Statutory Accounting Principles (E) Working Group
Hearing Agenda
December 17, 2024

ROLL CALL

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Melissa Gibson/Bill Werner	Louisiana		

NAIC Support Staff: Julie Gann, Robin Marcotte, Jake Stultz, Jason Farr, Wil Oden

Note: This meeting will be recorded for subsequent use.

REVIEW of COMMENTS on EXPOSED ITEMS

The following items are open for discussion and will be considered separately.

1. Ref #2024-10: Book Value Separate Accounts
2. Ref #2024-15: ALM Derivatives
3. Ref #2024-26EP: Fall 2024 Editorial Revisions
4. Ref #2024-05: Appendix A-791
5. Ref #2024-06: Risk Transfer Analysis of Combination Reinsurance Contracts

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-10 (Julie)	**Book Value Separate Accounts**	**1 – Agenda Item**	**Comments Received**	**IP – 1**

Summary:
On August 13, 2024, the Working Group exposed revisions to *SSAP No. 56—Separate Accounts,* to allow for review and consideration of potential changes to update measurement method guidance and specify the process to transfer assets for cash between the general account and book-value separate accounts. The Working Group requested comments from regulators and industry on noted questions included in the exposed agenda item.

ACLI Comments
We support clarification of statutory accounting guidance for Book Value Guaranteed Separate Accounts. ACLI is very appreciative of the on-going dialogue with SAPWG and the IMR Ad Hoc Working Group and stands ready to continue working with the NAIC on this initiative.

Within the exposure, NAIC staff has proposed changes to SSAP No. 56 and identified several items for further discussion. ACLI would like to provide specific comments regarding existing SSAP No. 56 guidance and proposed changes to SSAP No. 56, in addition to direct responses to NAIC Staff Questions.

The ACLI is in support of much of the exposed guidance updates. Particularly, we are in support of the proposed guidance for transfers between General Account and Separate Account (paragraphs 19 – 22). The ACLI previously provided a detailed presentation entitled "ACLI Derivative IMR Solution Proposal" ("ACLI Solution," included as Appendix I) to the IMR Ad Hoc Working Group. Discussions of the ACLI solution at the NAIC Ad Hoc IMR WG were the impetus for this exposure. The exposed guidance updates to SSAP No. 56 largely reflect the findings from the ACLI Solution presentation and, should it be beneficial to regulators, the ACLI would appreciate the opportunity to present to the full SAPWG membership and any additional interested regulators.

While in support of much of the exposed guidance updates, the ACLI would like to further discuss some of the proposed guidance for Book Value Guaranteed Separate Accounts; specifically within SSAP No. 56, paragraph 18.b. The General Account is often ultimately obligated to act as "an overall backstop or providing a guarantee", the ACLI has found that the distinct performance guarantee can be specified for some contracts. The current wording can be interpreted that a distinct performance guarantee is never specified and we recommend the following verbiage change: "…although a distinct performance guarantee may not be specified (such as minimum crediting rate, death benefit, etc…).

Additionally, while the first sentence of 18b is clear that Book Value Separate Accounts should be created with regulator approval, the subsequent inclusion of a list of current approved policy types could be misinterpreted as a restrictive list of those policy types available for regulator approval rather than a list of current examples. The ACLI recommends removing reference to specific Book Value Separate Account policy types to avoid the potential for misinterpretation and the subsequent diversity in practice that may lead to.

Also, stating that book value separate accounts provide benefits that are not directly tied to the performance of the assets is not always accurate as there are certain book value separate accounts where the asset performance is used to determine the general account obligation. Our proposed edits are highlighted below, which address these comments: (Staff has underlined the edits instead of the highlighting.)

> 18.b. With approval of the state insurance regulator, assets supporting insulated or non-insulated separate account contracts that are similar to contracts generally found in the general account, but do not directly pass all investment experience of the underlying assets to the policyholder, will be recorded as if the assets were held in the general account. Unlike traditional separate account contracts, these contracts do not have investment directives determined by the contract holder and investment performance results are not attributed to a specific contract holder. The general account may serve as an overall backstop or may provide an implied guarantee, although a distinct performance guarantee may not be specified (such as a minimum crediting rate, death benefit, etc.).

Within the exposure NAIC Staff posed specific questions (below in **bold**) with ACLI responses immediately following:

NAIC Staff Question: Information on the current measurement method for seed money is requested from industry. Although the guidance implies that seed money should be at book value, there is an assumption that companies may utilize fair value when included in a fair value separate account.

Fair Value Separate Accounts are primarily invested in assets that would otherwise be recorded at Fair Value if held directly on the General Account. While ACLI has, to date, not identified any diversity in practice from SSAP No. 56, paragraph 17 guidance, we do recognize the possibility that commingling of seed money and policyholder funds within the investment strategy assets has the potential to lead to fair value reporting of seed money that would not otherwise be recorded at Fair Value if held directly on the General Account. The ACLI welcomes further discussion with regulators to determine if the accounting guidance updates currently being exposed can be utilized to solve for the, albeit remote, potential for diversity in practice.

NAIC Staff Question: Feedback is requested on the named contracts (PRT and RILA) and whether other example contracts should be named.

In addition to PRT and RILA, BOLI policies have also been identified as current separate account policy types being carried at Book Value by member companies. As previously addressed above, the listing of current book value separate account policy types does not account for the development and regulator approval of book value separate account policies in the future. As has been the case with the existing guidance, the listing of policy types could be misinterpreted by some as a definitive listing of approved Book Value Separate Accounts which will again lead to diversity in practice and the need to regularly update guidance to include new policy types within the list and/or could lead to implicit prescribed practices. For these reasons, the ACLI recommends that neither a full list nor example list of policy types be included within the guidance.

NAIC Staff Question: Additional information is requested from industry on these transfers (asset to asset swaps, contributions of general account assets to support separate account deficiencies, dividends of assets from the separate account to the general account). NAIC staff recommend that these areas be expanded with consistent guidance for the treatment of transfers.

The ACLI maintains that these types of transactions remain a) not common and b) often subject to accounting standard outlined within each separate account Memorandum or Plan of Operations ("Memorandum of Operations). Any codification of accounting guidance for these transactions could result in implicit prescribed practices where updated accounting guidance within SSAP No. 56 differs from the accounting guidance agreed upon with the domicile state within the Memorandum of Operations. The ACLI recommends further discussion as to the appropriateness of recommended expanded treatment, specifically as relates to the potential for and complications that arise from prescribed practice, effecting changes to Memorandum of Operations, and/or applying expanded guidance only to policies written after a certain date.

NAIC Staff Question: Clarification is requested to this guidance for seed money similar to the prior question.

The ACLI maintains that reporting guidance for seed money transfers, other than seed transfers of cash, can often be subject to accounting standard outlined within each separate account Memorandum of Operations. Please refer to concerns expressed in the prior question.

Recommendation:

NAIC staff recommend that the Working Group expose updated revisions to *SSAP No. 56—Separate Accounts* to reflect consideration of some of the ACLI comments. In addition, the proposed edits include direction to utilize fair value for other transfers (not in exchange for cash) in paragraph 23. With this action, NAIC staff requests feedback from regulators on three specific issues:

1) **With specification of a fair value measurement for other transfers, whether additional guidance for the treatment of IMR is needed. This includes transfers that include but are not limited to the following:**

    - **Asset to asset swaps**
    - **Contributions of general account assets to support separate account deficiencies**
    - **Dividends of assets from the separate account to the general account.**

2) **Whether discussion, and possible clarifications, are needed to clarify the definition of a "guarantee" pursuant to the SSAP No. 56 glossary to ensure it includes both implicit and explicit guarantees. The ACLI did not address this question as part of the exposure.**

3) **Whether a referral to the Life RBC (E) Working Group should recommend expanded detail and calculation of RBC for book-value separate accounts. Under existing RBC instructions, reporting entities shall calculate RBC as if the asset was held in the general account and report that in the RBC formula, but this process provides no transparency and relies fully on the company-provided information in the formula.**

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Discussion on the proposed edits and the items recommended for discussion are provided below:

Proposed Edits to SSAP No. 56: As detailed in the ACLI comment letter, they are largely supportive of the exposed edits. The ACLI has proposed edits to paragraph 18.b. regarding contracts for which a state insurance regulator could approve for reporting at book value. In addition to revised wording regarding the investment pass-through, the ACLI have also proposed eliminating the example contracts from the guidance. NAIC staff has incorporated much of this proposed language but has revised the ACLI proposal for “will be recorded” to “may be recorded” as paragraph 18.b. is only allowed if regulator approval is obtained, and has retained the examples of contracts, expanded to also refer to bank-owned life insurance (BOLI) contracts.

18. Assets supporting the following separate account contracts are permitted to be reported as if the assets were held in the general account. This measurement method is referred to as “book value.” For these assets, measurement shall follow all provisions of the SSAP to which the asset would be applicable if held in the general account. Assets that would not qualify for admittance in the general account are not permitted in a book-value separate account. Separate account contracts that do not qualify in the following categories are not permitted at book value without a permitted or prescribed practice from the state of domicile.

    a. Assets supporting fund accumulation contracts (GICs), which do not participate in underlying portfolio experience, with a fixed interest rate guarantee, purchased under a retirement plan or plan of deferred compensation, or established or maintained by an employer, will be recorded as if the assets were held in the general account.

    b. With approval of the state insurance regulator, assets supporting insulated or non-insulated separate account contracts that are similar to contracts generally found in the general account[1], but do not directly pass all investment experience of the underlying assets to the policyholder may be recorded as if the assets were held in the general account. Unlike traditional separate account contracts, these contracts do not have investment directives determined by the contract holder and investment performance results are not attributed to a specific contract holder. ~~Furthermore, unlike traditional separate account contracts, the insurance reporting entity (general account) is often ultimately obligated to provide contract benefits that are not directly tied to the performance of the underlying assets, resulting with~~ The general account may serve ~~serving~~ as an overall backstop or may provide ~~providing~~ an implied guarantee, although a distinct performance guarantee may ~~is~~ not be specified (such as a minimum crediting rate, death benefit, etc.). Examples of contracts expected to be captured within this provision include, but are not limited to, pension risk transfer (PRT) contracts, bank-owned life insurance (BOLI) and registered index-linked annuity (RILA) contracts.

    Footnote 1: The inclusion of this guidance does not imply support for these contracts within the separate account instead of the general account. The domiciliary state insurance regulator is responsible for assessing and approving separate account contract classification in accordance with state statutes.

Paragraph 18.b. shown clean:

With approval of the state insurance regulator, assets supporting insulated or non-insulated separate account contracts that are similar to contracts generally found in the general account[1], but do not directly pass all investment experience of the underlying assets to the policyholder may be recorded as if the assets were held in the general account. Unlike traditional separate account contracts, these contracts do not have investment directives determined by the contract holder and investment performance results are not attributed to a specific contract holder. The general account may serve as an overall backstop or may provide an implied guarantee, although a distinct performance guarantee may not be specified (such as a minimum crediting rate, death benefit, etc.). Examples of contracts expected to be captured within this provision include, but are not limited to, pension risk transfer (PRT) contracts, bank-owned life insurance (BOLI) and registered index-linked annuity (RILA) contracts

Footnote 1: The inclusion of this guidance does not imply support for these contracts within the separate account instead of the general account. The domiciliary state insurance regulator is responsible for assessing and approving separate account contract classification in accordance with state statutes.

Additionally, paragraph 22 is proposed to be expanded to reference fair value as the measurement method for other transfers. This is further discussed below, with a request for comments on the treatment of IMR, but also shown here as part of the proposed updated revisions for exposure: (This entire paragraph is new in the SSAP, the changes from the prior exposure are shaded.)

22. Asset transfers that do not reflect sales for cash between the general account and separate account are subject to domiciliary state approval and shall be recorded at fair value. Any transfer that does not represent an asset sale for cash shall be specifically disclosed in both the general account and separate account as detailed in paragraph 34.e. This shall include, but not be limited to, the following transfers:

    a. Asset to asset swaps

    b. Contributions of general account assets to support separate account deficiencies

    c. Dividends of assets from the separate account to the general account.

Discussion of Additional Guidance / Questions Exposed: As detailed in the ACLI comment letter, the ACLI has indicated that codification of guidance for other transfers and the accounting for seed money could result in “implicit prescribed practices” where established accounting guidance prescribed in SSAP No. 56 differs from what is detailed in the memorandum of operations for the separate account with the domiciliary state.

NAIC staff wants to clarify that a separate account memorandum of operations filed by an insurance company with their domiciliary insurer for an insurer-specific product does not reflect a prescribed practice of accounting. Prescribed accounting practices are practices incorporated directly or by reference to state laws, regulators and general administrative rules and are applicable to all insurance enterprises domiciled and/or licensed in a particular state. One of the fundamental concepts of statutory accounting is consistency, as consistent accounting and reporting for similar transactions is necessary for appropriate financial regulator review, solvency assessment and comparability purposes. With the establishment of codified accounting treatment, then all insurers will be following the same accounting and reporting guidance, and if the domestic insurer approves a practice that deviates from the uniform approach, that practice would be detailed in Note 1 of the financial statements as a prescribed or permitted accounting practice.

Although the ACLI has indicated that the other forms of noted transfers (asset to asset swaps, contributions of general account assets to support separate account deficiencies, and dividends of assets from the separate account to the general account) are not common, NAIC staff believes that such transfers, if they are occurring, could be key elements for regulator and solvency assessment. As such, NAIC staff suggests the inclusion of guidance to specify the accounting, and possible disclosure, of these actions and has proposed a fair value measurement.

NAIC staff proposes exposure of the following revised language, clarifying that the transfers shall be recorded at fair value, with a request for comment during the exposure period on whether IMR treatment between the general and separate account should be specifically described:

(This entire paragraph is new in the SSAP, the changes from the prior exposure are shaded.)

23. Asset transfers that do not reflect sales for cash between the general account and separate account are subject to domiciliary state approval and shall be recorded at fair value. Any transfer that does not represent an asset sale for cash shall be specifically disclosed in both the general account and separate account as detailed in paragraph 34.e. This shall include, but not be limited to, the following transfers:

a. Asset to asset swaps

b. Contributions of general account assets to support separate account deficiencies

c. Dividends of assets from the separate account to the general account.

Discussion of Separate Account Guarantees and RBC Calculation: For the other remaining items, NAIC staff highlights that the focus/purpose of separate accounts has changed since the origination of statutory accounting guidance in SSAP No. 56 and the RBC calculation. Historically, (and to achieve separate account accounting under U.S. GAAP), separate accounts reflected specific assets designated for contractholders, as the assets reflected investment options directed by the contractholder where 100% of the investment proceeds were attributed to the contractholder (less expenses). For these products, the fair value of the separate account assets would agree to the fair value of the separate account liability (amount owed to policyholders), and other than the risk of an insurer not acting/investing as directed by the contractholder, (as guarantees are reserved for in the general account) there was little risk to the insurer reflected in the separate account.

The use of separate accounts has expanded significantly from the original focus, and insurers are requesting use of separate accounts to serve as "segregated general accounts" rather than as true historic-design of separate accounts. With the revised use, and as the products (and assets/reserves) captured in the separate account would traditionally be considered general account products, it is important to include these separate account assets and liabilities with the overall solvency assessment for the company.

Ultimately, the discussion within this section requests feedback from regulators on whether other revisions or disclosures are needed to SSAP No. 56 to ensure full transparency of separate account products that do not fit within what is historically expected in scope of the standard. This is particularly noted with the definition of a guarantee (as the new SA products often do not have a stated guarantee), less explicit restrictions on investments (as the concept of nonadmittance does not exist in the SA blank and separate accounts can be excluded from state investment laws), and the lack of detail in determining RBC. It is noted that the disclosures in SSAP No. 56 do not match the category breakouts in the RBC calculation. Further, for the items reported at book value, the calculation of RBC (and the assets / factors to determine RBC) are all company records without detail provided in the RBC filing. NAIC staff has proposed a referral to Life RBC, but comments and discussion from regulators is requested.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-15 (Julie)	**ALM Derivatives**	**2 – Agenda Item**	**Comments Received**	**IP – 10**

Summary:
On August 13, 2024, the Working Group moved this item to the active listing, classified as a new SAP concept, and exposed this agenda item with a request for feedback on the items noted within the agenda item, which included an overall inquiry on the development of new guidance for the deferral of realized gains/losses for non-accounting effective hedges captured in *SSAP No. 86—Derivatives*. Discussion items captured in the agenda item included the following:

1) Do Working Group members support the development of statutory accounting guidance that would defer derivative gains/losses for structures that hedge interest rate risk with amortization over time into income? (These derivative programs would not qualify as accounting effective under SSAP No. 86 and are not captured within the specific variable annuity guarantee guidance in SSAP No. 108.)

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2) If further development / consideration of guidance is supported, the following items are noted for discussion:

   a. Determination of effectiveness that permits the derivative program to qualify for the special accounting treatment.

   b. Discussion of whether net deferred losses (reported as assets) would be admissible, and if so, any admittance limitations.

   c. Macro-limits on admittable net deferred losses (reported as assets) and other “soft” assets. (For example, capturing IMR and derivative deferred net losses, and then perhaps considering other soft assets, such as DTAs, EDP equipment and software, goodwill, etc.)

   d. Timeframes over which deferred items are amortized into income.

   e. Extent of application across the industry. (NAIC staff notes that SSAP No. 108 is only applied by 9 entities, and from a review of the derivative disclosures for INT 23-01, only 14 entities captured derivative gains/losses in the IMR balance.)

ACLI Comments:
We support the development of new statutory accounting guidance for interest-rate hedging derivatives that do not qualify for hedge accounting under *SSAP No. 86—Derivatives,* but that are used for asset-liability management (ALM), also referred to as “ALM Hedges”. ACLI is very appreciative of the on-going dialogue with SAPWG and the IMR Ad Hoc Working Group and stands ready to continue working with the NAIC on this initiative.

Companies manage ALM programs to mitigate reinvestment, guarantee, and disintermediation risks, and to manage asset portfolios within limited ranges around a liability target duration. The new statutory accounting guidance is intended for derivative transactions that alter the interest rate characteristics of assets/liabilities under these types of risk mitigation programs. More specifically, “macro-hedging” ALM programs hedge risks that are often off-balance sheet risks given the “amortized cost” nature of statutory accounting, and therefore hedge accounting frameworks do not address this type of hedging construct. As discussed in our white paper “Derivatives and Hedging with Life Insurance” (included as Appendix I), this is because the duration and convexity of assets and liabilities may differ. When interest rates change, asset and liability durations may change by different amounts, making it nearly impossible to maintain the tight effectiveness assessment corridor requirements as the measurement criteria do not include metrics commonly used in these programs (e.g., duration). As a result, economically effective “macro-hedges” are generally considered hedges and carried at fair value, which misstates insurer solvency by causing surplus volatility or worse, can disincentivize prudent risk management. As further discussed in Appendix I, there is a critical need for developing appropriate accounting guidance.

Within the exposure, NAIC staff has identified several items for further discussion:

2) If further development / consideration of guidance is supported, the following items are noted for discussion:
   a. Determination of effectiveness that permits the derivative program to qualify for the special accounting treatment.
   b. Discussion of whether net deferred losses (reported as assets) would be admissible, and if so, any admittance limitations.
   c. Macro-limits on admittable net deferred losses (reported as assets) and other “soft” assets. (For example, capturing IMR and derivative deferred net losses, and then perhaps considering other soft assets, such as DTAs, EDP equipment and software, goodwill, etc.)
   d. Timeframes over which deferred items are amortized into income.

e. Extent of application across the industry. (NAIC staff notes that SSAP No. 108 is only applied by 9 entities, and from a review of the derivative disclosures for INT 23-01, only 14 entities captured derivative gains/losses in the IMR balance.)

The ACLI previously provided a detailed presentation entitled "ACLI Derivative IMR Solution Proposal" ("ACLI Solution," included as Appendix II) to the IMR Ad Hoc Working Group. Discussions of the ACLI solution at the NAIC Ad Hoc IMR WG were the impetus for this exposure. The solution addresses many of the exposure's components and ACLI would appreciate the opportunity to present to the full SAPWG membership and any additional interested regulators.

Additionally, the ACLI would like to provide specific comments regarding the admittance limitations identified in discussion points 2b and 2c. Although one of the methods within the ACLI Solution includes accounting which does not utilize the IMR, discussion of accounting treatment revisions for ALM Hedging arose within the context of derivatives and IMR. Therefore, our comments start with the "Definition of IMR" developed by the IMR Ad Hoc Working Group:

> NAIC Staff Note: Although discussed at the ad hoc group, the following definition has not been exposed or adopted by the SAPWG:
>
> *IMR is a valuation adjustment to maintain consistency between insurance liabilities (the assumptions for which are often unchanged from origin) and the assets needed to support them (where the assumptions can essentially be revisited any time there are fixed income realizations).*
>
> *IMR defers and amortizes the recognition of non-economic gains or losses where investment activity, whether through fixed income investment sales or fixed income derivative hedging transactions, essentially unlock unrealized gains/losses for either assets or liabilities. IMR is not intended to defer economic gains and losses related to asset sales compelled by liquidity pressures that fund significant cash outflows (e.g., such as excess withdrawals and collateral calls).*
>
> *Specifically, the IMR valuation adjustment more appropriately reflects the impact to statutory surplus from fluctuations in interest rates and therefore provides a more accurate representation of solvency under the NAIC's statutory framework which often includes amortized cost valuation of fixed income investments and liability valuations with fixed assumptions in accordance with the Accounting Practices and Procedures and Valuation Manual.*

This definition is part of a broader document (see attached Appendix III) that provides foundational principles for the NAIC's statutory accounting framework.

As the document and definition of IMR states: fixed income investment assumptions can be more easily revised, that is "unlocked," when the investments are sold/purchased. Statutory reserve liability assumptions typically are not revised. Therefore, to avoid situations in which transitory interest rate related realized gains/losses caused inaccurate solvency reflections (which could disguise an insurer's true ability to pay claims), the IMR valuation adjustment was developed. Appendix III provides detailed examples in which this could occur. The IMR also remains a vital element of the statutory accounting framework and was incorporated in the methodology within other evolutions such as Principle-Based Reserving (PBR) and Asset Adequacy Testing (AAT).

The IMR is not an intangible asset, it is a valuation adjustment to reflect the company's true solvency position under statutory accounting. Therefore, equating negative IMR to an asset (tangible or intangible) with claims paying ability, is not logical or appropriate. Following this, imposing any limit on admittance would misconstrue an insurer's true solvency and would equate to a limit on unrealized losses on fixed income instruments more broadly, such as bonds where the unrealized losses are embedded within their amortized cost valuation; contrary to the purpose of the IMR and consistent valuation of assets and liabilities.

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ACLI understands regulators may wish to separate ALM derivatives from IMR (both for recording unrealized during their lives and for recording any applicable realized gains/losses). However, ACLI emphasizes, in light of the previous, that:

1. Fixed income ALM hedges can be used to alter the interest rate characteristics of assets and/or liabilities, and therefore are another method of "unlocking" the fixed assumptions. Whether ALM hedge realized gains/losses are included in the IMR or a separate valuation adjustment, they will be theoretically aligned and maintain the intent of the IMR (see the definition of IMR discussed above); and

2. Any fixed income hedge unrealized gains/losses are not intangible assets. They represent the offset to the valuation of the derivative itself (the contract asset/liability) and equate to the value needed to close (settle) the derivative contract with the counterparty.

Any limits (or potential subsequent non-admittance) on these components would in fact equate to a limit on ALM hedging programs themselves, disincentivizing insurers from engaging in vital, prudent, fixed income hedging strategies. As discussed in Appendix I and II, ALM hedges are used to mitigate reinvestment, guarantee, and disintermediation risks, as well as managing asset portfolios within limited ranges around a liability target duration, all of which are shared goals between regulators and insurers.

Further limiting hedging programs through statutory accounting guidance creates significant regulatory redundancies given other existing, effective regulatory protections:

1. From a state perspective, insurer hedging programs are limited under individual state laws and insurer DUPs, such as the type(s) of derivative programs and/or derivative contract(s). Insurers are also prohibited from speculative derivatives.

2. From a federal perspective, most standard US agreements with derivative counterparties also require derivative trades to be collateralized through margin requirements.[1] Collateral agreements ensure each counterparty (both the insurer and the institution on the other side of the derivative) are able to financially fulfill the derivative contract (ie., pay the amount owed for the derivative's fair value) and/or reduce default risks incorporated in the contract for either party. In this case, any limit on the "valuation offset" is overly punitive when the insurer is legally required to post collateral to the counterparty.

Therefore, an aggregate cap for IMR and/or ALM derivatives is not appropriate, and it is not logical to call them intangible assets that cannot be used to pay claims. Rather, "negative" or "asset" valuation adjustments are simply explicitly shown on the balance sheet, whereas other unrealized losses are embedded in their amortized cost carrying values (i.e., bonds), both of which are required for consistent valuation of assets and liabilities so surplus properly reflects an insurers claims paying ability.

Turning to the macro cap on "soft assets," it is difficult to group these items as one category given their unique characteristics and purpose within the statutory accounting framework. Prudent business and risk decisions should not be disincentivized by the presence of completely unrelated economically viable assets or valuation adjustments on a company's balance sheet. To view these "soft assets" or intangibles in isolation from their broader purpose is also not appropriate. The NAIC's framework is an "amortized cost framework" with appropriate embedded conservatism, not a liquidation basis of accounting, for both assets and liabilities.

[1] Mandated by the Dodd Frank Act and related SEC and CFTC regulatory requirements.

Deferred Tax Assets (DTAs) have appropriate conservatism by limiting reversals to 3-years as well as limiting carryback and carryforward potential. Further, DTAs represent real economic value to an insurer, and in fact does help pay claims by way of realizing tax benefits (i.e., reduction in tax payments).

Goodwill generally represents the difference between the cost of acquiring an entity and the reporting entity's share of the book value of the acquired entity. Within the acquisition, components of Goodwill could represent things of value such as costs acquiring a fully amortized building or an asset manager. Asset managers generally have limited balance sheet assets where its value is attributable to asset manager fees and directly proportional to assets under management (i.e., a not balance sheet metric).

Unlike US GAAP or IFRS, where Goodwill is not amortized because it is considered to have an indefinite useful life, until it is determined to be impaired, under statutory accounting Goodwill is conservatively amortized over a period not to exceed 10-years, as well as being subject to impairment testing.

DTAs and Goodwill also have percentage of surplus limitations, which serves as another layer of conservativism.

The common theme among all of these valuation adjustments and/or assets is that they either adjust values for consistent valuation of assets and liabilities to provide an accurate picture of claims paying ability or represent real economic value that help insurers pay claims. They are also all unique, with distinct purpose in the statutory accounting framework, so an aggregate limiting cap across other completely unrelated economically viable assets or valuation adjustments on a company's balance sheet is inappropriate.

Lastly, ACLI proposes a few brief comments on exposure item 2e regarding the extent of application in industry. From conversations with our members, use of SSAP No. 108 is limited due to its narrow scope (variable annuity guarantees only) and the relative rigor of guardrails that must be satisfied to implement (resource intensive, so the benefit must be substantial to justify the effort). However, we understand that the population of insurers who engage in macro-hedging programs is significantly larger and using the Negative IMR disclosures to gauge the population is not truly representative for several reasons, such as:

1. The interim solution did not allow insurers to engage in new hedging programs or to include any hedging programs that did not previously include realized gains within the IMR. There could be insurers who have had to adjust or start programs as the interest rate environment evolved, which may have disqualified them from using this guidance and therefore including their programs in the disclosure.

2. There is diversity in practice in insurer's interpretation of SSAP No. 86; not all insurers included gains/losses from interest rate related macro-hedging programs in the IMR, which also would have precluded them from using the interim guidance and included balances in the disclosure. Ensuring clear ALM hedging guidance would reduce diversity in practice and would likely lead to more insurers clearly identifying these programs in any future required disclosures.

<u>*Recommendation:*</u>
NAIC Staff highlights that this exposure was focused on soliciting information from regulators on whether new statutory accounting guidance should be established that would allow the deferral of gains/losses for derivative transactions that do not qualify as accounting-effective hedges under *SSAP No. 86—Derivatives.* The ACLI has indicated support for new accounting guidance.

If the Working Group supports proceeding with this approach, NAIC staff recommend directions to proceed with developing statutory accounting guidance, working closely with Working Group members and ACLI representatives with development. NAIC staff anticipates that the guidance may be complex but will work to present updates and drafts to the Working Group for consideration if so directed. It is anticipated that to the extent feasible, NAIC staff may leverage guidance and the approach in *SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees*. <u>**Additionally, NAIC staff notes that this is a complex topic and there are several**</u>

<u>**comments to consider. As such, the Working Group could choose to delay this decision to allow regulators a thorough review of the comments and possible ramifications of establishing guidance.**</u>

NAIC staff notes there are several comments in the ACLI's letter indicating support for reporting realized losses as admitted assets, and comments opposing any limit as to the admittance of these realized losses (or an aggregate admittance limit on "soft assets"), that makes it appear that the detailed questions / inquiries are not necessary before proceeding with these allowances under statutory accounting. NAIC staff does not believe it is a given that these items should qualify as admitted assets or have unlimited admissibility, and believes distinct discussions by the Working Group are warranted for the following reasons:

- **Prior to the issuance of INT 23-01, net negative IMR was reported as a nonadmitted asset**. The INT guidance permitting admittance up to 10% of adjusted capital and surplus is a new, limited-time permission. It is up to the Working Group whether net negative IMR (which reflects realized losses) should be permitted as an admitted asset after the INT expiration, and if there should be a limit as to admittance. Prior to the August 2023 adoption of the INT, insurers that elected to engage in these derivative transactions with realized losses were unable to admit these losses. As such, it should not be viewed as a given under statutory accounting / derivative risk management to allow the admittance of these derivative losses. Additionally, some have acknowledged that IMR can be a managed item, with companies having the ability to select assets to sale in accordance with how it would impact the IMR balance (liability or asset) and overall financial statements. With the 2023 admittance of net negative IMR up to 10% adjusted capital and surplus, financial data show that companies are trending towards a net loss (asset) position up to the admitted asset parameters. This same dynamic could occur if derivative losses are permitted to be deferred within IMR and recognized as admitted assets.

- **Prior to the issuance of INT 23-01, state insurance regulators were unaware that some insurance companies were interpreting the annual statement instruction reference of "hedging" to permit capitalization of realized losses for non-accounting effective derivatives through IMR**. The guidance in *SSAP No. 86—Derivatives* is specific that such treatment was only permitted for accounting-effective hedges, as the offset between the hedged item and hedging instrument basically eliminated the impact to IMR. Reporting entities pointed to a generic reference in the A/S instructions as support for the inclusion of "non-accounting effective" hedges, but that was not the original intent of the adopted statutory accounting guidance. With the process that some companies currently follow, realized losses from non-accounting effective hedges are being repeatedly recognized (3-month derivatives) and the amortization timeframe companies support stretches over a significant period of time (years). With this approach, as long as the derivative arrangements result in realized losses, the amount of realized losses permitted to be presented as admitted assets (if further allowed) will just continue to increase as the amortization amount (over the longer timeframe) is much less than what is currently being recognized. As the realized loss balance builds, there would have to be derivative arrangements that result in substantial realized gains to reduce the balance timelier.

- **Deferring and amortizing gains and losses from derivative transactions is not permitted under U.S. GAAP. Under U.S. GAAP, all derivatives are reported at fair value, and all gains/losses are recognized immediately. It is only the location of the gain/loss, either directly through earnings or through other comprehensive income, that varies under U.S. GAAP based on whether the derivative is designated as hedging.** Under U.S. GAAP, derivative accounting is essentially an income-statement matching exercise where the gain/loss from the hedging instrument offsets the gain/loss for the hedged item. If the transaction does not qualify as hedged, the gain/loss is recognized currently in earnings**. In FAS 133, the FASB discussed decisions to require all derivatives to be reported at fair value, as well as their conclusion that only items that are assets or liabilities should be reported as such in the financials. Pursuant to this discussion (paragraph 229 of FASB 133), the FASB clarifies that gains and losses from derivative transactions are not separate assets or liabilities because they have none of the essential characteristics of assets or liabilities.**

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229. Only items that are assets or liabilities should be reported as such in financial statements. Derivatives are assets or liabilities, and the Board decided that they should be reported in financial statements (fundamental decision 1) and measured at fair value (fundamental decision 2). If derivatives are measured at fair value, the losses or gains that result from changes in their fair values must be reported in the financial statements**. However, those losses or gains are not separate assets or liabilities because they have none of the essential characteristics of assets or liabilities as described in paragraph 218. The act of designating a derivative as a hedging instrument does not convert a subsequent loss or gain into an asset or a liability. A loss is not an asset because no future economic benefit is associated with it. The loss cannot be exchanged for cash, a financial asset, or a nonfinancial asset used to produce something of value, or used to settle liabilities. Similarly, a gain is not a liability because no obligation exists to sacrifice assets in the future. Consequently, the Board concluded that losses or gains on derivatives should not be reported as assets or liabilities in a statement of financial position.**

- **Although industry compares unrecognized unrealized losses for bonds held at amortized cost to realized losses from the sale of bonds, some may disagree with this comparison**. While bonds held at amortized cost may have unrecognized fair value changes over time, when the bond matures, the insurer will receive the principal return. The unrecognized fair value fluctuations, unless there is a credit event, has no impact on what the insurer will receive at maturity and can use for policyholders. A realized loss from the sale of a bond is a definite action that monetizes a fair value change. Recovering that loss is contingent on actions to reinvest the sale proceeds to obtain a higher yield. If reinvestment does not occur, an action that is difficult to verify given the fungibility of cash flows, that realized loss will not be recovered. Therefore, while realized and unrealized losses can obtain equivalent economic results, there is much higher execution and verification risk associated with realized losses that requires significant guardrails to prevent the masking of economic losses.

- **The ultimate objective of solvency regulation is to ensure that the policyholder, contract holder and other legal obligations are met when they come due and that companies maintain capital and surplus at all times and in such forms as required by statute to provide a margin of safety.** Pursuant to the SAP recognition concept pursuant to paragraph 36 of the Preamble to the *Accounting Practices and Procedures Manual*, "the ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third-party interests should not be recognized on the balance sheet but rather should be charged against surplus when acquired or when availability otherwise becomes questionable." The Preamble here recognizes both current and future obligations as being relevant to the economic value of assets, hence supporting carrying bonds at amortized cost even when it exceeds their current marketable value. **A realized loss does not reflect an asset that is available for policyholder claims.** (Consistent with the U.S. FASB position, a realized loss does not qualify as an asset under SSAP No. 4 as there is no future benefit generated from the loss.) While a loss on an economic hedge does, in theory, represent a future value that is expected to be generated by incremental return on the invested assets, it does not have a direct, marketable value in accordance with the Preamble. **Although consideration can be given to permit admitted asset classification for realized derivative losses, such consideration would be a specific provision by the Working Group and is not consistent with the statutory accounting definition of an admitted asset (or as an asset under U.S. GAAP)**. Some have noted that, although this is being considered as a potential admitted asset" it should be thought of as an adjustment to the policy reserve to partially "unlock" the valuation rate. Ultimately, the prevalence of "soft" assets (and realized losses permitted as admitted assets) should be monitored and managed by regulators as they do not reflect the types of assets that can be directly utilized for policyholder claims. Establishing an aggregate admittance limit or getting aggregate disclosures on these items collectively, is within the purview of state insurance regulators and the oversight of insurer solvency.

- **Industry has argued that implementing an aggregate cap on "soft assets" would be inappropriate. However, specific regulatory caps and limits already exist for certain types of "soft assets," and it is consistent with statutory principles to apply an aggregate cap on the accumulation of such assets within the same framework.** Industry notes that the common theme for “soft assets” is that they either adjust values for consistent valuation of assets and liabilities to provide an accurate picture of claims paying ability or represent real economic value that help insurers pay claims. While NAIC staff does not necessarily disagree with this perspective, the economic value of these assets and valuation adjustments do not directly correspond to funds available for paying policyholder claims, and neither are they readily marketable as discussed in the prior paragraph. Furthermore, concentrations of such assets pose an increased solvency risk. However, the statutory caps currently in place take a narrow, individual view of the risks associated with these soft assets. If an insurer were to accumulate multiple types of soft assets and admit amounts up to the individual caps for each, the combined admitted value could significantly impact admitted surplus. While these financial instruments are distinct, they all represent abstractions of economic value in the context of the preamble recognition concept cited above. Implementing an aggregate cap to guard against the excessive accumulation of various kinds of “soft assets” would align with existing statutory principles and fall within the scope of regulatory oversight.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-26EP (Julie)	**Fall 2024 Editorial Revisions**	**3 – Agenda Item**	**Comments Received**	**IP – 61**

<u>*Summary:*</u>
On November 17, 2024, the Working Group exposed editorial revisions to *SSAP No. 26—Bonds* to clarify an annual audited disclosure for assets receiving bond treatment, with clarification that the disclosure shall be completed by category and subcategory as reported in Schedule D-1-1 and D-1-2. This item was exposed with a shortened comment deadline ending November 9, 2024.

39e. For each annual balance sheet presented, the book/adjusted carrying values, fair values, excess of book/carrying value over fair value or fair value over book/adjusted carrying values for each pertinent bond or assets receiving bond treatment, by category and subcategory as reported in Annual Statement Schedule D – Part 1, Section 1 (Issuer Credit Obligations) and Section 2 (Asset-Backed Securities).

<u>*Interested Parties’ Comments:*</u>
Interested parties request a deferral of Ref #2024-26 EP for further discussion in 2025 to address several concerns that we have with the proposal. We believe that the terms ‘category and subcategory’ need clarification as we’ve interpreted that category equates to *ICO* and *ABS* and subcategory equates to examples such as ‘*Non-U.S. Sovereign Jurisdiction Securities*’ and ‘*Other Non-Financial Asset-Backed Securities – Practical Expedient*’. We suggest clarifying language in the Investment Schedules General Instructions of the Annual Statement Instructions to differentiate between Categories and Subcategories. The proposed revisions to SSAP No. 26 would require disclosure of all the new Schedule D – Part 1 categories and the underlying subcategories in the audited financial statements. The Principles-Based Bond Project has: a) significantly increased the number of Schedule D – Part 1 categories/subcategories and b) introduced more judgment and subjectivity with respect to the classification of bonds into these subcategories. As a result, we are concerned that subjecting these processes to audit will result in additional reporting and audit burden disproportionate to the value of these disclosures in the audited financial statements. We understand regulators' desire for comfort with respect to the appropriate classification of bonds. However, we would like to discuss whether a less prescriptive, principles-based approach might provide the desired information and audit comfort, while limiting the undue burdens for reporting entities and their auditors.

Recommendation:
NAIC staff recommend adopting the exposed editorial change to *SSAP No. 26—Bonds*. The proposed requirement is consistent with the current disclosure, just using broad terms to detail the reporting level rather than named categories.

NAIC staff notes that the agenda item was created as industry representatives raised concerns that the disclosure (which eliminated the named categories that currently exist in SSAP No. 26) could require a full listing of bonds in the audited financial statements. NAIC staff highlights that the existing guidance in SSAP No. 26 requires a per category disclosure breakdown. Although NAIC staff recognizes that the categories have been expanded under the principles-based bond project, this has been done to ensure that regulators have more transparency of the investments held that are classified as "bonds." NAIC staff recognizes that state regulators often rely on the work of auditors in the annual audit for verification. NAIC staff have concerns that the reliance on the revised reporting categories will be diminished if a more generic audit requirement is permitted. For example, if the categories were only at the issuer credit obligation (ICO) or asset-backed security (ABS) level, then the reporting verification of ABS backed by equity or ABS that required a full analysis would not be captured. As it is anticipated that regulators may focus enhanced examination procedures on these categories, it would be imperative to ensure that the bonds being reported in those categories represent an accurate, complete picture of those bonds held.

NAIC staff also notes that auditors often employ a risk-focused examination approach, therefore the audit efforts required will be contingent on that assessment on a per-company basis.

NAIC supports adoption of the revisions so that the guidance is in place for 2025 with a suggestion for subsequent industry proposals if future consideration is necessary.

Existing disclosure in SSAP No. 26:

> 30.e For each balance sheet presented, the book/adjusted carrying values, fair values, excess of book/carrying value over fair value or fair value over book/adjusted carrying values for each pertinent bond or assets receiving bond treatment, category reported in Annual Statement Schedule D – Bonds issued by:
>
> i. U.S. Governments;
> ii. All Other Governments;
> iii. States, Territories and Possessions (Direct and Guaranteed);
> iv. U.S. Political Subdivisions of States, Territories and Possessions (Direct and Guaranteed);
> v. U.S. Special Revenue & Special Assessment Obligations and all Non-Guaranteed Obligations of Agencies and Authorities of Governments and Their Political Subdivisions;
> vi. Industrial & Miscellaneous (Unaffiliated);
> vii. Hybrid Securities;
> viii. Parent, Subsidiaries and Affiliates;

The comment letters are included in Attachment 4 (62 pages).

(Note, the ACLI included referenced appendices in their comment letters.)

Statutory Accounting Principles (E) Working Group
Meeting Agenda
December 17, 2024

A. Consideration of Maintenance Agenda – Pending List

1. Ref #2024-27: Issue Papers in Statutory Hierarchy
2. Ref #2024-28: Holders of Capital Notes

Ref #	Title	Attachment #
2024-27 (Julie)	**Issue Papers in Statutory Hierarchy**	**A – Form A**

Summary:
This agenda item has been drafted to capture issue papers in level 5 of the statutory hierarchy pursuant to the direction from the 2024 Fall National Meeting. Additionally, revisions have been proposed to update the process to develop issue papers to reflect current Working Group practice. (For example, historical guidance references issue papers as the first step of a new SSAP/new SAP concept, but current practice most often has issue papers developed subsequent to statutory accounting revisions to detail discussions and decisions for historical reference.)

The revisions in the agenda item include the following:

- Reference of statutory issue papers to Level 5 of the statutory hierarchy
- Guidance on issue papers in the Appendix E – Issue Papers introduction
- Guidance on issue papers in "How to Use This Manual"
- Reference to issue papers in "NAIC Policy Statement on Maintenance of Statutory Accounting Principles"

Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing and expose the proposed revisions to include issue papers within Level 5 of the statutory hierarchy along with the corresponding revisions on the use and development of issue papers.

NAIC staff does not recommend revising the historical language in adopted issue papers, but with adoption of this agenda item, recommends the following to be added to each Issue Paper: "On (month/year), Issue Papers were included in Level 5 of the Statutory Hierarchy."

Ref #	Title	Attachment #
2024-28 (Julie)	**Holders of Capital Notes**	**B – Form A**

Summary:
This agenda item has been prepared in response to the direction of the Working Group during the 2024 Fall National Meeting with the adoption of *INT 24-01: Principles-Based Bond Definition Implementation Questions and Answers*. With the adoption of the INT, and the guidance for reporting certain debt securities as capital notes in scope of *SSAP No. 41—Surplus Notes*, industry identified that slight revisions may be necessary to reflect the capital note distinctions. The Working Group directed NAIC staff to work with industry in this review and identifying necessary changes.

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From the initial review and working with industry, revisions have been proposed to address the following specifically for capital notes:

1. Incorporate a definition / reference to the INT for capital notes.
2. Clarify the admittance restrictions.
3. Clarify the guidance for NAIC designations.
4. Update the impairment guidance to refer to capital notes.

In addition to these items, it was identified that an existing disclosure for surplus notes, which requires disclosures of holders for registered surplus notes, is likely an extensive administrative burden, may not be feasible to complete, and as a narrative disclosure only, is likely not being utilized by regulators. From a review of the disclosure, it predates the issuance of *SSAP No. 41—Surplus Notes*, and there are questions as to its purpose / use. NAIC staff has proposed to eliminate this aspect of the disclosure but retain the disclosure focusing on surplus notes with affiliates.

Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing as a SAP clarification and expose revisions to incorporate revisions to *SSAP No. 41—Surplus Notes*, to incorporate needed changes to clarify capital note references and guidance. As part of the review, revisions were also incorporated into other aspects identified for clarification.

As there are two separate reporting lines on Schedule BA for "Surplus Notes" and "Capital Notes" with very few items currently being reported in the "Capital Note" category, this agenda item recommends annual statement instruction revisions to clarify that qualifying insurer-issued notes held by another insurance reporting entity be reported as "Surplus Notes" on Schedule BA. There is also proposed clarification on what should be included as "Capital Notes.

B. Consideration of Items on the Active Maintenance Agenda

1. Ref #2024-16: Repack and Derivative Investments

Ref #	Title	Attachment #
2024-16 (Julie)	**Repack and Derivative Investments**	**C – Form A**

Summary:
On November 17, 2024, the Working Group elected to not proceed with the proposed edits to SSAP No. 86 to require bifurcation of debt securities with derivative wrappers or components. With this action, debt securities with derivative components that reflect structured notes will be retained in *SSAP No. 86—Derivatives*, and all other debt securities with derivative components and wrappers shall be assessed in accordance with the principles-based bond definition. Debt securities that do not qualify as bonds under the principles-based bond definition shall be reported as non-bond debt securities in scope of *SSAP No. 21—Other Admitted Assets* and on Schedule BA. The Working Group did agree with proceeding with the clarifications in the investment disposal schedules, and the sponsoring of a blanks proposal, to ensure that a debt security sold to an SPV and reacquired with derivative components is shown as a disposal and an acquisition in the investment schedules.

Recommendation:
NAIC staff recommend that the Working Group expose this item to be concurrent with a blanks exposure to update the investment schedule disposal schedules. (The Blanks Working Group will expose their proposal via email shortly after the SAPWG exposure for a concurrent period.)

C. <u>**Any Other Matters**</u>

The following agenda items were exposed until Dec. 16, 2024. Although comments have been received, they are not planned for discussion until 2025, either on an interim call or at the 2025 Spring National Meeting.

- 2022-14: Issue Paper on revisions to *SSAP No. 93—Investments in Tax Credit Structures* and *SSAP No. 94—State and Federal Tax Credits*

- 2023-24: Issue Paper that details U.S. GAAP guidance prior to the adoption of the current expected credit loss (CECL) guidance.

- 2024-04: Exposed agenda item and memo that details accounting, reporting and RBC guidance for repo and sec lending transactions.

- 2024-07: Exposed revisions to the annual statement and related instructions to add new reinsurance schedules to capture information on modified co-insurance reporting.

Comment Deadlines:

- **All exposed items are proposed to have a comment deadline of Jan. 31, 2025.** This corresponds with the deadline for items exposed at the Fall National Meeting. If additional time is needed for a specific topic, industry is requested to submit those requests directly to NAIC staff.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/12-17-2024/00 - 12-17-2024 - SAPWG Hearing Agenda.docx

Statutory Accounting Principles (E) Working Group
Hearing Agenda 2
December 17, 2024

ROLL CALL

Dale Bruggeman, Chair	Ohio	Judy Weaver/Steve Mayhew	Michigan
Kevin Clark, Vice Chair	Iowa	Doug Bartlett	New Hampshire
Sheila Travis/Richard Russell	Alabama	Bob Kasinow	New York
Kim Hudson	California	Diana Sherman	Pennsylvania
William Arfanis/Michael Estabrook	Connecticut	Jamie Walker	Texas
Rylynn Brown	Delaware	Doug Stolte/Jennifer Blizzard	Virginia
Cindy Andersen	Illinois	Amy Malm/Elena Vetrina	Wisconsin
Melissa Gibson/Bill Werner	Louisiana		

NAIC Support Staff: Julie Gann, Robin Marcotte, Jake Stultz, Jason Farr, Wil Oden

Note: This meeting will be recorded for subsequent use.

REVIEW of COMMENTS on EXPOSED ITEMS

The following items are open for discussion and will be considered separately.

1. Ref #2024-05: Appendix A-791
2. Ref #2024-06: Risk Transfer Analysis of Combination Reinsurance Contracts

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-05 (Robin)	**Appendix A-791**	**2.1 – Agenda Item**	**Comments Received**	**ACLI – 2**

Summary:
At the Summer National meeting the Working Group noted that no written comments on the Spring 2024 exposure were received. However, at the verbal request of the ACLI, the Working Group re-exposed revisions to Appendix-791, paragraph 2c's Question and Answer. The comment deadline on this agenda item was subsequently extended to Dec. 9 at the request of the ACLI.

This agenda item was developed in response to the December 2023 Valuation Analysis (E) Working Group's (VAWG) referral to the Statutory Accounting Principles (E) Working Group which recommends making a clarifying edit to *Appendix A-791 Life and Health Reinsurance Agreements* (A-791), Section 2.c's Question and Answer by removing the first sentence, which reads, "Unlike individual life insurance where reserves held by the ceding insurer reflect a statutorily prescribed valuation premium above which reinsurance premium rates would be considered unreasonable, group term life has no such guide." The referral notes that:

> First, this sentence is unnecessary, as it is an aside in a discussion about group term life. More importantly, this statement is being misinterpreted as supporting the use of Commissioner's Standard Ordinary (CSO) rates as a "safe harbor," at or below which YRT rates would be automatically considered not to be excessive.

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> The 791 section 2c QA guidance does not provide a safe harbor based on CSO. It indicates that if the YRT reinsurance premium is higher than the proportionate underlying direct premium for the risk reinsured, then the reinsurance premium is excessive. VAWG observes that the prudent mortality under the *Valuation Manual*, Section 20: Requirements for Principle-Based Reserves for Life Products (VM-20), may appropriately be either higher or lower than the CSO rate depending on the facts and circumstances.

The Working Group also notified the Valuation Analysis (E) Working Group, the Life Actuarial (A) Task Force and the Reinsurance (E) Task Force of the exposure.

ACLI Comments
ACLI would like to express our sincere gratitude for your time and willingness to collaborate with us on these reinsurance matters. We value the open dialogue and believe it has contributed to a more informed and constructive regulatory process. Through our discussions, we have gained a deeper understanding of the concerns raised by SAPWG regulators while also conveying the perspectives of our members.

ACLI members continue to believe that the two proposals (Ref #2024-05 and Ref #2024-06) are inextricably linked and should be considered together.

Ref #2024-05: A-791 Paragraph 2.c.

ACLI members believe that retaining the language in Appendix A-791, paragraph 2.c., is consistent with the statutory accounting requirement that reinsurance should not deprive a ceding insurer of surplus. With that said, we propose changes below to SAPWG 2024-06 that, if adopted, would address our concerns with the exposed changes in SAPWG 2024-05.

ACLI agrees that statutory risk transfer requires a careful evaluation of the facts and circumstances of a reinsurance agreement and should never rely on a simplistic application of “safe harbor” rules. Appendix A-791 already provides an objective standard by which to assess whether YRT premiums are excessive. That is, premiums are considered excessive if they result in the deprivation of ceding insurer surplus. The adoption of the change proposed by 2024-05 might be interpreted as introducing some other standard to determine whether premiums are excessive. However, no objective criteria have been provided by which to apply such other standards and, as a result, the adoption of the proposed change serves to create the potential for a range of interpretations as to what constitutes an excessive YRT premium. Such differences in interpretation are already surfacing with some parties interpreting the combination of the two SAPWG exposures to indicate that all combination Coinsurance-YRT (Co-YRT) agreements are non-proportional and therefore do not provide reserve credit; a conclusion that ACLI believes is inconsistent with SAPWG intent based on conversations we have had with regulators.

To avoid the potential for misinterpretation, ACLI proposes that the 2024-05 exposed changes only be adopted if done concurrently with the ACLI version of SAPWG 2024-06 proposed below.

Another concern is that some may interpret the proposed 2024-05 exposure to require an assessment of YRT premiums using a standard other than the existing standard provided in SSAP No. 61 that precludes ceding insurer surplus deprivation. In such a case, there could be significant variation in regulatory interpretations as to what constitutes an “excessive” YRT premium leading to inconsistency rather than harmonization.

Recommendation:
NAIC staff continues to agree with the original Dec. 9, 2023 VAWG referral to the Working Group which noted that the sentence in A-791, paragraph 2c is an unnecessary sentence. The sentence proposed for deletion is to contrast that **individual life** insurance is different in a question / answer about **group term life** (see below). The reason that VAWG suggested deleting the sentence is that companies were misusing it to imply that the different individual life rules could be used for group term life and that is incorrect. NAIC staff defers to the Working Group on timing but continues to recommend deletion of this sentence.

March 2024 exposed revision to A-791, Life and Health Reinsurance Agreements, paragraph 2c QA:

2. No insurer shall, for reinsurance ceded, reduce any liability or establish any asset in any statutory financial statement if, by the terms of the reinsurance agreement, in substance or effect, any of the following conditions exist:

c. The ceding insurer is required to reimburse the reinsurer for negative experience under the reinsurance agreement, except that neither offsetting experience refunds against current and prior years' losses under the agreement nor payment by the ceding insurer of an amount equal to the current and prior years' losses under the agreement upon voluntary termination of in force reinsurance by the ceding insurer shall be considered such a reimbursement to the reinsurer for negative experience. Voluntary termination does not include situations where termination occurs because of unreasonable provisions which allow the reinsurer to reduce its risk under the agreement. An example of such a provision is the right of the reinsurer to increase reinsurance premiums or risk and expense charges to excessive levels forcing the ceding company to prematurely terminate the reinsurance treaty;

A-791, Life and Health Reinsurance Agreements, paragraph 2c's, Question and Answer):

Q – If group term life business is reinsured under a YRT reinsurance agreement (which includes risk-limiting features such as with an experience refund provision which offsets refunds against current and/or prior years' losses (i.e., a "loss carryforward" provision), under what circumstances would any provisions of the reinsurance agreement be considered "unreasonable provisions which allow the reinsurer to reduce its risk under the agreement" thereby violating subsection 2.c.?

A – ~~Unlike individual life insurance where reserves held by the ceding insurer reflect a statutorily prescribed valuation premium above which reinsurance premium rates would be considered unreasonable, group term life has no such guide.~~ So long as the reinsurer cannot charge premiums in excess of the premium received by the ceding insurer under the provisions of the YRT reinsurance agreement, such provisions would not be considered unreasonable. Any provision in the YRT reinsurance agreement which allows the reinsurer to charge reinsurance premiums in excess of the proportionate premium received by the ceding insurer would be considered unreasonable. The revisions to this QA regarding group term life yearly renewable term agreements ~~is~~ are effective for contracts in effect as of January 1, 2021.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-06 (Robin)	Risk Transfer Analysis on Combination Reinsurance Contracts	2.2 – Agenda Item	Comments Received	ACLI– 3 Stevenson –7

Summary:

The Working Group exposed agenda item 2024-06 in March 2024 to address the risk transfer aspect of a December 2023 referral by the Valuation Analysis (E) Working Group (VAWG). The exposed *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance* revisions were narrowly focused and incorporated guidance noting that interdependent contract features such as shared experience refunds must be analyzed in the aggregate when determining risk transfer. At the Summer National Meeting, the Working Group reviewed two letters. One that was in support of the exposed revisions and comments from the ACLI that requested further discussion. The Working

Group re-exposed the revisions previously exposed in March 2024 with a request for specific recommendations. The comment deadline on this agenda item was subsequently extended to Dec. 9 at the request of the ACLI.

The Working Group exposure is based on existing guidance that is in both U.S. GAAP and in *SSAP No. 62—Property and Casualty Reinsurance Exhibit A – Implementation Questions and Answers,* question 10. The exposed guidance **provides that contracts with interdependent features must be analyzed in the aggregate for risk transfer.** In addition, a reference to A-791, paragraph 6 which requires that the reinsurance contract include provisions that the agreement shall constitute the entire agreement between the parties with respect to the business being reinsured thereunder and that there are no understandings other than as expressed in the agreement was proposed to be added to the existing required YRT criteria.

The VAWG referral, excerpted below, included risk transfer concerns regarding interdependent contract features which had been analyzed for risk transfer separately instead of in the aggregate. It also raised several concerns regarding the classification of reinsurance contracts and the size of the reinsurance credit taken. The referral noted that **(bolding added for emphasis)**:

> VAWG has identified that issues arise when evaluating reinsurance for risk transfer in accordance with *SSAP No. 61—Life, Deposit-Type and Accident and Health Reinsurance*, when treaties involve more than one type of reinsurance, and there is **interdependence of the types of reinsurance, including but not limited to an experience refund that is based on the aggregate experience**. In such cases, VAWG regulators find that these types of reinsurance must be evaluated together and cannot be evaluated separately for the purpose of risk transfer. For example, where a treaty includes coinsurance and YRT with an **aggregate experience refund and the inability to independently recapture the separate types of reinsurance**, **it is not adequate to separately review the coinsurance and YRT pieces of the transaction for risk transfer**. The treaty as a whole is non-proportional. **This complexity is not immediately apparent to the regulatory reviewer, and it is important that this issue be raised broadly, so that individual state regulators are aware. In**dividual regulators are encouraged to contact VAWG if they would like additional perspective when reviewing such treaties.
>
> Generally, VAWG regulators observe that **some companies are reporting an overstated reserve credit due to a bifurcated risk transfer analysis.** Specifically, some companies reported a proportional reserve credit for a coinsurance component, despite in aggregate the reinsurer only being exposed to loss in tail scenarios. From an actuarial perspective, there is consensus among VAWG members that it is not appropriate for a ceding company to take a proportional reserve credit that reflects the transfer of all actuarial risks when not all actuarial risks are transferred.
>
> VAWG recommends that SAPWG discuss this issue, to 1**) increase familiarity with the issue and 2) consider whether any clarifications to risk transfer requirements is appropriate.**

As noted in the referral above, regulators have observed reinsurance transactions that combine both coinsurance and YRT, with interdependent features including an aggregate experience refund and recapture provisions that allow for recapture by the cedant, but only if both components are recaptured simultaneously.

VAWG observed that some insurers have assessed these components under A-791 as if they were separate agreements, concluding that the requirements for risk transfer are met for each. Reserve credit was then taken on each component; a proportional credit for the quota share on the coinsured policies, and a YRT credit for the YRT component. Note that YRT contracts ordinarily cover a percentage of the one-year mortality risk for the net amount at risk on a policy. A simple way to describe net amount at risk is the difference between the policy reserve held and the face value of the policy.

ACLI Comments
ACLI members continue to believe that the two proposals (Ref #2024-05 and Ref #2024-06) are inextricably linked and should be considered together.

Ref #2024-06: Risk Transfer Analysis for Combination Reinsurance Contracts

ACLI would like to thank SAPWG for the ongoing discussions regarding SAPWG 2024-06. During our discussions, we showed that combination Co-YRT agreements can be structured in ways that satisfy statutory risk transfer requirements as well as in ways that fail to satisfy statutory risk transfer requirements. We showed that when the YRT premiums were set at or below valuation level mortality, risk transfer was achieved (as ceding insurer surplus was protected against deprivation), but when YRT premiums were in excess of these amounts that risk transfer was not achieved (as ceding insurer surplus was not protected and could become negative). We concluded that taking a full proportional reserve credit for coinsured business and a ½ c_x credit for business ceded on a YRT basis (under a combination Co-YRT agreement) would be appropriate when agreements meet statutory risk transfer requirements such as having YRT premiums set at or below valuation mortality. To clarify SAPWG 2024-06 in order for it to recognize this result, we propose the following refinements to the exposure.

Proposed Risk Transfer Framework

ACLI proposes the following framework for assessing combination Co-YRT agreements for statutory risk transfer purposes:

- Any risk transfer assessment of combination Co-YRT agreements should be conducted in the context of applicable SAP guidance and based on the facts and circumstances of the relevant reinsurance agreement(s).
- SAP coinsurance guidance should be applied to the coinsurance component of the agreement(s) and SAP YRT guidance should be applied to the YRT component of the agreement(s).
- Additionally, an overall assessment of the combined agreement should be performed consistent with the requirement that "the agreement shall constitute the entire agreement between the parties with respect to the business being reinsured thereunder[.]"[1] to ensure that ceding insurer surplus is not deprived.

ACLI agrees that if any individual component of a combination Co-YRT agreement does not pass statutory risk transfer, then the aggregate transaction would not pass statutory risk transfer regardless of how it is structured. An overall assessment should include, among other things, an evaluation of:

i) the coinsurance agreement(s) to ensure that all significant risks inherent in the reinsured business are transferred, and

ii) the YRT agreement(s) to ensure that the conditions described in Appendix A-791, paragraphs 2.b., 2.c., 2.d., 2.h., 2.i., 2.j. or 2.k. are not violated, and

iii) the entire agreement to confirm that, when assessed in aggregate, it does not deprive a ceding insurer of surplus or require payments other than from the statutory net gain before adjustments (i.e., as defined in the 2023 SAP life blank line 29, hereinafter "net gain") realized from the reinsured policies.

ACLI agrees that agreements that inappropriately preclude any possibility of reinsurance losses being incurred because of excessive YRT premiums would be of concern from a statutory risk transfer perspective. In evaluating whether this is the case, YRT premium levels should be assessed using statutory principles as any resulting reserve credit will also have been established using statutory principles. In applying statutory principles, statutory valuation assumptions serve as an acceptable benchmark when assessing whether YRT premiums are excessive. More specifically:

- YRT reinsurance results in the assumption of mortality risk for the lifetime of the underlying business. In

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such a context, the statutory valuation framework already defines a reasonably prudent valuation mortality basis for ceding insurers when reserving for such risks. As such, this same valuation mortality basis should also serve as a reasonable and prudent benchmark for reinsurers to consider when committing to the assumption of mortality risk for the lifetime of the underlying business.

- The determination of reserve credit relates to the underlying statutory reserves that are held by the ceding insurer and determined based on statutory principles and assumptions. It would be inconsistent to determine a reserve credit using GAAP principles and assumptions in relation to underlying reserves that are computed using statutory principles and assumptions.

Proposed Changes to SSAP No. 61 and Appendix A-791

In response to SAPWG's request for specific recommendations, ACLI proposes the following changes to SSAP No. 61 and the introduction of a new question to be added to Appendix A-791 in lieu of the exposed changes proposed in SAPWG 2024-06.

ACLI proposes the following paragraph be adopted in SSAP No. 61. This proposal aims to maintain SAPWG's objective of evaluating agreements in aggregate and ensuring the appropriate application of current risk transfer principles.

> 18. *For purposes of evaluating whether a reinsurance agreement satisfies statutory risk transfer requirements, the determination of what constitutes an agreement is essentially a question of substance. Multiple agreements should be evaluated together for risk transfer purposes when they are entered into together to achieve one overall commercial effect and where considerations to be exchanged under one agreement depend on the performance of the other agreement(s). For individual agreements that contemplate reinsurance on both a YRT and coinsurance basis, each of the YRT and coinsurance reinsurance components need to satisfy risk transfer requirements on their respective bases. In addition, when evaluated in its entirety, such agreements cannot deprive the ceding insurer of surplus nor require payments to the reinsurer for amounts other than the net gain realized from the reinsured policies.*

ACLI proposes a second question be added to Appendix A-791 2b:

Question

> *If business is reinsured under a combination reinsurance agreement where the reinsurer assumes certain risks on a coinsurance, modified coinsurance, and/or coinsurance funds withheld basis and other risks on a YRT basis, what conditions are required to ensure that the ceding insurer is neither deprived of surplus nor required to make payments to the reinsurer from other than the net gain realized from the reinsured policies such that risk transfer is achieved? How are these conditions impacted by the agreement having an experience refund formula?*
>
> a. *The reinsurance agreement cannot deprive the ceding insurer of surplus or assets. If treaty provisions limit payment of amounts to the reinsurer to the amount of net gain realized from the reinsured business, then the ceding insurer surplus is not deprived, and risk transfer is achieved.*
>
> *For example, risk transfer requirements are satisfied when YRT premiums are contractually stipulated to be equal to or less than the level of valuation mortality used by the ceding insurer in calculating reserves for the reinsured business at the time of inception of the reinsurance agreement and are contractually constrained not to exceed this level.*
>
> b. *The fact that there is an experience refund does not, in itself, cause an agreement to fail risk transfer. However, an experience refund that requires that the ceding insurer reimburse the reinsurer for negative*

experience using amounts it has in surplus is a violation of risk transfer requirements, except that neither offsetting experience refunds against current and prior years' losses under the agreement nor payment by the ceding insurer of an amount equal to the current and prior years' losses under the agreement upon voluntary termination of in-force reinsurance by the ceding insurer shall be considered such a reimbursement to the reinsurer for negative experience.

Summary

Ultimately, our primary concern remains that some may interpret the proposed 2024-06 exposure to indicate that all combination Co-YRT agreements are non-proportional and therefore should not provide reserve credit. Such an interpretation would affect in-force combination Co-YRT agreements and create the potential for material volatility in surplus levels for ceding insurers who have previously entered into such agreements. In addition, such an interpretation would effectively eliminate the ability to use such agreements going forward. Based on our discussions with SAPWG, it is our understanding that neither of these outcomes are intended.

Another concern is that some may interpret the proposed 2024-05 exposure to require an assessment of YRT premiums using a standard other than the existing standard provided in SSAP No. 61 that precludes ceding insurer surplus deprivation. In such a case, there could be significant variation in regulatory interpretations as to what constitutes an “excessive” YRT premium leading to inconsistency rather than harmonization.

ACLI believes that one way to maintain the ability to use compliant combination agreements and not bring into question the reserve credits currently being taken by ceding insurers who are party to such agreements is by adopting proposed changes to SSAP No. 61 and Appendix A-791 consistent with those proposed by ACLI above. Such changes aim to make clear that compliant agreements cannot charge “excessive” YRT premiums and provide a clear basis for how an assessment of YRT premiums anchored to existing SAP guidance is to be performed.

Along with the suggested changes above, we propose forming a small working group consisting of regulators and industry experts to finalize language consistent with the objectives noted above within a defined timeline.

Jeffrey G. Stevenson FSA (Sevenson Associates, Inc) Comments

I am a retired actuary with years of experience in reinsurance, primarily with respect to transactions where the primary motivations are not primarily risk transfer. Not long ago I was asked about a treaty arrangement involving combinations of coinsurance and YRT and was told there was some controversy with respect to the accounting.

Combination coinsurance and YRT agreements have been around forever; there shouldn’t be much controversy.

Traditionally, the YRT combined in coinsurance agreements is YRT reinsurance inuring to the benefit of the reinsured block.

In this respect, the cash flows of the coinsurance (or Modco) treaty (principally of those intended for purposes other than risk transfer) have traditionally been:

+Premiums
-Claims
-Surrender & Maturity Benefits
-Commissions and Expense Allowances

-Ceded Reins Prems (on Inuring agreements)
+Ceded Reins Dbs (on Inuring agreements)
+Ceded reins Exp Refunds (on Inuring agreements)

-Modco Res Incr (if Modco)

+Modco Interest (if Modco)

- Experience Refunds (if included)

The above result may result in an expense and risk charge with favorable experience.

The inuring agreements in the above could be YRT of mortality risk or other coinsurance of reinsured business of the benefits or even catastrophic stop loss arrangements. The inuring agreements could be traditional YRT with an experience refund arrangement. They could also be YRT agreements of a more financially motivated arrangement, i.e., a high YRT premium based on a high percentage of the valuation mortality basis, combined with a large experience refund.

There is no reason the YRT couldn't be additional quota share of the same block as the coinsurance. Why would ceding companies do this? Well in past circumstances, perhaps they were reinsuring the business with two reinsurers and one reinsurer does not want to retain catastrophic mortality risk but the second reinsurer is willing to take that additional risk in addition to the risks in its own portion of the reinsurer. Including such reinsurance in the single tradition would be done for administrative convenience and if structured as YRT would include additional impacts on reserve and capital requirements. This type of arrangement would not be uncommon for divestiture of the business (might be referred to as administrative reinsurance). My first impression of the combo YRT treaties presented to me is that the additional YRT is nothing more than inuring reinsurance regardless of what the reinsured business is, just like these arrangements in the past.

My understanding of the new variations of combo treaties is that the YRT is indeed an additional quota share of the coinsured business but the interpretation is that the YRT is not inuring to the benefit of the coinsured business. In fact, in the new interpretations the YRT is treated as a separate agreement with its own cash flows. Moreover, the YRT mortality risk treaty might be on the basis of a high percentage of the valuation table thereby generating a generous experience refund under expected assumptions.

The interpretation being made that the extra YRT arrangement is more like a standalone rider produces a result that in the event of adverse investment scenarios, the high experience refund (on the YRT mortality component) can be combined with adverse experience on the coinsured business to merely produce a lower experience refund with the reinsurer not necessarily reimbursing the ceding company for the adverse experience of the coinsured business.

That might look okay with the arithmetic but in my opinion, it is a clear violation of the life reinsurance model regulation. The reserve or capital credits associated with any treaty with such an arrangement (and with the YRT component not accounted for as inuring reinsurance) should be denied.

Here is the explanation.

Accounting requirements of the model regulation are:

1. Renewal expense allowances provided or to be provided to the ceding insurer by the reinsurer in any accounting period, a must be sufficient to cover anticipated allocable renewal expenses of the ceding insurer on the portion of the business reinsured
2. The ceding insurer can't be deprived of surplus or assets at the reinsurer's option or automatically upon the occurrence of some event
3. The ceding insurer is required to reimburse the reinsurer for negative experience under the reinsurance agreement
4. The reinsurance agreement can't involve the possible payment by the ceding insurer to the reinsurer of amounts other than from income realized from the reinsured policies.

The new interpretation of the added YRT component (an additional quota share of the underlying coinsured business) violates some of all of these accounting requirements.

First off, as for the YRT exemption from the requirements of the model regulation, the combo treaty "interpretation" does not allow for any YRT exemption because the surplus and capital aid of the combination exceeds that of a zero premium YRT treaty. The model regulation accounting requirements should apply to all the components of the treaty.

Let's assume the coinsured portion of the business produces negative cash flows as a result of poor investment experience and the additional YRT business produces an experience refund that more than offsets the negative experience.

Note that all reinsurance has a cost. The YRT portion of the business has a cost associated with it. The cost is Premiums minus Claims minus Experience Refund. (This typically nets to a cost equal to a risk fee or the profit margin of the reinsurer which may or not be a mere risk fee). But in this case the adverse experience of the coinsured business reduces the YRT portion's experience refund, that YRT reinsurance now has an additional cost in addition to the profit margin.

That cost is now a cost of the ceding company. Reinsurance costs of the ceding company have to be reimbursed by the reinsurer through the expense allowance. In this case then, the reinsurer has to reimburse its own charge, thereby resulting in a wash, so there is, in fact, no recovery of the adverse experience refund.

You can also think of the experience refund as an "optional experience refund." In this case a portion of the YRT experience refund is denied at the option of the reinsurer (it's automatically denied with the occurrence of the adverse experience on the coinsurance). So the use of the YRT as an offset to adverse experience is automatically denying the ceding company of surplus automatically on the occurrence of some event.

The recovery of the adverse experience on the coinsurance is also technically a payment that is not made out of the profits on that coinsured business. It is coming out of an additional premium payment to the reinsurer (the YRT premium).

I recognize that some might make nuanced arguments against these above arguments. However, and most importantly, let's look at the essential substance of the YRT portion of the transaction. The companion YRT arrangement typically has a YRT premium which is a high percentage of valuation mortality (let's say 90%) and any premiums in excess of the claims are experience refunded net of a risk charge. The substance of this transaction is that there is a risk charge paid and claims in excess of 90% of valuation mortality are experience refunded back to the ceding company. (Now this might be structured as YRT because there are other accounting entries such as face amount ceded and reserve credits accompanying the accounting, but the essence of the transaction is essentially a non- proportional stop loss arrangement). The YRT component of the transaction is basically a stop loss arrangement with a risk charge for a premium. In exchange for this risk premium, the reinsurer will pay claims only if they exceed the percentage of the valuation basis mortality relating to the premium. It is an excess of loss structure.

So if we think of the companion YRT agreement in this true economic form, the companion treaty in addition to the coinsurance is nothing more than a risk premium paid to the reinsurer for catastrophic mortality. From this standpoint, the combo treaty arrangement's result in the event of adverse experience on the coinsurance is that the reinsurer is receiving a payment in addition to the risk charge from the ceding company to cover that adverse experience (as is argued above). This is because in order for the transaction to provide for an offset to the losses on the coinsurance, the ceding company would be required to make a payment to the reinsurer in addition to the risk charge! When viewed from this true economic perspective, this is clearly a violation of the model regulation.

To argue that merely changing the companion contract from a stop loss format to an equivalent YRT structure would change the above interpretation (that the contract violates the model regulation) seems just plain wrong.

One can also think of this additional payment as essentially the same as using an artificially high interest rate (like 12%) to calculate coinsurance experience refunds or modco profits. Everyone should recognize that this provision

would be a violation of the model regulation as it would be an additional payment or a payment outside of profits in the business. Likewise, any additional premium paid, or reduction in experience refund of associated treaty provisions, would similarly be a violation of the model regulation.

In P&C arrangements, there is often reference to this type of arrangement as a "reinstatement premium." This has no place in a life reinsurance transaction.

This concluding argument of looking through to the substance of the transaction validates all the other above arguments that this new interpretation of the combo structure violates the model regulation!

If the additional YRT is, in essence, accounted for as an inuring agreement, just has it has always been done, the appropriate cash flows fall out in the treaty accounting and the reserve credits are justified.

Recommendation:

NAIC staff notes that the exposed revisions are narrowly focused on the issue that interdependent contracts, and/or interdependent contract features, must be analyzed in aggregate and (including all relevant facts and circumstances). As all of the parties who have commented agree that the entirety of the contract must be analyzed, NAIC staff continues to support adoption of the exposed revisions, with timing subject to the discretion of the Working Group. If the Working Group wants to continue discussions on this topic, NAIC staff recommend a joint meeting of the Statutory Accounting Principles (E) Working Group and the Life Actuarial (A) Task Force. This is because actuarial expertise would be beneficial in discussing some of the comments received on the actuarial risk transfer analysis. In addition, the Dec. 2023 referral was from the Valuation Analysis (E) Working Group. The exposed revisions to SSAP No. 61 are below for reference:

> 18. For purposes of evaluating whether a contract with a reinsurer transfers risk, what constitutes a contract is essentially a question of substance. It may be difficult in some circumstances to determine the boundaries of a contract. For instance, the profit-sharing provisions of one contract may refer to experience on other contracts and, therefore, raise the question of whether, in substance, one contract rather than several contracts exist. The inconsistency that could result from varying interpretations of the term contract is limited by requiring that features of the contract or other contracts or agreements that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in evaluating whether a particular contract transfers risk. Therefore, if agreements with the reinsurer or related reinsurers in the aggregate do not transfer risk, the individual contracts that make up those agreements also would not be considered to transfer risk, regardless of how they are structured.

In addition, the following was exposed as addition to existing SSAP No. 61, paragraph 19 on YRT.

> YRT agreements shall follow the requirements of A-791, paragraph 6, regarding the entire agreement and the effective date of agreements.

NAIC staff does not recommend exposing the ACLI proposed revisions to add a new paragraph 18 to *SSAP No. 61—Life, Deposit-Type and Accident and Health Reinsurance* and to add a second question to Appendix A-791, question 2b for reasons which are further detailed below. In short, the ACLI proposed revisions would codify a bifurcated risk transfer analysis that VAWG has previously noted as problematic. In addition, the proposed ACLI safe harbor of YRT premium that is not greater than the valuation mortality is problematic as detailed below. Also included below are a few key points regarding the comments received from Jeffrey Stevenson (retired actuary commenter). NAIC Staff has limited the key points below for brevity but can provide a more detailed analysis if needed for a joint call.

1. **Areas of agreement –** NAIC staff concurs with the comments that reinsurance agreements need to be evaluated using all of the relevant facts and circumstances and existing guidance. NAIC staff agrees that some combination reinsurance agreements of YRT and Coinsurance with interdependent features will pass risk transfer and some contracts will not.

- Comments from VAWG and from Stevenson note that not all such combination contracts are concerning, but also noted that some of the more concerning combination contracts have structural variations or assumptions on the cash flows that differ from the historic structure / assumptions of many such contracts.
- Stevenson notes that, "Traditionally, the YRT combined in coinsurance agreements is YRT reinsurance inuring to the benefit of the reinsured block." He provides further comments on variations that are concerning on newer interpretations and newer combination structures in his comments on inuring agreements compared to separate agreement cash flow evaluation.

2. **Bifurcated analysis** - ACLI proposed revisions to SSAP No. 61 and to A-791 QA would formally require a bifurcated risk transfer analysis. This type of bifurcated analysis would look at each type of coverage in the contract separately and evaluate an interdependent contract under two separate criteria for risk transfer (Ex. one set of criteria for YRT and one set for the coinsurance piece). This type of bifurcated analysis was noted as concerning by the VAWG referral because of the interdependent contract features of a shared experience refund and the inability to separately recapture the parts of the contract. Because interdependent contract features require aggregated analysis, NAIC staff does not recommend codifying bifurcated risk transfer analysis.

3. **Use of a Valuation Mortality Measure** - The ACLI recommendation is that risk transfer for the entire combination reinsurance contract is achieved if the YRT premium does not exceed the cedent valuation mortality at the time of contract inception. Conversations with actuaries note that the valuation mortality is not fixed under principles-based reserving. The valuation mortality could be based on the net premium reserve, or the modelled reserve. In addition, the reinsurer's valuation mortality can be different than the ceding entity's valuation mortality because the valuation mortality can change over time. Using the valuation mortality at inception does not guarantee that there will not be a future deprivation of surplus to the ceding entity. Therefore, this risk transfer measurement method will not work as a proposed safe harbor. In addition, the Stevenson comments also noted that YRT reinsurance that was a higher percentage of the valuation mortality as being more financially motivated.

4. **YRT requirements** - Note that all the Appendix A-791 requirements apply to coinsurance and only a subset of the A-791 requirements apply to certain types of YRT agreements. SSAP No. 61, paragraph 19 excerpted below specifies the paragraphs of A-791 which apply. Part of the reason noted in the A-791 QA (excerpted below) for excluding YRT from being required to follow all of A-791, is that YRT reinsurance typically only resulted in limited reserve credit. This is typically a portion of the current year mortality benefit (commonly referred to as ½ cx). However, if the YRT treaty credit is higher as specified in A-791 excerpt below, **that type of higher credit YRT treaty is not intended to be excluded from any of the A-791 requirements.**

   One of the VAWG concerns that was echoed by comments from Stevenson, is that the concerning type of combination contracts are resulting in a larger type of reinsurance credit that was not intended to be excluded from A-791 requirements. **Stevenson noted that some of the concerning contracts are resulting in a reinsurance credit that is greater than that of a zero premium YRT treaty (see A-791 QA excerpt below), which indicates that the YRT treaty of this type was not intended to be excluded from A-791.**

From A-791 QA paragraph 1. (Bolding added)

Q – Aside from assumption reinsurance, what other types of reinsurance are exempt from the accounting requirements?

A – Yearly renewable term (YRT) and certain nonproportional reinsurance arrangements, such as stop loss and catastrophe reinsurance are exempt because these do not normally provide significant surplus relief and therefore are outside the scope of this Appendix. If a catastrophe

arrangement takes a reserve credit for actual losses beyond the attachment point or the unearned premium reserve (UPR) of the current year's premium, there will most likely be no regulatory concern.

Similarly, if a YRT treaty provides incidental reserve credits for the ceding insurer's net amount at risk for the year with no other allowance to enhance surplus, there will most likely be no regulatory concern. **For purposes of this exemption, a treaty labeled as YRT does not meet the intended definition of YRT if the surplus relief in the first year is greater than that provided by a YRT treaty with zero first year reinsurance premium and no additional allowance from the reinsurer.**

Additional pertinent information applicable to all YRT treaties and to non-proportional reinsurance arrangements is contained in paragraphs 19 and 20 of SSAP No. 61R.

From SSAP No. 61, paragraph 19:

19. Yearly renewable term (YRT) reinsurance agreements that transfer a proportionate share of mortality or morbidity risk inherent in the business being reinsured and do not contain any of the conditions described in Appendix A-791, paragraphs 2**.b., 2.c., 2.d., 2.h., 2.i., 2.j. or 2.k.,** shall follow the guidance for reinsurance accounting, including paragraphs 55-57 of this statement that apply to indemnity reinsurance. Contracts that fail to meet the requirements for reinsurance accounting shall follow the guidance for Deposit Accounting. For all treaties entered into on or after January 1, 2003, the deferral guidance in paragraph 3 of A-791 shall also apply to YRT agreements. Since YRT agreements only transfer the mortality or morbidity risks to the reinsurer, the recognition of income shall be reflected on a net of tax basis, as gains emerge based on the mortality or morbidity experience.

5. **Prohibited Elements in Part of a Combination Contract**– Steveson is noting that the YRT combination contract is resulting in the surplus and capital aid that exceeds that of a zero premium YRT treaty which is not intended to be excluded from A-791 (from the discussion and quotes above). Therefore the A-791 accounting requirements should apply to all the components of the treaty. **Stevenson commented that having contract terms in an interdependent contract which are prohibited in a coinsurance agreement on a standalone basis under A-791 would not be compliant with the model law. This is similar to some of the comments and concerns noted by VAWG.**

6. **Stevenson also makes comments about the overall result of the reinsurance contract coverage from the combination of the coverages which echoed other parts of the concerns of VAWG.**

Comments are in Attachment 2.3

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