NAIC Summer National Meeting

Global Insurance Solutions

As of August 2017

ON AUGUST 6-8, WE ATTENDED THE NAIC SUMMER NATIONAL MEETING IN PHILADELPHIA, PA TO STAY INFORMED FOR YOU ABOUT IMPORTANT REGULATORY ISSUES THAT ARE AFFECTING THE INSURANCE INDUSTRY TODAY. SUMMARIZED IN THIS DOCUMENT ARE THE MOST RELEVANT SESSIONS AND DISCUSSIONS FROM THE MEETING.

- **The Investment RBC Working Group continues to iron out industry concerns around new factor implementation**
- **The Statutory Accounting Principles Working Group will continue to look at bank loans and derivatives more closely**
- **The Blanks Working Group adopts revisions to quarterly and annual reporting**
- **Power generation investments, CMBS, fund holdings and filing exempt (FE) securities were topics of discussion with the Valuation of Securities Task Force**

THE INVESTMENTS RISK BASED CAPITAL WORKING GROUP (IRBCWG)

The IRBCWG started off by approving previous minutes and interim conference call on June 13 around the scope and release of the new RBC factors. *Please reach out to us for a summary of that call.*

The primary focus has been the review from the industry and interested parties discussing proposals from the American Academy of Actuaries (AAA) and the American Council of Life Insurers (ACLI) with regards to the new bond factors and real estate factors respectively. Several comment letters were received, many voicing concerns around implementation "as is."

There continues to be nothing uniformly concrete and agreed upon by the Life, P&C and Health industry. The initial model was derived with the Life industry as the focus, but as the guidance has been made to be effective for the entire insurance industry, many have voiced concerns around a variety of factors including:

- How are ETF's treated in the portfolio adjustment factor.
- The portfolio adjustment factors (previously called bond size factors) have changed significantly in the proposal, thus having the potential to produce a negative impact to both the small and mid-size companies RBC.
- Consideration of the impact of granularity with a Nationally Recognized Statistical Rating Organization (NRSRO) modifier.
- Default and recovery rates to be more in line with actual results, and more aligned to each industry type.
- Tax offsetting getting different treatment within each type of insurer.
- Duration and credit rating differences between asset strategies within the types of insurers.

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FOR MORE INFORMATION

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J.P.Morgan Asset Management

- The AAA and ACLI still do not fully agree on the new bond factors and implementation.
- Treatment of below investment grade bonds and the differing treatments between Life, P&C, and Health on the NAIC designation and book adjusted carry value within those segments.

Much of the modeling that was scheduled to be completed by the AAA was not presented as they still go through the comment letters they have received. The Working Group stated that they will have several conference calls between now and the next national meeting. The AAA's goal is to provide an update to the IRBCWG by the end of August, to be discussed on a TBD regulator conference call. The intent is still to implement by year end 2018

ACLI real estate factors:

Ref #2017-06-L: Updates the RBC calculation for many forms of real estate including Schedules A, B, and BA items. Several comment letters were received asking for additional considerations. The recommendation from the working group was to just focus on a factor or set of factors for variable forms of real estate, and not look to a market value adjustment as well. This will be addressed during future regulator conference call in the coming weeks.

Federal Home Loan Banks (FHLB) collateral proposal:

Ref #2017-03-L: NAIC continues discussion on the proposal to revise the non-controlled asset RBC charge (currently 1.3%) related to FHLB collateral. Regulators have decided that the proposal will remain exposed for the time being. The ACLI has worked with the NAIC to incorporate additional protections to account for excessive borrowing, and satisfy concerns about the spread lending activities of insurers. With a 2017 adoption being off the table, regulators will allow more time for additional input from NAIC staff and interested parties.

The regulators also detailed some inconsistencies in FHLB related reporting. The NAIC is considering releasing an annual report, which will detail insurers' level of borrowing activity, to monitor systemic risk within the industry.

THE STATUTORY ACCOUNTING PRINCIPLES WORKING GROUP (SAPWG)

Reviewed and revised comments on previously exposed SAPWG items include:

Ref #2016-41: AVR and IMR under Statement of Statutory Accounting Principles (SSAP) 26. Revisions drafted to identify the allocation of gains and losses between AVR and IMR as well as the assessment of OTTI. This should be dependent on the NAIC designation categories of investment grade versus non-investment grade within each insurer's rules of NAIC ratings.

Ref #2017-13: Purchased Amortization on Callable Debt Securities - SSAP will retain the statutory accounting provisions of "yield-to-worst" for callable debt securities.

Ref #2016-40: Definition of Loan-Backed and Structured Securities (LBaSS) under SSAP 43R to represent the collateral pools as a source of dynamic cash flows and which assets and what criteria should fall within that definition and applicable guidance. NAIC recommends disposing this item without further revisions.

Ref #2017-04: Settlement of Variation Margin—Exposed revisions to require changes to variation margin be recognized as unrealized gains/losses until the derivative contract has matured, been terminated, and/or expired, regardless of whether the counterparty/exchange considers the variation margin payment to be collateral or a legal settlement. For companies that have previously reporting the variation margin as a realized gain or loss, there will be an effective date of January 1, 2018 to apply this guidance on a prospective basis.

Ref #2017-10: Bank Loans: (re-exposed with expanded definition) Discussions will continue on whether bank loans directly issued/originated by the reporting entity or acquired through participation, syndication or assignment should be reported as bonds (within scope of SSAP 26).

- Are there regulatory concerns if bank loans issued by the reporting entity were captured as bonds on Schedule D1.
- Should "loans" (bank, collateral and non-collateral) be moved to a new SSAP and captured within Schedule BA.
- Do regulators support bank loans in the scope of SSAP 26, and should additional disclosures and/or reporting lines be added to separately identify bank loans?
- How does this guidance interact with SSAP 25 and existing guidance for loans made to entity's parent or to other related parties?

Exposed items under SAPWG include:

Ref #2017-20: SSAP 97, Foreign Entity Clarifications - revisions to SSAP 97 to incorporate language that all foreign insurance subsidiary controlled affiliates (SCA) regardless of whether they have been audited within U.S. GAAP standards be reported consistently within paragraph 9 of the guidance.

Ref #2017-23: Wash Sales involving Money Market Mutual Funds—proposal for comments on whether all cash equivalent investments should be excluded from any wash sale disclosure, and if some level of disclosure would be beneficial to regulators.

Ref #2017-24: Use of Net Asset Value instead of Fair Value—get feedback from the industry and regulators if the use of proposed guidance to allow net asset value per shares as a practical expedient to fair value either when specifically named in a SSAP or where a specific condition or asset type exists.

THE BLANKS WORKING GROUP (BWG)

The BWG started off by approving previous minutes and interim conference call on June 14. *Please reach out to us for a summary of that call.*

Adopted items include *(all to be effective with annual 2017 filings)*:

Ref #2017-03: Modify the CUSIP column for Schedule BA and Schedule DL and add an ISIN column to Schedule DL for consistency with changes made to Schedule D.

Ref #2017-10: Remove the definition for notional amount from the Schedule DB 'General Instructions', Schedule DB, Part A 'General Instructions' and replace with the definition of "notional amount."

Ref #2017-11: Modify the instructions and illustrations for Note 5A(4) and Note 5A(5) to reflect additional disclosures required by SSAP No. 37—Mortgage Loans.

Ref #2017-12: Add to the "Code" column to allow designation of SVO Identified Funds for valuation using systematic value and make the appropriate modifications to the instructions for the "Book Adjusted/Carrying Value" column, the "Unrealized Valuation Increase/(Decrease)" column and the "Current Year's (Amortization)/Accretion" column.

Adopted items include: *(all to be effective with quarterly 2018 filings)*:

Ref #2017-17: Add a new line B10 to the bond section of the Cash from Investments Worksheet in the Cash Flow Statement instructions, renumber the remaining lines in the bond section (B10 and B11) and update the formula for the existing line B11 to reflect the line addition.

Ref #2017-19: Add a question to the General Interrogatories, Part 2 to help identify insurers that assume reinsurance business covering risks in at least two states.

BWG deferred a previous proposal listed below in our 2017 NAIC Spring National Meeting Summary:

Ref #2017-07: Add a new designation in the designation column for bonds and preferred stock that receive a Private Letter (PL) rating, and Reporting Exemption (RE) suffixes. Allowable suffix designations for a specific security would now be: "FE," "RE," "PL," "AM," "FM," "Z," "S", "F" or "*" with this proposal. This was also the topic of discussion of the Valuation of Securities Task Force (VOSTF), which focused around how to automate the data feeds and provide a verification procedure around data quality. Because of the proprietary nature of private letter ratings, many industry participants questioned the process, legal ramifications on confidentiality, and how the data will be controlled and verified by the Securities Valuation Office (SVO). The earliest the regulators see this rolling out is Jan 1, 2018.

BWG proposed one new item, and exposed it for a 30-day comment period.

Ref #2017-20: Add a question to the General Interrogatories to determine if the reporting entity is part of a publically traded group and subject to SEC reporting requirements.

THE VALUATION OF SECURITIES TASK FORCE (VOSTF)

Relevant topics include:

Add a Power Generation Methodology to the *Purposes and Procedures (P&P) Manual of the NAIC Investment Analysis Office* (IAO)—Adopted

The NAIC's IAO has developed a joint proposal with the ACLI for an analytical framework and methodology for power generation and renewable power projects. For decades, the SVO has assigned designations to power-generation facilities based on older technology. Renewable energy projects are a newer asset type in the asset class, but have also been assigned designations for a number of years. The industry had expressed concern that SVO standards for this asset class are no longer transparent and as a result, insurers may make capital decisions without a clear understanding of regulatory treatment. The new methodology will seek to provide greater transparency and increased safeguards regarding regulatory interests.

Formalize the transfer of the 5*/6* project to the Interrogatory

The SVO recommends that all current uses of NAIC 5*/6* be transferred to the Interrogatory and instructions necessary to guide the use of the NAIC 5*/6* certification procedures be developed.

SVO report on fund investments

Proposal to Add a Clarifying Instruction to the P&P Manual – Exposed for 45-day comment period

The NAIC staff requests that the VOSTF consider amending the P&P Manual to clarify that fund investments are not filed with the SVO for an NAIC designation and that fund investments are not eligible for filing exemption, except for the specific exceptions recognized in the *P&P Manual* and the *AP&P Manual*. These three exceptions are:

- ETFs that qualify for bond or preferred stock treatment
- Bond mutual funds that qualify for bond treatment
- Money market mutual funds on the *U.S. Direct Obligations/ Full Faith and Credit Exempt List*

Structured Securities Group (SSG) report on the financial model for CMBS

Recent enhancements by BlackRock Solutions to the CMBS credit model focus on better capturing property specific performance and risks through the introduction of a Monte Carlo tenant lease simulation. The enhanced model uses actual reported property level financials and tenancy as the starting point of cash flow forecasting.

Adopted policies to enhance the administration of the filing exempt (FE) designation process

Regulators proposed modifications to allow the IAO to oversee the production of FE designations (which includes the issue of Private Letter ratings) and to partner with state regulators in verifying the FE process. This responsibility includes working with industry and state regulators to reduce reporting exceptions that arise as a result of the FE designation process. There will also be a responsibility to monitor the types of securities both public and private that make up the FE universe and report to the VOSTF any relevant information about these rated securities.

Regulator objectives:

- Reduce the number of filing exceptions.
- Create uniformity and efficiency in the application of the FE process.
- Gain a better understanding of the FE universe of securities.

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