Attachment 6

Statutory Accounting Principles (E) Working Group
October 23, 2023
Comment Letters Received

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D. Keith Bell, CPA
Senior Vice President
Accounting Policy
Corporate Finance
The Travelers Companies, Inc.
860-277-0537; FAX 860-954-3708
Email: d.keith.bell@travelers.com

Rose Albrizio, CPA
Vice President
Accounting Practices
Equitable
201-743-7221
Email: Rosemarie.Albrizio@equitable.com

September 12, 2023

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

RE: Interested Parties Comments on Items Exposed for Comment with Comments due September 12

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the following items that were exposed for comment during the NAIC National Meeting in Seattle by the Statutory Accounting Working Group (the Working Group).

Ref # 2022-11: Collateral for Loans

The Working Group re-exposed this agenda item to allow additional time to submit additional comments regarding the measurement of collateral pledged from SSAP No. 48 and SSAP No. 97 entities, as requested by industry.

Interested parties extend our appreciation to the Working Group for the additional 30 days to consider exposure Reference No. 2022-11—*Collateral for Loans* (the "exposure") and for the opportunity to submit a new comment letter. After further consideration of the exposure, in light of the discussion at the August 13, 2023 Working Group meeting, interested parties continue to support the clarification that collateral pledged to secure a collateral loan must qualify as an admitted asset for the collateral loan itself to qualify as an admitted asset. Therefore, we continue to support the specific clarification that when the collateral pledged to secure a collateral loan would be in the scope of SSAP No. 48 or SSAP No. 97 if held directly by the reporting entity, audited financial statements are required for the collateral (and thus the collateral loan) to qualify as an admitted asset.

Interested parties also agree there should not be optionality in the guidance; however, we believe that fair value, not audited equity value, is the most appropriate measure of the sufficiency of collateral. Fair value is the most representative measure of the value of assets that would be available to support policyholder liabilities in the event a reporting entity forecloses on the pledged collateral. Fair value also reflects the basis that a reporting entity would use to recognize the collateral in its financial statements in the event of foreclosure and the basis used to test collateral loans for impairment. As a result, interested parties propose the following revision to the exposure, which would eliminate the exposed change to the valuation basis used for the collateral test for these types of collateral loans (the underlined red text is the Working Group's currently exposed changes).

b. Nonadmitted Asset – In Accordance with *SSAP No. 20—Nonadmitted Assets*, collateral loans secured by assets that do not qualify as investments which would otherwise be admitted shall be nonadmitted. Further, any amount of the loan outstanding which is in excess of the permitted relationship of fair value of the pledged investment to the collateral loan shall be treated as a nonadmitted asset. ~~For qualifying investments which are pledged as collateral that would be in the scope of SSAP No. 48 or SSAP No. 97 if held directly by the reporting entity, such as joint ventures, partnerships and limited liability companies and investments that would qualify as SCAs if held directly, the proportionate audited equity valuation shall be used for the comparison for the adequacy of pledged collateral. If the collateral loan exceeds the audited equity valuation of these pledged investments, then the excess shall be nonadmitted.~~ To support the admissibility of collateral loans, reporting entities shall maintain documentation sufficient to support the reasonableness of the fair value measurement of the underlying collateral, which shall be made available to the applicable domiciliary regulator and independent audit firm upon request.

Interested parties understand that some insurance regulators have expressed concerns about the uncertainty inherent in fair value measurements, particularly Level 2 and Level 3 measurements, due to the use of unobservable inputs and assumptions, and therefore, would like to see an additional level of third-party validation applied to the fair value measurement of the collateral securing these types of collateral loans. However, we note that these fair value measurements are subject to the same valuation standards per SSAP No. 100R – *Fair Value Measurements*, as all other investments carried at fair value, lower of cost or fair value, or for which the fair value is disclosed in the annual statements and audited financial statements, many of which are also Level 2 and Level 3 measurements. Therefore, interested parties believe it would be appropriate to continue to apply a consistent standard of valuation for all types of investments. Furthermore, interested parties note that the guidance in SSAP No. 21R, which requires the fair value of collateral to equal or exceed the carrying value of the collateral loan, represents an accounting assertion that is subject to audit by each reporting entity's independent auditor. As a result, the fair value measurements underpinning the collateral test are already subject to third-party validation by independent audit firms that either employ qualified valuation experts or would seek the expertise of qualified valuation experts when auditing the admissibility of a reporting entity's collateral loans. Interested parties believe this, along with the clarified requirement for reporting entities to obtain audited financial statements for underlying collateral that represents an interest in an entity within the scope of SSAP No. 48 or SSAP No. 97, provides an appropriate level of assurance and third-party validation that should sufficiently address regulators' concerns without the need to impose a greater cost burden on reporting entities in the form of additional third-party validation requirements..

In summary, interested parties support the proposed clarifications to SSAP No. 21R; however, we believe that fair value remains the best and most appropriate measure of the sufficiency of collateral pledged to secure collateral loans, and we believe the independent audit process provides the necessary level of assurance around these fair value measurements. As a result, we respectfully request that the Working Group revise the exposure to allow reporting entities to continue to use fair value consistently for all types of collateral loans and to continue to apply valuation frameworks and methodologies consistent with current practices and the guidance in SSAP No. 100R.

Ref #2023-12: Residuals in SSAP No. 48 Investments

The Working Group exposed several revisions in the updated July 2023 recommendation. The updated recommendation was based on interim discussions and coordination with industry representatives. We offer the following comments:

For clarity and consistency's sake, once the new bond definition in SSAP Nos. 26R and 43R is effective, ABS Issuer can replace the definition of a residual in SSAP No. 43R paragraph 27 and SSAP No. 48 paragraph 19.

As the Form A for Ref #2013-12 would be effective immediately, we suggest that the effective date of December 21, 2023, be noted in the Form A, as that is what we understand the intent to be. This will give companies time to review their investment portfolios.

We also note that the proposed revisions to Annual Statement Instructions guidance is considered to be accounting in nature as it includes a partial definition of what is meant by "residual". As part of Ref #2023-01: Review Annual Statement Instructions for Accounting Guidance, NAIC staff is proceeding with a broad project to review the annual statement instructions and ensure accounting guidance is included in the related SSAPs**.** The focus of this project is to ensure that the annual or quarterly statement instructions are not the source of statutory accounting guidance. Although the annual statements is not the source of this accounting guidance, inclusion of part of the guidance could be misleading. We suggest the following section highlighted in yellow be deleted.

Schedule BA Annual Statement Instructions:

<u>**Residual Tranches or Interests with Underlying Assets Having Characteristics of:**</u>

Investment in Residual Tranches or Interests~~, as defined within *SSAP No. 43R – Loan-Backed and Structured Securities or SSAP No. 48 – Joint Ventures, Partnerships and Limited Liabilities*~~

~~*Companies*~~ should be assigned to the subcategory with the highest underlying asset concentration. There shouldn't be any bifurcation of the underlying assets among the subcategories.

Include: Residual tranches or interests from securitization tranches and beneficial interests as well as other structures captured in scope of *SSAP No. 43R – Loan-Backed and Structured Securities.*

Investments in joint ventures, partnerships and limited liability companies captured in scope of *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* that represent residual interests, or that predominantly hold residual interests.

This category shall also include residual interests or residual security tranches within investment structures that are not captured in scope of SSAP No. 43R or SSAP No. 48 but that reflect, in substance, residual interests or residual security tranches.

~~The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive 'residual' the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure a security reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests / residual security tranches include the items noted below, but the presence of absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined.~~

a. Residuals often do not have contractual principal or interest.

b. Residuals may be structured with terms that appear to be ~~have~~ stated principal or interest but that lack substance, and ~~with terms that~~ result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.

c. Residuals do not have credit ratings or NAIC assigned designations. Rather, they are first loss positions that provide ~~the~~ subordination to support the credit quality of the typically rated debt tranches.

d. Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after ~~other~~ debt tranche holders receive contractual principal and interest payments.

e. Frequently, there are contractual triggers that divert cash flows from the residual ~~tranche~~ holders to the debt tranches if the structure becomes stressed.

We also continue to seek clarification on the issues raised in the interested parties comment letter dated July 14, 2023 (copy attached). We understand that the residual definition is related to investment structures that issue debt securities created for the primary purpose of raising debt capital backed by a discrete pool of collateral assets (ABS issuers as defined in paragraph 8 of the current bond exposure in SSAP Nos. 26R) rather than debt issued for liquidity/operating purposes. As a result, interested parties do not believe the intent was to include the following types of investment structures:

- Private Funds (e.g., equity, debt, hedge)- that issued debt for liquidity / operating purposes rather than to raise capital backed by a discrete pool of collateral assets.
- Real Estate Funds (including REITs and JVs) (i.e., considered Issuer Credit Obligations, or "ICOs", in the proposed bond standard)
- Non-US registered Funds (i.e., considered ICOs in the proposed bond standard)
- Other ICOs in the proposed bond definition, such as 40 Act Funds, Business Development Company, Operating Entities, and Holding Companies supported by operating companies.

We request that the Working Group evaluate this issue and provide clarification.

INT 23-02T: Third Quarter 2023 Inflation Reduction Act – Corporate Alternative Minimum Tax

The Working Group reached tentative consensuses to the noted issues included in INT 23-02T for comment. The interpretation recommends that for third-quarter 2023, reporting entities should disclosure whatever information is available regarding the corporate alternative minimum tax and their applicable reporting entity status.

Prior submissions to the Working Group by interested parties in connection with the CAMT have advocated a deferral of statutory financial reporting for the CAMT while permanent guidance is being developed. Accordingly, interested parties is supportive of the provisions of this currently exposed version of INT 23-02T. We note, however, a few edits to the exposed INT that would be helpful for clarification in the attached edited version of the exposure. (Copy is attached.)

Ref #2023-04: Corporate Alternative Minimum Tax Guidance

The Working Group exposed *INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax* for comment with a proposed effective date of year-end 2023. After discussion, the Working Group also directed that the exposed INT 23-03T, including guidance which provides for the admissibility of CAMT credits under SSAP No. 101, paragraph 11c. should be consistent with the treatment of other DTAs under this step (see exposure paragraph 34). The exposure provides a simple and reasonable solution that addresses the nuances of the new alternative tax structure and interested parties commends the Working Group on providing the guidance before year-end.

Interested parties submitted a marked draft of INT 23-03 with comments by email on September 5th to NAIC staff. (Copy is attached.)

The comments provided in this letter and the attached redline version of INT 23-03 are intended to clarify language that could cause misinterpretation within the industry and inconsistency in treatment. Again, interested parties support the overall accounting approach laid out in the INT.

A summary of our comments is as follows:

1) Interested parties suggests a few wording changes for consistency purposes, such as referring to "CAMT tax" as "CAMT" and "CAMT credit carryforwards" as CAMT credit DTAs". These suggested wording changes are not substantive and do not change the underlying meaning of INT 23-03.

2) A reporting entity determines if it will be an applicable corporation on a tax-controlled basis; however, TSAs are completed for consolidated tax return groups. Interested parties suggests changing "tax-controlled" to "consolidated tax return group" depending on the context of the paragraph.

3) The INT refers to the CAMT as indefinite tax credit. To avoid confusion with DTAs that do not reverse, interested parties suggests replacing "indefinite" with "non-expiring".

4) Paragraph 1.h. describes credit usage against CAMT. Foreign tax credits have specific carryforward rules depending on type and to avoid detailing the exact carryforward structure interested parties suggests removing the paragraph.

5) Paragraph 11.c. provides as a criterion that for reporting entities to have a TSA exclusion the TSA must have a term that the reporting entity reasonably expects or has knowledge that related parties under the TSA are meeting their obligations. Interested parties does not believe the requirement provided in 11.c. would exist in a legal document and would thus preclude most companies from the TSA exclusion. The requirement could also be interpreted to imply additional liquidity or going concern documentation is necessary. We believe the intent of 11.c, to reinforce joint and severable liability of tax liabilities, is covered in paragraph 12. We suggest deleting this paragraph.

6) Paragraph 12 states that even with the TSA exclusions, the guidance for joint and severable liabilities under SSAP No. 5, paragraph 5 continues to apply; however, SSAP 5 includes a specific exclusion for taxes in footnote 2. To address the Working Group's concern that the TSA exclusion could be widely interpreted so that reporting entities do not recognize taxes

due of co-obligors unable to meet their tax obligation, we propose referencing SSAP No. 101, paragraph 3.

SSAP No. 101, paragraph 3 states:

> "Income taxes incurred" shall include current income taxes, the amount of federal and foreign income taxes paid (recovered) or payable (receivable) for the current year.

The general definition of when a reporting entity recognizes current income taxes is broad enough to cover taxes paid on behalf of another entity (regular tax or CAMT). We propose referencing SSAP No. 101, paragraph 3 which avoids change to SSAP No. 5, but still allows the Working Group to reinforce the reporting still must recognize any CAMT paid or payable on behalf of a co-obligor.

7) Paragraph 13 provides the general accounting considerations for the CAMT. We suggest replacing the term "expected" in this paragraph with "reasonably estimated" to align with accounting standards.

8) Paragraphs 21.a., 28, and 31 reference the allocation of the CAMT credit DTA (or valuation allowance of the CAMT credit DTA). Interested parties proposes specifically stating that the allocations in these instances are to be made consistent with the TSA. Although the reader should assume as such, this language is intended to provide certainty.

9) Paragraph 24 describes the admissibility of deferred tax assets for CAMT credits. The use of CAMT credits depends on the consolidated tax return group, prompting the exception to SSAP No 4. Interested parties agrees with the concept but proposes wording changes to focus on the CAMT credit DTA instead of the current liability.

10) Paragraph 28 references the SSAP No. 101, paragraph 11 realization tables, as well as the ExDTA ACL RBC percentages used in SSAP No. 101, paragraph 11. We suggest adding a footnote or other clarification for non-RBC reporting entities and replacing "RBC" with "ExDTA ACL RBC".

11) Paragraph 28 provides that CAMT credit DTAs not realizable within the timetables for admittance are required to be non-admitted; however, the CAMT credit DTA could be admitted under SSAP No. 101, paragraph 11.c. Although paragraph 34 specifically allows admittance under SSAP No. 101, paragraph 11.c. interested parties proposes clarifying language to paragraph 28.

12) Paragraph 31 states the reporting entity is not required to take CAMT into account in calculating the "with and without" liability. Interested parties is concerned that because the CAMT credit DTA is evaluated for admittance separate from regular reversing DTAs misinterpretation could arise. In other words, explicitly state CAMT is not taken into account in the "with and with-out" calculation and 11.b. admittance is not reduced by projected

CAMT of the consolidated group (if any) during the three-year reversal period. This additional language is intended to prevent any potential misreading.

13) Paragraph 34 allows the CAMT credit DTAs to be admitted against DTLs in accordance with SSAP No. 101, paragraph 11.c. The language specifies the CAMT credit DTA can only be admitted against "applicable DTLs". We suggest removing "applicable" to avoid misinterpretation that certain DTLs are not applicable. Paragraph 34 also implies that CAMT credit DTAs can be admitted under SSAP No. 101, paragraph 11.a. The CAMT credit cannot be carried back and therefore interested parties suggests removal of the paragraph 11.a. reference.

14) Paragraph 35 details the consideration of tax projections in the admittance of the CAMT credit DTA. Interested parties suggests additional clarifying language to certain phrases. When projecting the CAMT liability, "groupings" is referenced from SSAP No. 101; however, it is more appropriate to state "groupings of assets and liabilities". Also, when describing modifications to the estimates, interested parties suggests "modifications to the estimate process" to avoid misinterpretation that any modification requires disclosure.

15) Paragraph 37.b. provides that if a reporting entity has filed its TSA and the domiciliary regulatory has confirmed that they have no objections to using the new TSA amendment or new TSA, while under review then the reporting entity can account for the TSA as applicable for the 2023 reporting period. Requiring confirmation from regulators while the TSA is under review raises many concerns. First, interested parties does not believe regulators will provide positive confirmation while under review, especially in writing. Without written confirmation audit firms will likely object to a reporting entity following an unapproved TSA which will result in variances in practices depending on the audit firm. For example, the reporting entity could be forced to account for CAMT in its 11.b. with and without calculation or payments of CAMT between related parties could be recharacterized as contributions/dividends. Finally, to obtain confirmation from regulators while the TSA is under review, reporting entities could seek permitted practices. Although permitted practices would provide a sound solution for 2023, they undermine why INT 23-03 was necessary in the first place – to avoid reporting entities establishing individualized policies for accounting for the CAMT.

    Interested parties agrees that if a reporting entity has filed its TSA while under review the reporting entity should follow the TSA for 2023. We propose updated language allowing reporting entities to follow the TSA for 2023 so long as the domiciliary regulator has not provided formal rejection while during the review period. This approach ensures all reporting entities follow their submitted TSAs without petitioning for a permitted practice for one year.

16) Paragraph 40.b. requires disclosure of the Realization Threshold Limitations Tables; however, these tables are already disclosed under SSAP No. 101. Interested parties suggests removing this disclosure.

17) Paragraph 46 illustrates a situation where an applicable reporting entity meets or exceeds the top line of the relevant SSAP No. 101 Realization Threshold Limitation. Interested parties suggests expanded language to parity the other proposed lanugage in this letter. Specifically, we suggest including a year where the consolidated tax return group expects to pay the CAMT to illustrate 11.b. admittance is not impacted. We also suggest including a statement that if only a portion of the CAMT credit DTA is expected utilized then the reporting entity would only admit an allocation of the CAMT credit DTA, determined consistent with the TSA. These additions are intended to bridge our comments to the examples.

* * * *

Please feel free to contact either one of us with any questions you may have.

Sincerely,

D. Keith Bell   Rose Albrizio

cc: Interested parties
NAIC staff

D. Keith Bell, CPA
Senior Vice President
Accounting Policy
Corporate Finance
The Travelers Companies, Inc.
860-277-0537; FAX 860-954-3708
Email: d.keith.bell@travelers.com

Rose Albrizio, CPA
Vice President
Accounting Practices
Equitable
201-743-7221
Email: Rosemarie.Albrizio@equitable.com

September 29, 2023

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

RE: Interested Parties Comments on Items Exposed for Comment with Comments due September 29

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the following items that were exposed for comment during the NAIC National Meeting in Seattle by the Statutory Accounting Working Group (the Working Group).

Ref # 2019-21: Principles-Based Bond Definition

The Working Group exposed revisions to SSAP No. 21R for debt securities that do not qualify as bonds, including the accounting for residual tranches, as well as an Issue Paper to detail historical discussions on the bond project. Interested parties have no comments on the Issue Paper.

Interested parties met with NAIC Staff to discuss SSAP No. 21R issues, other than the accounting for residual tranches, and agreed there are issues that need clarification and/or consistency between SSAP No. 21R, SSAP No. 26R, SSAP 43R, and the recently adopted language on the definition of residual tranches in SSAP No. 48.

As these are nuanced and interrelated changes still subject to the best approach in achieving clarification and/or consistency, it was agreed it was most efficient to work through the changes collaboratively especially given the significant agreement on the end results that are trying to be achieved. As part of this collaboration, interested parties would also like to discuss with NAIC staff and regulators the concept of audit requirements for residual tranches. The remainder of interested parties' comments relate to the proposed accounting for residual tranches.

In response to the residual accounting proposal forwarded by regulators, interested parties understand concerns about accreting investments above this initial cost, but also believe there may be a more reasonable accounting method for these investments versus the proposed cost recovery method.

Residual Tranche Accounting Alternatives (Paragraph 31)

Interested parties noted that the example provided by regulators showed a risky asset accreting high yields for multiple periods even if no cash is received, which is concerning from the point of view of accounting conservatism. While this example may raise alarms to regulators, it may not be representative of residual tranche investments in the industry currently. Many residual tranche investments generate positive cash flows period after period, by design and in practice. Additionally, since the risk of residual tranches is already being addressed through risk-based-capital regulation, we hope that accounting may be formulated to be reasonable on its own, without attempting to address risk through a second channel.

Interested parties initially proposed the effective yield method of accounting, which regulators rejected, noting in some cases it could lead to income generation which was deemed to be aggressive or premature. Regulators then proposed cost recovery method of accounting, which interested parties believe is too punitive in cases where healthy cash generating assets would be written down to zero before recognizing any income.

We hope that a third alternative can be reached which incorporates these two principles:

- Assets cannot be accreted above original (or subsequent) consideration paid; and
- Assets may use a systematic approach to record investment income to the extent cash is received.

In industry discussions it became clear that variety and complexity exists which impacts this topic including:

- Underlying collateral assets span from loans to mortgages to real estate to equity to lease backed assets, each case which may suggest a different expected earnings and cash flow pattern.
- Certain servicers clearly delineate the amount of principal vs. interest cash flows generated by the collateral that are allocated to each tranche of investment. Interested parties are currently reaching out to investment advisors to understand whether some servicers do not provide this same level of granularity.
- Certain investments accounted for currently under the equity method, may prospectively be classified as residuals. Currently under the equity method, distributions are allocated between return of capital and return on capital.

Interested parties have been discussing several alternatives, two of which are described below: servicer reports and capital statements and an effective yield method with a cap. Both alternatives will also use a lower of adjusted cost or fair value concept and appropriate treatment for other than temporary impairments (OTTI). Interested parties would like the opportunity to discuss these alternatives with the Working Group to determine whether one or both of these approaches may be considered a reasonable alternative to the cost recovery method.

Servicer Reports or Capital and Distribution Statements

Servicer reports generally attribute every cash distribution into cash receipts from the interest payment on the collateral versus principal paydowns on the collateral. These cash distributions are allocated to each tranche of investment (including the residual) based upon a priority of payments schedule formalized in the operative documents for the respective securitization. Similarly, capital and distribution statements schedule out the return on capital and the return of capital. Insurers applying the equity method are accustomed to the appropriate timing to record a distribution as a dividend on the income statement under the equity method of accounting.

One alternative is to guide companies to refer to servicer reports or capital and distribution statements to recognize income equal to the portion of the residual interest's cash disbursements generated from interest receipts on the collateral pool. This method is simple, reliable and supportable.

Effective Yield Method with a Cap

Another alternative which could be applied is an effective yield method with a cap on income, such that income could only be recognized to the extent that there is a receipt of cash. As part of this alternative, the carry value of this asset may not be accreted above the cost of consideration paid. A detailed example of how this method would compare to effective yield method and cost recovery method has been drafted, noting that this third alternative would generally – if not always – result in a period-over-period carry value which is lower than the effective yield method and higher than the cost recovery method, meaning it represents a middle road, as expected. For this proposal, initial draft language has been presented for discussion as well.

We would like to offer the following principles for discussion, with the intent of replacing paragraph 31 in its entirety. Should this concept be acceptable to regulators, interested parties could also suggest actual SSAP language to accomplish what is described below.

Each period the book adjusted carrying value and interest income would be determined in the following manner:

1. At the beginning of the period, calculate the book yield as the discount rate that equates the then current best estimate of cash flows projections to the cost basis of the asset.
2. The maximum amount of interest income will be the product of the book yield and beginning of period book adjusted carrying value.
3. If cash distributed to the asset is less than the maximum amount of interest income:
    - Interest income equals total amount of cash distributions.
    - Book adjusted carrying value of the asset is not decreased.

4. If cash distributed to the asset is greater than the maximum amount of interest income:
   - Interest income equals the maximum amount calculated above.
   - Book adjusted carrying value is decreased by the amount of cash distributions in excess of the maximum amount of interest income.

Both a servicer report/capital and distribution statement method and an effective yield method with a cap would ensure that the carrying value is not accreted above cost and would allow for income recognition which is supported by cash receipts.

Comment on OTTI (Paragraphs 30 and 32)

It appears that the most recent draft of residual tranche guidance was adjusted to depart from standard lower of cost or market (LOCOM) accounting to automatically record any decrease of fair value below adjusted cost to be an other-than-temporary impairment, rather than capturing temporary reductions as unrealized losses. Interested parties generally would expect that LOCOM and OTTI processes would remain consistent for this asset class as it would be applied to other asset classes. We believe the following language, currently in SSAP 43R paragraph 26.c., should be moved to this standard:

> "For residual tranches or interests captured in scope of this statement, all reporting entities shall report the item on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value. Changes in reported value from the prior period shall be recorded as unrealized gains or losses. For reporting entities that maintain an AVR, the accounting for unrealized gains and losses shall be in accordance with SSAP No. 7-Asset Valuation Reserve and Interest Maintenance Reserve."

Additionally, the language from SSAP No. 48 paragraphs 18 and 19 addresses the impairment process of an equity method investment and SSAP No. 43R, paragraphs 34 and 36, addresses the impairment process of a residual interest in a beneficial interest.

As noted, many alternatives are being discussed by interested parties. We have shared examples of our latest thinking above in order to continue a productive discussion with regulators on this important topic. We look forward to continuing to engage with regulators and stand ready to answer any questions you may have on this topic.

Ref #2022-12: Review of INT 03-02*: Modification to an Existing Intercompany Pooling Arrangement*

The Working Group re-exposed the intent to nullify INT 03-02 and directed NAIC staff to work with industry regarding some of their comments and examples to be submitted by industry.

In response to the Working Group's request for examples of a modification to an existing intercompany pooling arrangement, interested parties identified the two most common modifications to intercompany pooling arrangements:

- 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 (discontinued line of business)

These two types of modifications may involve the movement of a significant amount of assets and liabilities to re-balance the capital and surplus of the insurance subsidiaries involved to manage the impact to a targeted RBC for the members of the intercompany pooling arrangement. A less common modification is the re-capitalization of the members of the pooling arrangement to adjust for changes in investment strategy over time. Because this latter type of transaction usually involves the movement of cash, not assets and liabilities, we are not including an example as the effects are fairly straight forward.

For purposes of the Example 1 below, please see the attached Organization Chart – Pre-Acquisition.

Example 1 is the combination of <u>two intercompany pools following the acquisition of a group of companies:</u>

- Insurance Group (Holdco) A acquires Insurance Group (Holdco) B.
- Insurance Group A and Insurance Group B have the following intercompany pools:

<u>Intercompany Pool A:</u>	<u>Pool participation percentage:</u>
Entity A1	70%
Entity A2	26%
Entity A3	4%

<u>Intercompany Pool B:</u>	<u>Pool participation percentage:</u>
Entity B1	60%
Entity B2	22%
Entity B3	18%

Upon completion of the acquisition, the acquired companies are owned by a common holding company for this example (please see attached Organizational Chart Post Acquisition – Example 1).

- Intercompany Pool A modifies its pooling arrangement, brings Intercompany Pool B into Intercompany Pool A and resets the pool participation percentages retroactive to January 1 of the current year as follows:

<u>Intercompany Pool A:</u>	<u>Pool participation percentage:</u>
Entity A1	40%
Entity A2	20%
Entity A3	3%

Entity B1	22%
Entity B2	8%
Entity B3	7%

- In this example, each entity's pool participation percentage have been reset in order to balance future capital needs, with consideration of risk-based capital and other financial measures (e.g., IRIS ratios).

- As a result of the pooling modification, the three former Intercompany Pool B entities must transfer net assets to each of the Intercompany Pool A entities. For purposes of this example, entity B1 transfers bonds totaling $9,000,000 to entity A1 in order to support the $9,000,000 of reserves[1] transferred to entity A1.

Scenario 1:

- If bonds with a market value of $9,000,000 and an amortized cost of $8,000,000 are transferred from entity B1 to entity A1 at market value, entity B1 may or may not have to defer its gain resulting from the transfer. This will depend on whether entity A1 and entity B1 have a common insurance entity parent. For example, if entity B1 is under entity A1's ownership chain or vice-versa as shown in the attached Organizational Chart Post Acquisition – Example 1, the gain will be deferred; otherwise, the gain will be realized. In the example provided, B1 would realize the gain on the transfers of assets to A1 as the two entities are not owned by the same insurer. However, if A3 transferred assets to A1, the gain in this instance would be deferred.

- More importantly, because insurers generally hold most bond investments to maturity, the cash flows from the contractual payments over the term of the bonds will be aligned with the bonds' amortized cost, not the market value at a point in time. Because entity B1 transferred bonds with an amortized cost of $1,000,000 less than that needed to support the reserves transferred (at book value) to entity A1, entity A1 will have received a deficient amount of assets (future cashflows) as part of the modification of the intercompany pooling arrangement. This will result because entity A1 will realize cash flows closer to the $8,000,000 amortized cost of the bonds rather than the market value at the time of the pooling modification of $9,000,000.

- In addition, if entity B1 has recorded a gain in surplus as a result of the transfer of the bonds as part of the intercompany pooling modification transaction, entity B1 must treat the intercompany pooling as retroactive reinsurance pursuant to paragraph 36d of SSAP No. 62R as provided in the example.

[1] The reserves transferred would typically include loss and loss adjustment expenses and other underwriting expense reserves, net of any premiums receivable subject to the pooling arrangement.

Scenario 2:

- If bonds with a market value of $9,000,000 and an amortized cost of $10,000,000 are transferred from entity B1 to entity A1 at market value, entity A1 will have received excess assets of $1,000,000 above the reserves transferred (at book value) to entity A1, as entity A1 will realize cash flows from the $10,000,000 amortized cost of the bonds rather than the market value at the time of the pooling modification of $9,000,000. Therefore, if entity B1 is required to transfer the assets at fair value, it has essentially sent a dividend of $1,000,000 to entity A1.

Example 2 is the removal of an insurance subsidiary from an intercompany pooling arrangement in preparation for the sale of the subsidiary (discontinued line of business). For this example, please see attached Organizational Chart – Example 2:

- Entity A6 is removed from the Intercompany Pool comprised of 6 insurance subsidiaries under Holdco A (as the insurance group is discontinuing A6's lines of business and selling the entity A6).

- The intercompany pooling arrangement is modified and the pooling percentages are reset such that entity A1 absorbs A6's pooling participation (retroactive to January 1 of the current year).

- Prior to the modification, the intercompany pooling percentages are:

Intercompany Pool participant:	Pool participation percentage:
Entity A1	37%
Entity A2	14%
Entity A3	2%
Entity A4	28%
Entity A5	10%
Entity A6	9%

- After the modification, the intercompany pooling percentages are:

Intercompany Pool participant:	Pool participation percentage:
Entity A1	46%
Entity A2	14%
Entity A3	2%
Entity A4	28%
Entity A5	10%

- As a result of the pooling modification, entity A6 must transfer net assets to entity A1. For purposes of this example, entity A6 transfers bonds totaling $27,000,000 to entity A1 in order to support the reserves[2] transferred to entity A1 for the business retained by the intercompany pool.

Scenario 1:

- If bonds with a market value of $27,000,000 and an amortized cost of $26,000,000 are transferred from entity A6 to entity A1 at market value, the implications of such a transfer are the same as in Example 1. Entity A6 may or may not have to defer its gain resulting from the transfer. This will depend on whether or not entity A1 and entity A6 have a common insurance entity parent (the attached Example 2 assumes that the entities do not have a common insurance entity parent). For example, if entity was a subsidiary of entity A1, the gain will be deferred; otherwise, the gain will be realized. In the example provided, A6 would realize the gain on the transfers of assets to A1 as the two entities are not owned by the same insurer. However, if A3 transferred assets to A1, the gain in this instance would be deferred.

- Because entity A6 transferred bonds with an amortized cost of $1,000,000 less than that needed to support the reserves transferred (at book value) to entity A1, entity A1 will have received a deficient amount of assets (future cash flows) as part of the modification of the intercompany pooling arrangement. This will result because entity A1 will realize cash flows closer to the $26,000,000 amortized cost of the bonds rather than the market value of $27,000,000 at the time of the pooling modification.

- In addition, if entity A6 has recorded a gain in surplus as a result of the transfer of the bonds as part of the intercompany pooling modification transaction, entity A6 must treat the intercompany pooling as retroactive reinsurance pursuant to SSAP No. 62R.

Scenario 2:

- If bonds with a market value of $27,000,000 and an amortized cost of $28,000,000 are transferred from entity A6 to entity A1 at market value, entity A1 will have received excess assets of $1,000,000 above the reserves transferred (at book value) to entity A1, as entity A1 will realize cash flows from the $28,000,000 amortized cost of the bonds rather than the market value of $27,000,000 at the time of the pooling modification. Therefore, if entity A6 is required to transfer the assets at fair value, it has essentially sent a dividend of $1,000,000 to entity A1.

Ref #2022-14: New Market Tax Credits

The Working Group exposed additional revisions made to SSAP No. 93 and SSAP No. 94R. Additionally, the Working Group directed NAIC staff to work with interested parties to draft revisions to the annual statement instructions and reporting updates.

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[2] The reserves transferred would typically include loss and loss adjustment expenses and other underwriting expense reserves, net of any premiums receivable subject to the pooling arrangement.

Revisions to SSAP No. 93 – *Low-Income Housing Tax Credit Property Investments* and SSAP No. 94R – *Transferable and non-transferable State Tax Credits* and updates were made in response to comments received from interested parties.

Interested parties appreciate the opportunity to comment on the substantive revisions exposed by the Working Group for SSAP No. 93 – *Low Income Housing Tax Credit Property Investments* and SSAP No. 94 - *Transferable and Non-Transferable State Tax Credits* under item Ref #2022-14 *New Markets Tax Credits* (the Exposure). As stated in our prior comment letter on this topic, interested parties agree with having uniformity in accounting and reporting for equity and debt investments for which the return is earned primarily through tax credits. Interested parties agree that the proportional amortization method is an appropriate method to use for any type of investment (debt or equity) where the return is primarily earned through tax credits. However, we have concerns regarding the proposed adoption and scope provisions of the Exposure along with concerns that certain aspects of the Exposure could be misinterpreted which are outlined in the comments below:

SSAP No. 93 Admissibility Requirements for Ownership Interests in Tax Credit Investments
Paragraph 18 requires reporting entities to annually assess the future utilization of the unallocated tax credits associated with an entity's ownership interest in a tax credit investment project to determine if the investment can be admitted. Interested parties agree with the requirements of this paragraph to the extent that a tax credit investment meets **both** of the following criteria:

1) a reporting entity is not permitted to sell its ownership interest in a tax credit investment project to a 3rd party, and
2) the tax credits generated by the investment are not transferrable post allocation by the tax credit investment project.

If both of these criteria are met, a reporting entity's ownership interest in a tax credit investment can only be converted into allocated tax credits for use by the reporting entity and therefore, evaluation for admittance based on a reporting entity's ability to utilize the tax credits is appropriate.

Interested parties do not believe that the admissibility criteria within paragraph 18 should apply to ownership interests in tax credit investments that are unrestricted for sale (regardless of the type of tax credits that it generates and allocates) **or** for ownership interests in tax credit investments that are restricted but generate transferrable tax credits. Ownership interests in these types of tax credit investments represent investments that can be directly liquidated to satisfy policyholder obligations either through sale of the reporting entity's ownership interest in the investment (i.e., the future rights to receive tax credits that have not yet been generated and allocated by the tax credit investment) *or* sale of the transferrable tax credit post allocation. Therefore, we believe that these types of tax credit investments represent admitted assets and are fundamentally different from nonsaleable ownership interests in tax credit investments that only allocate non-transferrable tax credits.

Interested parties acknowledge that paragraphs 18(a) and 18(b) appear to provide an exception to the admissibility requirements in paragraph 18 for these types of investments:

> *18(a). Tax credit investments which allocate tax credits which are certificated or transferable in accordance with permitted IRS or state tax provisions may admit up to the lesser of the proportional amortized cost, or fair value of the tax credits. If the fair market value is not determinable, then the reporting entity may only admit the amount calculated in paragraph 18.*
>
> *18(b). Tax credit investments which allocate tax credits eligible for direct payment may admit up to the lesser of the proportional amortized cost, or the estimated proceeds.*

With respect to paragraph 18(a), interested parties disagree with the concept that if the fair value of a tax credit investment is not determinable, a reporting entity must apply the admissibility criteria within paragraph 18 because this conflicts with the impairment requirements in paragraph 25 of SSAP No. 93R, which provides guidance to ensure that a reporting entity's ownership interest in a tax credit investment would never exceed its fair value. We believe paragraph 25 of SSAP No. 93R appropriately addresses admissibility for these scenarios and therefore the language in paragraph 18(a) should be removed from the Exposure. Further, paragraph 25 requires a reporting entity to test its investment in tax credit projects for impairment annually and permits a reporting entity to estimate fair value as the present value of the future tax credits and other tax benefits that are expected to be generated by the tax credit investment discounted at a risk-free rate of return. Interested parties believe that this method provides a reasonable approximation of the fair value of a reporting entity's ownership interest in a tax credit investment, as it is based on assumptions that would be used by market participants when determining the purchase price of a similar investment (i.e., fair value is directly tied to the tax credits/benefits expected to be generated by the investment). As these types of tax credit investments are unrestricted for sale, we believe these ownership interests should be considered admitted assets and that admissibility is appropriately captured by the impairment testing requirements of paragraph 25. In addition, interest parties believe paragraph 25 also addresses admissibility for ownership interests in tax credit investments that may be restricted for sale if they allocate transferrable tax credits. This is because of the direct link between a tax credit investment's fair value and the value of the tax credits it allocates. Accordingly, in these circumstances because the tax credit allocated by the investment can ultimately be sold to a 3rd party, the impairment testing requirements of paragraph 25 also appropriately address admissibility considerations related to the tax credit investment.

With respect to paragraph 18(b), interested parties believe the meaning of "estimated proceeds" has the same meaning as fair value and represents the price that would be received by the reporting entity for its ownership interest in a tax credit investment in an orderly transaction between market participants and that wording should therefore be stricken from paragraph 18. We believe that ownership interests in tax credit investments that allocate tax credits eligible for direct payment (i.e., non-transferrable tax credits) are no different from those that allocate transferrable assets because a reporting entity can sell its ownership interest in the tax credit investment (i.e., the rights to receive tax credits that have not yet been generated and allocated by the tax credit investment). Similarly, we believe that admissibility of these tax credit investments is appropriately addressed by the impairment requirements of paragraph 25 because the fair value of a reporting entity's ownership interest in these tax credit investments is directly tied to the future tax credits and other tax benefits that are expected to be generated by the tax credit investment project.

Given these considerations, interest parties suggest the following revisions to paragraph 18; note that the proposed revisions below do not contemplate changes that may arise from the other comments discussed in this letter:

Reporting entities are required to annually assess the future utilization of the investment's current portion of unallocated tax credits against the estimated tax liabilities for both the tax year in which the tax credits can be initially utilized as well as any applicable carryback periods for a reporting entity's ownership interest in tax credit investments that meet both of the following criteria:

a. *the ownership interest in the tax credit investment is legally restricted for sale, and*
b. *the tax credits allocated to the reporting entity by the tax credit investment are not transferrable post allocation.*

~~*Based on this assessment,*~~ *For tax credit investments that meet both of these criteria,* *……………………………..*

.... ~~*As an exception to the admittance assessment detailed above, if the tax credit investment allocates tax credits with the following features the reporting entity may perform a secondary assessment to determine if additional amounts of the tax credit investment may be admitted*~~*:*

~~a.~~ ~~*Tax credit investments which allocate tax credits which are certificated or transferable in accordance with permitted IRS or state tax provisions may admit up to the lesser of the proportional amortized cost, or fair value of the tax credits. If the fair market value is not determinable, then the reporting entity may only admit the amount calculated in paragraph 18.*~~
~~b.~~ ~~*Tax credit investments which allocate tax credits eligible for direct payment may admit up to the lesser of the proportional amortized cost, or the estimated proceeds.*~~

SSAP No. 93 Paragraph 18 Clarifications
Interested parties also suggest clarification of key terms in paragraph 18. Based on previous dialog with the Working Group, we propose the following definitions:

1) "unallocated tax credits" - the portion of tax credits expected to be earned and allocated to the reporting entity through the investment structure.
2) "current portion" - the credits allocated within one year of the reporting period.

In addition, to avoid misinterpretation we propose that instead of assessing if the unallocated tax credits will be used over the life of the investment, that the assessment should occur over the life of the tax credit. This language aligns with the next sentence, which references if the unallocated tax credits will exceed what can be utilized under IRS or state tax provisions, the reporting entity must non-admit a portion of the investments. IRS and state tax authorities generally provide that if tax credits allocated or generated in the current year cannot be used to offset the current tax liability, they are carried forward for a specified number of years.

> "...if the reporting entity does not expect to substantially utilize the current portion of unallocated investment tax credits, the reporting entity shall perform an expanded assessment to determine the extent that it will be able to utilize all of the investment's unallocated tax credits over the life of the tax credit ~~the life of the investment~~. If assessment projections identify that the investment's unallocated tax credits will exceed what can be utilized under IRS or state tax provisions (current and carryforward periods ~~other applicable tax periods~~), the reporting entity shall nonadmit investments as necessary so that investments in scope of this statement (in aggregate) are only admitted to the extent tax credits are expected to be utilized within carryforward periods. Additionally, if the assessment indicates that the next three years of investment tax credits cannot be substantially utilized within the carryforward periods then the entire investment shall be nonadmitted."

Paragraph 18 disallows reporting entities from assuming that future operations will increase as support for the utilization of tax credits. However, interested parties assume that tax planning strategies are required when assessing the utilization of unallocated tax credits, similar to the valuation allowance requirements under SSAP No. 101. Explicitly providing this requirement prevents misinterpretation and avoids unintended fluctuations in surplus in the year credits are allocated and assessed under the guidelines in SSAP No. 101.

Retrospective Versus Prospective Adoption
Interested parties believe that applying the requirements under the revised standards upon transition should be done on a prospective basis so that no adjustments to surplus are recorded at the date of adoption. Under the prospective method, companies will analyze which of their investments meet the criteria under each standard. For SSAP No. 93 investments, the carrying book value at the date of adoption will become the starting balance, which will be used to determine future amortization under the proportional amortization method based on future tax credits and other tax benefits to be earned. Under SSAP No. 94, the requirement to record the credits at their face value should be applied to future purchases only. Otherwise, we would have to adjust the book value of those credits upon adoption due to the change in accounting for SSAP No. 94 purchased tax credits that requires recording these credits at face value rather than actual cost.

Adoption Date
Due to the level of work required to review investments for which tax credits are received to determine if they meet the criteria under SSAP No. 93, we believe that having an effective date of 1/1/25 would be more reasonable. In addition, we understand that changes to Schedule BA along with review by the NAIC's Capital Adequacy Working Group will need to take place to report the new investments in the appropriate section of the schedule. Since this will require

additional time as well, 1/1/25 seems reasonable. Although the FASB ASU has an adoption date of 1/1/2024 for many insurers, many other insurers do not apply US GAAP and/or meet the requirements to adopt the ASU after 1/1/2024. Additionally, the accounting requirements for the new FASB ASU are different than those under the Exposure and thus, additional time to adopt the Exposure is warranted.

For SSAP No. 94 tax credits, since the adoption of this standard requires minimal changes to the annual statement as these are reported as other-than-invested assets and not as investments, an effective date of 1/1/25 with early adoption allowed will be beneficial for industry. Early adoption will allow insurers that purchase federal tax credits to apply the proposed accounting under SSAP No. 94. Otherwise, there may be questions of admissibility for new instruments purchased, since today's SSAP No. 94 only addresses state tax credits.

SSAP No. 94 Scope

There have been some questions about whether there is enough clarity about the types of tax credits that fall within SSAP No. 93 versus SSAP. No. 94. Interested parties' understanding is that SSAP No. 93 relates to debt and equity investments where the return on the investment is predominantly from tax credits and other tax benefits whereas SSAP No. 94 addresses tax credit "vouchers" that are purchased outright from any party, which are not considered investments (but instead represent receivables). To that end, we want to suggest the following edits to the SSAP No. 94 scope:

> "This statement establishes statutory accounting principles for state and federal tax credits that are purchased1 by the reporting entity without being a~~n~~ bond or equity investor in the entity from which the tax credit were purchased."

Ref #2023-14: ***SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve***

The Working Group moved this agenda item to the active listing, categorized as a new SAP concept and exposed this agenda item with the overall concept for a long-term project to capture accounting guidance for AVR and IMR in SSAP No. 7. Although revisions may be considered and adopted to allow focus on specific discussion aspects, ultimately, the movement of the accounting guidance to SSAP No. 7, and any revisions from the annual statement instructions when incorporating SAP guidance, is proposed to be captured as a new SAP concept with a corresponding issue paper to detail the revisions. The agenda item identifies discussion topics to be included in this project.

Interested parties support the comments made by the ACLI in its comment letter.

Schedule Ref #2023-16: Schedule BA Reporting Categories

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification and exposed this agenda item to further define for consistency purposes the investments captured as non-registered private funds, joint ventures, partnerships or limited liability companies, or residual interests and reported based on the underlying characteristics of assets. This item contains revisions to further define, for consistency purposes, investments captured as non-registered private funds, joint ventures, partnerships or limited liability companies, or residual interests and reported based on the underlying characteristics of assets.

Interested parties recommend several edits to further clarify and define the investments that should be categorized as non-registered private funds, joint ventures, partnerships or limited liability companies or residual interests, based on the characteristics of the underlying assets.

Please see the related attachment with marked edits.

We do not recommend any changes to the language describing Non-Registered Private Funds, but we would like to comment on what is included in that section in response to the Working Group's request: in addition to private funds which have been filed with the SVO and private funds which have not been filed with the SVO, there are certain fixed income instruments not included on schedule D or schedule B, consistent with the Annual Statement Instructions for that schedule.

Ref #2023-17: Short-term Investments

The Working Group moved this agenda item to the active listing, categorized as a new SAP concept, and exposed revisions to further restrict the investments that are permitted for cash equivalent or short-term investment reporting. To correspond with the bond project, this agenda item proposes an effective date of Jan. 1, 2025. Additionally, subsequent blanks reporting changes will be considered to modify the cash equivalent and short-term reporting lines accordingly. This item contains revisions to further restrict the investments that are permitted to be included in cash or shorter-term investment reporting.

Interested parties have no comments on this item.

Ref #2023-18: ***Proposed Revisions to SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets***

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification and exposed revisions to adopt, with modification, *ASU 2016-19, Technical Corrections and Improvements* for statutory accounting in SSAP Nos. 5R, 92, 102, and 103R as illustrated in the proposal. The proposed revisions adopt with modification certain aspects of *ASU 2016-19: Technical Corrections and Improvements*. The revisions also include amending SSAP No. 92 – *Postretirement Benefits Other Than Pensions* guidance on insurance contracts to use the same terminology as that used in SSAP No. 102 – *Pensions*.

Interested parties have no comments on this item.

Ref #2023-19: ASU 2018-09, Codification Improvements

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification and exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2018-09 Codification Improvements* as not applicable for statutory accounting.

Interested parties agree with the recommendation in this agenda item.

Ref #2023-20: ASU 2020-10, Codification Improvements

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification and exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2020-10, Codification Improvements* as not applicable for statutory accounting.

Interested parties agree with the recommendation in this agenda item.

Ref #2023-21: Removal of Transition Guidance from SSAP No. 92 and SSAP No. 102

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 92 and SSAP No. 102 to remove the transition guidance that was no longer applicable as the ten-year effective period for that transition has ended.

Interested parties agree with the recommendation in this agenda item.

Ref #2023-22: Actuarial Guideline 51 and Appendix A-010 Interaction

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 54R to clarify that gross premium valuation (under Appendix A-010) and cash flow testing (under AG 51) are both required, if indicated. In addition, the Working Group directed staff to provide formal notice of the exposure to the Long-Term Care Actuarial (B) Working Group and the Valuation Analysis (E) Working Group.

Interested parties have no comments on this item.

* * * *

Please feel free to contact either one of us with any questions you may have.

Sincerely,

D. Keith Bell

Rose Albrizio

cc: Interested parties
NAIC staff