AGENDA

1. Consider Adoption of Draft Memorandum from Committee Regarding LIBOR—Commissioner Scott White (VA)
   - Draft Memorandum from Committee
   - Request & Draft Bulletin from ACLI

2. Consider Extension on Mortgage Forbearance—Commissioner Scott White (VA)
   - Request from ACLI & Other Trades
   - Original Mortgage Forbearance Guidance from Committee & Related Q&A

3. Discuss Any Other Matters Brought Before the Committee—Commissioner Scott White (VA)

4. Adjournment
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MEMORANDUM

TO: Commissioners, Directors and Superintendents

FROM: Commissioner Scott A. White (VA)
Chair of the Financial Condition (E) Committee

DATE: June 12, 2020

RE: Support for Commissioner Forbearance Regarding State Law on Derivatives

Background Information
The London Interbank Offered Rate (LIBOR) is a set of reference rates based on average rates for short-term
interbank unsecured loans quoted by London banks, and it is not expected to be available as a financial reference
rate after 2021. As part of a market-wide transition away from LIBOR and toward the Secured Overnight Financing
Rate (SOFR), U.S. central clearing counterparties (CCPs) will shift their discounting rate from the Effective Federal
Funds Rate (EFFR) to the SOFR using a one-time special valuation cycle. This is expected to occur once on Oct.
16. As part of this unique market event, the CCPs will revalue existing cleared swaps and issue basis swaps on a
mandatory basis to all parties that clear swaps on the CCPs to restore a counterparty’s original risk profile. Insurance
companies use derivatives, such as interest rate swaps and credit default swaps, primarily for hedging purposes,
including to manage risks associated with matching an insurer’s projected liabilities with large bond portfolios and
protect an insurer’s exposure to various cash instruments and market conditions.

When using derivatives, insurance companies are required to abide by investment guidelines and legal and
regulatory constraints established by the commissioner for their general account assets in a state. Most state laws
limit insurers’ derivative use to activities such as hedging, replication, and certain income-generation activities. Life
insurance companies have asked for clarification that the basis swaps they will receive as part of CCP’s transition
to the SOFR discounting and certain transactions entered into in connection with receipt of those basis swaps will
be deemed effective hedges under the uses of derivatives allowed by regulation in a state and under any derivative
use plan required to be submitted under state insurance law.

Support for Commissioner Clarification
Due to the above circumstances and the fact that insurers have no control over the distribution of such basis swaps
to them, and recognizing that insurers may be disadvantaged if required to dispose of such basis swaps upon receipt
or a time thereafter, the Financial Condition (E) Committee is issuing this memorandum to make commissioners,
directors and superintendents aware of this issue and offering support for those who issue bulletins on this issue.
The Committee, however, has not concluded that the basis swaps should be deemed effective hedges, but rather,
they should be deemed “permissible derivative investments.” Therefore, the Committee supports that for the
purposes of applicable state law, any basis swap (or group thereof) incurred by an insurer in connection with a
clearinghouse’s shift in discounting from the EFFR to the SOFR (CCP Cutover) shall be deemed a permissible derivative investment for up to one year past the date of the CCP Cutover. We recognize that a commissioner’s decision to provide clarification on a state law set forth by state legislatures is an individual one, and we would respect that some commissioners may wish to perform further due diligence with their own domestic insurers before issuing a bulletin offering such clarification.
RE: LIBOR Transition: Basis Swap Clarification Request Renewed

Dear Chairman White & Members of the Committee:

Thank you, again, for the opportunity on May 15 to present to the Committee the ACLI concerns relating to the transition away from general use of the London Interbank Offered Rate (LIBOR) as a financial reference rate after 2021. During the presentation, the ACLI previewed its request that the NAIC encourage all state insurance regulators to provide a temporary safe harbor so that life insurers may deem basis swaps issued to the insurer as a result of the planned discounting rate change/swap revaluation as hedging transactions. We proposed the following guidance:

"For the purposes of [applicable state law], any basis swap (or group thereof) incurred by a life insurer with the purpose of mitigating risk in connection with a clearinghouse’s shift in discounting from the federal funds effective rate to the secured overnight financing rate (a "CCP Cutover") shall be deemed an effective hedging transaction notwithstanding any other provision of [applicable state law] or such life insurer’s derivatives use plan, so long as the life insurer has documented the fact that it has engaged in such basis swap (or group thereof) with the express purpose of mitigating risk in connection with a CCP Cutover. This would apply for a period up to 1 year past the date of the CCP Cutover".

Attached to this communication is a proposal for a NAIC model bulletin template. Thank you for your consideration of this draft template and this matter of industry concern.

Sincerely,

THE AMERICAN COUNCIL OF LIFE INSURERS

Michael Lovendusky
Vice President & Associate General Counsel

Mike Monahan
Senior Director of Accounting Policy

Attachment: Proposed Template for Clarification re LIBOR Transition (5/19/20)
NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Draft: 5/19/20

TEMPLATE FOR CLARIFICATION PERTAINING TO LIBOR TRANSITION

[Insert Date]

TO: All Insurers Transacting the Business of Insurance in [Insert Name of State]

FROM: [Insert Name of Commissioner, Director or Superintendent]

RE: Clarifying Status of Certain Derivatives Relating to LIBOR Transition

[Insert Name of Commissioner] takes notice that the London Interbank Offered Rate (LIBOR), a set of reference rates based on average rates for short-term interbank unsecured loans quoted by London banks, is not expected to be available as a financial reference rate after 2021.

As part of a market-wide transition away from LIBOR and toward the Secured Overnight Financing Rate (SOFR), US central clearing parties (CCPs) will shift their discounting rate from the Effective Federal Funds Rate (EFFR) to SOFR using a one-time special valuation cycle. This is expected to occur in October 2020. As part of this unique market event, the CCPs will revalue existing cleared swaps and issue basis swaps on a mandatory basis to all parties that clear swaps on the CCPs, including life insurers. These basis swaps are intended to restore the counterparty’s original risk profile. This discounting change and the resulting basis swap allocation is expected to be a one-time solution to the market transition from LIBOR to an alternative rate.

Life insurance companies use derivatives, such as interest rate swaps and credit default swaps, primarily for hedging purposes, including to manage risks associated with matching the insurer’s projected liabilities with large bond portfolios and to protect the insurer’s exposure to various cash instruments and market conditions. When using derivatives, life insurance companies abide by investment guidelines and legal and regulatory constraints established by the [Department of Insurance] for their general account assets in this state. [Name of state] law and regulation limits life insurers’ derivative use to [activities such as hedging, replication, and certain income-generation activities.] Federal regulations arising from the Dodd Frank Wall Street Reform and Consumer Protection Act require financial market participants, such as life insurers, to use CCPs to clear certain swaps.

Life insurance companies have asked for clarification that the basis swaps they will receive as part of CCP’s transition to SOFR discounting and certain transactions entered into in connection with receipt of those basis swaps will be deemed effective hedges under the uses of derivatives allowed by regulation in this state [and under any derivatives use plan required to be submitted under state insurance law].

Effective immediately, the Department stipulates that, for the purposes of [applicable state law], any basis swap (or group thereof) incurred by a life insurer with the purpose of mitigating risk in connection with a clearinghouse’s shift in discounting from the federal funds effective rate to the secured overnight financing rate (a “CCP Cutover”) shall be deemed an effective hedging transaction notwithstanding any other provision of [applicable state law] or such life insurer’s derivatives use plan, so long as the life insurer has documented the fact that it has engaged in such basis swap (or group thereof) with the
express purpose of mitigating risk in connection with a CCP Cutover. This will apply for a period up to one (1) year past the date of the CCP Cutover.

So ordered by the authority vested in me this [day] of [month], 2020. [Et cetera] <END>
May 19, 2020

Honorable Scott A. White, Chair  
Financial Condition (E) Committee  
National Association of Insurance Commissioners  
1100 Walnut Street, Suite 1500  
Kansas City, MO 64106-2197

Honorable Eric Cioppa, Vice Chair  
Financial Condition (E) Committee  
National Association of Insurance Commissioners  
1100 Walnut Street, Suite 1500  
Kansas City, MO 64106-2197

RE: Request for Extension of Modification Period under March 27, 2020 RBC Guidance

Dear Commissioner White and Superintendent Cioppa:

The undersigned organizations respectfully request that of the Financial Condition (E) Committee of the National Association of Insurance Commissioners (NAIC) extend the modification period under the risk-based capital guidance issued on March 27, 2020, to conform it to a related NAIC accounting interpretation issued April 15, 2020 and to section 4013 of the CARES Act.

The undersigned appreciate the time and effort that you, the Committee, Statutory Accounting Principles (E) Working Group (SAPWG), NAIC staff, and others have already devoted to the accounting and risk-based capital issues that have arisen as a result of the COVID-19 pandemic, and we appreciate the guidance issued to date. Nevertheless, we need to request that you take this additional action now.
Background

On March 27, 2020, the Financial Condition (E) Committee released Guidance for Troubled Debt Restructurings for March 31–June 30 Statutory Financial Statements and Related Interim Risk-Based Capital Filings (where required) (“RBC Guidance”). The modification period under the RBC Guidance ends June 30, 2020.\(^1\)

The CARES Act was enacted later that same day.\(^2\) Section 4013 of the CARES Act provided optional relief from generally accepted accounting principles (GAAP) for loan modifications related to the coronavirus disease 2019 (COVID–19) pandemic that would otherwise be categorized as a troubled debt restructuring (TDR). That option applies to loan modifications during the period beginning on March 1, 2020 and ending on the earlier of December 31, 2020, or the date that is 60 days after the date on which the national emergency concerning the novel coronavirus disease (COVID–19) outbreak declared by the President on March 13, 2020 under the National Emergencies Act (50 U.S.C. 1601 et seq.) terminates.


**INT 20-03**: Troubled Debt Restructuring Due to COVID-19. INT 20-03 adopts the modification period specified in section 4013 the CARES Act (i.e., it applies to the term of modifications that occur during the period from March 1, 2020 until the earlier of 60 days after the national declaration of emergency is terminated or December 31, 2020.\(^3\)

**INT 20-04**: Mortgage Loan Impairment Assessment Due to COVID-19. INT 20-04 applies to reporting for March 31 and June 30, 2020.\(^4\) However, NAIC staff has interpreted INT 20-04 as applying to modifications that occur through September 29, 2020.\(^5\)

On March 30, April 13, and April 22, 2020, NAIC staff posted Questions and Answers on the RBC Guidance.\(^6\)

Request for Extension of Modification Period

We are requesting an extension of the modification period covered by the RBC Guidance now because a modification period ending June 30, 2020 does not provide time for insurers and borrowers to fully assess the COVID-19 impacts and determine appropriate modifications or other accommodations in many cases. Modification decisions insurers make in May or June will need to be informed by

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\(^1\) Available at: https://content.naic.org/sites/default/files/inline-files/Guidance%20for%20Insurers%20from%20Financial%20Condition%20%28E%29%20Commitee.pdf

\(^2\) Available at: https://www.congress.gov/116/bills/hr748/BILLS-116hr748enr.pdf

\(^3\) Available at: https://content.naic.org/sites/default/files/inline-files/INT%2020-03%20Trouble-Debt-Restructuring%20Due%20to%20COVID-19.pdf

\(^4\) Available at: https://content.naic.org/sites/default/files/inline-files/INT%2020-04%20Mortgage-Loan-Impairment-Assessment%20Due%20to%20COVID-19.pdf

\(^5\) See NAIC staff interpretation, SAPWG April 15, 2020 Hearing Agenda, at p. 15 (“In response to the OneAmerica comments and interested parties comments on the application of the effective date, NAIC staff agree that loan modifications up till Sept. 29, 2020 are permitted under the exposed INT.”).

\(^6\) Available at: https://content.naic.org/sites/default/files/inline-files/QA%20for%20Guidance%20for%20Insurers%20from%20Financial%20Condition%20%28E%29%20Commitee_2.pdf
knowledge of whether there is available runway to further tailor modifications before the modification window closes.

Widespread business closures and social distancing began in late March 2020, and various jurisdictions across the nation are easing restrictions to varying degrees and on different timelines. The $2 trillion CARES Act was enacted March 27, 2020, and additional funding for the Paycheck Protection Program was appropriated on April 24, 2020. The economic impact of those enormous legislative efforts will be realized over a period of months ahead as assistance is distributed and as the recipients, in turn, deploy it. In the meantime, businesses are adjusting operations and preparing to ramp up as restrictions ease, and consumer confidence changes, and additional governmental efforts are sure to follow.

It will take until after June 30 for these facts to unfold and for insurers to determine many borrowers’ short-term and longer-term prospects. As a result, it may be most prudent for insurers to employ a measured multi-stage modification processes (e.g., an initial 90- interest-only (IO) period followed by a reassessment and a subsequent temporary IO period or other modification based on that later assessment).

To accommodate such a measured multi-step approach, we request that the Committee adopt the modification period specified in section 4013 of the CARES Act and adopted in INT 20-03: the modification period ending on the earlier of 60 days after the national declaration of emergency is terminated, or December 31, 2020, and that the Committee issue that extension as soon as possible. Alternatively, the Committee could extend the modification period under the RBC Guidance to September 30, 2020, with a decision on an extension beyond September 30, 2020, no later than the NAIC National Meeting in August.

* * *

Thank you for considering this request. If you have any questions, please do not hesitate to contact Mike Monahan, Senior Director of Accounting Policy, ACLI (MikeMonahan@acli.com) or Bruce Oliver, Associate Vice President, CMF Policy, MBA (boliver@mba.org).

Sincerely,

Paul S. Graham III
Senior Vice President, Policy Development
American Council of Life Insurers

Chris Burgoyne
Vice President, Government and Political Affairs
American Hotel & Lodging Association

Chirag K. Shah
Vice President for Government Affairs and Counsel
Asian American Hotel Owners Association

Justin Ailes
Managing Director, Government Relations
CRE Finance Council
Jennifer Platt  
Vice President, Federal Operations  
International Council of Shopping Centers

Mike Flood  
Senior Vice President, CMF Policy & Member Engagement  
Mortgage Bankers Association

Gregory Scott Brown  
Senior Vice President, Government Affairs  
National Apartment Association

Aquiles Suarez  
Senior Vice President for Government Affairs  
NAIOP, the Commercial Real Estate Development Association

Dave Borsos  
Vice President, Capital Markets  
National Multifamily Housing Council

Clifton E. (Chip) Rodgers, Jr.  
Senior Vice President  
The Real Estate Roundtable

cc: Members of NAIC Financial Condition (E) Committee  
Mr. Philip Barlow, Chair, Life Risk-Based Capital Working Group  
Mr. Dan Daveline, Director, NAIC Financial Regulatory Services
To: All Insurers  
From: Financial Condition (E) Committee  
Date: March 27, 2020  
RE: Guidance for Troubled Debt Restructurings for March 31-June 30 Statutory Financial Statements and Related Interim Risk-Based Capital Filings (where required)  

**Background Information**  
This guidance is being issued by the Financial Condition (E) Committee to all U.S. insurers filing with the NAIC in an effort to encourage insurers to work with borrowers who are unable to, or may become unable to meet their contractual payment obligations because of the effects of COVID-19. The Committee, which is the NAIC parent committee of all the solvency policy making task forces and working groups of the NAIC, supports the use of prudent loan modifications that can mitigate the impact of COVID-19.  

**Parameters of Guidance**  
This guidance applies to a troubled debt restructuring issued as a result of COVID-19 and is applicable to the term of the loan modification, but solely with respect to a modification, including a forbearance arrangement, an interest rate modification, a repayment plan, and any other similar arrangement that defers or delays the payment of principal or interest, which occurs during the applicable reporting period for a loan that was not more than 30 days past due as of December 31, 2019. Nothing in this guidance supersedes the requirement or authority of any state, particularly any state that has separately issued COVID-19 orders, directives or other guidance the impact of which may lead to debt becoming troubled and/or needing to be restructured.  

**Direct Mortgage Loans & Schedule BA Mortgages**  
For purposes of any risk-based capital calculations prepared by insurers for March 31 and June 30, all direct mortgages and Schedule BA mortgages for which the insurer chooses, or is government mandated, to allow delays in any required principal and interest payments in accordance with the above parameters are not required to be reclassified to a different RBC category (e.g. will not affect the origination date, valued date, and net operating income or be treated as delinquent) than was utilized during the December 31, 2019 RBC filing and which may have otherwise required a higher capital charge for such a mortgage.  

**RMBS and CMBS Securities**  
For purposes of the reporting of NAIC designations in the financial statements prepared for March 31 and June 30 or any risk-based capital calculations prepared by insurers for March 31 and June 30, all RMBS and CMBS securities which were modeled by the NAIC for year-end 2019 and for which any required principal and interest payments have been deferred in accordance with the above parameters may be reported with the same NAIC designation as used for year-end 2019 and are not required to receive an updated NAIC designation despite the fact that payments may have been deferred as previously described.  

**Related Accounting Guidance & Updates**  
Please see the following for both related accounting guidance and updates to this guidance via Q&A.  
https://content.naic.org/cmte_e_app_blanks.htm  
(Please see related documents tab)  

**Questions**  
Any questions on this guidance should be directed to Dan Daveline by e-mail at ddaveline@naic.org
To: All Insurers
RE: April 22 Question & Answer on Guidance for Mortgages for March 31-June 30 Statutory Financial Statements and Related Interim Risk-Based Capital Filings

Background Information
On March 27, the Financial Condition (E) Committee issued guidance to encourage insurers to work with borrowers who are unable to, or may become unable to meet their contractual payment obligations because of the effects of COVID-19. Nothing in that guidance supersedes the requirement or authority of any state, particularly any state that has separately issued COVID-19 orders, directives or other guidance the impact of which may lead to debt becoming troubled and/or needing to be restructured.

April 22 Question
Q1-Is the March 27 guidance also intended to apply to insurers that are not required to report risk-based capital calculations to their domestic regulator or the NAIC for March 31 and June 30?
A1-Yes. The guidance applies to all U.S. insurers filing and is not specific only to insurers that are required to report quarterly risk-based capital calculations. The reference to risk-based capital calculations prepared by insurers for March 31 and June 30 is intended to provide guidance for periodic internal reporting and reporting to policyholders, the public, and rating agencies that is not otherwise a prohibited announcement under state law.

Q2-Is this guidance intended to apply to all COVID-19 loan modifications that occur through June 30, 2020, so that an insurer that modifies a loan in accordance with the parameters of the guidance within that period is not required to adjust the origination date, valued date, or property value as of the modification date (as required under current RBC rules for loan restructures) for current or future RBC reporting periods?
A2-Yes. The intent of the guidance is to encourage insurers to make prudent loan modifications for borrowers who are temporarily unable to meet their contractual payment obligations because of the effects of COVID-19 and is not intended to have long-term negative impacts under current RBC rules. Consistent with this intent, if an insurer modifies a loan in accordance with the parameters of the guidance, the insurer is not required to adjust the origination date, valued date, or property value for current or future RBC reporting periods. In addition, an insurer is not required to reclassify to a different RBC category (such as within CM categories (e.g., CM1 to CM2) or within standing categories (e.g., In Good Standing, Overdue, Not in Process, In Process of Foreclosure)) for March 31 and June 30. The expectation is that further, more deliberative discussion is expected to occur in the future, likely through the Life Risk-Based Capital (E) Working Group, regarding these loans for future reporting periods.

Q3-Some construction projects are not allowed to operate because of government imposed stay-at-home orders. Current RBC rules specify that a loan with “construction loan issues” (e.g., abandoned) is required to have a CM5 rating. Is the guidance that loans are not required to be reclassified to a different RBC category as a result of government-mandated delays in any required principal and interest payments in the first and second quarters of 2020 also intended not to require reclassification of construction loans in cases of government-mandated delays in construction?
A3-Yes. No RBC category change is required to be changed for March 31 and June 30 as a result of government-mandated construction delays in the first and second quarters of 2020. The expectation is that further, more deliberative discussion is expected to occur in the future, likely through the Life Risk-Based Capital (E) Working Group, regarding these loans for future reporting periods.
Q4 - Many properties for which borrowers are not requesting relief may be impacted by valuation and NOI changes resulting from the COVID-19 pandemic. What will be the risk-based capital treatment of these loans?

A4 - The expectation is that further, more deliberative discussion on valuation, NOI impacts and other impacts COVID-19 may cause will occur in the future, likely through the Life Risk-Based Capital (E) Working Group.

April 13 Questions

Q1 - The guidance indicates support for loan modifications as a result of COVID-19 but seems to restrict to only those loans that are troubled debt restructures, was this intentional?

A1 - No, the guidance was intending to apply to all loan modifications made as a result of COVID-19 before June 30 even if they would otherwise be categorized a troubled debt restructure; setting forth a safe harbor for all such changes made as a result of COVID-19 during that time period with the intent of the Life Risk-Based Capital (E) Working Group developing more explicit and detailed RBC guidance for both 3Q and 4Q and beyond, as well as how loan modifications made subsequent to the June 30 date would be treated. While such a safe harbor was intending to encourage loan modifications that are prudent so that there was no long-term impact on policyholders asset values, the view was that guidance on things such as operating income or other considerations within the RBC formula that attempt to measure the future risk of loans would be better addressed by the Life RBC Working Group. (Modifications of loan terms do not automatically result in TDRs. According to U.S. GAAP, a restructuring of a debt constitutes a TDR if the creditor, for economic or legal reasons related to the debtor’s financial difficulties, grants a concession to the debtor that it would not otherwise consider. Short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief, are not TDRs. This includes short-term (e.g., six months) modifications such as payment deferrals, fee waivers, extensions of repayment terms, or other delays in payment that are insignificant. Borrowers considered current are those that are less than 30 days past due on their contractual payments at the time a modification program is implemented. Working with borrowers that are current on existing loans, either individually or as part of a program for creditworthy borrowers who are experiencing short-term financial or operational problems as a result of COVID-19, generally would not be considered TDRs.)

March 30 Questions

Q1 - Is the guidance expected to be updated in the future for 3Q and 4Q financial statements and if so how?

A1 - The March 27 guidance developed was intended issued to provide immediate guidance and the expectation is that further, more deliberative discussion is expected to occur in the future, likely through the Life Risk-Based Capital (E) Working Group.

Q2 - The guidance indicates that delays in any required principal and interest payments in accordance with the defined parameters are not required to be reclassified to a different RBC category, does this include reclassification either within CM categories (e.g. CM1 to CM2) or within other categories (e.g. In Good Standing, Overdue, Not in Process, In Process of Foreclosure, or both?)

A2 - The guidance is meant to apply to both situations, the CM categories and the standing categories.