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Statutory Accounting Principles (E) Working Group

Virtual Meeting

September 10, 2025

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met Sept. 10, 2025. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Richard Russell (AL); Kim Hudson (CA); Michael Estabrook (CT); Rylynn Brown (DE); Cindy Andersen (IL); Shantell Taylor and Tom Travis (LA); Steve Mayhew and Kristin Hynes (MI); Ned Cataldo (NH); Bob Kasinow (NY); Diana Sherman (PA); Jamie Walker (TX); Doug Stolte (VA); and Amy Malm (WI). Also participating were Rachel Hemphill (TX) and William B. Carmello (NY).

1. Heard a Presentation from the ACLI on ALM Derivatives

Bruggeman stated that the American Council of Life Insurers (ACLI) submitted a presentation to discuss two proposed approaches for ALM derivatives (Attachment 1). The first proposal outlined a fair value approach (Attachment 2), while the second focused on an amortized cost approach (Attachment 3).

Thomas Karafin (Prudential), representing the ACLI, stated that last year, there were conversations among various attendees of today’s meeting regarding ALM derivatives, which prompted the ACLI’s comment letter dated Nov. 20, 2024, regarding this same topic. Karafin stated that at the NAIC Spring National Meeting, a group, including Julie Gann (NAIC), discussed what a proposed statement of statutory accounting principles (SSAP) on this topic could look like. He stated that there are two versions of the draft proposal; in case regulators are not comfortable with one, there would be an alternative to consider.

Karafin said that the proposal aims to enhance the alignment of each company's reported surplus with its actual solvency and liquidation value and seeks to avoid situations where financials contain inappropriate portrayals of surplus and illusory financial strength. ALM derivatives are hedging instruments that hedge the duration difference between designated asset and liability portfolios. This helps in preserving surplus and ensuring that policyholder benefits can be fulfilled. Common duration measures include modified duration, which is the effect that a 100 basis point (1%) change in interest rates will have on the price of an instrument; Macaulay duration, which is the weighted average time until cash flows are received and is measured in years; and DV01, which measures the dollar change in an instrument's price for a one basis point (0.01%) change in rates.

He said that entities hedge the duration difference between assets and liabilities to eliminate deficits in liquidation value and preserve surplus. Asset and liability durations evolve over time with product sales, benefit payments, asset maturities, etc. Hedging strategies need to be dynamic and cannot always be solved by buying and selling investments due to availability, tax costs, bid/ask spreads, etc. ALM derivatives and duration hedging are common in the industry but often do not qualify for hedge accounting under *SSAP No. 86—Derivatives* or *SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees*.

He said that two versions of the SSAP draft proposal are being submitted. The first is the amortized cost method, which is favored by the industry due to its operational simplicity and alignment with hedged items. The second is the mark-and-spread method, which is offered as an alternative option for regulators. Both proposals require multiple hedge effectiveness tests each quarter, and all must be passed to apply either proposal.

The amortized cost method involves assessing hedge effectiveness at least quarterly and requires the hedging relationship to be highly effective in reducing duration differences. All highly effective designated hedging derivatives are reported in the financial statements at amortized cost. Amortized cost treatment will discontinue in scenarios such as maturities/terminations and de-designation. Deferred assets/liabilities are amortized using a straight-line method into net gain from operations (NGO) over a finite amortization period.

The mark-and-spread method is similar to the amortized cost method but with different measurement/recognition and amortization starting points. All designated highly effective hedging derivatives are reported at fair value. Fair value fluctuations in the hedging instruments attributable to the hedged risk are recognized as deferred assets and deferred liabilities. Deferred assets/liabilities (including those that are unrealized) are amortized using a straight-line method into NGO over a finite amortization period.

He said that the guidance is proposed to be applied on a prospective basis for qualifying programs in place on or after the effective date. This proposal aims to significantly enhance the accuracy of solvency reporting and claims-paying ability, encouraging prudent risk management, which benefits policyholders, insurance companies, and regulators.

In response to Karafin’s statement that derivatives with asymmetrical payoff patterns and/or derivative premiums at inception (e.g., options) would not be permitted under the guidance, Carmello stated that options are an effective way to hedge and questioned why options would not be permitted to be used as hedges.

Karafin stated that the ACLI is flexible on that point and that it was more of a concession for regulator feedback to have this be a limited set of derivatives and an attempt to avoid a cycle of paying premiums and deferring.

Hemphill questioned the amortized cost method because Karafin stated that it would match when interest rates and mortality were locked in at issue. She stated that a comparable situation exists with the interest maintenance reserve (IMR), where certain calculations, such as those involving the principle-based reserve (PBR)-modeled reserve or cash flow testing, show that this alignment does not hold, prompting an IMR adjustment. She stated that, in that framework, the question was raised whether similar adjustments are being proposed for the PBR modeled reserve or cash flow testing. She stated that when performing a PBR-modeled reserve, an allocated amount of IMR is essentially removed from the starting assets, since the rationale for establishing it initially does not apply, liabilities are not locked in and are, instead, more responsive. Therefore, locking in assets when liabilities are not locked in would be inconsistent. Hemphill asked whether another adjustment, similar to the current IMR treatment, would be needed for this approach in the PBR modeled reserve, whether deterministic or stochastic, and in the cash flow testing starting asset amount.

Carmello questioned whether the cash flow testing is for the starting assets. He stated that this would have to be treated like IMR, where you would include an adjustment for deferred items (whether positive or negative) in whatever the starting assets were.

Clark stated that this might be a reason why the amortized cost approach would not work because there would not be anything recognized to back out in the cash flow testing.

Gann stated that under the mark-and-spread method, amortization would begin while the derivatives are open; therefore, the derivative could change position in a subsequent quarter, where it could reverse the other way (loss or gain or gain to loss). So, there are a lot of moving parts with the mark-and-spread method.

Karafin stated that one reason the industry favored amortized costs is that the operational complexities are much less than those of the mark-and-spread method.

Gann stated that she believed the proposed guidance would apply to all companies, but life companies would mostly utilize it. She stated that right now there is Schedule DB for derivatives and a separate Schedule DB for SSAP No. 108 and questioned whether this would require a new schedule specific to these programs, or whether they would be folded into an existing Schedule DB. She stated that currently these programs would be detailed in the Schedule DB and presumably, they would fall under the “hedging—other” category, since they would not qualify as accounting effective under SSAP No. 86. Gann questioned whether there should be separate reporting for them or whether they would be commingled with existing reporting components. She stated that for balance sheet reporting, it may be appropriate to incorporate new reporting lines, but adding lines to the balance sheet pages does not occur frequently.

Karafin stated that the industry would be flexible and that support to be as practical as possible. He stated that a reporting entity could have between five and 15 derivative programs, depending on the legal entity, portfolio, or business unit. He stated that the anticipation is to summarize each of those programs and that the industry is flexible on reporting to ensure it is practical for regulator needs. He stated that commingling with other reporting components is not ideal. He stated that it is separate and distinct from SSAP No. 86 and SSAP. No. 108, so it should be separate. He stated that the industry used SSAP No. 108 as a template. He agreed that under current reporting, it would default to a write-in on the balance sheet, and that write-in lines are not always ideal. He stated that the industry is flexible on how to report ALM derivatives and the deferred assets/liabilities.

Carmello asked how this would be handled using amortized cost.

Karafin stated that they would be recorded at the initial carry value, which sometimes is zero. Swaps (over the course of their lives) would impact surplus via swap settlements (as swaps mature with a fair value of zero).  If a swap (or other derivative type) is terminated or de-designated prior to maturity, deferral/amortization would begin at that time.  Other derivative types can also have fair values at maturity (e.g., forwards, futures, etc.), in which case deferral/amortization begins at maturity.  In the amortized cost model, fair value would always be disclosed and seen on the balance sheet with a deferral upon termination, maturity, or de-designation.

Carmello questioned whether, if set up so that there are only two-way derivatives, the amortized costs would always be zero.

Karafin stated that most swaps have a face value of zero at inception, as do future forwards, which are really the target and the most likely derivative to be caught up here, and that would have an amortized cost of zero and would only emerge either through swap settlements, termination, maturity, or de-designation.

Carmello stated that the amortized cost approach seems more intuitive and is more consistent with the IMR approach.

Angelica Tamayo-Sanchez (New York Life), representing interested parties, stated that the amortized cost method would mirror SSAP No. 86, but the hedge effectiveness test being used is different. She stated that under SSAP No. 86, the focus is on changes in the fair value of the derivative. For example, to determine the 80 to 120 range. In this case, the test evaluates whether the derivative is doing what it was intended to do. So, if the goal is an extension of duration, the hedge effectiveness test would confirm that as long as the hedge effectiveness test is passed, the accounting would essentially follow the same approach currently used under SSAP No. 86, with the derivative carried at amortized cost. She stated that the value would usually be zero because at inception, it is zero. The only way a deferred asset or liability would arise is through termination or de-designation. Whatever the realized gain or loss is at that point is what goes into the deferral account. Throughout the life of the derivative, it is carried at amortized cost.

Tamayo-Sanchez stated that the reason for this proposal is that there is concern about the current framework, where derivatives are carried at fair value and unrealized gains and losses sit in surplus throughout the life of the derivative. Upon termination or de-designation, that amount is moved to IMR. She stated that the understanding is that regulators are concerned that recording a loss and then increasing surplus by moving it to IMR may be problematic. The proposal to use amortized cost, as long as the hedge effectiveness test under this potential method is met, would avoid that issue. This is the issue regulators are concerned with when derivatives are marked to market in surplus. She stated that under the mark-and-spread method, fair value would still be used as it is today. However, instead of marking to market (fair value) in surplus, deferral accounting would be applied, and amortization would begin immediately. Similar to IMR, as soon as the unrealized gain or loss is moved to the deferral account, amortization begins. She stated that this could add complexity because there could be an unrealized gain in one period and an unrealized loss in the next.

Carmello questioned whether, under the amortized cost method, where the amortized cost is zero, the fair value is recorded somewhere as a notional amount, or how the standing value of those derivatives is known.

Karafin stated it would be similar to SSAP No. 86, where the additional information is in the Schedule DB reporting, but it is analogous to SSAP No. 86, with the difference in effectiveness tests.

Clark stated that the amortized cost method aligns more closely with how IMR works because the assets are not marked to market and are only deferred through IMR once realized. He clarified that he was not yet supporting one approach over the other and had not yet decided which he preferred. He emphasized that the key question is whether the information about the value of derivatives should appear on the balance sheet or be presented off-balance sheet in the disclosures within Schedule DB reporting. Clark stated that there is diversity in practice regarding whether companies have been putting these through IMR to date. What they have generally been doing is marking to market (fair value) through surplus, while the gain or loss is unrealized. Then, if the derivative is terminated, they defer the realized gain or loss into IMR. That is where the concern arises; essentially, reversing the unrealized amount upon termination creates a very strange mismatch.

Bruggeman stated that when those derivatives are in an unrealized loss position, recording at fair value means surplus is reduced. At termination or maturity, instead of surplus remaining at the fair value level, the unrealized amount goes away, so surplus goes back up. That entire amount is then deferred via the IMR as an IMR asset, if that is all they have, and it is not offset with other IMR liabilities. In other words, surplus goes back up after termination because of the IMR asset. He stated this is part of the challenge raised with IMR and was intended to be addressed through either the amortized cost method or the market spread method, so the whipsaw effect does not occur. He stated that companies could simply say, "I want to get a full implementation of the IMR," and terminate the derivative. Just like that, it would have no fluctuation left, whether that was the appropriate action or not. It could, in essence, achieve a better outcome than would normally happen. This is viewed as a way to balance things out, especially when there is no cost up front. When there is no cost up front, there is no impact to surplus until termination, and there is no fair value movement and no unrealized gain or loss either way. Then, in IMR, everything is locked in at maturity and amortized into P&L over five or 10 years, whatever the period is.

He stated that the next question is when there is a cost for these derivatives up front, and what happens to that cost. He stated that if there is a cost that affects this, if cash is reduced and credited, what is being debited? Is the derivative being debited to be amortized at that point, similar to a market spread, or is this fully deferred? He stated that right now, the assumption in these presentations is that a derivative is purchased, but there is no cost until the end.

Karafin stated that the ACLI looks to SSAP No. 86 as precedent for that. Most derivatives do not have a cost at inception, but it is certainly possible that they could. SSAP No. 86 states that a derivative with a cost that enters a hedge accounting relationship would typically, depending on the circumstances, be amortized. For example, if there is a credit to cash and a debit to a derivative asset, and it enters into this type of accounting, the ACLI would refer to SSAP No. 86, which would typically call for amortization during the hedge accounting relationship.

Gann stated that with IMR, there is currently a limit on the extent to which net negative IMR (which can include derivative deferred assets) can be admitted. She stated that there does not appear to be any proposal within the suggested guidance regarding a cap on the extent to which deferred assets would be allowed to be admitted, and she wanted to raise this for the regulators as part of the discussion. While there is no current cap in SSAP No. 108, this issue has been highlighted recently in relation to the IMR discussion.

Bruggeman stated that, on one hand, he does not want to put a company in a position where terminating a derivative is the best answer but produces a bad outcome. On the other hand, not terminating might seem preferable, but termination could result in a better outcome due to an accounting issue. He stated that these are considerations that need to be worked through and understood. Where there is value in a derivative, it is usually because there is an associated asset and liability situation. He stated that after maturity or termination, that becomes the challenge, and this issue needs to be considered from both sides.

Karafin stated that the whipsaw effect was considered. He stated that it was important that, upon maturity or termination, the outcome would be essentially surplus neutral. He stated that it is reflected in the example entries, and it was a key priority to eliminate the whipsaw effect. He stated that another observation is that the assets and liabilities appeared to be admitted in exchange for a short amortization period, typically five to 10 years, while the hedged item could span 20 to 30 years. He stated that it seemed like a fair trade-off.

Bruggeman stated that what Gann was explaining is the potential that a deferred asset could be exceedingly large, and whether a cap should be placed on the asset side. That is the question, and he would hope there is some level of balance, rather than a constant deferred asset being carried. He stated that it also has to be the right approach for the protection of policyholders. At the same time, there is a layer of amortization involved. There are some answers in reporting and other scenarios that can address this, but the overarching issue remains the presentation on the balance sheet. He stated that in the example, the goal is to avoid a whipsaw effect, but also to avoid a situation where surplus is in flux with portions being amortized away over the next five to 10 years.

Clark stated that he struggles with the idea of an admittance cap. He stated that they are talking about interest rate hedging, and placing a cap would essentially mean limiting a highly effective hedging program designed to mitigate interest rate risk, precisely when interest rates move significantly over time. That seems counter to the purpose of the hedge. He stated that he struggles with how a cap would work. Whether it results in an asset balance or a liability balance over time simply depends on what interest rates do. As interest rates go up, they will generally accumulate into an asset balance, and as interest rates go down, they will accumulate into a liability balance, or vice versa. He stated that it is something to consider, but he finds it challenging.

Bruggeman stated that the materials for this meeting were posted on the Working Group’s web page and are available for indirect exposure but are not listed under the exposure drafts. He questioned whether the Working Group should proceed with an official exposure of those topics for public comment or take more time to assess before considering exposure at a subsequent meeting.

Gann stated that a good path forward may be to expose the entire package, including the presentation and both drafts, with a request for comments from the industry and regulators regarding their preferred approach or elements that need further discussion. Based on those comments, the Working Group could decide how to proceed and which method is preferred. She stated that this would technically be an exposure, but not necessarily an exposure of proposed guidance at this time. She suggested that the exposure have a public comment period ending Oct. 31.

Bob Gorney (New York Life) questioned whether the draft exposure could be changed to include Carmello's earlier concerns about including options.

Gann commented on the derivative exclusions, including options, noting that based on the feedback received on the current application of existing derivative guidance, when a company acquires a derivative at a cost and it expires unused, that cost has not been amortized and becomes a realized loss, and could be reflected as a deferred asset. She stated that it has been noted that these deferred assets could accumulate over time, and the amortization period may be much longer than the life of the derivative itself. For example, if a company purchases a three-month derivative that expires unused every three months, the deferred asset balance could continue to grow, while amortization occurs over 10 years. She stated that this is the main concern related to options with an upfront cost. She stated that feedback is welcome on whether there are ways to restrict this, such as preventing the upfront cost from being a deferred asset over time.

Clark stated that, for this exposure, he proposes limiting it to feedback on the two different approaches as drafted by the ACLI, as well as whether to direct NAIC staff to continue work on this item. He stated that once the Working Group decides which of the two options to pursue, NAIC staff can begin working on suggested revisions.

Clark made a motion, seconded by Hynes, to expose the ACLI presentation on ALM derivatives and the two ACLI proposal drafts for a 51-day public comment period ending Oct. 31. The motion passed unanimously.

Having no further business, the Statutory Accounting Principles (E) Working Group adjourned.

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