NAIC 2019 Summer National Meeting

Global Insurance Solutions

As of August 2019

ON AUGUST 3–6, WE ATTENDED THE 2019 NAIC SUMMER NATIONAL MEETING IN NEW YORK TO STAY INFORMED ON IMPORTANT REGULATORY ISSUES THAT ARE AFFECTING THE INSURANCE INDUSTRY TODAY. SUMMARIZED IN THIS ARTICLE ARE THE MOST RELEVANT SESSIONS AND DISCUSSIONS FROM THE CONFERENCE.

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FOR MORE INFORMATION

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KEY SESSIONS AND TOPICS (Full details below)

- **Valuation of Securities Task Force focuses on "bespoke" securities that have uncertain risk characteristics**
- **Principal Protected Notes may be removed from Filing Exempt (FE) process**
- **The Blanks Working Group adopts 16 more changes for 2019**

THE VALUATION OF SECURITIES TASK FORCE (VOSTF)

The VOSTF has identified a number of securities that it feels the risk profile is not represented accurately either from a reporting aspect or the related risks inherent with the asset. It has dubbed this category of assets "Bespoke Securities." The credit risk of the asset appears blended with other risk factors that impact the probability of full par repayment typically seen in a traditional security or investment. Examples of the assets with embedded features of asset types include:

- **Affiliated Party** – affiliated parties placed in trusts and buying notes issued by that trust
- **Aircraft** – investment in trusts whose sole assets are aircraft
- **Circular** – transactions where the credit is owned or controlled by the issuer

Current practices and policies make identifying the underlying risk problematic due to:

- Many are rated by a NAIC Credit Rating Provider (CRP) – public or private rating, most being privately rated
- Face value (description) of the asset doesn't reflect what is within the asset
- Avoids public transparency or scrutiny
- Regulators can't assess the true solvency impact of the asset
- Avoids detection by NAIC to identify the risk profile or underlying unique characteristics for each security

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Asset Management

The VOSTF feels there are some things that identify or set red flags to these assets:

- Singular Rating
- Private Letter Rating
- Assets backing the security are owned by the insurer or one of its affiliates
- Assets backing the security don't generate a typical bond cash flow for Principal and/or Interest (P&I)
- Some level of an affiliate is also underwriting the asset

The VOSTF will continue to focus on this framework with the term "Critical Developing Issue" quoted. An update during an interim call or at the Fall National Meeting is expected. We will continue to follow this closely and will update our findings accordingly.

Exposed items included:

Received and exposed for 45-day comment period a proposal to the P&P Manual to update the definition and instructions for investments known as **Principal Protected Notes/Loans**, also known as **Combo Notes**. This public comment period ends Sept. 19, 2019. The amendment proposes removing this class of securities from eligibility for Filing Exemption (FE) process and requiring that they be filed with the Securities Valuation Office (SVO) for proper analysis. Many of these types of assets contain similar themes:

- Typically are labeled as structured securities
- Mixes a traditional bond with assets that do not pose the same structure or characteristic (equity, derivative, indices)
- Those assets are generally there for excess return attributes
- This hybrid model contains risk characteristics and assets that do not belong on the bond Schedule D, nor do they meet the criteria for bond-like Risk Based Capital (RBC)
- Typically rated by an approved credit rating provider on the bond level asset, not the other component(s)
- Appropriate transparency of the underlying risks and asset structure is not sufficient
- Components within the structure don't share the same credit or repayment language as the bond portion of the asset

There were several staff report updates that were also given regarding:

- Review of existing Credit Tenant Loan (CTL) guidance and to possibly include other forms of leasing transactions
- Updates and forward process of the RMBS and CMBS price breakpoints with the potential upcoming expansion of the NAIC designation categories
- Monitoring of Infrastructure Investments and continued gathering of additional data
- Referral to Blanks Working Group (BWG) to add NAIC designations to SEC-registered fund investments
- Removal of the obsolete concept for the Modified Filing Exempt (MFE) process
- Clarifications of the grandfathering clause for "Investments in Funds Eligible for Fixed Income-Like Treatment" will require a **public rating** to be certified or reaffirmed annually

THE STATUTORY ACCOUNTING PRINCIPLES WORKING GROUP (SAPWG)

Adopted items included:

Ref #2018-32 / SSAP 26R: Prepayment Penalties (this item was re-exposed from previous guidance). Provide clarity and accounting treatment and reporting of investment income, realized gains/(losses) or fees when bonds are prepaid for consideration that results in a loss.

Ref #2018-22 / SSAP-37: Mortgage Loans (this item was re-exposed from previous guidance).

- Clarify mortgage loans include loans acquired or obtained through assignment, participation or syndication.
- Clarify the definitions of a single loan agreement and a bundled mortgage loan, which the latter is out of scope for this guidance
- Incorporate language to clarify participating interests

Ref #2018-03: Reporting NAIC Designations as Weighted Averages is not permitted. In the event of acquiring multiple lots of the same security, an insurer has two reporting options: 1. report a single line item using the lowest NAIC designation; or 2. report each lot with its own purchase date, cost basis and applicable rating.

With the elimination of the Modified Filing Exempt (MFE) process in 2019, staff feels the impact of this adoption is minimal.

Exposed items included:

SSAP-43R: To exclude collateralized fund obligations and other structures with underlying equity components. Revision also prevents existing equity assets from being reported as securitized long-term bonds.

Ref #2019-18 / SSAP-86: Clarifications that derivatives not used for hedging, income generation or replication should be reported at fair value and are considered non-admitted assets.

SSAP-97: Add two new suffixes for SVO filings that are carried over from prior year.

THE BLANKS WORKING GROUP (BWG)

Adopted 16 more items for 2019 including: (for the list of previously adopted 2019 items, please follow the link to our 2019 Spring summary)

Ref #2019-03BWG: Add designation column for mutual funds to the annual Schedule D2.2 as well as add applicable columns and instructions for the quarterly reporting on Schedule D3 and D4.

Ref #2019-04BWG: Remove reference to Life and Fraternal only for Schedule BA instructions regarding investments with characteristics of bonds or fixed income. Also remove reference regarding cusip and NAIC designation columns. Add lines for Fixed or Variable Interest Rate Investments that have underlying characteristics of a bond, mortgage loan or other fixed interest rate investment. Add categories to distinguish between which ones have/have not been approved by the Securities Valuation Office (SVO).

Ref #2019-05BWG: Add new instructions and illustrations for life policies where the reporting entity is the owner and beneficiary or has obtained the rights to control the policy.

Ref #2019-07BWG: Modify instructions for Note 20 – Fair Value to reflect changes to SSAP- 100R.

Ref #2019-10BWG: Add clarification to determine gain/loss for prepayment penalties where received amount is less than par.

Ref #2019-12BWG: Add a code for foreign mutual funds for Schedule D2.2, column 3. Add instructions for foreign open-ended funds to be included as mutual funds.

Ref #2019-13BWG: Add disclosure of top 10 fund managers.

Ref #2019-17BWG: Add lines for affiliated and modify existing lines for bank loans for unaffiliated loans on Schedules D1, DA, DL, E. Subtotal should equal all affiliated and unaffiliated loans.

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