separate Accounts Statement. The following information is presented to assist in determining the proper accounting:

<u>General Account IMR Balance</u>	<u>Separate Account IMR Balance</u>	<u>Net IMR Balance</u>
Positive	Positive	Positive (See rule a)
Negative	Negative	Negative (See rule b)
Positive	Negative	Positive (See rule c)
Positive	Negative	Negative (See rule d)
Negative	Positive	Positive (See rule e)
Negative	Positive	Negative (See rule f)

Rules:

- a. If both balances are positive, then report each as a liability in its respective statement.
 - b. If both balances are negative, then no portion of the negative balances is allowable as a negative liability in either statement. Report a zero for the IMR liability in each statement and follow the above instructions for handling disallowed negative IMR balances in each statement.
 - c. If the general account balance is positive, the separate accounts balance is negative and the combined net balance is positive, then all of the negative IMR balance is allowable as a negative liability in the Separate Accounts Statement.
 - d. If the general account balance is positive, the separate account balance is negative, and the combined net balance is negative, then the negative amount not covered by the positive amount is not allowable. Report only the allowable portion as a negative liability in the Separate Accounts Statement and follow the above instructions for handling the disallowed portion of negative IMR balances in the Separate Accounts Statement.
 - e. If the general account balance is negative, the separate account balance is positive, and the combined net balance is positive, then all of the negative IMR balance is allowable as a negative liability in the General Account Statement.
 - f. If the general account balance is negative, the separate account balance is positive, and the combined net balance is negative, then the negative amount not covered by the positive amount is not allowable. Report only the allowable portion as a negative liability in the General Account Statement and follow the above instructions for handling the disallowed portion of negative IMR balances in the General Account Statement.
5. In October 2022, the ACLI requested the Statutory Accounting Principles (E) Working Group to reassess the guidance for net negative (disallowed) IMR, with a request to consider admittance of those amounts. The ACLI noted that the nonadmittance of disallowed negative IMR can have adverse negative ramifications for insurers with two key themes:

- a. In general, rising interest rates are favorable to the financial health of the insurance industry and policyholders. However, with negative IMR, there is an inappropriate perception of decreased financial strength through lower surplus and risk-based capital.
 - b. Negative IMR could impact the rating agency view of the industry or incentivize companies to avoid prudent investment transactions that are 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 a reporting entity's financial health or its policyholders.
6. In considering the request, the Working Group concluded that for year-end 2022, there would be no change to statutory accounting guidance and deviations from statutory accounting principles would need to be approved via a permitted or prescribed practice. The Working Group then held company-specific educational sessions in January 2023 to receive detailed information regarding negative IMR and received a subsequent comment letter from the ACLI.
7. During the 2023 Spring National Meeting, the Working Group further discussed the topic of negative IMR and directed NAIC staff to proceed with drafting guidance for both a 2023 solution and to begin work towards a long-term solution.

INT 23-01T Discussion

8. This tentative interpretation prescribes limited-time, optional, statutory accounting guidance, as an exception to the existing guidance detailed in SSAP No. 7 and the annual statement instructions that requires nonadmittance of net negative (disallowed) IMR in the general account as a short-term solution for 2023. This interpretation is specific for general account treatment only and assessment of possible revisions for the separate account will be considered as part of the long-term solution. Specifically, this interpretation impacts the annual statement instruction rules regarding disallowed negative IMR in the general account, detailed in rules 'b' and 'f' shown in paragraph 4. (As detailed within, admittance in the general account does not impact the determination or reporting of IMR in the separate accounts.) **As this interpretation overrides existing guidance, it will require a 2/3rd vote.**
9. Reporting entities are permitted to admit net negative (disallowed) IMR in the general account with the following restrictions:
- a. Reporting entities with an RBC greater than 300% are permitted to admit net negative (disallowed) IMR, as defined in paragraph 9b, up to 5% of the reporting entity's general account capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for its most recently filed statement with the domiciliary state commissioner adjusted to exclude any net positive goodwill, EDP equipment and operating system software, net deferred tax assets and admitted net negative IMR. Reporting entities with a 300% or lower RBC are not permitted to admit net negative (disallowed) IMR.
 - b. Negative (disallowed) IMR admitted pursuant to paragraph 9a is limited to IMR generated from losses incurred from the sale of bonds, or other qualifying fixed income investments, that were reported at amortized cost prior to the sale, and for which the proceeds of the sale were immediately used to acquire bonds, or other qualifying fixed income investments, that will be reported at amortized cost. (This provision intends to explicitly exclude

derivative losses from derivatives reported at fair value that have been allocated to IMR from being admitted under this guidance¹.)

10. Reporting entities that admit net negative disallowed IMR in the general account pursuant to paragraph 9 shall report the admittance in the balance sheet as follows:

- a. Reporting entities shall report the net negative (disallowed) IMR as a write-in to miscellaneous other-than-invested asset (named as “Disallowed IMR”) on the asset page. The net negative (disallowed) IMR shall be admitted to the extent permitted per paragraph 9, with the remaining net negative (disallowed) IMR balance nonadmitted.
- b. Reporting entities shall allocate an amount equal to the general account admitted net negative (disallowed) IMR to special surplus. Although dividends are contingent on state specific statutes and laws, the intent of this reporting is to provide transparency and preclude the ability for admitted negative IMR to be reported as funds available to dividend.

11. Reporting entities admitting net negative (disallowed) IMR are required to complete the following disclosures in the annual and quarterly financial statements for IMR:

- a. Reporting entities that have allocated gains/losses to IMR from derivatives that were reported at fair value prior to the closing / termination / settlement / expiration of the derivative shall disclose the non-amortized impact to IMR from these allocations separately between gains and losses. This disclosure shall illustrate the removal of these balances from the total general account IMR to determine the net negative amount that is permitted to be admitted under paragraph 9b.
- b. Reporting entities shall complete a note disclosure that details the gross negative (disallowed) IMR, the amounts of negative IMR admitted and nonadmitted, adjusted capital and surplus per paragraph 9a and the percentage of adjusted capital and surplus for which the admitted negative IMR represents.

12. The provisions in this interpretation intend to be specific on the following prohibitions:

- a. Negative IMR permitted to be admitted shall not include losses from derivatives that were reported at fair value prior to settlement / termination / expiration / closing of the derivative. (Only derivative losses from derivatives that qualified as effective hedges (and reported under ‘hedge accounting’ as detailed in *SSAP No. 86—Derivatives*), which hedged an item that had offsetting adjustments to IMR, are permitted to be included in the admittance calculation.) The allocation of derivative losses to IMR, for derivatives held at fair value and were not offset by a hedged asset that was also subject to IMR, is not in line with the original intent of the IMR guidance in *SSAP No. 86* or the annual statement instructions. Consideration of this industry interpretation and clarification of derivatives through the IMR will be addressed as part of the long-term proposal.
- b. The admittance of net negative (disallowed) IMR in the general account shall have no impact on the reporting of IMR in the separate account. The comparison of general account

¹ It has been identified that some reporting entities have allocated derivative losses to IMR for derivatives that were reported at fair value throughout the derivative life, as they did not qualify as effective hedges under statutory accounting, and that were not hedging assets with offsetting amounts to the IMR. As detailed in paragraph 9b, these losses shall be removed from the IMR balance in determining the net negative (disallowed) IMR balance permissible for admittance.

and separate account IMR shall occur on the gross positive and negative balances prior to any admittance in the general account. Disallowed negative IMR in the separate account shall continue to be fully disallowed as a direct charge to surplus. The IMR annual statement instructions predate current guidance that requires insulated and non-insulated separate account blanks. Consideration of separate account treatment of IMR will be addressed in a long-term proposal that will assess the concepts of insulated separate accounts and whether the balances of the general account shall have any influence on how IMR shall be reported in those separate account statements.

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13. The consensuses in this interpretation were adopted on _____, to provide limited-time exception guidance to SSAP No. 7 and the annual statement instruction for the reporting of negative (disallowed) IMR in the general account. The provisions within this interpretation are permitted until _____ and will be automatically nullified on _____.

14. Further discussion is planned.