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Handout

August 7, 2023

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

Dear Mr. Bruggeman:

Re: Exposure Reference No. 2022-11 – *Collateral for Loans*

Security Benefit Life Insurance Company ("Security Benefit", "our", "we") extends its appreciation to the Statutory Accounting Principles Working Group ("SAPWG") for the opportunity to submit a new comment letter on Exposure Reference No. 2022-11—*Collateral for Loans* (the "Exposure"). After further consideration of the Exposure, we agree that clarification of the guidance in SSAP No. 21R is necessary, and we support the clarification that collateral pledged to secure a collateral loan must qualify as an admitted asset for the collateral loan itself to qualify as an admitted asset. Therefore, we also support the specific clarification that when the collateral pledged to secure a collateral loan would be in the scope of SSAP No. 48 or SSAP No. 97 if held directly by the reporting entity, audited financial statements are required for the collateral (and thus the collateral loan) to qualify as an admitted asset. However, we respectfully request that the SAPWG reconsider the proposed guidance that, if adopted, would require reporting entities to use the proportionate audited equity valuation ("book value") when testing the sufficiency of the collateral ("collateral test") for collateral loans secured by collateral that would be in the scope of SSAP No. 48 or SSAP No. 97 if held directly by the reporting entity. More specifically, we ask the SAPWG to revise the Exposure to allow reporting entities to make an accounting policy election, applied consistently and across all applicable collateral loans, to use either fair value or book value when performing the collateral test. Below is Security Benefit's proposed revision to the Exposure (underlined, italicized and in green font, the underlined red text is the SAPWG's currently exposed changes).

b. Nonadmitted Asset – In Accordance with *SSAP No. 20—Nonadmitted Assets*, collateral loans secured by assets that do not qualify as investments which would otherwise be admitted shall be nonadmitted. Further, any amount of the loan outstanding which is in excess of the permitted relationship of fair value of the pledged investment to the collateral loan shall be treated as a nonadmitted asset. For qualifying investments which are pledged as collateral that would be in the scope of SSAP No. 48 or SSAP No. 97 if held directly by the reporting entity, such as joint ventures, partnerships and limited liability companies and investments that would qualify as SCAs if held directly, *reporting entities shall elect to use either fair value or the proportionate audited equity valuation of the pledged investment* for the comparison for the adequacy of pledged collateral. *This election shall be considered an accounting policy election subject to the guidance in SSAP No. 3—Accounting Changes and Corrections of Errors and is required to be applied consistently to all such pledged investments.* If the collateral loan exceeds the *elected valuation basis* of these pledged investments, then the excess shall be nonadmitted.

Security Benefit understands that SAPWG's proposed change to the valuation basis used for the collateral test may have emanated from industry concerns over the need to obtain both audited financial statements and fair value measurements of these pledged investments. We believe our proposed revisions to the Exposure would simultaneously address those industry concerns and prevent unintended consequences, namely that reporting entities that have historically relied on the use of fair value as the basis for the collateral test may suddenly be required to nonadmit portions of their collateral loans. Furthermore, we believe that fair value continues to be the most appropriate measure of the sufficiency of collateral as fair value is the most representative measure of the value of assets that would be available to support policyholder liabilities in the event a reporting entity forecloses on the pledged collateral. Finally, allowing reporting entities to elect to continue to use fair value for the collateral test will retain a level of consistency with collateral loans secured by other forms of qualifying investments, and also, across other types of instruments where the sufficiency of collateral is based on fair value (i.e., repurchase agreements, securities lending agreements, derivatives, etc.).

Security Benefit also understands that state regulators may have concerns about the uncertainty inherent in fair value measurements, particularly Level 2 and Level 3 measurements, due to the use of unobservable inputs and/or assumptions, and these concerns may have also contributed to the desire to use the book value of these pledged investments for the collateral test. While we agree that Level 2 and Level 3 fair value measurements may have a greater level of uncertainty, Security Benefit obtains independent valuations, and independent reviews of our internal valuations, from reputable third-party valuation experts for these pledged investments, and in all cases, these valuations are subject to independent audit. It is our understanding that this is common industry practice, which we believe should sufficiently alleviate the regulatory concern. Additionally, we would like to note that the use of book value may not, and in many cases will not, reduce the reliance on Level 2 and Level 3 measurements when reporting entities perform the collateral test. Specifically, we expect that most of these pledged investments are considered investment companies that recognize and measure all assets at fair value on their financial statements where many, and in some cases all, of those assets are valued using Level 2 and Level 3 fair value measurements.

In summary, Security Benefit supports the proposed clarifications to SSAP No. 21R; however, we believe the proposed change to the valuation basis for the collateral test represents a substantive change that could materially and adversely impact reporting entities that have historically underwritten collateral loans based on the fair value of the pledged collateral. We believe fair value remains the best and most appropriate measure of the sufficiency of collateral pledged to secure collateral loans. As a result, we respectfully request that the SAPWG revise the Exposure to allow reporting entities to continue to use fair value based on an accounting policy election.

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We appreciate your attention to and consideration of our comments and would be pleased to discuss our comments with the SAPWG or its staff at your convenience.

Kind Regards,

Caleb Brainerd
SVP, Chief Financial Officer
Security Benefit Life Insurance Company