NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Virtual Meeting

Statutory Accounting Principles (E) Working Group
Thursday, May 20, 2021
2:00 – 3:30 p.m. ET / 1:00 – 2:30 p.m. CT / 12:00 – 1:30 p.m. MT / 11:00 a.m. – 12:30 p.m. PT

OVERVIEW AGENDA

HEARING AGENDA

	Hearing Page Number	Attachment
1. SAPWG Hearing – Review and Adoption of Non-Contested Positions *—Dale Bruggeman (OH)*		
• Ref #2020-37: Separate Account Product Mix	1	1
• Ref #2020-38: Pension Risk Transfer Disclosure	2	2
• Ref #2021-02: ASU 2020-08 – Premium Amortization on Callable Debt Securities	3	3
• Ref #2021-03: SSAP No. 103R - Disclosures	4	4
• Ref #2021-06EP: Editorial Updates	5	5
• Ref #2021-07: *ASU 2020-11 - Financial Services – Insurance: Effective Date*	5	6
• Ref #2021-08: *ASU 2021-02 – Franchisors Revenue from Contracts with Customers*	6	7
2. SAPWG Hearing – Review of Comments on Exposed Items—*Dale Bruggeman (OH)* *—Dale Bruggeman (OH)*		
• Ref #2020-36: Derivatives Hedging Fixed Indexed Products	7	8
• Ref #2021-01: *ASU 2021-01, Reference Rate Reform*	8	9 & 10
• Ref #2021-04: SSAP No. 97 – Valuation of Foreign Insurance SCAs	10	11
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MEETING AGENDA

	Meeting Page Number	Attachment
3. SAPWG Meeting – Maintenance Agenda – Pending List—*Dale Bruggeman (OH)*		
• Ref #2019-21: SSAP No. 43R	1	A
4. SAPWG Meeting – Any Other Matters Brought Before the Working Group —*Dale Bruggeman (OH)*		
• Life Risk-Based Capital (E) Working Group Referral	3	B & C
• Credit Tenant Loans – Valuation of Securities (E) Task Force Referral Response	4	D
• INT 20-10: Reporting Nonconforming Credit Tenant Loans	4	E

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Statutory Accounting Principles (E) Working Group
Hearing Agenda
May 20, 2021
1:00 p.m. – 2:30 p.m. CT

ROLL CALL

Dale Bruggeman, Chair	Ohio	Judy Weaver	Michigan
Carrie Mears/Kevin Clark, Co-Vice Chairs	Iowa	Doug Bartlett	New Hampshire
Richard Ford	Alabama	Bob Kasinow	New York
Kim Hudson	California	Kimberly Rankin/Melissa Greiner	Pennsylvania
Kathy Belfi/William Arfanis	Connecticut	Jamie Walker	Texas
Rylynn Brown	Delaware	Doug Stolte/David Smith	Virginia
Eric Moser	Illinois	Amy Malm	Wisconsin
Stewart Guerin/Melissa Gibson	Louisiana		

NAIC Support Staff: Julie Gann, Robin Marcotte, Jim Pinegar, Fatima Sediqzad, Jake Stultz

Note: This meeting may be recorded for subsequent use.

The Statutory Accounting Principles (E) Working Group met in regulator-to-regulator session on May 4. This regulator session was pursuant to the NAIC Open Meetings Policy paragraph 3 (discussion of specific companies, entities or individuals) and paragraph 6 (consultations with NAIC staff related to NAIC technical guidance of the *Accounting Practices and Procedures Manual*). No actions were taken during this meeting - this was an informational session regarding interim progress on agenda item 2019-21, referred to as the SSAP No. 43R project.

REVIEW AND ADOPTION of NON-CONTESTED POSITIONS

The Working Group may individually discuss the following items, or may consider adoption in a single motion:

1. Ref #2020-37: Separate Account Product Mix
2. Ref #2020-38: Pension Risk Transfer Disclosure
3. Ref #2021-02: ASU 2020-08 – Premium Amortization on Callable Debt Securities
4. Ref #2021-03: SSAP No. 103R - Disclosures
5. Ref #2021-06EP: Editorial Updates
6. Ref #2021-07: *ASU 2020-11 - Financial Services – Insurance: Effective Date*
7. Ref #2021-08: *ASU 2021-02 – Franchisors Revenue from Contracts with Customers*

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-37 SSAP No. 56 (Jim)	**Separate Account Product Mix**	**1 – Agenda Item**	**In Agreement**	**IP – 4**

Summary:
At the request of regulators, primarily in response to the recent growth of pension risk transfer (PRT) transactions and registered indexed linked annuity (RILA) products, improved reporting was requested so financial statement users could more readily identify and review these products, which are generally held in separate accounts. Upon review of the separate account general interrogatories in the 2019 financial statements, it was found that most

entities grouped their separate account products in 3-4 broad categories. As a result of the aggregated grouping, regulators have expressed difficulty in assessing the risk with each associated product.

Accordingly, on Nov. 12, the Working Group exposed this agenda item, primarily to solicit comments regarding the degree of product identifying details needed to adequately assess PRT and RILA product features and reserve liabilities. While this agenda item did not recommend modifications to *SSAP No. 56—Separate Accounts,* depending on the nature of the comments received, it was anticipated that a proposal would be sent to the Blanks (E) Working Group with annual statement instruction modifications regarding the separate account general interrogatories – primarily requiring disaggregation in reporting of PRT and RILA products.

On March 15, 2021, the Working Group exposed this agenda item with a concurrent Blanks (E) Working Group exposure (2021-03BWG). This exposure did not propose changes to statutory accounting however the blanks proposal added product identifiers for PRT and RILA products and provided modifications to the General Interrogatory instructions, requiring that a distinct disaggregated product identifier be used for each product represented. The disaggregation will require that each separate account product filing or policy form be separately identified. For example, if a company has 5 different separate account group annuities, each annuity shall be separately reported. Additionally, the instructions indicate that companies may eliminate proprietary information (e.g., such as XYZ company Pension Plan), however such elimination will still require the use of a unique reporting identifier (such as PRT #1). This disaggregation of reporting will be utilized for all applicable General Interrogatories (e.g., 1.01, 2.4, 4.1) and was at the direct request of regulators to assist in regulator review so that each product (i.e., applicable transactions, guarantees and reserve assumptions), primarily products in which may potentially expose the general account to funding risk, may be independently examined.

<u>*Interested Parties' Comments:*</u>
Interested parties supports the re-exposure to add pension risk transfer (PRT) and registered indexed linked annuity (RILA) product totals in the interrogatory and with the disaggregation required for each separate account product filing to be separately identified.

NAIC staff note – NAIC staff confirmed with interested parties via email on May 3 that the comments above support adoption.

<u>*Recommended Action:*</u>
NAIC staff recommends that the Working Group recommend 2021-03BWG for adoption by the Blanks (E) Working Group. (NAIC staff note that no comments were received by the Blanks (E) Working Group in response to the concurrent exposure). This agenda item does not result in statutory accounting revisions but adoption by the SAPWG will indicate support for the adoption at the Blanks Working Group.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-38 SSAP No. 56 (Jim)	**Pension Risk Transfer Disclosure**	**2– Agenda Item**	**In Agreement**	**IP - 5**

<u>*Summary:*</u>
On Nov. 12, the Working Group exposed this agenda item to solicit comments from state insurance regulators and industry regarding possible modifications to SSAP No. 56*,* specifically in terms of increased product identification and disclosure of pension risk transfer (PRT) transactions in the separate account financial statements. In response to the recent growth of PRT transactions, regulators expressed a desire for improved reporting so such items could

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be more readily identified and analyzed. While the information request was broad, regulators discussed several possible enhancements, including separated PRT reporting and improved PRT disclosure regarding reserves, associated assets, and general account exposure.

Currently, the most specific details concerning PRT transactions are generally captured/disclosed in question 1.01 (product mix) of the separate account general interrogatories (GI 1.01). While other details of the broadly categorized products are captured in various other general interrogatories, this agenda item, at the request of regulators, proposes enhanced detailed reporting to the existing requirements for pension risk transfer products and transactions in the scope of SSAP No. 56.

On March 15, 2021, the Working Group exposed this agenda item with a concurrent Blanks (E) Working Group exposure (2021-03BWG). This exposure did not propose changes to statutory accounting however the blanks proposal added product identifiers for PRT and RILA products and provided modifications to the General Interrogatory instructions, requiring that a distinct disaggregated product identifier be used for each product represented. The disaggregation will require that each separate account product filing or policy form be separately identified. For example, if a company has 5 different separate account group annuities, each annuity shall be separately reported. Additionally, the instructions indicate that companies may eliminate proprietary information (e.g., such as XYZ company Pension Plan), however such elimination will still require the use of a unique reporting identifier (such as PRT #1). This disaggregation of reporting will be utilized for all applicable General Interrogatories (e.g., 1.01, 2.4, 4.1) and was at the direct request of regulators to assist in regulator review so that each product (i.e., applicable transactions, guarantees and reserve assumptions), primarily products in which may potentially expose the general account to funding risk, may be independently examined.

<u>*Interested Parties' Comments:*</u>
Interested parties supports the re-exposure, noting that it will provide additional detail for pension risk transfer (PRT) products in the General Interrogatories.

NAIC staff note – NAIC staff confirmed with interested parties via email on May 3 that the comments above support adoption.

<u>*Recommended Action:*</u>
NAIC staff recommends that the Working Group recommend 2021-03BWG for adoption by the Blanks (E) Working Group. (NAIC staff note that no comments were received by the Blanks (E) Working Group in response to the concurrent exposure). This agenda item does not result in statutory accounting revisions but adoption by the SAPWG will indicate support for the adoption at the Blanks Working Group.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2021-02 SSAP No. 26R (Jim)	**ASU 2020-08 – Premium Amortization on Callable Debt Securities**	**3 – Agenda Item**	**In Agreement**	**IP - 7**

<u>*Summary:*</u>
On March 15, the Working Group exposed revisions to *SSAP No. 26R—Bonds* to reject *ASU 2020-08, Codification Improvements to Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs* for statutory accounting. ASU 2020-08 requires that to the extent the amortized cost basis of a callable debt security exceeds the amount repayable by the issuer, any associated premium (above the call price) is to be amortized to the next effective call price/date. While the amortization requirements closely mimic existing guidance in SSAP No. 26R, it does preclude

statutory accounting's yield-to-worst concept, which requires amortizing premiums to the call or the maturity value/date in which produces the lowest asset value. There may be scenarios, for statutory accounting, in which premiums amortized to the maturity value/date will yield a lower asset value than simply amortizing applicable premium to the next effective call date (as is required in ASU 2020-08).

Interested Parties' Comments:
Interested parties support the rejection of ASU 2020-08 as insurers are using the yield-to-worst concept for statutory reporting.

Recommended Action:
NAIC staff recommends that the Working Group adopt the exposed nonsubstantive revisions to *SSAP No. 26R—Bonds* to reject *ASU 2020-08, Codification Improvements to Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs* for statutory accounting.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2021-03 SSAP No. 103R (Jim)	**SSAP No. 103R - Disclosures**	**4 – Agenda Item**	**In Agreement**	**IP - 7**

Summary:
This agenda item proposed additional disclosures and to data-capture certain existing disclosure elements in *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*; it was drafted in response to discussions that occurred during the Working Group's continued deliberation of agenda item 2019-21: SSAP No. 43R – Equity Instruments (referred to as the SSAP No. 43R Project). Agenda item 2019-21, a substantive project to consider what investments fall within scope of *SSAP No. 43R—Loan-Backed and Structured Securities,* which was subsequently expanded to determine which investments are eligible for reporting on Schedule D-1: Long Term Bonds.

On March 15, the Working Group exposed this agenda item which proposed new disclosure elements and a data-capture template for existing disclosures in SSAP No. 103R. Consequently, a concurrent Blanks (E) Working Group (2021-05BWG) agenda item was exposed for public comment.

In response to feedback received from interested parties, on April 20, the Working Group exposed an updated agenda item, incorporating edits as jointly collaborated with Iowa regulators, interested parties and NAIC staff. While the updated exposure included minor disclosure enhancements, the primary revision included updated data-capture fields and detailed instructions to ensure filers understood the requirements of the disclosure template. Note: while an updated blanks proposal was not posted by the Blanks (E) Working Group, the updated exposed data capture template can be seen beginning on page 8 of agenda item 4.

Interested Parties' Comments:
Interested parties thank NAIC staff for working with us in clarifying the purpose of the proposal and the requirements themselves. It was [a] very good collaboration and we support the revised draft.

Recommended Action:
NAIC staff recommends that the Working Group adopt the exposed nonsubstantive revisions to *SSAP No. 103R— Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The revisions incorporate additional disclosure elements and a data-capture template for certain disclosures in SSAP No.

103R. The disclosures and data-capture template will assist regulators in their assessment of situations where an entity has transferred (or sold) assets but still retains a material participation in the transferred asset. The updated blanks proposal (page 8 of agenda item 4) is anticipated to be in place for 2021 year-end reporting. (In response to comments received by the Blanks (E) Working Group support staff as a result of the exposure of this agenda item, it is anticipated that minor editorial changes to the blanks proposal will occur.)

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2021-06EP Multiple (Jake)	**Editorial Updates**	**5 - Agenda Item**	**No Comments**	**IP - 10**

<u>*Summary:*</u>
On March 15, the Working Group exposed editorial revisions as summarized below:

- *SSAP No. 53—Property Casualty Contracts – Premiums* retitle to *SSAP No. 53—Property and Casualty Contracts – Premiums*.

- *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* - corrects grammatical errors in paragraph 54.

- SSAP Glossary - Removes the footnote noted in title and replaces it as an opening paragraph with updated verbiage.

<u>*Interested Parties' Comments:*</u>
Interested parties have no comment on the revisions.

<u>*Recommended Action:*</u>
NAIC staff recommends that the Working Group adopt the editorial revisions to SSAP No. 53, SSAP No. 97 and the SSAP Glossary as final.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2021-07 Appendix D (Jake)	***ASU 2020-11, Financial Services—Insurance: Effective Date and Early Application***	**6 – Agenda Item**	**No Comments**	**IP - 11**

<u>*Summary:*</u>
On March 15, the Working Group exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2020-11, Financial Services—Insurance: Effective Date and Early Application* as not applicable for statutory accounting. ASU 2020-11 updated effective dates of recent amendments in *ASU 2019-09, Financial Services – Insurance* and *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts,*

delaying the effective dates because of the effects of COVID-19. Both ASU 2019-09 and 2018-12 have previously been rejected for statutory accounting.

<u>*Interested Parties' Comments:*</u>
Interested parties have no comment on this item.

<u>*Recommended Action:*</u>
NAIC staff recommends the Working Group adopt the exposed nonsubstantive to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2020-11, Financial Services—Insurance: Effective Date and Early Application* as not applicable for statutory accounting.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2021-08 SSAP No. 47 (Jake)	***ASU 2021-02, Franchisors—Revenue from Contracts with Customers***	**7 – Agenda Item**	**No Comments**	**IP - 11**

<u>*Summary:*</u>
On March 15, the Working Group exposed revisions to *SSAP No. 47—Uninsured Plans* to reject *ASU 2021-02, Franchisors—Revenue from Contracts with Customers (Subtopic 952-606)* for statutory accounting. ASU 2021-02 slightly amended previous guidance issued in in *ASU 2014-09, Revenue from Contracts with Customers*, as it relates to franchisors. In 2018, the Working Group rejected the guidance in ASU 2014-09 and several other accounting standards updates related to revenue recognition in *SSAP No. 47—Uninsured Plans*. Since 2018, all additional ASUs related to revenue recognition have been reviewed by NAIC staff and have been rejected for statutory accounting.

<u>*Interested Parties' Comments:*</u>
Interested parties have no comment on this item.

<u>*Recommended Action:*</u>
NAIC staff recommends the Working Group adopt the exposed nonsubstantive to *SSAP No. 47—Uninsured Plans* to reject *ASU 2021-02, Franchisors—Revenue from Contracts with Customers (Subtopic 952-606)* for statutory accounting.

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<u>REVIEW of COMMENTS on EXPOSED ITEMS</u>

The following items received comments during the exposure period:

1. Ref #2020-36: Derivatives Hedging Fixed Indexed Products
2. Ref #2021-01: *ASU 2021-01, Reference Rate Reform*
3. Ref #2021-04: SSAP No. 97 – Valuation of Foreign Insurance SCAs
4. Ref #2021-05: Accounting for Cryptocurrencies
5. Ref #2021-09: State ACA Reinsurance Programs

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-36 SSAP No. 108 (Julie)	**Derivatives Hedging Fixed Indexed Products**	**8 – Agenda Item**	**Comments Received**	**IP - 3**

<u>Summary:</u>
This agenda item proposes the development of new guidance for the accounting and reporting of derivatives that effectively hedge the growth in interest credited for fixed indexed products (for example, fixed indexed annuity (FIA) and indexed universal life (IUL) reported in the general account. (NAIC staff is also investigating the classification of structured / registered indexed linked annuities (RILA) in the separate account, and the use of derivatives in the separate account to hedge risk related to these products. This assessment will be completed within a separate agenda item.) This agenda item is proposed to be substantive, with potential development of a new SSAP.

On Nov. 12, 2020, the Working Group moved this item to the active listing, categorized as substantive, and exposed the agenda item to solicit comment from state insurance regulators and industry on establishing accounting and reporting guidance for derivatives hedging the growth in interest for fixed indexed products. In addition to the two general options presented in the agenda item, the Working Group is open for additional commentary and suggestions and directs NAIC staff to work with industry throughout the process similar to the collaborative efforts that occurred when developing the guidance in *SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees*. With this exposure, the Working Group directed notification to the Life Actuarial (E) Task Force.

On March 15, 2021, the Working Group re-exposed this item to provide additional time for interested parties to develop a proposal.

<u>Interested Parties' Comments:</u>
We continue our work assessing the proposal and evaluating potential variances to the exposure. As noted in 2020-36, "With this exposure, notification to the Life Actuarial (E) Task Force (LATF) will occur". We would request that a referral be made to LATF, as to whether there is interest in changing the reserve framework to accommodate the derivative approach as this may influence our view on the approach to recommend.

Interested parties are committed to working with NAIC staff and SAPWG on this very complicated and important topic, so far meeting with NAIC staff to share initial views.

<u>Recommended Action:</u>
NAIC staff recommends the Working Group send a formal referral to the Life Actuarial (E) Task Force, seeking input regarding whether the Task Force would consider changes to the reserve framework of fixed index annuity products as their response will likely directly influence the accounting options for derivatives

hedging these products. In the interim, NAIC staff will continue to work with interested parties and Working Group members to review and discuss possible options.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2021-01 SSAP No. 86 (Jim)	***ASU 2021-01, Reference Rate Reform***	**9 – Agenda Item 10 - INT**	**Comments Received**	**IP - 5**

Summary:
In March 2020, FASB issued *ASU 2020-04, Reference Rate Reform (Topic 848) Facilitation of the Effects of Reference Rate Reform on Financial Reporting* to ensure the financial reporting of hedging relationships would reflect a continuation of the original contract and hedging relationship during the period of the market-wide transition to alternative reference rates. ASU 2020-04, which was adopted by the Working Group through *INT 20-01: ASU 2020-04 - Reference Rate Reform*, provides temporary, optional, and expedient relief in that a qualifying modification (because of reference rate reform) should not be considered an event that requires contract remeasurement at the modification date or reassessment of a previous accounting determination.

In January 2021, FASB issued ASU 2021-01 to clarify that all derivative instruments affected by changes to the interest rates used for discounting, margining or contract price alignment (regardless of whether they reference LIBOR or another rate that is expected to be discontinued as a result of reference rate reform) are in afforded the contract modification relief provided in ASU 2020-04. In short summary, ASU 2021-01 expands the scope of ASU 2020-04 by allowing an entity to apply the optional expedients, by stating that a change to the interest rate used for margining, discounting or contract price alignment for a derivative is not considered to be a change to the critical terms of the hedging relationship that requires dedesignation.

On March 15, the Working Group exposed interpretative guidance proposing to expand *INT 20-01: ASU 2020-04 - Reference Rate Reform* to include the new temporary (optional) expedient guidance as provided for in *ASU 2021-01, Reference Rate Reform.*

Interested Parties' Comments:
Interested parties agree with the revisions proposed in INT 20-01 to address related FASB guidance in ASU 2021-01 and we believe that it will provide significant relief to all companies that have entered into contracts that reference LIBOR (or another reference rate expected to be discontinued due to reference rate reform).

Other Comments from Interested Parties

During the reference rate reform period there has been discussion amongst industry participants related to derivative contract modification market mechanisms and the potential unique impact on statutory accounting. Although the overarching principle of ASU 2020-04 and ASU 2021-01 and thus INT 20-01 is that contracts within scope that are modified due to reference rate reform can be accounted for as a continuation of the existing contract, the guidance only specifically addresses derivatives in the context of qualifying hedging relationships. Neither derivatives used in hedging relationships that do not qualify for hedge accounting (i.e., non-qualifying relationships) nor replication (synthetic asset) transactions (RSAT) are specifically addressed.

Addressing modifications associated with derivatives used in non-qualifying relationships or RSATs is not necessary for generally accepted accounting principles (GAAP) because under GAAP these transactions are always accounted for at market value and both unrealized and realized gains/losses are recorded within the same income

statement line. Under SAP, however, gains/losses on these transactions may have different financial statement geography or may not be recognized in the income statement, for example, depending on whether they are unrealized or realized. Further, statutory reporting guidance requires detailed disclosure, through Schedule DB, of each held and terminated derivative transaction.

Exacerbating the need for clarity on this issue is the standard market mechanism for centrally cleared swaps. While bilateral derivative contracts can be amended without termination, it is typical market convention that a cleared derivative contract would be terminated and replaced with an off-market contract in order to amend terms associated with reference rate reform. Without relief, it is standard practice that these amendments would be treated as terminations within statutory accounting and reporting, with resulting impacts on the financial statements.

Although interested parties believe it is the intention of the Working Group and NAIC staff to allow all derivative contract amendments, including non-qualifying relationships and RSATs, associated with reference rate reform to be accounted for and reported as continuations under INT 20-01, we request that clarifying language be included to address the concern of industry participants. We believe this addition will provide statutory accounting and reporting clarity and ensure operational relief for all derivatives as companies plan and begin reference rate modifications.

We believe the most effective way to provide this requested clarity is the addition of the following language as subsection "e" within section 12 of the exposed revision to INT 20-01(changes noted in underline):

> For all derivatives (those qualifying for hedge accounting, those that do not qualify for hedge accounting and RSAT's), allow a reporting entity to account for and report modifications (that <u>are within</u> the scope of INT 20-01) as a continuation of the existing contract even when the legal form of the modification is a termination of the original <u>contract</u> and its replacement with a new reference rate reform contract. This includes in-scope modifications of centrally cleared swap contracts whether they are <u>automatically transitioned at a cessation date or voluntarily executed prior to cessation</u>.

We believe this additional language within INT 20-01 will provide statutory accounting and reporting clarity to companies as they prepare and begin to transition both bilateral and cleared derivatives as part of reference rate reform.

NAIC staff note – NAIC staff confirmed with interested parties that the references to "changes noted in underline" should be disregarded entire propose paragraph is new – not just the items emphasized with underlining.

<u>*Recommended Action:*</u>
NAIC staff recommends that the Working Group adopt the INT 20-01 with the inclusion of edits as recommended by interested parties. The edits to the INT will clarify that derivative contracts that are modified by changing the reference rate used for margining, discounting, or contract price alignment that is a result of reference rate reform (regardless of whether the reference rate being modified is expected to be discontinued) are afforded the temporary, optional expedient guidance provided for in ASU 2020-04. As such, the contract modifications are not required to be considered a change in the critical terms that would require dedesignation of the hedging relationship.

Although the INT is all-encompassing for "any hedging relationships," for clarity purposes, NAIC staff agrees with <u>incorporating the additional language suggested by interested parties in paragraph 13.</u> NAIC staff believe the intent of INT 20-01 (both as currently adopted and as proposed to be modified in the current exposure) is to capture all hedging transaction types, regardless of if the transaction occurred bilaterally or through a central clearing party. The proposed addition by interested parties will simply clarify that ancillary actions taken by a central clearing party (i.e., changes in legal form of the contract or its replacement with a new contract) should not impact the accounting for the original transaction (if the modification of the original hedging transaction or replication (synthetic asset) transactions (RSAT) is as a result of reference rate reform.) This

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recommendation is consistent and akin to the previous action taken by the Working Group in its adoption of *INT 20-09: Basis Swaps as a Result of the LIBOR Transaction* – which directed that ancillary contracts issued by central clearing parties shall be classified as a derivative used for hedging purposes.

The INT attachment details the exposed edits, however the additional revisions proposed by interested parties are shown in grey below:

> 13. For Issue 5, the Working Group came to a tentative consensus on March 15, 2021, that ASU 2021-01 shall be applied to derivative transactions for statutory accounting. Accordingly, derivative instruments that are modified to change the reference rate used for margining, discounting, or contract price alignment that is a result of reference rate reform (regardless of whether the reference rate that is expected to be discontinued) are eligible for the exception guidance afforded in ASU 2020-04 in that such a modification is not considered a change in the critical terms that would require dedesignation of the hedging relationship. In addition, for all derivatives (those qualifying for hedge accounting, those that do not qualify for hedge accounting and replication (synthetic asset) transactions (RSAT)), a reporting entity may account for and report modifications (that are within the scope of INT 20-01) as a continuation of the existing contract even when the legal form of the modification is a termination of the original contract and its replacement with a new reference rate reform contract. This includes in-scope modifications of centrally cleared swap contracts whether they are automatically transitioned at a cessation date or voluntarily executed prior to cessation.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2021-04 SSAP No. 97 (Fatima)	**Valuation of Foreign Insurance SCAs**	**11 – Agenda Item**	**Comments Received**	**IP - 8 NYL - 17**

Summary:
This agenda item was created because of comments received during the March 2020 development of agenda item 2018-26 – SCA Loss Tracking – Accounting Guidance adopted revisions in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* to state that reported equity method losses of an investment in a subsidiary controlled or affiliated entity (SCA) would not create a negative value in a SCA investment, thus equity method losses would stop at zero. However, the agenda item also clarified that to the extent there was a financial guarantee or commitment, it would require recognition under *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets.* Further, in November 2020, the Working Group adopted agenda item 2020-18 - SSAP No. 97 Update which removed a lingering, superseded reference regarding negative equity method loss valuations.

Guidance in SSAP No. 97 requires specific limited statutory basis of accounting adjustments to 8.b.ii (insurance related SCA) and 8.b.iv (foreign insurance SCA) entities. These long-standing adjustments are to prevent assets held by an SCA from receiving more favorable treatment than had the assets been held directly by the insurer. (For example, if an insurer held assets that would be nonadmitted, but the SCA would not have that same restriction.) Per SSAP No. 97, the equity method of accounting for 8.b.ii and 8.b.iv entities would be a beginning point from which the limited adjustments are made (commonly referred to as SSAP No. 97, paragraph 9 adjustments). It is important to note that it was an intentional decision that the outcome of these adjustments can result in a negative equity valuation of the investment. Again, this is so assets held by an SCA are not reported at a higher value than had they been held directly by the insurer. During the discussion of the earlier agenda item, industry comments requested consideration of whether 8.b.iv entities should continue to be subject to the current explicit provisions of SSAP No. 97, specifically that paragraph 9 adjustments may result in a negative SCA valuation. While stating many positions, industry's primary response that foreign insurance operations are subject to foreign jurisdiction and should be allowed to stand independently of a domestic insurer – thus in the absence of a guarantee or commitment,

equity valuation should not go negative and would stop at zero. Comments received from industry noted that the circumstances that would cause a foreign insurance reporting entity to record negative equity is uncommon, however indicated the potential to arise in the future.

The industry discussion expanded to include certain investments in scope of SSAP No. *48—Joint Ventures, Partnerships and Limited Liability Companies* and whether the required SSAP No. 97, paragraph 9 limited statutory adjustments should be modified for SSAP No. 48 investments which are foreign insurers. Under the guidance in SSAP No. 48, unless there is a minor ownership interest, those investments are to be reported using an equity method as defined in SSAP No. 97, paragraphs 8.b.i through 8.b.iv. The industry comments have indicated that foreign insurance entities including those held through a partnership, LLC or joint venture under SSAP No. 48 should also be permitted to stop the equity value at zero without reflecting a negative valuation in response to statutory adjustments.

NAIC staff notes it is important to separate the paragraph 13 equity method adjustments which stop at zero from the paragraph 9 limited statutory basis adjustments, which intentionally do not stop at zero. However, it is noted that reporting entities with investments captured under SSAP No. 48, which requires an audit for admittance, may not be completing U.S. GAAP financials. If these SSAP No. 48 investments are not audited, reporting entities may have difficulty calculating the required adjustments to be made pursuant to SSAP No. 97, paragraph 9.

Interested Parties' Comments:
As described in the exposure draft, the Working Group does not believe that any changes to SSAP No. 97 are necessary at this point. As such, the reporting entity should record negative equity in an 8.b.iv foreign insurance subsidiary if negative equity arises from the application of the SSAP No. 97 paragraph 9 adjustments even if there is no financial guarantee or commitment by the reporting entity. This approach applies the same treatment to 8.b.iv foreign insurance subsidiaries and 8.b.ii non-insurance subsidiaries.

As stated in our previous comment letter on this topic dated September 18, 2020, interested parties agree with the current accounting guidance, which requires 8.b.ii entities to report negative equity. This is because 8.b.ii entities are considered an extension of the insurance company and since 8.b.ii entities may own assets that would not be admitted if owned by the insurer, it is reasonable to require the insurer to report negative equity in those subsidiaries if negative equity arises due to the non-admission of certain assets.

Interested parties, however, do not agree that the application of the paragraph 9 adjustments should ever result in the insurer's investment in a foreign insurance subsidiary being reported at an amount less than zero. Foreign insurance subsidiaries have a true business purpose, independent from the parent insurer and are subject to significant regulations in the foreign jurisdiction in which they operate (including with respect to how they invest, the assets they are allowed to own, and the amount of capital they are required to hold). In this way, foreign insurance subsidiaries operate similarly to domestic insurance subsidiaries, and are subject to comparable levels of oversight. It does not appear reasonable to treat a foreign insurance subsidiary differently from the way a domestic insurance subsidiary is treated whereby losses are floored at zero unless the reporting entity has guaranteed obligations or is otherwise committed to provide further financial support for the domestic insurance subsidiary, as stated in SSAP No. 97, paragraph 14e.

We agree with the comments included in the exposure draft regarding the fact that in the past few years, there probably have not been instances of insurers recording negative equity in their foreign insurance subsidiaries. However, we believe that regardless of whether or not this is a common occurrence, the accounting standards should reflect the appropriate accounting treatment and provide guidance for this circumstance, which might arise in the future. As mentioned in our previous comment letter, negative equity could arise due to the non-allowance of deferred acquisition costs recorded by the foreign insurer. Since GAAP allows the explicit recognition of a DAC asset, the gross GAAP reserves are usually higher than statutory reserves, which have an implicit credit for acquisition expenses. As a result, when applying the SSAP No. 97 adjustments to non-admit DAC, we end up with a reserve that is more conservative than statutory rules. One of the reasons why this has not resulted in negative equity in the past is due to the current interest rate environment, which has caused most insurers' fixed income

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portfolios to be in a sustained unrealized gain position. If interest rates rise and these unrealized gains reverse out over time, it will likely result in a negative equity position.

Assuming rates stay as low as they are today, negative equity will also be very likely to occur once a foreign insurer uses the new U.S. GAAP standard on long-duration insurance contracts in the paragraph 8.b.iv valuation, since insurance liabilities will increase due to the required market value adjustment under the new standard. Under this scenario, having to report insurance liabilities at market value will then negate any unrealized gains on an insurer's bond portfolio. This change will go into effect in 2025 for non-public life insurance companies.

Finally, not all foreign insurance companies receive audited GAAP financial statements. In these situations, the investment in the foreign insurance subsidiary (cost basis) is non-admitted, and no results are reflected in surplus until the foreign insurance company distributes earnings to the parent insurance company. If a parent insurance company decides to obtain an audit of its foreign insurance company, it should not result in an impact to surplus that is worse than non-admitting the investment.

We are able and willing to work with NAIC staff to draft potential amendments to SSAP No. 97 to modify the accounting and reporting requirements of foreign insurers to address the negative equity issue.

New York Life Comments:
New York Life ("NYL") appreciates the opportunity to provide comments on Item 2021-04 (the "Exposure"), which was exposed by the Statutory Accounting Principles (E) Working Group (the "SAPWG") on March 15, 2021. We write to request SAPWG pursue the changes to SSAP No. 97 we detail below. We should note that we recognize amending SSAP No. 97 could bring potential unintendedconsequences. With that in mind, while we offer some suggested language to address such issues later inthis letter, we are committed to working with SAPWG on any additional language changes deemed necessary.

As described in the Exposure, SAPWG does not believe that any changes to SSAP No. 97 are necessaryat this point. As such, the reporting entity should record negative equity in an 8.b.iv foreign insurance subsidiary if negative equity arises from the application of the SSAP No. 97 paragraph 9 adjustments even if there is no financial guarantee or commitment by the reporting entity. This approach applies thesame treatment to 8.b.iv foreign insurance subsidiaries and 8.b.ii non-insurance subsidiaries.

As stated in our previous comment letter on this topic dated October 27, 2020 (attached), there are significant differences between 8.b.ii and 8.b.iv subsidiaries, which, in our view, warrant different accounting treatment. 8.b.ii entities generally operate as an extension of the insurance company and own assets that for the most part would not be admitted if owned by the insurer. In those circumstances, recording negative equity makes sense. In contrast, foreign insurance subsidiaries have a true business purpose, independent from the parent insurer, and are subject to significant regulations in the foreign jurisdiction in which they operate (including with respect to how they invest and the assets they own). In this way, foreign insurance subsidiaries operate similarly to domestic insurance subsidiaries, and are subject to comparable levels of oversight. It does not appear reasonable to treat a foreign insurance subsidiary differently from the way a domestic insurance subsidiary is treated whereby losses are floored at zero unless the reporting entity has guaranteed obligations or is otherwise committed to provide furtherfinancial support for the domestic insurance subsidiary, as stated in SSAP No. 97, paragraph 14e.

Furthermore, if the foreign insurer is solvent and has positive capital on a local statutory basis, recording negative equity only due to the SSAP No. 97 paragraph 9 adjustments does not appear to provide the right accounting result. We agree with the comments included in the Exposure regarding the fact that in the past few years, there probably have not been instances of insurers recording negative equity in their foreign insurance subsidiaries. However, just because it hasn't happened recently, does not mean it cannot happen in the future under very realistic scenarios. Accordingly, we believe the accounting standards should reflect the appropriate accounting treatment and provide guidance for this likely circumstance.

As mentioned in our previous comment letter, negative equity could arise due to the non-allowance of deferred acquisition costs ("DAC") recorded by the foreign insurer. Since GAAP allows the explicit recognition of a DAC asset, the gross GAAP reserves are usually higher than statutory reserves, which have an implicit credit for acquisition expenses. As a result, when applying the SSAP No. 97 adjustments to non-admit DAC, we end up with a reserve that is more conservative than statutory rules. One of the reasons why this has not resulted in negative equity in the past is due to the current interest rate environment, which has caused most insurers' fixed income portfolios to be in a sustained unrealized gain position. If interest rates rise and these unrealized gains reverse out over time, it will likely result in a negative equity position. We have included an example below to illustrate the sensitivity to interest rates of certain foreign insurers' fixed income portfolios. It is possible that other foreign insurers might have different interest rate sensitivity due to differences in their current GAAP equity and underlying portfolios. This example is based on a sensitivity analysis performed by NYL using certain assumptions regarding asset composition. Based on our analysis, an increase of as little as 50 basis points in the 10- year treasury rate can deplete about $200 million of unrealized gains.

Reconciliation from U.S. GAAP to statutory admitted equity (in millions)	Admitted equity at 12/31/20		Assumes a 0.5% increase in the 10-year treasury rate	Assumes a 1.5% increase in the 10-year treasury rate
SCA GAAP Equity*	1,300		1,100	700
Less para. 9 adjustments				
DAC	570		570	570
Other non-admitted assets	44		44	44
Goodwill	90		90	90
Adjusted Equity	**596**		**396**	**(4)**

*GAAP equity includes $900 million of unrealized gains on the foreign insurer's bond portfolio at 12/31/20.

In light of the fact that negative equity can occur realistically in the near term, we believe that changes are needed to the accounting standards to address this issue. At the same time, we understand the need to protect against potential abuses that could arise if SSAP No. 97 is updated to remove the negative equity concept for a foreign insurance subsidiary. As suggested in our previous comment letter, we have crafted the below underlined language, which we would propose inserting into the last sentence of paragraph 9:

> Note that the outcome of these adjustments can result in a negative equity valuation of the investment for all 8.b.ii SCA entities. For an 8.b.iv SCA entity, the application of these adjustments will not result in negative equity unless either of the following circumstances arises:
>
> 1) The reporting entity has guaranteed obligations of the 8.b.iv SCA entity or is otherwise committed to provide further financial support for the 8.b.iv SCA entity. In this case, accounting for the equity pick-up after application of the paragraph 9 adjustments, should bebased on the guidance in SSAP No. 97, paragraph 14e;
> 2) The 8.b.iv SCA entity provides services to, or holds assets on behalf of, the reporting entity.In this case, negative equity has to be recorded.
>
> Note – if there are any reinsurance transactions between the reporting entity and the foreign insurance subsidiary, the adjustments required in paragraph 8.b.iv of SSAP No. 97 must be followed.

We believe this language addresses the two competing interests described above: (1) reflect the appropriate accounting for an 8.b.iv entity and (2) prevent potential abuses from allowing an 8.b.iv entity's equity to be floored at zero. However, we are open to any other language SAPWG believes would help distinguish true operating foreign insurance subsidiaries that are independent from the U.S. insurer and have a true business purpose from entities that operate to shield the reporting entity from U.S. statutory accounting rules. Our intent is not to amend SSAP No. 97 in a way that creates loopholes – instead we want to incorporate changes that contain sufficient guardrails while also appropriately accounting for foreign insurance subsidiaries. We will be happy to work with you on re-drafting our proposal to address potentialloopholes and prevent any abuses from occurring.

We would also like to take this opportunity to raise another issue related to the accounting and reporting of foreign insurance subsidiaries. Due to the high cost of implementing new U.S. GAAP standards related to credit losses and long duration insurance contracts, NYL has decided to discontinue the preparation of financial statements on a U.S. GAAP basis in 2023, which will include our Mexican subsidiary. Once that occurs, it is unclear to us which accounting basis to use to record our investment in the foreign insurance subsidiary, which would then be non-admitted since there is no U.S. GAAP audit. In that scenario, we would have to record our investment at cost or local statutory equity. To that end, wewould appreciate the opportunity to engage in a conversation with you and SAPWG staff regarding the ability to potentially allow for foreign insurance subsidiaries without U.S. GAAP financial statements to be admitted and to be carried at the lower of cost or local audited statutory basis, adjusted for paragraph 9 requirements, but flooring those adjustments at zero if negative equity arises. Our understanding of the current guidance in SSAP No. 97 paragraph 8.b.iv is that we are allowed to use audited foreign statutory basis financial statements of the foreign insurer, but the foreign insurer's financial statements still need to include a reconciliation to U.S. GAAP, which means that U.S. GAAP books and records still need to be prepared.

Recommended Action:
NAIC staff notes that this is a unique situation and theoretical at this time however staff request regulator input on whether the limited statutory accounting adjustments in SSAP No. 97 should be revised to not result in a negative equity position for certain situations as proposed by industry comments. Staff notes there are no identified instances of BA (SSAP No. 48) or Schedule D, part 6 section 1 assets reported at a negative value. **If the Working Group is interested in considering such a limitation, NAIC staff has provided a modified version of the language proposed by New York Life illustrated below for possible exposure. This language would limit paragraph 9 adjustments for foreign insurance SCAs (8.b.iv) to stop at zero if the entity is not engaged in providing services to, or holding assets on behalf of the U.S. insurers.** In addition, staff has proposed some additional SSAP No. 48 language to clearly indicate that the equity method valuation referenced in SSAP No. 97 can result in a negative equity valuation.

Scope - Based on the comments received, NAIC staff notes the underlying issue involves both SSAP No. 97 (which reflect stock-ownership entities) as well as investments captured in SSAP No. 48, which requires audited financial statements and valuation based on of the equity method (except for those with a minor ownership interest) as defined in SSAP No. 97, paragraphs 8.b.i through 8.b.iv.

SSAP No. 97 requires traditional equity method accounting adjustments in paragraph 13 and also requires limited statutory basis of accounting adjustments (commonly referred to as paragraph 9 adjustments) for entities captured under paragraph 8.b.ii (insurance-related SCAs) and paragraph 8.b.iv (foreign insurance SCAs). **Paragraph 9 specifically indicates that "the outcome of the adjustments can result in a negative equity valuation of the investment."** This fact pattern is so that assets held in an insurance-related or foreign insurance subsidiary are not granted preferential treatment when compared to identical assets held by a U.S. insurer. While commenters reference the reliance on local jurisdictional regulations as a control mechanism to ensure only appropriate assets are recognized as admissible, the blanket adjustments required in SSAP No. 97 are in place to ensure a level playing field, consistent reporting among insurers and to recognize that jurisdictional differences may vary significantly. NAIC staff further notes that nonadmitting the SSAP No. 97 SCA/SSAP No. 48 investment does not discontinue the use of equity method accounting; equity method accounting simply determines the valuation amount that would

be reported on Schedule BA or D-6-1 (and nonadmitted on the balance sheet unless the audit requirements of SSAP No. 48 and SSAP No. 97 are met.)

NAIC staff note that 8.b.iv foreign insurers are carried at audited US GAAP with paragraph 9 statutory adjustments. If an entity uses foreign basis GAAP (including IFRS), then an audited footnote reconciliation to U.S. GAAP reconciliation is required to have comparable valuations among entities. NAIC staff does not recommend expanding this agenda item to address comments received by New York Life, which notes that they will voluntarily discontinue application of US GAAP financial statements in 2023. While we believe this to be a limited focus issue, Working Group should provide direction regarding whether to address this question in a separate agenda item.

Edits for Working Group Review (SSAP No. 97 & SSAP No. 48):

SSAP No. 97, paragraph 9

9. The limited statutory basis of accounting for investments in noninsurance SCA entities, subject to paragraph 8.b.ii. and foreign insurance SCA entities, subject to paragraph 8.b.iv., shall be adjusted for the following:

a. Nonadmit assets pursuant to the following statutory accounting principles as promulgated by the NAIC in the *Accounting Practices and Procedures Manual*;

i. *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*

ii. *SSAP No. 16R—Electronic Data Processing Equipment and Software*

iii. *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements*

iv. *SSAP No. 20—Nonadmitted Assets*

v. *SSAP No. 21R—Other Admitted Assets* (e.g., collateral loans secured by assets that do not qualify as investments are nonadmitted under SAP)

vi. *SSAP No. 29—Prepaid Expenses*

vii. *SSAP No. 105R—Working Capital Finance Investments*

b. Expense costs that are capitalized in accordance with GAAP but are expensed pursuant to statutory accounting as promulgated by the NAIC in the *Accounting Practices and Procedures Manual* (e.g., deferred policy acquisition costs, preoperating, development and research costs, etc.);

c. Adjust depreciation for certain assets in accordance with the following statutory accounting principles:

i. *SSAP No. 16R—Electronic Data Processing Equipment and Software*

ii. *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements*

iii. *SSAP No. 68—Business Combinations and Goodwill*

d. Nonadmit the amount of goodwill of the SCA in excess of 10% of the audited U.S. GAAP equity of the SCA's last audited financial statements.

e. Nonadmit amount of the net deferred tax assets (DTAs) of the SCA in excess of 10% of the audited U.S. GAAP equity of the SCA's last audited financial statements.

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f. Nonadmit any surplus notes held by the SCA issued by the reporting entity.

g. Adjust the U.S. GAAP annuity account value reserves of a foreign insurance SCA, with respect to the business it wrote directly, using the commissioners' annuity reserve valuation method (CARVM) as defined in paragraphs 14 and 15 of Appendix A-820 (including the reserving provisions in the various Actuarial Guidelines which support CARVM). The valuation interest rate and mortality tables to be used in applying CARVM should be that prescribed by the foreign insurance SCA's country of domicile. If the Foreign SCA's country of domicile does not prescribe the necessary tables and/or rates, no reserve adjustment shall be made.

Note that the outcome of these adjustments can result in a negative equity valuation of the investment for all 8.b.ii entities. For an 8.b.iv entity, the application of these adjustments will stop at zero, and will not result in negative equity valuation unless the 8.b.iv entity provides services to the reporting entity or its affiliates or holds assets on behalf of the reporting entity. If such services, including reinsurance transactions, are occurring, the adjustments required in this paragraph can result in a negative equity valuation. (See additional equity method application guidance in paragraph 13.e. regarding guarantees and financial support.)

SSAP No. 48, paragraph 6

6. Investments in these ventures, except for joint ventures, partnerships and limited liability companies with a minor ownership interest, shall be reported using an equity method as defined in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, paragraphs 8.b.i. through 8.b.iv. (The equity method calculation may result with a negative valuation of the investment, therefore the SSAP No. 97 equity method calculation shall occur regardless of whether the investment is supported by an audit and the reporting entity will nonadmit the investment.) A reporting entity whose shares of losses in a SSAP No. 48 entity exceeds its investment in the SSAP No. 48 entity shall disclose the information required by SSAP No. 97, paragraph 35.a.

NAIC staff note – the proposed edits shown above in SSAP No. 48, paragraph 6 (shown above) are intended to explicitly state existing requirements that SSAP No. 48 entities are subject to the equity method of accounting as required by SSAP No. 97 paragraph 13 – which may result in a negative equity position regardless of SSAP No. 97, paragraph 9 adjustments. If the Working Group does not believe these edits are necessary, this can be removed from the proposed exposure.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2021-05 SSAP No. 2R (Jake)	**Accounting for Cryptocurrencies**	**12 - Agenda Item 13 - INT**	**Comments Received**	**DE Ins Dept. - 1 IP - 9**

Summary:

On March 15, the Working Group exposed interpretative guidance in *INT 20-01T: Statutory Accounting Treatment for Crypto currencies* to clarify that cryptocurrencies do not meet the definition of cash in *SSAP No. 2R—Cash, Cash Equivalents, Drafts, and Short-Term Investments* and do not meet the criteria for admission as defined in *SSAP No. 4—Assets and Nonadmitted Assets.*

Crypto currency is defined as digital currency in which transactions are verified and records maintained by a decentralized system using cryptography (e.g., utilizing technology typically referred to as Blockchain), rather than by a centralized authority, such as the Federal Reserve System. The exposure also included a request for input on

the extent to which companies hold (or have an interest in) crypto currencies and the manner in which they are held (e.g., held directly or held through a SCA).

Delaware Insurance Department:
On behalf of Insurance Commissioner Navarro, please accept this letter as a recommendation that the Statutory Accounting Principles (E) Working Group (SAPWG) expand the scope of Exposure 2021-05 regarding INT 21-01T to consider the investment in cryptocurrency mutual funds by insurers. Thus far, the exposure is limited to insurers directly investing in cryptocurrencies. The exposure should expand to consider investments in mutual and other securities funds that may have cryptocurrencies within their portfolios.

Today there are approximately 4,000 different cryptocurrencies available on about 200 different cryptocurrency exchanges. Cryptocurrencies have seen significant price volatility and have experienced an extreme increase in value over the past year, with the value of total outstanding cryptocurrencies nearing $1 trillion as of February 2021. The Delaware Insurance Department's captive insurance program already has captive insurers investing in such funds. If captive insurers are doing so, it is very possible that commercial insurers are either already or considering doing the same.

SAPWG determined that if an insurer directly invests in cryptocurrencies, the investment is non-admitted under statutory accounting because cryptocurrencies are not cash under *Statement of Statutory Accounting Principles (SSAP) No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments.* Cryptocurrencies are not cash under this SSAP because cryptocurrencies are not a medium of exchange that a bank or other similar financial institution will accept for deposit and allow an immediate credit to the depositor's account.

The SAPWG's decision to only consider insurers directly investing in cryptocurrencies and not indirect investments via mutual funds reveals an important distinction between what is an admitted versus non-admitted asset. SSAP No. 30R—Unaffiliated Common Stock does not limit an insurer's investments in mutual funds. Specifically, paragraph 4(c) includes Securities and Exchange Commission (SEC) registered funds regardless of the fund's mix or type of securities owned. If the mutual fund is not SEC registered, per *SSAP No. 48—Joint Ventures, Partnerships, and Limited Liability Companies,* the investment receives treatment as a joint venture. Consequently, an insurer may indirectly invest in cryptocurrencies through a mutual fund and hold the investment as an admitted asset.

The use of cryptocurrencies is evolving. PayPal now allows users to buy, sell and hold some cryptocurrencies, but it is important to note that PayPal is not recognized as a bank. In addition to Bitcoin, some banks have shown interest in stablecoins, which trade like cryptocurrencies but are pegged to existing government-backed currencies, such as the U.S. dollar. Because the Delaware Insurance Department has experience with this evolution via captive insurers investing in cryptocurrency funds, it offers its experience to assist the working group. Captive insurers typically adopt Generally Accepted Accounting Principles (GAAP) as opposed to Statutory Accounting Principles for financial reporting. Accordingly, captive insurers report mutual fund investments at market value under GAAP. Despite this significant accounting difference, there is commonality between captive and commercial insurers for how they may invest in cryptocurrencies.

Interested Parties' Comments:
Interested parties agree that cryptocurrencies (e.g., Bitcoin) currently do not meet the definition of cash under SSAP No. 2R *Cash, Cash Equivalents, Drafts, and Short-Term Investments*. However, based on our understanding of how cryptocurrencies work, we believe that cryptocurrencies do meet the definition of an asset. As stated in SSAP No. 4 *Assets and Non-Admitted Assets*, an asset is defined as "having future economic benefits obtained or controlled by a particular entity as a result of past transactions or events." Cryptocurrencies certainly have a future economic benefit as this asset can be sold for cash or exchanged for goods and services in markets that accept cryptocurrencies as payment. In addition, to be an admitted an asset, an asset needs to be readily marketable. Interested parties note that there is an active market for cryptocurrencies as they can be purchased and/or redeemed in an open market at readily determinable fair values.

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Based on interested parties' understanding, the overall extent of direct and indirect cryptocurrency ownership is unknown. We do not believe that insurers are directly investing in cryptocurrencies, nor are we aware of any companies that are currently transacting with cryptocurrencies for goods or services. However, we are aware of a very small number of insurers that are currently considering whether to directly hold cryptocurrency for purposes of investment. In addition, some companies have indicated they are interested in potentially using cryptocurrencies to transact business in the future.

Most insurers' involvement in this asset class so far seems to be limited to investments in private funds set up as limited partnerships/limited liability companies, which invest in cryptocurrency. The funds, for U.S. GAAP purposes, are generally classified as investment companies. Therefore, these funds carry their investments at fair value, and the carrying value under the statutory equity method is essentially fair value. Since the reporting entity's investment is held by a fund, the investment also results in an equity-based capital charge.

The general level of interest for future investment is difficult to gauge, however, based on what's transpiring in the financial services market and beyond, cryptocurrencies continue to gain mainstream traction as an investment and accepted medium of exchange, with Bitcoin being the predominant cryptocurrency chosen. The level of interest for holding or transacting with cryptocurrencies may increase as blockchain technology applications are developed and deployed in the years to come. Interest may also increase as companies look to diversify their portfolios. Bitcoin can potentially be a good source of diversification as so far bitcoin appears not to have a strong correlation with the performance of other assets that are impacted by interest rate movements and government regulation for example. In addition, bitcoin may act as an inflation hedge. The supply of traditional currencies is set by a central bank or a similar institution that can run the printing presses, which can cause hyperinflation caused by the printing of too much money. In contrast, the supply of Bitcoin is set as strong incentives provide assurances that there will likely be no more than 21 million bitcoin ever created.

Recommended Action:

NAIC staff recommends that the Working Group adopt the exposed nonsubstantive interpretative guidance provided by *INT 21-01: Statutory Accounting Treatment for Cryptocurrencies*. The INT clarifies that directly held cryptocurrencies do not meet the definition of cash in *SSAP No. 2R—Cash, Cash Equivalents, Drafts, and Short-Term Investments* nor, when directly held, meet definition of an admitted asset per *SSAP No. 4—Assets and Nonadmitted Assets.* As a result of the comments received, the INT includes minor revisions to clarify that only directly held cryptocurrencies are considered nonadmitted assets, and that this does not impact the guidance for investments in funds that may hold cryptocurrencies in SSAP No. 30R, SSAP No. 48 or SSAP No. 97. The minor revisions are included below.

At this time, NAIC staff does not recommend revisions to SSAP No. 30R, SSAP No. 48 or SSAP No. 97 to restrict cryptocurrencies in funds or indirect ownership (such as in SCAs or within a joint venture, partnership or LLC). Comments are requested from regulators on whether such restrictions should be considered.

INT 21-01T

4. This Interpretation intends to clarify that directly held cryptocurrencies are nonadmitted assets for statutory accounting.

5. Directly held ~~C~~cryptocurrencies have not been identified in the *Accounting Practices and Procedures Manual* (AP&P Manual) as an admitted asset, and do not meet the definition of any admitted asset that is defined in the AP&P Manual. Accordingly, by default they are a nonadmitted asset per *SSAP No. 4—Assets and Nonadmitted Assets,* paragraph 3, as they are not specifically identified in the *Accounting Practices and Procedures Manual* as an admitted asset.

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7. The Statutory Accounting Principles (E) Working Group reached a tentative consensus that directly held cryptocurrencies do not meet the definition of an admitted asset and are therefore considered to be a nonadmitted asset for statutory accounting. The Working Group intends to rely on this interpretation for statutory accounting and will address cryptocurrencies further once FASB has provided definitive guidance.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2021-09 SSAP No. 107 (Robin)	**State ACA Reinsurance Programs**	**14 – Agenda Item**	**Comments Received**	**IP - 12**

<u>*Summary:*</u>
On March 15, the Working Group moved this item to the active listing, categorized as nonsubstantive and exposed revisions to *SSAP No. 107—Risk-Sharing Provisions of the Affordable Care Act* as illustrated below. These revisions would include State ACA reinsurance programs which are using Section 1332 waivers in the scope of *SSAP No. 107—Risk-Sharing Provisions of the Affordable Care Act*. The intent of the proposed accounting revisions is to continue to follow the SSAP No. 107 hybrid accounting approach for the state ACA programs as they operate in a similar manner.

In general, state ACA reinsurance programs provide funding to issuers in the individual market that incur high claims costs for enrollees. The programs often require assessments from issuers typically on behalf of group health plans. At a high level this hybrid accounting approach divides products into 3 broad categories. This includes:

a. Subject individual products (typically individual plans) that may pay a reinsurance funding contribution and are eligible to receive reinsurance distributions shall report similar to an involuntary reinsurance pool as described in *SSAP No. 63—Underwriting Pools*.

b. Other insured Health products (typically group plans) that are not eligible for reinsurance distributions under the terms of the state ACA reinsurance program shall treat the amounts as assessments reported in taxes, licenses and fees similar to treatment under *SSAP No. 35R—Guaranty Funds and Other Assessments*.

c. Self-insured plans where the reporting entity is acting as an administrator and will exclude the payments made on behalf of the self-insured plan from the reporting entity's operations, shall report consistent with the guidance in *SSAP No. 47—Uninsured Plans*.

<u>*Interested Parties' Comments:*</u>
In summary, the view of interested parties is that the principles underlying the exposure draft are appropriate. However, there are important variances among the state ACA Reinsurance Programs as to how they are funded and operate, much more so than was apparently contemplated in the drafting of the proposed guidance in the exposure draft. The significance of such variances requires additional context and guidance to assure that health plans report activity related to any particular state's ACA Reinsurance Program in a consistent manner. These points are described below, along with suggestions for such additional context and guidance for Working Group's consideration.

The proposed guidance suggested by the exposure draft is largely prefaced on the following statement therein (emphasis added):

> To date, most of the states that have sought 1332 waivers did so to implement state ACA reinsurance programs which have the goal of using the reinsurance programs to lower individual health insurance premium in the jurisdiction. As these programs seek to operate to cover higher individual health claims in a manner similar to the transitional reinsurance program, the initial recommendation is to provide guidance that such state programs should follow the guidance in SSAP No. 107 to the extent the state program has similar terms.

While interested parties agree that the goal of the various state ACA Reinsurance Programs is to lower individual health insurance premiums, the second sentence in the above passage is based on a faulty premise. In fact, the various state ACA Reinsurance Programs aim to achieve that goal in ways that differ operationally in important ways, not just from the former Federal ACA Reinsurance Program, but also from each other.

As a result of those differences, it would be difficult to apply the guidance as proposed in the exposure draft which largely mirrors the current text in SSAP No. 107 applicable to the former Federal ACA Reinsurance Program to the State ACA Reinsurance Programs. It is likely that different health plans could reach different conclusions on how to report any particular state's ACA Reinsurance Program activity notwithstanding a common set of facts and circumstances about how that state's program operates. Likewise, independent auditors and state examiners could also reach different interpretations and conclusions.

This is not to suggest that the principles from SSAP No. 107 which the exposure draft proposes to apply as well to state ACA Reinsurance Programs are necessarily flawed, rather that additional context and guidance is needed to assure that statutory accounting will be more uniformly applied by health plans with respect to the same facts and circumstances involving a particular state's ACA Reinsurance Program.

For the former Federal ACA Reinsurance Program, SSAP No. 107 recognized that additional guidance was needed, noting that:

> "… the term "reinsurance" does not represent actual reinsurance between licensed insurers as defined by *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*. This program is similar to an involuntary pool in *SSAP No. 63—Underwriting Pools* for the individual insured health products subject to the 2014 ACA market reforms."

Despite the failure of the former Federal ACA Reinsurance Program to clearly meet all the requirements of SSAP No. 61R or SSAP No. 63, SSAP No. 107 nonetheless included clarifying language to deem certain aspects of the program to be reinsurance and to be accounted for as such for statutory reporting. With subject health plans participating in a single federal program for which No. SSAP No. 107 deemed the activity as reinsurance, uniformity in reporting by health plans was more assured.

However, uniformity in reporting by health plans for their activity with the various state ACA Reinsurance Programs would not be similarly assured under the current text of the exposure draft, as each such state plan differs from the former Federal ACA Reinsurance Program – as well as from each other – in various ways. Some examples of those operational differences follow:

- Unlike the former Federal ACA Reinsurance Program, many of the state ACA Reinsurance Programs charge a single assessment that funds many other elements of healthcare affordability within the state and administration of the program, in addition to funding the reinsurance program itself. Other states may fund their program through use of existing premium taxes and have appropriated certain amounts within the state's general fund to support the reinsurance program and its administration.
- The foregoing differences in funding sources also result in differences in the amount of funding for a state's ACA Reinsurance Program that is ultimately paid by the participating health plans. In most cases, participating health plans fund a minority of the total program costs. For some state ACA Reinsurance

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Programs, none of the cost is borne by participating health plans. An anomalous outcome therefore is where a health plan pays very little if any of the state ACA Reinsurance Program's cost, includes no provision for such cost in its rates, and therefore does not report any premium that it could "cede" but nonetheless reports ceded claims.

- For some state ACA Reinsurance Programs, the state does not itemize the use of assessments. Application of the current proposed guidance may therefore be operationally onerous for organizations and, in some cases, may not be possible without the state providing a specific itemization of the use of the assessments. This may cause health plans to have to estimate the ceded portion versus the expense portion of payments resulting in unintended diversity in practice in treatment for the assessments, potentially reducing comparability in reporting across health plans with respect to their participation in the same state ACA Reinsurance Program.
- The assessments or fees charged are to fund more than just the reinsurance program (distributions and administration of the program); they may also include amounts related to other affordability initiatives.
- The attachment points, coinsurance, and payment caps may be more favorable to the insurer than that of the federal program particularly in the context where the fees might be lower (because the fee charged pay for more than the reinsurance program, or the fact there may be no fee at all).

SSAP No. 107, as well as the current text of the exposure draft, provides principle-based guidance that is intended to help health plans determine which of the following accounting treatments is appropriate, depending on the facts and circumstances:

- As a reinsurance cession following reinsurance accounting in accordance with *SSAP No. 61R, Life, Deposit-Type and Accident and Health Reinsurance*
- As an involuntary assessment consistent with *SSAP No. 35R, Guaranty Fund and Other Assessments*
- As an assessment made on behalf of self-insured plans which are administered by the reporting entity following the guidance of *SSAP No. 47—Uninsured Plans*

Interested parties support a similar conceptual structure to determine the appropriate statutory accounting treatment for state ACA Reinsurance Programs. However, and as a practical matter based on what is known about such programs currently in effect, reinsurance accounting would not seem to be appropriate in most cases. This is because relatively little of the cost is paid by health plans for most of the state ACA Reinsurance Programs (even zero in some cases).

That would leave as remaining options either accounting pursuant to SSAP No. 35R (assessment) or SSAP No. 47 (uninsured plan). However, for some state ACA Reinsurance Programs, the facts and circumstances may not be sufficiently clear to determine which of those would necessarily be appropriate, e.g., in the case of a state ACA Reinsurance Program for which the funding is used for a variety of health-related initiatives and which would vary by nature and amount each year based on legislative action.

As a result, it may be appropriate for the text in the exposure draft to be amended to include additional context and guidance. AHIP offers the following suggestions for the Working Group's consideration:

- Additional context to inform readers as to the nature, extent, and significance of the various ways in which state ACA Reinsurance Programs differ from the former Federal ACA Reinsurance Program, as well as from each other.
- Section 1332 Waivers should be reviewed by health plans and their auditors to see if traditional reinsurance under SSAP No. 61R would apply. Again, based on the operational aspects of the state ACA Reinsurance Programs currently in place, reinsurance accounting would not appear to be appropriate in most instances.

- If it is determined that reinsurance accounting criteria is not met, then a determination should be made as to whether the guidance of SSAP No. 47 for uninsured plans (e.g., like that under INT 05-05 for Medicare Part D), or of SSAP No. 35R (assessment reporting) would apply.
- In cases where reinsurance accounting is then not deemed appropriate, and where the facts and circumstances do not clearly indicate which of SSAP No. 35R or SSAP No. 47 should apply, include a default provision as to which of those should then apply (e.g., SSAP No. 35R). The assessments under the state ACA Reinsurance Programs are generally unavoidable if the insurer writes business within the state which is more characteristic of a business tax or similar assessment. Insurers are generally required to reduce their rates if the state reinsurance programs are in effect, and therefore, recording all of the assessment to expense is unlikely to meaningfully distort any underwriting ratios.

Timing and recognition of assessments. The updates in SSAP No. 107 currently do not address the timing of accounting recognition for the assessments. Because state ACA Reinsurance Programs vary operationally as described above, assessments may be charged such that the current year assessment is based on prior year premiums (i.e., a premium-based assessment); this could lead to diversity in practice if health plans operating in the same state have varying views of when to recognize the assessment in the absence of specific guidance.

Additional guidance could be provided to clarify when the assessment should be recognized and recorded, e.g., by referencing within SSAP No. 107 the accounting model in SSAP No. 35R, paragraph 4a-c, and providing clarity as to how to apply the recognition criteria to the State Reinsurance assessments.

Treatment of receivables from state-based reinsurance plans as admitted assets. Under the former federal reinsurance program, SSAP No. 107 provided the following guidance:

> "All receivables from the transitional reinsurance program are subject to the 90-day non-admission rule beginning from when program receivables are due to be disbursed by the government or a government-sponsored entity. That is, the 90-day rule begins when governmental receivables are due, not from the date of initial accrual. The announced governmental or government-sponsored entity distribution date shall be the contractual due date similar to Appendix A-791, paragraph 2.h., which requires that payments due from the reinsurer are made in cash within ninety (90) days of the settlement date. The receivable is also subject to impairment analysis."

Since most of the existing state ACA Reinsurance Programs are funded by large measure based on state budgetary authority, similar guidance should apply to receivables from such programs.

<u>Recommended Action:</u>
NAIC staff recommends that the Working Group direct staff to develop additional revisions for Working Group consideration that expand the principles-based guidance to address the diversity in state programs identified in the industry comments. NAIC staff provides the following preliminary comments.

1. The primary issue identified is that while some state programs have a flow of funds similar to the original federal transitional reinsurance program, other state programs have different arrangements. These arrangements include not assessing some insurers and instead using federal funds, or single assessments used by the state for multiple different programs for which the allocation of funds may not be clear to the assessed entities. In such cases, the assessed entities may not know how much of the assessment should be allocated to the reinsurance program.
2. Program reimbursements for claims costs should reduce claims incurred.
3. Timing - liabilities should be recognized when they meet the definition of a liability pursuant to SSAP No. 5R.
4. Guidance similar to the SSAP No. 107 federal receivables guidance is recommended to apply to the state ACA reinsurance programs guidance.

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The comment letters are included in Attachment 15 (20 pages).

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Statutory Accounting Principles (E) Working Group
Meeting Agenda
May 20, 2021

A. Consideration of Maintenance Agenda – Active List

1. Ref #2019-21: SSAP No. 43R

Ref #	Title	Attachment #
2019-21 SSAP No. 26R SSAP No. 43R	**SSAP No. 43R**	**A – Proposed Bond Definition**

Summary:
In 2013, the Working Group began the "Investment Classification Project" with the intent to undertake a comprehensive project to review the investment SSAPs to clarify definitions, scope, and the accounting method / related reporting. This substantive project specifically noted an intent to consider investments that were outside of "investment-type" definitions and consider characteristics to ensure appropriate valuation and reporting. Since origination of the project, the SAPWG has adopted substantive revisions to *SSAP No. 26R—Bonds, SSAP No. 30R—Common Stock* and *SSAP No. 32R—Preferred Stock.* Discussion of *SSAP No. 43R—Loan-Backed and Structured Securities* began in 2019 with a specific focus of underlying equity investments. Since then, the discussion expanded to be a complete review of the SSAP under the investment classification project and thus far has consisted of the following:

- August 2019: Exposed proposed revisions to exclude collateralized fund obligations (CFOs) and similar structures that reflect underlying equity interests from SSAP No. 43R, as well as prevent equity assets from being repackaged as securitizations and reported as long-term bonds.

- January 2020: Directed comprehensive project and the development of an issue paper to consider revisions to SSAP No. 43R.

- March 2020: Exposed preliminary issue paper for assessment. This issue paper introduced potential options to consider when assessing substantive revisions, focusing on different types of investments based on their characteristics. It began with an initial assessment of "asset-backed securities" under the Code of Federal Regulations (CFR) and items that would not fit within that definition.

- October 2020: Conducted hearing to receive industry comments on the exposed issue paper. Industry comments focused on two main themes: 1) Classification between 26R and 43R and 2) Definition of Asset Backed Security (ABS). After the discussion, Iowa proposed stepping back from the 26R vs 43R discussion with a more holistic principles-based approach to define a bond eligible for reporting on *Schedule D-1: Long-Term Bonds* (whether 26R or 43R). With this recommendation, the Working Group exposed draft principles for a bond definition as a starting point.

- Since the Fall of 2020, a small group comprised of Iowa, NAIC staff and Industry Reps have been meeting weekly to develop a draft bond proposal for consideration.

The small 43R group has developed a proposed definition to be used for all securities in determining whether they qualify for reporting on Schedule D-1. This proposed definition intends to reflect principle concepts, that focus on substance over form, to ensure appropriate consideration on whether a structure qualifies as an issuer credit obligation or asset-backed security prior to reporting as a bond.

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Key aspects of the proposed definition:

- A bond represents a credit relationship in substance, not just legal form.
    - Investments with equity-like characteristics or that represent ownership interests in substance, are not bonds.
    - Includes a rebuttable presumption that investments which rely on equity return cash flows are not bonds. The presumption may only be overcome through documented analysis supporting the recharacterization of the underlying equity risks into bond risk through structuring and diversification of collateral. This allows certain investments (such as collateralized fund obligations) that have appropriate structuring and collateral to be reported as bonds, only if properly supported by analysis.
- Bonds are either issuer obligations or asset-backed securities (ABS).
    - Issuer obligations are supported primarily by the general creditworthiness of an operating entity or entities. Examples of issuer obligations have been expanded to include project finance bonds issued by operating entities, bonds issued by REITs or similar property trusts, bonds issued by closed-end funds and other operating entities registered under the 1940 Act, and equipment trust certificates (ETCs), EETCs and credit tenant loans (CTLs) when payment is fully supported by a lease to an operating entity.
    - ABS are issued by entities that have a primary purpose of raising debt capital backed by collateral that provides the cash flows to service the debt. Although typically issued by special purpose entities (SPVs). An SPV is not a necessary component in classifying as an ABS. ABS shall be backed by either financial assets or cash-generating non-financial assets.
        - SSAP 103R defines a financial asset as cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right (a) to receive cash or another financial instrument from a second entity or (b) to exchange other financial instruments on potentially favorable terms with the second entity. Per the bond definition, financial assets do not include assets for which the realization of the benefits depends on the completion of a performance obligation (e.g., leases, mortgage servicing rights, royalty rights, etc.). These assets represent non-financial assets, or a means through which non-financial assets produce cash flows, until the performance obligation has been satisfied.
    - To qualify as a bond, an ABS must put the investment holder in a different economic position than owning the collateral directly. This is a requirement for all ABS regardless of the collateral backing the investment. This is accomplished through sufficient credit enhancement (process to absorb losses), overcollateralization, or other forms of guarantees or recourse.
    - To qualify as a bond, cash-generating non-financial assets backing ABS shall be expected to generate a meaningful source of cash flows for repayment of the bond, other than through the sale or refinancing of the assets. (The nature of the non-financial assets must lend itself to the production of fixed-income-like cash flows.)
    - Determination of sufficient credit enhancement and meaningful cash flows are determined at origination and are the responsibility of the insurer reporting entity. Documentation of the analysis shall be maintained and provided to regulators / auditors to support bond determination. Examples to assess sufficiency and meaningful are included in the proposed definition.

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- The principle concepts included in the proposed definition are intended to apply to all investments subject for inclusion on D-1. As such, specific consideration for certain investments (such as CTLs) may no longer be applicable. As detailed in the proposed definition, CTLs fully supported by a current lease would be considered an issuer obligation. CTLs that have residual risk (not fully supported) would be subject to the ABS provisions of sufficiency and meaningful.

Although the proposed definition includes the principle concepts for the bond definition, discussions and developments are still required on the following aspects:

- Proposal to improve transparency and reporting for Schedule D-1 items. This is planned to revise the existing reporting lines / categories and include more granular / descriptive reporting lines as well as a potential sub-schedule to identify items that have underlying equity risk or that do not self-liquidate. (Discussions on this item by the small group is expected to begin during the definition's exposure period.)

- Inclusion of actual revisions to the SSAPs to incorporate the bond definition as well as the development and adoption of an issue paper to document the discussions and revisions in developing the bond definition. (This work is not anticipated until after the proposed bond definition has been exposed and comments have been considered.)

- Development of accounting and reporting guidance for investments that do not fit the scope of *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* and that do not qualify under the bond definition. The current reporting guidance on Schedule BA only permits SSAP No. 48 items and private equity items to have NAIC designations for RBC impact. Additionally, the guidance in SSAP No. 48 requires audited financial statements for admittance and this provision may not be applicable for investments that may be captured on BA as they do not meet the principles for bond reporting.

- Consideration of transition guidance. It should be clearly noted that wide-spread grandfather provisions are not expected. As such, investments that have previously been reported as bonds may be required to move to BA (or another schedule) in accordance with the bond definition. However, consideration is expected on how to assess existing investments in determining whether they qualify for bond reporting at transition. It is recognized that assessing investments per historical origination date information may not be feasible.

Recommendation:
NAIC staff recommends that the Working Group expose the proposed bond definition for a public comment period ending July 15, 2021.

The focus of this exposure is specific to the proposed bond definition, but comments on future developments (such as reporting changes on Schedule D-1, development of accounting and reporting guidance for items that do not qualify for bond reporting, transition guidance, etc.) may also be submitted to assist in the development of these items.

<u>ANY OTHER MATTERS</u>

a. Life Risk-Based Capital (E) Working Group – Referral (Julie) (Attachment B) & Draft Response (Attachment C)

On April 26, 2021, the Life Risk-Based Capital (E) Working Group sent a referral to SAPWG requesting consideration on the accounting and reporting aspects of an American Council of Life Insurers (ACLI) proposal to modify the treatment of real estate in the life RBC formula. Per the referral, one aspect included is the incorporation of an adjustment to the factor applied based, in part, on the fair value of real estate reported in the annual statement. This proposal requests this treatment for real estate reported on Schedule A: Real Estate and for items captured as "Joint Venture, Partnership, or Limited Liability Company Investments with

the Underlying Characteristics of Real Estate" (reporting lines 219999 and 229999 on Schedule BA).

After considering the use of fair value on these Schedules (which has historically only been used to support BACV from an OTTI), the inconsistent reporting of fair value on Schedule A and BA and the limited appraisal requirements in *SSAP No. 40—Real Estate Investments*, a draft response has been prepared to note comments and concerns with this proposal based on accounting and reporting provisions. This response highlights that using reported fair value to reduce RBC creates a situation that is susceptible for RBC optimization.

b. Credit Tenant Loans – VOSTF Referral Response & INT 20-10 Update (Julie) (Attachment D)

On Jan. 22, 2021, the Working Group provided a referral to the Valuation of Securities (E) Task Force pursuant to the discussion and direction that occurred in 2020 regarding credit tenant loans (CTLs). This referral requested the Task Force to provide comments on the following:

- Whether it is appropriate to revisit the 5% residual asset risk threshold as a restriction for conforming CTLs. If applicable, a recommendation of an appropriate residual risk threshold.
- Whether other mechanisms or compensating controls (beyond a residual risk insurance policy) could be incorporated as a mitigating factor for CTLs that exceed the 5% residual risk threshold (or a threshold as recommended).
- A listing of the nonconforming CTLs that were filed with the SVO in accordance with the direction of Interpretation (INT) 20-10. Please include high level details including outstanding principal and NAIC designation assigned by the SVO.
- To the extent possible using best efforts, on 1) how many CTLs originally exceeded the residual risk threshold but were later considered as "conforming" due to mitigating factors, and 2) the nature of those factors (i.e., a residual risk insurance policy).

The Task Force provided a detailed response to this referral on May 1, 2021. As the referral response was just recently received, NAIC staff will be reviewing the response and discussing next steps regarding CTLs with the Working Group. Further discussion is expected during the interim or the Summer National Meeting.

In addition to the public information, a regulator-only addendum was provided to detail the nonconforming CTLs that were filed with the SVO in accordance with INT 20-10. Since this is investment specific data, and could be utilized to identify holdings at insurers, this has been provided as a regulator-only memorandum.

c. INT 20-10: Reporting Nonconforming Credit Tenant Loans (Attachment E)

In response to the Valuation of Securities (E) Task Force agenda item to consider edits to filing exempt requirements, tentative revisions have been proposed to INT 20-10. These revisions intend to prevent a situation in which the interpretation may require use of SVO-assigned designations beyond what is required in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual). The Task Force will consider action on their item during their upcoming May 24 call. **The Working Group is requested to consider action to expose this item, contingent on the Task Force action.** If the Task Force exposes, then the Working Group exposure period will match the Task Force exposure. If the Task Force adopts their item, then the Working Group will expose the revised INT for a 2-week period, and if the Task Force withdraws or delays action, then the Working Group exposure will not occur. As an alternative, the Working Group could wait to take action until after the Task Force meeting and complete an evote to expose at that time.

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