|  |  |
| --- | --- |
| **D. Keith Bell, CPA**Senior Vice PresidentAccounting PolicyCorporate FinanceThe Travelers Companies, Inc.860-277-0537; FAX 860-954-3708Email: d.keith.bell@travelers.com | **Rose Albrizio, CPA**Vice PresidentAccounting PracticesAXA Equitable.201-743-7221Email: rosemarie.albrizio@axa-equitable.com |

January 31, 2020

Mr. Dale Bruggeman, Chairman

Statutory Accounting Principles Working Group

National Association of Insurance Commissioners

1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

RE: Items Exposed for Comment During the NAIC Winter National Meeting with Comments due January 31

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the exposure drafts released for comment by the Statutory Accounting Principles (E) Working Group (the “Working Group”), during the NAIC Fall National Meeting in Austin. We offer the following comments:

**Ref #2018-26: SCA Loss Tracking – Accounting Guidance**

The Working Group exposed revisions, with modifications suggested by interested parties to *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* to expand guidance regarding financial guarantees and the use of the equity method for when losses exceed the equity value of an SCA investment. With the revisions, the equity value of an SCA would not go negative, and guaranteed liabilities would be reported to the extent that there is a financial guarantee or commitment. The “Illustration of the Application of INT 00-24” will also be inserted into *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.

Interested parties have no comment on this item.

**Ref #2018-38: Prepayments to Service and Claims Adjusting Providers**

NAIC Staff recommended that the Working Group expose revisions incorporating the majority of interested parties’ comments to SSAP No. 55 (rather than the changes reflected in the draft for the Summer 2019 exposure). Interested parties’ comments primarily delete the exposed guidance and move the same or similar concepts into the broad product guidance for property and casualty, life and health or health in SSAP No. 55. These revisions are to reinstate annual statement references by entity type and to adjust scoping language and make the SSAP No. 29 prepaid guidance consistent. (Staff proposed variations in wording are shaded to differentiate from the interested parties proposed wording that accomplishes a similar intent.)

The exposed revisions to *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses* incorporate interested parties’ previous recommendations to separate the guidance by product type and emphasize guidance that loss and loss adjusting expense liabilities are established regardless of payments to third parties (except for capitated health claim payments). The revisions emphasize existing guidance that claims related liabilities are not recognized as paid until the losses are paid to claimants or claims are adjusted.

Interested parties have no comment on this item.

**Ref #2019-04: SSAP No. 32 – Investment Classification Project**

The Working Group exposed a revised *Issue Paper No. 1XX—Preferred Stock* and a substantively-revised draft *SSAP No. 32—Preferred Stock* as part of the Investment Classification Project.

Interested parties substantially agree with the objectives of the proposal and appreciate Staff’s inclusion of revisions for previously communicated comments. We have the following additional comments related to the issue paper:

Scope

Interested parties note that the scope retains, albeit edited, the guidance that preferred stock of subsidiary, controlled and affiliated entities is included and therefore accounted for under the guidance for preferred stock regardless of their SCA character. We acknowledge the current exposure added the requirement to file investments in response to our request. The existing wording in SSAP No. 32 and the exposed language for SSAP No. 32 is below with interested parties suggested clarifying sentence and additional wording (underlined).

Existing language in SSAP No. 32:

SCOPE OF STATEMENT

1.This statement establishes statutory accounting principles for preferred stock.

2. Investments in preferred stock of subsidiaries, controlled or affiliated entities, including preferred stock interests of certified capital companies (CAPCO) per INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO) are included within the scope of this statement.

Exposed language in SSAP No. 32 and interested parties suggested additional sentence (underlined):

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for preferred stock.

2. Investments in preferred stock of entities captured in SSAP No. 97—*Investments in Subsidiaries, Controlled or Affiliated Entities* or SSAP No. 48—*Joint Ventures, Partnerships and Limited Liability Companies*, as well as preferred stock interests of certified capital companies per INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO) are included within the scope of this statement. The requirement to file investments in preferred stock of certain subsidiaries, controlled or affiliated entities with the NAIC pursuant to SSAP No. 97 does not affect the application of the accounting*, valuation or admissibility* under this statement.

Definitions

We are opposed to the proposed edits to the definitions of redeemable and perpetual preferred stock for the following reasons:

1. The change would create a divergence from GAAP that does not exist under the current definitions. Both the definition and accounting for redeemable securities under the current definition aligns with the GAAP definition and accounting for debt securities. Preferred stock accounted for as debt securities under GAAP are those where ability for the holder to collect repayment is assured by the contract terms. We have not identified any benefit to diverging from this view for statutory reporting. The NAIC guidance is different from the GAAP ASC 480 guidance for issuers in multiple ways:
* Preferred stock redeemable at the option of the holder for GAAP is classified as equity (mezzanine equity for SEC filers) but under statutory reporting currently (and proposed) is classified as debt-like in valuation. This conflicts with GAAP ASC 480 guidance for issuers and so it is more straight forward to use the GAAP ASC guidance for holders.
* Alignment of statutory accounting with the ASC 320 guidance for holders results in more equity-like classification in the valuation of preferred stock which is generally more conservative than debt-like classification in valuation.
* Preferred stock redeemable for other reasons outside of issuer’s control is equity (mezzanine equity for SEC filers) for GAAP but equity-like in valuation under current statutory reporting and debt-like in valuation under the proposed statutory reporting.
1. The definition that the NAIC staff has proposed to align to is used in GAAP only for compliance with SEC Regulation S-X, Rule 5-02, which is relevant only to the issuer of preferred stock and does not apply to nonpublic companies. Further, the definitions under Rule 5-02 were designed to include preferred stock with redemption features outside of the control of the issuer in order to provide investors information regarding potential future cash obligations. This is not a relevant consideration for the holder of preferred stock, which is why GAAP does not consider this from the holder’s perspective. From the holder’s perspective, the only relevant consideration is whether the holder is able to redeem its investment, either through a fixed and determinable date, or through a redemption option that the holder can control.
2. Evaluation of whether there are any features that are outside the control of the issuer is a very complex and cumbersome analysis, even on an infrequent basis as is the case under GAAP (as it only applies to issuers). This is because there are a vast number of potential features that could be outside the control of the issuer (i.e., change in control, lapse in SEC registration, failure to pay dividend, etc.). Insurance companies frequently invest in preferred stock and often purchase many such securities each reporting period. Evaluating every preferred stock investment at this level of detail would be operationally burdensome and would provide no additional benefit as the investor is often economically indifferent to many of these low-probability redemption features that are outside of the control of both the issuer and investor.

As a result, we propose the following edits to the proposed definitions:

1. Redeemable preferred stock, which is preferred stock subject to mandatory redemption requirements or whose redemption is ~~outside the control~~ at the option of the ~~issuer~~ holders. Redeemable preferred stock is any stock which 1) the issuer undertakes to redeem at a fixed or determinable price on the fixed or determinable date or dates, whether by operation of a sinking fund or otherwise; or 2) is redeemable at the option of the holders~~; or 3) has conditions for redemption which are not solely within the control of the issuer, such as stock which must be redeemed out of future earnings~~. Preferred stock which meet one or more of these ~~three~~ two criteria would be classified as redeemable preferred stock regardless of other attributes such as voting rights or dividend rights;
2. Perpetual preferred stock, which is preferred stocks which are not redeemable or for which redemption is not at the option of the holder ~~are redeemable solely at the option of the issuer~~ (non-redeemable preferred stock). Perpetual preferred stock is any preferred stock which does not meet the criteria to be classified as redeemable preferred stock pursuant to paragraph 3.a.

Balance Sheet Amount

The issue paper discusses carrying perpetual preferred at fair value capped by any stated call price. However, it did not provide guidance on timing for application of the cap. Because the call may not be effective for a period of time, and to ensure that purchases of perpetual preferred stock could still be carried at values greater than par (assuming market values remain above par), we recommend the following revisions to paragraph 10.a.ii, 10.b.ii and the correspondingly to paragraph 11 (underlined):

Paragraphs 10.a.ii and 10.b.ii:

* + 1. Perpetual preferred stocks shall be valued at fair value, not to exceed *any currently effective call price*.

Paragraph 11:

11. An other-than-temporary (INT 06-07) impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to collect all amounts due according to the contractual terms of the preferred stock in effect at the date of acquisition. An assessment of other-than-temporary impairment shall occur whenever mandatory redemption rights or sinking fund requirements do not occur. A decline in fair value which is other-than-temporary includes situations where the reporting entity has made a decision to sell the preferred stock prior to its maturity at an amount below its carrying value (i.e., amortized cost). If it is determined that a decline in the fair value of a redeemable preferred stock is other-than-temporary, an impairment loss shall be recognized as a realized loss equal to the entire difference between the redeemable preferred stock’s carrying value and its fair value, *not to exceed* *any currently effective call price*, at the balance sheet date of the reporting period for which the assessment is made. The measurement of the impairment loss shall not include partial recoveries of fair value subsequent to the balance sheet date. For reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with SSAP No. 7.

Income

The issue paper clarifies the guidance on dividends on preferred stock. Specifically, paragraph 14 states:

“14. Dividends on preferred stock shall be recorded as investment income for qualifying preferred stock on the ex-dividend date with a corresponding receivable to be extinguished upon dividend settlement.”

Interested parties request clarification on the use of the term “qualifying” preferred stock as the term is not defined within the issue paper or within the new glossary of terms. If the inclusion of the word “qualifying” was unintentional, interested parties recommend deleting the word from paragraph 14 to avoid confusion.

**Ref #2019-08: Update Reporting Deposit-Type Contracts**

The Working Group exposed this agenda item to: 1) request feedback on the inclusion of a footnote excerpt for Exhibit 5 to disclose cases when a mortality risk is no longer present or a significant factor – i.e., due to a policyholder electing a payout benefit, 2) request feedback on circumstances where a morbidity risk is no longer present or a significant factor for Exhibit 6 items and whether a similar footnote disclosure would be appropriate, and 3) requested industry and regulator input for instruction clarifications regarding the classifications of deposit-type contracts captured in Exhibit 7. With this exposure, there are no proposed edits for statutory accounting. The Working Group directed NAIC staff to notify the Financial Stability (Ex) Task Force of this exposure.

Interested parties support the proposed Exhibit 5 footnote which, among other things, would provide clarification on contracts where a mortality risk is no longer present or a significant factor.

With respect to the implementation of additional disclosures for Exhibit 6, interested parties believe that the current product disaggregation in Exhibit 6 is sufficient to analyze the risks present in the subject contracts, and would suggest no changes.

Interested parties have no additional clarifications for Exhibit 7 instructions – we believe the current instructions are sufficiently clear for deposit type contracts

## **Ref #2019-12:** ***ASU 2014-17, Business Combinations – Pushdown Accounting, a Consensus of the FASB Emerging Issues Task Force***

The Working Group adopted, as final, a clarification edit to *SSAP No. 68—Business Combinations and Goodwill* to clarify that all goodwill from an insurance entity’s acquisition of SCAs, regardless of whether pushdown accounting is applied, is subject to the existing 10% admittance limitation. (With adoption of this edit, paragraph 9 was split into two separate paragraphs with the additional wording shown below.) The remainder of this agenda item was re-exposed to allow additional time for specific examples of pushdown accounting to be provided by interested parties, as well as consider comments received on pushdown.

9. Positive goodwill recorded under the statutory purchase method of accounting shall be admitted subject to the following limitation: Positive goodwill from all sources, including life, accident and health, and deposit-type assumption reinsurance and goodwill resulting from the acquisition of an SCA by the insurance reporting entity that is reported on the SCA’s financial statements (resulting from the application of pushdown accounting), is limited in the aggregate to 10% of the acquiring[[1]](#footnote-1) entity’s capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for its most recently filed statement with the domiciliary state commissioner adjusted to exclude any net positive goodwill, EDP equipment and operating system software, and net deferred tax assets. Additionally, all positive goodwill shall be nonadmitted when the underlying investment in the SCA or partnership, joint venture and limited liability company is nonadmitted. When negative goodwill exists, it shall be recorded as a contra-asset.

Interested parties is working on developing examples to illustrate the various ways in which goodwill can be generated and suggested approaches to how the statutory limitations could be applied. As a result of these efforts, we request an extension for this and the following item.

**Ref #2019-14: Attribution of Goodwill**

The Working Group re-exposed this agenda item to clarify that the “assignment” of goodwill is a disclosure element. The Working Group directed NAIC staff to prepare revisions to the Sub 1 Acquisition Overview template to capture this information for new SCA acquisitions.

Please see the comments on the preceding item.

**Ref #2019-20: Rolling Short-Term Investments**

The Working Group exposed revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* and *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, as shown in the “Proposed Revisions for Fall 2019 Discussion” to incorporate additional principle concepts in classifying investments as cash equivalents or short-term investments to prevent the “rolling” of certain investments. Fall revisions to the prior Summer National Meeting exposure incorporate guidance to exclude qualifying cash pools from the short-term rolling provisions.

With the Fall exposure, comments were requested from regulators and industry representatives on whether other investments should be included / excluded from the short-term rolling provisions. In particular, comments are requested on whether short-term lending (both collateral loans and affiliated loans) should be permitted to be continuously rolled/renewed as short-term, whether non-affiliated SSAP No. 26R investments should be subject to the short-term rolling restrictions, and whether an assessment of “re-underwriting” could be used as support to allow the rolling of short-term investments.

Interested parties appreciate the staff’s exclusion of qualifying cash pools from the provisions of the short-term rolling re-exposure. There remain two types of short-term lending arrangements within the scope of the re-exposure that should be addressed separately. We respectfully request that the Working Group give consideration to the broader implications discussed below prior to moving forward with this proposal. Specifically, it might be advantageous to split the exposure into two work streams – one for affiliated investments and anther for unaffiliated investments

**Non-affiliate Short-Term Lending**

In the case of non-affiliated loans (i.e., Schedule BA Other Invested Assets), in order to provide appropriate flexibility to both the lender and the borrower, a loan facility may be structured as a short-term obligation. Such short-term obligations permit an insurer to more efficiently deploy its capital and streamline its underwriting process. Specifically, short term, non-affiliated loans: (a) provide the insurer with the ability to review and consider credit and collateral on a regular basis, (b) allow the insurer to reevaluate each investment at maturity and make new investments based on current market conditions if desired, and (c) allow the insurer to consider a renewal with an existing base of knowledge about the borrower and collateral, making the underwriting process more streamlined and allowing for better informed credit decisions. As with any investment, diligent underwriting of the borrower and the collateral, and structuring of the investment with appropriate safeguards is critical and should not deviate from standards used for longer-term investments. These facilities fill a market need for borrowers that require short-term or warehouse-type financings on assets prior to reaching the window for securitization and provide the insurer with attractive risk-adjusted returns relative to other short-term investments.

In this context, interested parties propose that all non-affiliated short-term obligations, obligations in scope of either SSAP No. 26 or SSAP No. 43R, where the counterparty is not an affiliate or related party of the reporting entity, including collateral loans, which meet certain objective criteria should be defined, reported, and monitored in the existing Schedule DA as a non-affiliated short-term investment. In order for a non-affiliated transaction to qualify as short term for reporting purposes, such investment must include the following features:

1. The loan includes a maturity date less than one year from closing at which the borrower has an unconditional repayment obligation and on which the lender has a reasonable expectation that the investment can be terminated and repaid if so desired by the insurer; and
2. Any subsequent renewal is only completed in the sole discretion of BOTH the borrower and the lender.

Given that the transaction is between unaffiliated counterparties, interested parties believe the terms of these transactions, including the interest rate and advance rate, are on arms’ length terms.

Finally, with no obligation at any time to renew a transaction, the reporting entity is required to re-evaluate and re-underwrite the transaction at maturity. If any of the relevant underwriting criteria have changed, the insurer can require repayment or can request adjustments to the terms and conditions to conform to market conditions. If, but only if, both the borrower and lender agree to renew the transaction on the same or adjusted terms, the transaction may be renewed. This process, however, requires an independent credit decision and results in a new transaction.

Interested parties acknowledges the NAIC staff’s concern about the ability of auditors and regulators to discern between renewals that have been re-underwritten and those that have not; however, without an appreciation for the nuanced economic differences of these transactions, interested parties have concerns about unintended consequences of the re-exposure. Consider a transaction in which an entity purchases a GNMA with less than a one-year maturity, which was classified as a short-term investment or cash equivalent and matures/is settled as expected. Shortly after, that entity decides to purchase another GNMA with less than a one-year maturity. As proposed, the guidance precludes short-term investment or cash equivalent reporting for reacquired investments (or *substantially similar investments)* when purchased within one year from the initial investment. Without further clarification regarding *substantially similar investments,* or alternative objective criteria like those proposed above, we anticipate that diversity in practice could result. Additionally, regarding the example described, operationally burdensome tracking requirements would be required for entities to ensure appropriate reporting.

Therefore, we believe that unaffiliated SSAP No. 26 investments should be excluded from the scope of this exposure for the reasons discussed above. The scope of this exposure should also continue to exclude other unaffiliated SSAP No. 26 investments such as treasury bills, commercial paper, certificates of deposits and other similar short-term investments since such investments are used for short-term liquidity and do not have long-term investment risk.

**Affiliate Short-Term Lending**

Interested parties believe that the same principles discussed above and in our previous letter apply to affiliated short-term investments to merit continued classification as short term in nature, even when a subsequent short-term investment is re-underwritten to the same borrower within a year. We believe there is already sufficient regulatory oversight on the fundamental objectives, usage and risks of material affiliated transactions to validate the alignment of these vehicles with the fundamental characteristics implied by the statutory short-term investment classification. In this case, prudently managed, governed and executed liquidity optimization across an insurance holding company system can be observed with the current regulatory oversight mechanisms. While re-underwriting may be warranted based on liquidity needs, the risk profile continues to be commensurate with that of short-term investments.

NAIC Guidance should not supersede regulatory oversight.The domiciliary commissioners already have authority to disapprove of material affiliated transactions as deemed necessary. The NAIC Model Holding Company Act (the “Act”), which has been broadly incorporated into state laws, requires filing and domiciliary commissioner approval of affiliated transactions over certain materiality thresholds. As the Act was promulgated by the NAIC, interested parties believe that through use of the Act, commissioners put in place filing and approval requirements they deemed satisfactory to address their regulatory needs. Through these filings, state regulators have oversight over both the risk elements considered and the methodology utilized by companies in underwriting each material extension of credit within the holding company system. It would run counter to state authority to implement requirements resulting in NAIC guidance that would effectively supersede the authority of domiciliary commissioners or cast doubt, even implicitly, upon states’ ability to appropriately regulate the domiciled insurers with which they are intimately familiar. Principally, the Act allows regulators to verify the appropriateness of the short-term classification of material affiliated investments, providing oversight to ensure consistency in classification between affiliated and unaffiliated short-term investments.

Prudent and appropriately governed liquidity management within a holding company structure enhances insurance company solvency.Appropriately managed, governed and regulator-approved affiliate lending programs create opportunities for liquidity optimization across a holding company system, essentially sharing objectives similar to that of affiliated liquidity pools. This management is necessary due to diversification of product offerings as timing of cash receipts and disbursements will vary across such products and different entities within a holding company system. The ability to prudently draw upon excess liquidity surplus within one entity at a time when another entity has a short-term need for liquidity serves as an immediate buffer against uneconomic alternatives such as forced asset sales or relatively costly external short-term financing.  If adopted as written, the exposed guidance could result in entities foregoing this powerful in-house liquidity tool, which enables companies within a holding company system to more effectively manage inherent cash flow timing mismatches, and instead resort to alternatives that would result in an unnecessary drain on capital available to support policyholder obligations.

**SSAP 43R—Loan-backed and Structured Securities**

Investments in the scope of SSAP 43R, *Loan-backed and Structured Securities*, have payments that are driven by underlying collateral with modifications that are driven by the performance of the underlying assets and typically overseen by a collateral manager or otherwise laid out in deal documents. In many cases, these instruments also have clean-up call provisions that would remove the investment from the market while the remaining underlying collateral may be repackaged into a re-securitization. The concept of rolling a short-term investment that would be in the scope of SSAP 43R is often-times outside the control of investors in these instruments and possibly part of the normal life cycle of a small portion of the underlying collateral. Because of these characteristics, the interested parties propose that any non-affiliated investment that would qualify within SSAP 43R—Loan-backed and Structured Securities be exempt from the proposed new concepts like what is proposed for non-affiliated investment that would qualify within SSAP 26R—Bonds. Further consideration of affiliated investments that fall within SSAP 43R is recommended, given the underlying assets drive these investments and the other considerations for affiliate short-term lending outlined previously in this response.

Interested parties respectfully requests that the Working Group give consideration to these broader implications prior to moving forward with this proposal. If the Working Group has lingering concerns or appetite for additional elaboration as to the character and traditional efficacy of existing regulatory oversight mechanisms, interested parties would request that staff work with industry to draft materials for future dialogue and examination of this topic.

## **Ref #2019-24: Levelized and Persistency Commission**

The Working Group exposed revisions to *SSAP No. 71—Policy Acquisition Costs and Commissions*, to include additional NAIC staff modifications regarding persistency commission and levelized commission arrangements to address certain comments received and to allow for further discussion. With this exposure, the Working Group directed a notification of the exposure to be sent to the Life Actuarial (A) Task Force.

Interested parties appreciate staff’s availability to discuss the proposed revisions. Based on that discussion and the discussion at the Fall Meeting, interested parties propose suggested edits that we believe achieve the goal of a nonsubstantive change and clarify the original intent of SSAP 71.  (Note: the *NAIC Accounting Practices and Procedures Manual-Life* which was in force prior to the effective date of current SAP includes the same wording as current SSAP No. 71). The suggested edits add a clear definition of a funding agreement.  This will clarify the distinction between funding agreements and persistency-based commissions, without unintentionally changing the existing accounting.  We welcome the opportunity to discuss the suggested edits further with the Working Group.

Ref #2019-25: Working Capital Finance Notes (WCFN)

The Working Group exposed substantive revisions to *SSAP No. 105—Working Capital Finance Investments* (SSAP No. 105) to incorporate industry revisions to program requirements, as previously directed by the Working Group during the Summer National Meeting. The Working Group directed NAIC staff to prepare an issue paper.

In 2016, the American Council of Life Insurers (ACLI) advised the NAIC that the implementation of SSAP No. 105 was not successful and that adoption had been low. ACLI began a dialogue with staff and regulators about both the shortcomings of the 2013 adopted rules and outlined required changes to make the rules suitable. As part of that process, ACLI marked up both the SSAP and NAIC SVO Purposes and Procedures Manual (P&P Manual) with the suggested changes which have subsequently been characterized as "10 required items", which staff have in turn opined on, and noted that four of the items are not supported by staff. Absent all 10 required items, WCFI adoption will remain low. Staff have noted an immaterial number of programs have been filed with only a subset of those approved, resulting in limited investments made. The existing Exposure provided to staff and fegulators by ACLI and was utilized by staff to produce the current proposal, without addressing the proposed language by ACLI on the four required items not supported by staff.

Objections to the four required changes are:

1. evaluating non-rated subsidiaries of obligors (even though the existing SSAP already provides guidance to do).
2. expanding covered investment credit quality to include NAIC 3 and 4 investments,
3. requiring domiciliary regulator authorization for investment, and
4. requiring reporting on Schedule BA even though the asset class qualifies for look through RBC treatment.

In the ACLI draft provided to the NAIC, ACLI proposed an evaluation mechanism that is suitable for NAIC implementation on un-rated subsidiaries. With regard to NAIC objection on lower rated investments, such position is inexplicable as statutory RBC requirements reflect investment quality decisions in capital calculations limiting Industry investments to compliant assets. Domiciliary regulator prior approval for investment is a transfer of transaction review from staff to state insurance departments when, if regulators are concerned about the asset class, they can uniformly limit investment as a whole. Finally, Schedule BA reporting is both cumbersome and expensive for industry further exacerbating adoption without useful purpose. Regulators can track any specific asset class or investment by requiring the use of a specific investment code on the appropriate accounting schedule, which in the case of WCFI is Schedule DA).

Interested parties note that private placements, as opposed to public investments, are typically available only to large industry participants and that the economic impact of a $10,000 industry filing fee per issue per filing entity has an operating impact on a $1,000,000 investment in WCFI, which for the avoidance of doubt would be sizable for most industry investors, of 1% of the investment income in year 1 of that investment. Current investment yields for NAIC 1 and 2 investments in WCFI offer gross returns of 2 – 2.5%. Such a high cost to a small industry investor, coupled with the fact that dealers would unlikely choose to document such investments bilaterally with small industry investors, limits access to the assets to large industry investors. In summary, interested parties request that regulators re-consider ACLI markup with the additional four requirements as originally submitted by ACLI and ultimately, after appropriate exposure and review, to direct staff to implement these changes.

**Ref #2019-32: Look-Through with Multiple Holding Companies**

The Working Group moved this agenda item to the active listing and exposed revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, to clarify that a more-than-one holding company structure is permitted as a look-through if each of the holding companies within the structure complies with the requirements in SSAP No. 97.

Interested parties have no comment on this item.

**Ref #2019-33: SSAP No. 25 – Disclosures**

The Working Group moved this agenda item to the active listing and exposed the proposed data-capture templates. This exposure does not propose revisions to SSAP No. 25.

### Interested parties believe that clarifications to paragraph 20 of SSAP No. 25 are necessary. We believe that the aggregation of similar transactions may result in immaterial transactions becoming material, meeting the threshold of 1/2 of 1% of the total admitted assets of the reporting entity. Therefore, we propose the edits highlighted below to ensure that aggregation occurs subsequent to the application of the criteria in paragraph 20.b. for materially identified transactions.

**Proposed Edits to the exposure**

### Disclosures

20.        The financial statements shall include disclosures of **all material related-party transactions**. In some cases, aggregation of similar transactions, that on a stand-alone basis are not material, may be appropriate. Sometimes, the effect of the relationship between the parties may be so pervasive that disclosure of the relationship alone will be sufficient. If necessary to the understanding of the relationship, the name of the related party should be disclosed. Transactions shall not be purported to be arm’s-length transactions unless there is demonstrable evidence to support such statement. The disclosures shall include:

1. **The nature of the relationships involved**;
2. **A description of the transactions for each of the periods for which financial statements are presented, and such other information considered necessary to obtain an understanding of the effects of the transactions on the financial statements**. Exclude reinsurance transactions, any non-insurance transactions which involve less than ½ of 1% of the total admitted assets of the reporting entity, and cost allocation transactions. The following information shall be provided if applicable:

**Ref #2019-34: Related Parties, Disclaimers of Affiliation and Variable Interest Entities**

The Working Group Staff exposed revisions to *SSAP No. 25—Affiliates and Other Related Parties.*  Key elements for discussion in the exposure draft are to:

* Clarify the identification of related parties and ensure that any related party identified under U.S. generally accepted accounting principles (GAAP) or Securities Exchange Commission (SEC) reporting requirements would be considered a related party under statutory accounting principles (SAP).
* Clarify that non-controlling ownership over 10% results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation.
* Clarify the impact of a disclaimer of control or disclaimer of affiliate under SAP. As detailed, such disclaimers impact holding company group allocation and reporting as an SCA under SSAP No. 97, but do not eliminate the classification as a “related party” and the disclosure of material transactions as required under SSAP No. 25.
* Incorporate a new disclosure of known non-arm’s-length transactions with any entity not identified as a related party.
* Propose rejection of several U.S. GAAP standards addressing variable interest entities.

Interested parties understand and agree with the need for transparency in disclosures of related party transactions. However, we have significant concerns with the proposal as it is not very clear based on the proposed changes to SSAP No. 25 what it is that will be required going forward based on the expansion of the definition of a related party. We include some of our observations below.

Interested parties would like clarity around the new proposed wording that states that non-controlling ownership over 10% results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation. One of our concerns in this area relates to limited partnership/joint ventures/limited liability company (LPs/JVs/LLCs) investments where the insurer owns more than 10% of the equity of the investee but has no affiliation to the investee’s general partner/asset manager. SSAP No. 97 currently includes a possible scope exception in paragraph 6 for these types of investments so that they are not considered affiliated or controlled investees of the insurer. It is not clear from the proposal what the expected impact is from now having to consider all investments in unaffiliated LPs/JVs/LLCs where the insurer owns more than 10% of the equity but has no other affiliation, as related parties. If the intent is just to have insurers disclose material transactions with these entities other than the equity investment held in each entity, we believe that this needs to be more clearly stated in the proposal so that there is no misrepresentation of what needs to be disclosed or whether these investments need to be reported in a different section of Schedule BA (i.e., affiliated vs. non-affiliated).

Another, but similar concern relates to certain entities consolidated under U.S. GAAP based on the Variable Interest Entity (VIEs) guidance. For some of these consolidated VIEs, the insurer has no control or affiliation with the VIE other than its debt investment in the entity. The insurer is simply a passive investor in the structure. However, under the VIE rules, the insurer must consolidate the entity as the insurer may be able to make decisions for the VIE if there is ever an event of default of the assets at some point in the future. These rights are given to certain classes of bonds issued by the securitization as a protection to the investors, but do not give the investors any type of power or control over the VIE at inception or on a day-to-day basis. It is important to note that consolidation rules under FASB Codification Topic 810 are very complex with some insurers concluding consolidation is required under a set of fact and circumstances and others concluding consolidation is not required under the same set of facts and circumstances. In the example just shared, some insurers have concluded consolidation is required because when no day-to-day decisions are being made for the VIE, decisions upon the occurrence of a certain event which may be unlikely to occur, rise to the point where they are the decisions that have the most significant impact on the economic results of the VIE. We believe that even though insurers have to consolidate these entities, there is no true related party affiliation. The proposal requires that any entity identified as a related party under U.S. GAAP will also be considered a related party for statutory reporting. Since these entities are consolidated for GAAP, the presumption would be that they are a related party of the insurer. If these entities will be considered related parties on a statutory basis going forward, the exposure needs to clarify that the inclusion of these types of entities only impacts related party disclosures for any material transactions held with these entities other than the debt investment held by the insurer in the VIE and that the debt instrument is still reported on Schedule D as unaffiliated.

Interested parties also have concerns with SSAP No. 25 including references to U.S. GAAP and SEC reporting for mutual insurers that do not prepare U.S. GAAP financial statements and do not file with the SEC. Therefore, interested parties recommend that the specific guidance from the GAAP and SEC be stated in SSAP No. 25 (rather than incorporated by reference) so that any future changes in GAAP and SEC guidance are subject to NAIC review prior to being applicable. Also, it is important to note that even when an entity is considered a related party under U.S. GAAP, disclosure of that relationship is only required when there are material transactions with that party. U.S. GAAP allows reporting entities to evaluate the significance of a relationship and determine when disclosure of that relationship is material/significant enough for disclosure to a user of the financial statements. As a result, we suggest this be clarified in the exposure as well so that it is clear that the reference to related parties under GAAP and SEC rules is only relevant if the insurer has material transactions with such parties outside of the insurer’s investment in the entity.

**Ref #2019-35: Update Withdrawal Disclosures**

# The Working Group moved this agenda item to the active listing and exposed revisions to *SSAP No. 51R—Life Contracts*, *SSAP No. 52—Deposit-Type Contracts*, and *SSAP No. 61R— Life, Deposit-Type and Accident and Health Reinsurance,* as illustrated in the staff recommendation,to:

* Add a consistency revision to SSAP No. 51R to ensure separate account guaranteed products are referenced in all applicable paragraphs of the withdrawal characteristics disclosures;
* Correct an identified inconsistency in one of the new disclosures that was added regarding products that will move from the reporting line of having surrender charges at 5% or more to the reporting line of surrender charges at less than 5%. A clarification is being recommended to ensure consistency in annual statement reporting; and
* Add a cross-reference from SSAP No. 56 to the existing disclosures by withdrawal characteristics in SSAP No. 51R and SSAP No. 61R as the disclosure include separate account products.

Interested parties have no comment on this item.

**Ref #2019-36: Expand MGA and TPA Disclosures**

The Working Group moved this agenda item to the active listing and exposed revisions to *SSAP No. 51R—Life Contracts*, paragraph 50, *SSAP No. 53—Property Casualty Contracts—Premiums*, paragraph 19, *SSAP No. 54R—Individual and Group Accident and Health Contracts*, paragraph 33 and *SSAP No. 59—Credit Life and Accident and Health Insurance Contracts,* paragraph 19, as illustrated in the staff recommendation above, to expand the MGA/TPA note as follows:

* Aggregate direct written premium and total premium written by MGA/TPA;
* Aggregate dollar amount of claims process / total claims processed by MGA/TPA; and
* Information on related party / affiliate status and if the MGA/TPA is independently audited and / or bonded.

Interested parties note that the proposal does not define a TPA.  It just states that TPAs “that write direct policies or provide claims adjusting or other services”.  That is overly broad and could include a variety of entities that provide services.  The NAIC model (NAIC Third Party Administrator Act, or NAIC model) guidelines define TPAs as it relates to life/health and workers compensation.  Also, the NAIC model definition has a long list of activities that are excluded from the definition, such as self-insured employers administering its own workers’ compensation, insurers administering coverage, producers engaged in selling insurance, attorneys handling claims, MGAs, etc.  We recommend that the proposed disclosure reference the NAIC model so that there is consistency in the definition used in applying the guidance.

Additionally, it is unclear how the reporting threshold should be applied. The reporting applies to TPAs if “the claims adjusting services are greater than 5% of annual average claims volume”.  Is that threshold based on the amount of claim dollars paid or the number of claims handled?  Is that measured across all lines of business for the company?  Would claims paid within insureds’ deductibles/SIRs be included? Depending on how this is defined, it could be quite burdensome for insurers to monitor. We recommend that the threshold be based on written premium, consistent with how other thresholds have been applied.

**Ref #2019-37: Surplus Notes – Enhanced Disclosures**

During the 2018 Spring National Meeting, the Working Group exposed revisions to *SSAP No. 41R – Surplus Notes (“SSAP No. 41R”)* to indicate that surplus notes, where the proceeds from the issuance of the surplus note were used to purchase an asset directly or indirectly from the holder of the surplus note, are not subordinate and do not qualify for reporting as surplus and should be classified as debt. Furthermore, the exposure draft stated that these assets were not considered available for policyholder claims and should be non-admitted. The exposure was the result of a referral from a Subgroup of the Reinsurance Task Force that was more narrowly focused on whether specific securities could be considered Primary Securities.

At the 2019 Summer National Meeting, the Working Group agreed to have an industry data call, due by December 31, 2019, to determine what financing structures existed that utilized the types of surplus notes described above.

At the 2019 Fall National Meeting, the Working Group exposed additional disclosures that should be captured in *SSAP No. 41R****.*** The Working Group does intend, later in 2020, to continue discussions on how to treat surplus notes where an associated asset is received by the surplus note issuer. This discussion will occur after a review and analysis of the data call.

***General Comments***

Interested parties understand regulators’ concerns that the details of certain transactions involving surplus notes may not be transparent to regulators who were not involved in the initial approval or ongoing review of such transactions. However, these transactions and the related pricing represent confidential information that we believe is inappropriate for public disclosure and may be misleading if presented in the proposed format.

Our concerns with the proposed disclosures are outlined in detail below, followed by our suggested revisions.

***The proposed disclosures may not provide the desired transparency or consistency***

Throughout the discussion on any potential revisions to *SSAP No. 41R* over the past twenty-two months, interested parties have agreed that robust disclosures should be added to *SSAP No. 41R*to fully reflect situations where a reporting entity receiving proceeds from the issuance of surplus notes used those proceeds to purchase an asset directly or indirectly from the holder of the surplus note. However, we also believe that these disclosures should be included in thefinancial statements of a ceding company, which would provide a much greater level of transparency and consistency in disclosure. We believe that in most situations where a surplus note issuer uses proceeds from the issuance to purchase an asset directly or indirectly from the holder of the surplus note, the surplus note issuer is an affiliated captive reinsurer. As some captive financial statements are not provided to the NAIC, we believe disclosure in the financial statements of the ceding company would provide a much greater level of transparency and consistency in disclosure for these transactions. Our proposed revisions include suggested language for this disclosure requirement.

***The proposed disclosure goes beyond the stated regulatory concern and requires additional information that may be incorrectly interpreted.***

We believe that the proposed disclosure departs from the original regulatory concern expressed in the public meetings of the Working Group, namely that a reporting entity should not be permitted to circumvent regulatory authority as it relates to the preservation of capital at a regulated entity by contractually linking the cash outflows associated with a surplus note to cash inflows from another financial instrument held by the surplus note issuer. However, rather than identify such transactions, the proposed disclosure would require detailed information about surplus note interest regardless of whether cash flows are contractually linked. We are concerned that the operational burden of compiling this information for all surplus notes with netting provisions exceeds the benefit to regulators of providing information on the few transactions of concern.

Interested parties note that the scope of the proposed disclosure is substantially identical to that of the recent surplus note data call issued by the NAIC. The stated intent of this data call was to obtain information on surplus note transactions without regard to whether offsetting of cash flows was due to: a) contractual linkage or b) administrative offset provisions. While we agree that this scope was appropriate to assess the universe of affected transactions, we do not believe it is the appropriate scope for an Annual Statement disclosure and could be misleading in certain cases as outlined below.

***The proposed disclosure includes confidential information that is not appropriate for public filings.***

The proposal would require the disclosure of surplus note interest paid, net of any payments made by the surplus note holder. As a practical matter, for many captive structures, this amount often corresponds to the fees paid to the financing provider(s) to provide liquidity in the event of adverse experience or other conditions with respect to the subject policies, as defined in the applicable agreement.

The pricing and terms of the subject transactions were heavily vetted, negotiated, and submitted to state regulators for approval with the reasonable understanding that this information was subject to robust confidentiality protections. We do not object to this information being made available to regulators in the context of a confidential data call or regulator communication. However, we are concerned with its inclusion in public filings. The primary focus should be on whether the surplus note issuer is statutorily solvent rather than its surplus note pricing terms.

***The net presentation of interest paid could be misleading for some transactions***

We also believe that the change to the current disclosure to replace surplus note interest paid with interest paid net of amounts offset is problematic. We believe this disclosure could be misleading for many of the transactions in the scope of the disclosure, given that the full amount of surplus note interest paid was/would be due regardless of whether a portion is offset pursuant to an administrative netting arrangement.

***Proposed Revisions***

Interested parties recommend revisions to the proposed disclosures which would provide regulators who are not involved in the approval and ongoing review of a surplus note transaction with information to assess the nature of the transaction and to determine whether more detailed review is needed. Specifically, our revisions would require disclosure of whether cash flows are offset but would differentiate between administrative offsetting and the contractual “linkage” that is of concern to regulators. These revisions would also remove information that we believe is confidential in nature and would not be appropriate for public disclosure. Finally, we have proposed several additions to the required disclosures, which we believe would provide useful information about transactions involving surplus notes.

Our suggested revisions to the disclosures are included in Exhibit A and summarized below. For ease of review, revisions proposed by NAIC staff have been accepted, and interested parties’ comments are presented as tracked changes.

***Summary of Proposed Revisions***

* Expand the disclosure requirement to the financial statements of the ceding company as well as the surplus note issuer.
* Retain the current disclosure of total interest paid (gross of any administrative or other netting)
* Replace quantitative disclosure of “interest remitted” and “cost of liquidity” with three Y/N disclosure columns which correspond to the criteria used in the data call scoping:
1. Do surplus note / associated asset terms negate or reduce cash flow exchanges, and/or are amounts payable under surplus notes and amounts receivable under other agreements contractually linked? (For example, the asset provides interest payments only when the surplus note provides interest payments.)
2. Are any amounts due under surplus notes and associated assets netted or offset (partially or in full) thus eliminating or reducing the exchange of cash or assets that would normally occur throughout the duration, or at maturity, of the agreement. (This may be referred to as administrative offsetting.)?
3. Were the proceeds from the issuance of a surplus note used to purchase an asset directly or indirectly from the holder of the surplus note?
* Replace confidential information about 3rd party liquidity (e.g. maximum liquidity amount and cost of liquidity source) with a description of terms under which liquidity would be provided should a triggering event occur.
* Add requirement for narrative disclosure of any related guarantees or support agreements.

**Ref #2019-38: Financing Derivatives**

The Working Group moved this agenda item to the active listing and exposed revisions to *SSAP No. 86—Derivatives*, to clarify the reporting of derivatives with financing premiums. The reporting revisions propose allowing the present value of the derivative premium receivable (and payable) for financed derivatives to be factored into the counterparty risk assessment for life RBC. (If supported, RBC changes would be subsequently referred to the Capital Adequacy (E) Task Force for consideration.) Comments are also requested as to whether derivatives and related financing provisions that would generally not meet the *SSAP No. 64—Offsetting and Netting of Assets and Liabilities* right to offset criteria and if explicit guidance allowing offset should be considered.

Interested parties request the exposure be given an effective date of at least January 1, 2021. The exposure represents a significant change to how certain companies account for derivatives and must be implemented in our investment systems prior to adoption. Interested parties do not believe the assets and liabilities under this exposure meet the right to offset criteria in *SSAP No. 64—Offsetting and Netting of Assets and Liabilities,* because they originate within the same contract. Additionally, we believe the netting guidance outlined in paragraph 19c would be difficult to implement and recommend it be removed.

**Ref #2019-39: Acceptable Collateral - Counterparty Exposure for Derivative Instruments**

The Working Group moved this agenda item to the active listing and exposed revisions to *SSAP No. 86—Derivatives*, to clarify that the fair value of collateral received or held, for derivative disclosure purposes, shall be reported net of collateral paid/pledged, in the event a counterparty has the legal right to offset against, as defined in *SSAP No. 64—Offsetting and Netting of Assets and Liabilities*. Minor updates to the applicable annual statement instructions were also proposed to be concurrently exposed.

Interested parties fully support the appropriate depiction within the statutory financial statements and schedules of the availability of insurance company assets to fulfill policyholder obligations, including consideration of a reporting entity’s access to and control over the assets and any contingencies pertaining to the attendant rights & benefits of ownership. We appreciate the opportunity to dialogue further on this matter and ensure the regulatory objective is achieved regarding both financial statement presentation and the risk-based assessment of capital.

The ability to make efficient use of derivative instruments as part of hedging transactions, income generation transactions and replication (synthetic asset) transactions, in accordance with SSAP No. 86 – *Derivatives* (“SSAP No. 86”), is a crucial component of insurers’ ability to effectively manage risk and prudently maintain yields in support of our ability to deliver on promises to our policy and contract holders. With broader federal regulation now driving a migration for many of the interest rate and credit derivatives insurers use to these ends towards the central clearinghouse or “cleared” space, the significance of appropriately depicting the specific economic substance and attendant risks associated with each of the various forms of collateral posted to central clearinghouses has never been greater.

Given this backdrop, our concerns with exposure 2019-39 are as follows:

1. The language in the proposal does not provide clear, consistent definition of scope or objective(s);
2. The exchange of initial margin on cleared trades represents a contingency distinct from that associated with the exchange of variation margin; and
3. The existing statutory accounting, reporting and risk-based capital models already appropriately depict the economic substance and inherent risk associated with the exchange of initial margin, and the proposed changes would result in inappropriate duplication of risk-based capital charges.

In terms of intended scope, the narrative commentary and proposed updates to existing guidance make it unclear as to whether the proposal aims to refine accounting & reporting guidance for:

* initial margin, variation margin, or both;
* bilateral (over-the-counter, “OTC”) trades, trades executed with central clearinghouses, or both;
* exchanges of cash collateral, non-cash collateral (e.g. securities) or both.

The summary introduction to the proposal appears to target a perceived issue with the Schedule DB-D, Section 1 reporting of initial margin exchanged with central clearinghouses. The narrative commentary provided does not identify specific concerns pertaining to the reporting of collateral associated with bilateral OTC trades or variation margin. However, the attendant proposed edits to SSAP No. 86 and the Blank Instructions for Schedule DB-D, Section 1 encompass collateral exchanges with both bilateral OTC counterparties and central clearinghouses…inherently scoping in both OTC and cleared trades as well as all forms of collateral (variation margin, initial margin and traditional margin on legacy bilateral OTC trades). In addition, the proposal makes no clear distinction between proposed updates regarding exchanges of cash collateral vs exchanges of non-cash collateral, often using the terms collectively and interchangeably, whereas the guidance within the AP&P Manual makes clear distinctions regarding their respective accounting and reporting - as they have distinct implications for users of statutory financial statements. The guidance for cash collateral exchanges under SSAP No. 103R – *Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (“SSAP 103R”) paragraphs 19 & 20 is distinct from that of non-cash collateral exchanges, which is also further detailed in INT 01-31 – *Assets Pledged as Collateral* (“INT 01-31”). Anecdotally, though the SSAP No. 86 Appendix C guidance for the initial carrying value on futures paraphrased in the 2019-39 exposure commentary applies to exchange traded derivatives (which do not appear to be within the scope of this current exposure), it maintains conceptual symmetry with the distinct cash collateral guidance from SSAP No. 103R; classifying only cash postings of initial margin as a form of basis deposit necessitating distinct accounting and financial statement presentation. Additional clarification regarding both the perceived issue(s) and the objective(s) underlying the proposed updates is requested in order to ensure industry can assist in fully and appropriately addressing each underlying concern in light of the applicable regulatory objective(s).

The exchange of initial margin with central clearinghouses is clearly distinct in function from the exchange of variation margin. As referenced in the proposal, initial margin is a minimum amount of equity that must be provided to a clearinghouse to initiate a position. It effectively represents the deposit of chips required to play at the table (“table stakes”), and is required from both respective parties entering into the derivative transaction as protection for the clearinghouse against the potential that either respective party will not make good on its respective commitments (i.e., initial and continuing participation in the transaction and the associated exchanges of variation margin driven by the derivative price movements until expiry or novation) – leaving the clearinghouse exposed, as intermediary, to the remaining party. Once such a trade expires or is novated, assuming the respective party has made good on all its variation margin payments during the course of the trade being open, the asset(s) posted to the clearinghouse as initial margin is returned to that exiting party. In the instance that a party exiting the derivative transaction has not stayed current with its respective variation margin obligations, the clearinghouse will return the remaining value of the initial margin after settling up the unpaid variation margin obligations. As such, the contingencies associated with maintenance of exclusive control over the rights and benefits of asset ownership for an entity posting initial margin are primarily a function of the entity’s continuing involvement in the trade with the clearinghouse, which is distinct from the derivative price movement contingencies directly associated with variation margin.

Reporting entities often utilize non-cash collateral (e.g., US Treasuries) for posting as initial margin to clearinghouses, as the required initial margin value can be comparatively high (driven by risk adjusted trailing price volatility of the underlying derivative and overcollateralization conventions) but the reporting entity maintains the full rights & benefits of ownership over an already held yield generating asset – in many instances preferable to locking up a chunk of otherwise investible cash. The ability to maintain full control over the rights and benefits of ownership on this yield generating non-cash collateral posted (e.g., avoiding forced sales of the non-cash collateral to satisfy unfulfilled variation margin obligations) also incentivizes a reporting entity to remain current on variation margin obligations while the trade remains open.

Existing statutory accounting guidance (e.g., the previously referenced SSAP No. 103R and INT 01-31) already provides for appropriate classification, measurement and presentation of collateral posted as initial margin. In the much more likely instance that non-cash collateral has been posted to a clearinghouse as initial margin, the pledging insurer continues to record the pledged collateral as an admitted asset until they have committed a contract default that has not been cured. In the unlikely instance that the non-cash collateral has to be liquidated in order to satisfy unmet variation margin payment obligations associated with a trade being exited, any associated realized loss would be recognized and the reclassification of the remaining initial margin value due back from the clearing house will be recorded – likely as either cash or a receivable - in accordance with applicable statutory guidance. The Blanks instructions require that any such non-cash or cash collateral posted as initial margin be marked as such on the attendant investment schedule, identified at the specific asset level on Schedule DB-D Section 2 (complete with an identifier indicating that the posting represents initial margin) and summarized within Note 5 (Restricted Assets). As such, the availability of the assets to fulfill policyholder obligations, as well as identification at the specific asset level of the unique and specific contingencies associated with initial margin posting are already presented appropriately for the consideration of financial statement users. Altering the presentation of initial margin postings on the summary Schedule DB-D Section 1 would not augment a financial statement user’s understanding of the reporting entity’s solvency or financial condition, as the “net realizable margin” associated with the open derivative contracts is already appropriately presented – initial margin posted is not directly or typically subject to the derivate price movement contingencies inherent in arriving at an appropriate “Exposure Net of Collateral” total on Schedule DB-D Section 1.

Equally as important, incorporation of initial margin posted into the “Exposure Net of Collateral” total on Schedule DB-D Section 1 would lead to inappropriate and misleading downstream consequences for a reporting entity’s Risk Based Capital calculation. Any collateral (whether non-cash or cash) posted as initial margin is already captured in the Life RBC formula on LR017 (Off Balance Sheet and Other Items), where all collateral postings are pulled directly from Schedule DB-D Section 2 and assessed RBC charges associated with the specific contingency of pledging of the assets to an external counterparty. Thus, netting initial margin postings into the “Exposure Net of Collateral” total on Schedule DB-D Section 1 would make the total derivative exposure (net of collateral) that flows through to LR012 in the Life RBC formula too high – inappropriately double counting the RBC charges associated with the posting of initial margin to a clearinghouse. In addition, the understatement of net realizable collateral (Fair Value of Acceptable Collateral) on Schedule DB-D Section 1 would also, in many instances, mechanically carry through to overstate the “Off Balance Sheet Exposure” reported on the same schedule – which would result in even further overstatement of RBC charges as this “Off Balance Sheet Exposure” flows through the Life RBC formula to be assessed charges on LR017. Doubling, and possibly tripling the RBC charges associated with the posting of initial margin to a central clearinghouse is not an appropriate depiction of true risk for such margin.

Given the ambiguities in the exposure language, the appropriate depiction of economic substance and inherent risk associated with exchanging initial margin within the existing statutory accounting, reporting and RBC frameworks, and the importance of maintaining insurers’ ability to utilize cleared derivatives to effectively manage risk and prudently support yields, we respectfully request that the Working Group withdraw the current proposal and direct NAIC Staff to collaborate with industry to specify and appropriately address any remaining concerns. We stand ready to work through any lingering misgivings the Working Group may have with regard to financial statement presentation but request that such endeavors be empirically grounded in specific observed instances of incomplete or inappropriate reporting.

**Ref #2019-40: Reporting of Installment Fees and Expenses**

The Working Group proposed revisions toSSAP No.53 – *Property and Casualty Contracts* (SSAP No. 53) to clarify that the installment fee reporting guidance should be narrowly applied. Comments are also requested on whether guidance should be developed to allow expenses associated with installment fees to be reported as a contra revenue in “aggregate write-ins for miscellaneous income” and whether diversity should be permitted in reporting installment fee expenses. Additionally, the Casualty Actuarial (C) Task Force and Property and Casualty Risk Based (E) Working Group will be notified of this exposure.

With regard to the proposed change to emphasize that current guidance in SSAP No. 53 should be interpreted narrowly, interested parties recommend the following revision to the last sentence of the proposed wording in the footnote to SSAP No. 53 paragraph 6:

~~Clarification r~~Reporting of installment fees in ~~of~~ finance and service charges as other income should not be construed as having any bearing on whether such charges are subject to premium taxation, which remains an issue of state law and regulation.

Although interested parties did not survey companies, we believe the assertion by NAIC staff that expenses associated with installment fees are often immaterial is reasonable. We also believe that current reporting of the related installment fee expenses in other underwriting expenses is appropriate. For practical purposes, we do not see the benefit of isolating the expense related to processing the relatively small fee component of a premium billing for separate expense reporting purposes. We believe the reporting of expenses should be consistent and would not support the reporting of the related expenses as an “aggregate write-ins for miscellaneous income” or as a contra revenue to “finance and service charges not included in premiums.”

**Ref #2019-41: Eliminating Financial Modeling Process**

The Working Group moved this agenda item to the active listing and exposed revisions to *SSAP No. 43R—Loan-backed and Structured Securities*, to eliminate the multi-step financial modeling designation guidance in determining final NAIC designations for residential mortgage-backed securities (RMBS) / commercial mortgage-backed securities (CMBS) securities. Exposure was contingent upon the Valuation of Securities (E) Task Force’s concurrent exposure, which occurred on December 8, 2019. The Working Group noted that final action on this would not be taken until the Valuation of Securities (E) Task Force takes action on their related item.

Interested parties have no comment on this item at this time.

**Ref #2019-42: Inclusion of Cash / Liquidity Pools - Cash Equivalents as defined in SSAP No. 2R**

The Working Group moved this agenda item to the active listing and exposed revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* to specify that cash pooling structures that meet specified criteria qualify as cash equivalents.

Interested parties appreciate that a separate Form A (Ref #2019-42) was written related to Cash/Liquidity Pools (“pools”) to clarify the accounting associated with them. We agree with the addition of a paragraph, similar to paragraph 8, to SSAP No. 2R to provide guidance related to pools; however, given that the characteristics of pools differ by company, we propose some modifications to paragraph 8 in order to address those varied characteristics.

Interested parties’ comments related to the proposed paragraph 8 are as follows:

1. Regarding the proposal to look through the ownership structure to report the assets held as cash equivalents, we agree that look through is appropriate. Some pools, as approved by regulators, consist of assets that meet the Statutory definition of cash equivalents and thus the interest held in the pools are reported as cash equivalents on Schedule E2. However, other pools, also approved by regulators, include assets that meet the definition of short-term investments in SSAP No. 2 and thus the interest held in the pools are reported as short-term investments on Schedule DA. Some pools may include both short-term investments and cash equivalents.

Given the varied characteristic discussed above, we recommend paragraph 8 be modified to state that, if the requirements of paragraph 8 are met, the reporting entity may look through the ownership structure and report the assets as either cash equivalents or short-term assets based on the predominant characteristic of the underlying assets. This would allow companies the flexibility to report their investments in the pools in the Statutory statement schedule that is more reflective of the type of underlying investments in their pool and prevent the need for companies to reclassify/change their existing reporting to Schedule E2 from DA if they currently report the pools in DA due to the underlying assets.

1. Regarding paragraph 8d (i.e., the requirement to produce annual U.S. GAAP audited report of the pools including schedules showing each affiliate’s prorata share of the investments), insurance companies already receive an independent audit under Statutory Accounting Principles (“SAP”), which would include the insurance company’s investment in a pool. Requiring cash pools to be separately audited under U.S. GAAP would come at a cost, in time and resources, to insurers with pools. In addition, some insurers have pools which are not in the form of legal entities.

An alternative to the U.S. GAAP audit requirement of paragraph 8d. is to require a footnote disclosure at the reporting date for each insurer that participates in a pool, which identifies that the insurer is invested in a cash pool, provides the reporting entity’s share of the pool, and the insurers dollar share of cash equivalents and short-term investments in the pool. This disclosure would be subject to audit on an SAP basis of accounting. IPs believe the audit of the disclosure along with the audit of the insurance company would be adequate to meet the objectives of ensuring that the pool allocation process is accurate. Other alternatives include targeted financial examination procedures for pools, which could include procedures to confirm the balance of the pool and verify the individual legal entities’ balances for participating in the pool.

1. We note that the addition of the proposed pool language in SSAP No. 2 does not specifically address the reporting and accounting for the interests held in the pool. We recommend, if the pool is managed on a fair value basis (i.e., interest in the pool are bought and sold at fair value), that the book/adjusted carrying value for the interest held in the pool would be reported at fair value with changes in fair value reported in unrealized gains and losses. If the pool is not managed on a fair value basis, the interest held in the pool would be reported at amortized cost. It is important to note that pools managed on a fair value basis may use amortized cost as the best estimate of fair value, depending on the characteristics of the underlying assets.

Finally, in the issue paper, NAIC staff questioned whether changes to SSAP No. 48, Joint Ventures, Partnerships and Limited Liability Companies are needed, since many pools are held in a Limited Liability Company (“LLC”). Interested parties do not believe such changes are needed to SSAP No. 48; however, it would be helpful to users of the SSAPs to add a footnote to paragraph 8 of proposed SSAP No. 2R stating that pools may be held in LLCs, for example, and if so, SSAP No. 2 is to be applied and not SSAP No. 48.

**Ref #2019-43: *ASU 2017-11 - Financial Instruments with Down Round Features***

The Working Group moved this agenda item to the active listing and exposed revisions to *SSAP No. 86—Derivatives* to reject *ASU 2017-11, Earning Per Share, Distinguishing Liabilities from Equity, Derivatives & Hedging* and incorporate guidance into *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets* and *SSAP No. 72—Surplus and Quasi-Reorganizations* for when certain freestanding instruments shall be recognized as liabilities and not equity.

Interested parties have no comment on this item.

Ref #2019-45: *ASU 2013-11, Presentation of an Unrecognized Tax Benefit*

The Working Group moved this agenda item to the active listing and exposed revisions to *SSAP No. 101—Income Taxes* to reject *ASU 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists* for statutory accounting.

Interested parties support adoption of this item but note that the following statement should be removed from the document as it is incorrect (see IFRC 23, Uncertainty over Income Tax Treatments):

**Convergence with International Financial Reporting Standards (IFRS):**

~~IFRS does not include specific guidance on the presentation of unrecognized tax benefits.~~

**Ref #2019-46: *ASU 2016-14, Presentation of Financial Statements of Not-for-Profit Entities***

The Working Group moved this agenda item to the active listing and exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2016-14, Presentation of Financial Statements of Not-for-Profit Entities* as not applicable to statutory accounting.

Interested parties have no comment on this item.

Ref #2019-47: Grade in of Variable Annuity Reserves

The Working Group moved this agenda item to the active listing and exposed revisions to *SSAP No. 51R—Life Contracts* and *SSAP No. 3—Accounting Changes and Corrections of Errors*. The revisions add reference, disclosures and accounting for Section 21 of the *Valuation Manual*, Requirements for Principle-Based Reserves for Variable Annuities, and grade-in requirements for reporting changes in the valuation basis for years beginning January 1, 2020.

This exposure consists of several parts, some of which we agree with and others we find both confusing and unnecessary. We agree that documentation of the choices made among the options for phase-in in VM-21 and the impact of those choices is important. The exposed edits focus on the adoption of the new reserve requirements for variable annuities (revised VM-21 and AG-43). Information on those choices and impacts will be provided to regulators through the PBR Actuarial Memorandum required by VM-31. This includes highlighting the elements of any Phase-in in the executive summary of the PBR Actuarial Memorandum. Given the current requirements of SSAP3 and SSAP51, documentation in the notes to the Annual Statement is also appropriate.

In Recommendation #2, the proposal would require the amounts from the Phase-in to be designated as “special surplus”. We disagree with this recommendation for the following reasons:

* This is a new requirement whose need has not been established. Disclosure of the amounts will provide information necessary for users of the financial statements to understand the basis of the reported financials.
* SSAP72 defines Special Surplus as amounts designated for specific contingencies. Recommendation #2 would be a change to the definition and purpose of special surplus that is inappropriate and would create an undesirable precedent.

Finally, the proposed language is unnecessary, and possibly confusing. VM-21 defines the minimum reserve requirement. Within that requirement, the company has the option to compute the reserves using the Phase-in provision of Section 2.B. Whichever option is elected, VM-21 defines the reserve. SSAP51 defines the amount of the “Change in Basis” as the difference between the amount under the prior VM-21 and the amount required by the current VM-21 as of 1/1/2020. If the Phase-in has been elected, that difference will generally be zero. The change in basis amount as defined in SSAP51 paragraph 39 is not being graded in – it is what it is following the VM-21 reserve requirements as stated. As such, SSAP51 does not need to make provision for a grade in. We propose the attached language as being clearer in defining the amounts to be disclosed, to use language consistent with VM-21, and to recognize the role of VM-21 to define the reserve requirement.

**Ref #2019-48: Disclosure Update for Reciprocal Jurisdiction Reinsurers**

The Working Group moved this agenda item to the active listing and exposed revisions to *SSAP No. 62R—Property and Casualty Reinsurance*, to incorporate disclosure updates for reinsurers from Reciprocal Jurisdictions.

Interested parties have no comment on this item.

Ref #2019-49: Retroactive Reinsurance Exception

The Working Group moved this agenda item to the active listing with a request for comments on the preferred approaches to reporting and the advantages and disadvantages to each approach being used, including impacts on the Schedule P (and related loss analysis) and risk-based capital. Industry and state insurance regulator volunteers are requested to assist with developing guidance to clarify both the accounting and reporting for retroactive contracts which are accounted for prospectively. The Working Group directed NAIC staff to notify the Casualty Actuarial and Statistical (C) Task Force of the request for comments.

With regard to retroactive portfolio transfer deals within the same group that qualify for prospective treatment, interested parties identified the following issues related to reporting transactions in Schedule P.

**Main Issues**

* Should there be a requirement to have offsetting entries for the ceding and assuming entity within the group, such that the group Schedule P is not impacted (and industry Schedule P is not impacted)?  (If so, then the ceding entity can’t’ record ceded amounts for prior AYs while the assuming company records assumed amounts all in the current CY/AY.)
* Should retroactive changes in previous premium amounts be allowed?  (If no, and there is a desire to have both entities record the ceded/assumed in the affected older AYs, then the reinsurance premium would need to be treated as a paid loss – positive paid for the ceding entity and negative paid for the assuming entity.)
* Should the reporting prevent “cliffs” in the historic development reported in Schedule P.  (If the cede transaction is reported as a premium and spreading to prior CYs, effectively changing prior values retroactively, then the prior incurred loss amounts in Schedule P, Part 2 would need to be adjusted to avoid a “cliff”.)  Note that cliffs in Schedule P, Part 2 can have a material RBC impact with regard to the company experience adjustment.

**Two Alternative Approaches**

Interested parties identified two alternative approaches to recording intercompany, retroactive reinsurance:

* Record the reinsurance premium as a paid loss (positive paid for the cedant, negative for the assuming company), spreading the “premium” to the same AYs as the ceded losses.  This avoids cliffs and avoids restating past CY Earned Premium, although it produces unusual results for the assuming company’s Schedule P.
* Record the reinsurance premium as premium, restating prior CY Earned Premium.  Spread losses to the impacted AYs.  This would create cliffs in Schedule P unless prior AYs are restated for the impact by AY of the reinsurance contract at inception.

\* \* \*

Thank you for considering interested parties’ comments. If you have any questions in the interim, please do not hesitate to contact us.

Sincerely,

D. Keith Bell Rose Albrizio

1. [↑](#footnote-ref-1)