

NAIC Summer National Meeting

Global Insurance Solutions

As of August 2018

ON AUGUST 4-7, WE ATTENDED THE 2018 NAIC SUMMER NATIONAL MEETING IN BOSTON TO STAY INFORMED ON IMPORTANT REGULATORY ISSUES THAT ARE AFFECTING THE INSURANCE INDUSTRY TODAY. SUMMARIZED IN THIS DOCUMENT ARE THE MOST RELEVANT SESSIONS AND DISCUSSIONS FROM THE CONFERENCE.

KEY SESSIONS AND TOPICS (Full details below)

- **Investment Risk-Based Capital Working Group**
 - Stated that the new corporate bond factors implementation of 2019 might be a “longshot”
- **Statutory Accounting Principles Working Group**
 - Continues to review multiple initiatives including Credit Losses
- **Blanks Working Group**
 - Adopted most of the previously exposed items from the NAIC Spring National Meeting for 2018 implementation
- **Valuation of Securities Task Force**
 - Has delayed incorporating and ultimately reviewing the Credit Rating Providers (CRP) Private Letter (PL) ratings with NASVA until September 30, 2018

THE INVESTMENT RISK-BASED CAPITAL WORKING GROUP (IRBCWG)

There was continued dialogue of the corporate bond factors, with the American Council of Life Insurers (ACLI) and the American Academy of Actuaries’ (AAA) still not agreeing on the underlying models and assumptions. The Chair of the Working Group, Kevin Fry, made clear that it is time to focus efforts while acknowledging that implementation is a “longshot” and year-end 2020 may be a more realistic target.

AAA focused the conversation on Risk Premium (RP) and upholds their recommended set of factors put forth in October 2017. In this previous proposal, the RP was set at the mean or expected credit loss distribution. The C1 Work Group (C1WG) continues their recommendations from October 2017 for the following reasons:

- The RP at the mean is identical to the assumed current C1 factors
- There have been no substantive changes to statutory reserve standards to justify any change
- If RP is changed, it impacts all other parts of the solvency framework and then the outputs would need to be further reviewed
- Asset Valuation Reserve (AVR) being included in the calculation of total adjusted capital should address this

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While the RBC framework was originally established in the early 1990s to strengthen the solvency framework and help regulators identify thinly capitalized companies, one could certainly argue that the complexity of the formula, coupled with the evolution of many new asset types in the past 25+ years, various regulations and other factors, have made the RBC calculation obsolete as a true metric of each individual company's solvency, which still places heavy reliance on rating agencies' credit assessments and timeliness of rating reviews.

As the joint P&C and Health RBC committee continues down the path towards new P&C and Health factors, the AAA outlined some of the parameters used, as well as assumptions and key differentiators between Life, P&C and Health including:

- Life Insurance specific adjustments, like Asset Valuation Reserve (AVR)
- Portfolio construction differences—such as size and duration—across industries
- Bond size factors
- Difference in the application for Federal Income Tax
- Difference in discount rates between the C1WG model, which uses a discount rate of 5% and a 10-year time horizon, vs. 2% before Federal Income Tax for the shorter P&C and Health time horizons.

Insight into P&C and Health bond portfolios...

DISTRIBUTION OF BONDS BY NAIC RATING CLASS (P&C AND HEALTH COMPANIES)

NAIC Class	P&C	Health
1	77.8%	74.4%
2	16.5%	19.3%
3	2.6%	3.9%
4	1.9%	2.1%
5	1.0%	0.2%
6	0.2%	0.0%
Total	100.0%	100.0%

Source: American Academy of Actuaries - Property & Casualty and Health Risk-Based Capital Bond Factors Report, 2016 NAIC Annual Statement Data (excludes US government bonds with zero risk factor)

...and the information used to assess the effects of changes in risk factors

DISTRIBUTION OF BONDS WITHIN EACH NAIC RATING CLASS (P&C AND HEALTH COMPANIES)

Rating Class				
Moody's	S&P	Current NAIC	P&C	Health
Aaa	AAA	1	26.4%	22.7%
Aa1	AA+	1	16.5%	11.3%
Aa2	AA	1	18.0%	14.8%
Aa3	AA-	1	12.8%	12.8%
A1	A+	1	9.4%	12.2%
A2	A	1	9.7%	14.9%
A3	A-	1	7.1%	11.3%
Class 1 Total			100.0%	100.0%
Baa1	BBB+	2	39.2%	38.6%
Baa2	BBB	2	42.2%	43.3%
Baa3	BBB-	2	18.6%	18.0%
Class 2 Total			100.0%	100.0%
Ba1	BB+	3	45.1%	40.5%
Ba2	BB	3	27.5%	30.1%
Ba3	BB-	3	27.5%	29.4%
Class 3 Total			100.0%	100.0%
B1	B+	4	43.1%	44.2%
B2	B	4	24.6%	26.9%
B3	B-	4	32.3%	28.8%
Class 4 Total			100.0%	100.0%
Caa1	CCC+	5	31.3%	18.5%
Caa2	CCC	5	31.3%	50.8%
Caa3	CCC-	5	37.4%	30.8%
Class 5 Total				
Ca or lower	CC+ or lower	6	100.0%	100.0%
Class 6 Total			100.0%	100.0%

Source: American Academy of Actuaries - Property & Casualty and Health Risk-Based Capital Bond Factors Report, 2011 NAIC Annual Statement Data (excludes US government bonds with zero risk factor)

Both reports (Life RBC and P&C/Health RBC analyses) were put out for a public comment exposure period of 60 days, ending October 4th.

THE LIFE RISK BASED CAPITAL WORKING GROUP (LRBCWG)

The LRBCWG has been holding regular weekly calls to address the new changes in the Federal Tax Reform (from a 35% rate to 21%), and specifically address when these changes can be incorporated into the RBC formula.

While both the numerator and denominator will be impacted, the focus remains on the denominator which incorporates the tax rate decrease. The LRBCWG will continue to update regulators on progress to the formula, but acknowledges there is still much to be done in a very short amount of time. This includes changes to AVR, but the expectations as of now is that these will be effective changes for 2019.

THE STATUTORY ACCOUNTING PRINCIPLES WORKING GROUP (SAPWG)

There are several projects in various phases of discussion, including reviews and comments for the following:

Ref #2017-32: Investment Classification Project

- Improvements to common stock definition
- Include Closed End Funds and Unit Investment Trusts
- NAIC designation reporting on Schedule 2.2

Ref #2017-33: Derivatives and Hedging

- Revisions to incorporate differences between STAT and GAAP that should be retained

Ref #2018-08: Private Placement Variable Annuities (PPVA)

- Support exclusive use of Internal Revenue Code (IRC) 7702 to determine if these are within scope of *SSAP No. 21*
- Revisions to specifically allow PPVA and Private Placement Life Insurance (PPLI) within *SSAP No. 21*
- Significance of these investments within the industry and review if admitted vs. non-admitted asset classification is appropriate, while still looking at RBC framework

Ref #2018-15: Additional Elements under the Tax Cuts and Jobs Act

Ref #2018-16: Summary Investment Schedules Update

Many of these had multiple comment letters from interested parties so more work and discussions are still pending.

Several exposed items included:

Ref #2018-17: Structured Settlements

Ref #2018-18: Structured Notes - where investor assumes a risk of principal loss unrelated to credit risk of the issuer

Ref #2018-19: Elimination of Modified Filing Exempt (MFE) process (aligned with VOSTF deletion of the process)

Ref #2018-21: SSAP #72 Distributions - clarity on differences between Return on Capital (ROC) vs. Dividend

Ref #2018-22: Participation Agreement in a Mortgage Loan - language and guidance clarity previously adopted in 2017 referenced in our [2017 Spring National Meeting notes](#)

Of note for further discussion is:

Ref #2016-20: Credit Losses

The intent is to align a version of potential expected credit losses into NAIC guidance, which may take a similar form or version as IFRS 9 implementation, but assigning an ECL against Book Adjusted Carry Value (BACV) vs. a Fair Value is something interested parties would like to review and opine on. A subsequent conference call will be scheduled to continue these discussions, and we will keep our clients informed of the outcome.

THE BLANKS WORKING GROUP (BWG)

Adopted 17 new items for 2018 (*unless otherwise noted for year of adoption*) including:

Ref #2018-01BWG: Update language for Schedule DB, Part D, Section 1 regarding ETFs and centrally cleared derivatives.

Ref #2018-03BWG: Add definition of “supranational” (entities with more than one sovereign government as a member) to the Supplemental Investment Risk Interrogatories section.

Ref #2018-07BWG: *Proposed and adopted by the Valuation of Securities Task Force*

- Add new symbols:
 - PL - Private Letter
 - PLGI - Private Letter General Interrogatory
 - YE (carry over procedure) - Annual Updates securities being refiled with the SVO for an annual review
 - IF (carry over procedure) - Initial Filings - filed with the SVO for the first time
- Modify symbol:
 - Z - a security is in transition process from one reporting status to another
- Eliminate symbols:
 - P - Perpetual
 - RP - Redeemable Preferred

These will be replaced with an aggregation line item to distinguish.
- Added a new general interrogatory for the Private Letter rated securities issued prior to January 1, 2018 with an effective date of year-end 2018.

- Remove the market indicator column from Schedule D2.2 which will be effective for 2019

Ref #2018-09BWG: Modify instructions for Notes 20A, 20C and 20D to reflect changes in *SSAP No. 100R - Fair Value*

Ref #2018-10BWG: Modify instructions for Line 2 of the interest maintenance reserve (IMR) and the asset valuation reserve (AVR) regarding bifurcation of other-than-temporary impairment (OTTI) investments subject to *SSAP No. 26R - Bonds*.

Ref #2018-11BWG: Add additional instruction to the “Fixed or Variable Interest Rate Investments that Have the Underlying Characteristics of a Bond, Mortgage Loan or Other Fixed Income Instrument” and “Joint Ventures or Partnership Interests for Which the Primary Underlying Investments are Considered to Be Fixed Income Instruments” categories to clarify not reporting investments in those categories when there is specific category for the investment.

Ref #2018-14BWG: *(please refer to the SAPWG section, Ref #2018-08 above for further details)* Add clarity in Separate Accounts General Interrogatories splitting columns to identify “Registered with the SEC” vs. “Not Registered with the SEC”. Add question 1.01A to distinguish between a Private Placement Variable Annuity (PPVA) and a Private Placement Life Insurance (PPLI).

Ref #2018-18BWG: Combining the annual and quarterly reporting for Life and Fraternal insurance companies into one blank.

Deferred was one previously exposed item with a comment deadline of September 19, 2018:

Ref #2018-02BWG: Update columns and rows on the Summary Investment Schedule to tie out to various other investment schedules (crosschecks on Annual Statements). This included a referral to SAPWG for comment.

THE VALUATION OF SECURITIES TASK FORCE (VOSTF)

VOSTF discussed Private Letter Rating updates with the submission status from the Credit Rating Providers (CRP) to feed filing data to the SVO. The previous deadline for feeding this data was originally July 1, 2018. This has now been delayed until September 30, 2018, with the North American Securities Valuation Association (NASVA) and the SVO holding regular conference calls in the interim to keep the industry and interested parties apprised of the status. The SVO is still working with its technology department to finalize connectivity to its

database, in order to receive the feeds from the seven CRPs that issue Private Letter Ratings.

Additional items were discussed including new processes and policies around the definition of a Credit Rating Provider, updating the status for the ninth approved CRP, H.R. Ratings de Mexico, and a possible addition of a tenth CRP application from Japan Credit Rating Agency, LTD (exposed for comment). Clarification that registered affiliated parties of the CRPs are admissible under the NAIC framework was also part of these discussions.

Also discussed, but with no action yet:

- Using short-term credit ratings to produce NAIC designations
- NAIC designation mapping utilizing Morningstar ratings of CC and C to be included as NAIC 6
- Infrastructure investments and whether the industry has any specific proposals or barriers foreseen
- Working Capital Finance (WCF), which would review eligibility to what should be classified as WCF, referencing SSAP No. 105
- Discussion on whether all insurers should be able to report NAIC designations for Schedule BA assets and get a similar capital treatment to life insurers.

A revised report from the SVO and NASVA around reformatting the text of the Purposes and Procedures (P&P) Manual in a more consolidated, unified and user friendly version to eliminate complexity and redundancy of language, has also been exposed for a 75-day comment period.

Several items were exposed for comment periods including:

- Proposal to unify and modernize the instructions for various fund investments
- Add Swiss GAAP as an acceptable presentation standard in the definition of audited financial statements
- Delete the language around Modified Filing Exemption (MFE) procedures from the P&P Manual
- P&P Manual deletion of valuation instructions and the SVO valuation mission
- Various definitions and methodology to determine bank loans

Adopted Items include:

- Delete designations “RP” and “P” and all related references to be effective year-end 2019
- Many minor language amendments to the Purposes and Procedures Manual

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