Statutory Accounting Principles (E) Working Group
Hearing Agenda
March 24, 2025

ROLL CALL

Dale Bruggeman, Chair	Ohio	Steve Mayhew/Kristin Hynes	Michigan
Kevin Clark, Vice Chair	Iowa	Doug Bartlett	New Hampshire
Sheila Travis/Richard Russell	Alabama	Bob Kasinow	New York
Kim Hudson	California	Diana Sherman	Pennsylvania
William Arfanis/Michael Estabrook	Connecticut	Jamie Walker	Texas
Rylynn Brown	Delaware	Doug Stolte/Jennifer Blizzard	Virginia
Cindy Andersen	Illinois	Amy Malm/Levi Olson	Wisconsin
Melissa Gibson/Shantell Taylor	Louisiana		

NAIC Support Staff: Julie Gann, Robin Marcotte, Jake Stultz, Jason Farr, Wil Oden

Note: This meeting will be recorded for subsequent use.

The Statutory Accounting Principles (E) Working Group met in regulator-to-regulator session on February 18 and March 18, 2025. These regulator-only sessions were pursuant to the NAIC Open Meetings Policy paragraph 3 (discussion of specific companies, entities or individuals) and paragraph 6 (consultations with NAIC staff related to NAIC technical guidance of the *Accounting Practices and Procedures Manual*). No actions were taken during these meetings, as the discussions related to reinsurance transactions at certain companies and for NAIC staff to present the technical guidance captured within the Spring National Meeting agenda.

REVIEW AND ADOPTION OF MINUTES

1. Fall National Meeting **(Attachment 1)**
2. Dec. 17, 2024 **(Attachment 2)**
3. Feb. 25, 2025 **(Attachment 3)**

REVIEW of COMMENTS on EXPOSED ITEMS

- **Attachment 13: Comments Ref #2023-28 through Ref #2024-01**
- **Attachment 14: 2024-15 ALM Derivatives Comments Only**

The following items are open for discussion and will be considered separately.
1. Ref #2023-28: Collateral Loan Reporting
2. Ref #2024-07: Reporting of Funds Withheld and Modco Assets
3. Ref #2024-20: Restricted Asset Clarification
4. Ref #2024-21: Investment Subsidiaries
5. Ref #2024-24: Medicare Part D – Prescription Payment Program
6. Ref #2024-04: Conforming Repurchase Agreement Assets
7. Ref #2024-15: ALM Derivatives

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2023-28 (Julie)	**Collateral Loan Reporting**	**4 – Agenda Item**	**Comments Received**	**IP – 29**

<u>*Summary:*</u>
On November 17, 2024, the Working Group re-exposed this agenda item detailing the proposed collateral loan reporting lines for Schedule BA and AVR to allow for concurrent exposure with blanks proposal 2024-19BWG. Comments received by the Blanks (E) Working Group and the SAPWG will be reviewed collectively.

The exposure (illustrated in the 2024 Summer National Meeting Updated Recommendation in the agenda item) proposed Schedule BA reporting lines (and corresponding AVR lines) for collateral lines as follows (all lines separated by affiliated/unaffiliated):

- Collateral loans backed by mortgage loans
- Collateral loans backed by joint ventures, partnerships or limited liability companies
- Collateral loans backed by residual interests
- Collateral loans backed by debt securities
- Collateral loans backed by real estate
- Collateral loans not captured in the specific reporting lines - (noted as all other)

With the inclusion of the new reporting lines, the recommendation also supported the following Schedule BA electronic-only columns for all collateral loan investments:

- Fair value of collateral backing the collateral loan
- Percentage of collateral to the collateral loan

With the exposure, specific questions were asked regarding the allocation of collateral loans backed by mortgage loans (as those have an interim process through the existing SSAP No. 48 BA underlying mortgage loan lines) as well as whether additional reporting lines are necessary for RBC assessment purposes.

<u>*Interested Parties' Comments - SAPWG:*</u>
Interested parties have responded (responses are in *italics*) to the following elements for which feedback was requested during the exposure:

1) Should collateral loans backed by mortgage loans be included in the new collateral loan category, or should those continue to flow through the "Investments with the Underlying Characteristics of Mortgage Loans" permitted during the interim as the long-term resolution?

   Interested parties believe the 'Collateral Loans – Backed by Mortgage Loans' Schedule BA subcategory should continue to flow through the "Investments with the Underlying Characteristics of Mortgage Loans" AVR category until a permanent solution is identified.

   If captured in the new collateral loan AVR category, to what extent should the underlying characteristic lines detailing quality / past due / foreclosure status (AVR lines 38-64) be duplicated?

   Interested parties believe there should be just 1 category in AVR for 'Collateral Loans – Backed by Mortgage Loans' and not bifurcate between quality / past due / foreclosure status. The accounting for Collateral Loans will be able to appropriately report the fair value of the underlying collateral.

2) What additional reporting lines (breakouts) of the proposed AVR categories are necessary to ensure appropriate look-through for RBC assessment purposes?

   Interested parties believe no changes in the following breakouts are warranted at this time. We will actively engage in the RBC discussions with the appropriate NAIC Working Group on this issue.

As it relates to the corresponding Blanks Working Group exposure 2024-19BWG, we have requested a re-exposure / deferral to address this item which was exposed for the first time. Our question to the Working Group is: should Ref #2023-28 also be re-exposed / deferred to align these 2 items?

<u>*Interested Parties' Comments – Blanks (E) Working Group:*</u>

<u>**2024-19BWG**</u> **-** Update Schedule BA line categories and instructions for the expansion of collateral loans. Add two electronic-only columns on Schedule BA, Part 1 for reporting fair value of collateral backing and the percentage of the collateral. Update the Assets Valuation Reserve instructions and blank for the added collateral loan lines. This is sponsored by SAPWG Ref #2023-28 (*Collateral Loan Reporting*). Anticipated effective date is Annual 2025 / Quarterly 2026.

Overall, IPs are supportive of regulator efforts to increase transparency and consistency of collateral loan reporting.

As it relates to mapping to RBC, the interim solution as adopted by CATF #2024-15-L states that for collateral loans backed by mortgage loans should be considered Schedule BA Mortgages. As such, IPs suggest keeping it 'as is' until a permanent solution is adopted.

After changes to the Schedule BA Collateral Loan categories are final, IPs ask that consideration be given to either aligning Annual Statement Footnote 5S with Schedule BA Collateral Loan categories or delete Annual Statement Footnote 5S as it is interpreted to be redundant with the changes to Schedule BA Collateral Loan categories. This would facilitate accounting systems reporting collateral loans consistently.

IPs suggest the following technical edits to the proposal:

For AVR Blanks Schedule - Equity Component:

- insertion of XXX into columns 2 and 3 for lines 93-105
- clarification on whether these new lines will be inserted before or after the 2023-12BWG adoption which modifies the AVR schedule for the insertion of Surplus Notes and Capital Notes lines, effective 1st Quarter 2025 – These lines will be after the Surplus Notes and Capital Notes lines.
- clarification if this proposal should be using the new line names adopted by 2024-11BWG (*Investment in Tax Credit Structures*)

For AVR Instructions, IPs suggest updates are needed to the line references for Lines 7, 9, and 10 on the front page of AVR as it relates to the Other Invested Asset total line on the Equity Component.

In the instructions for the 'Backed by Debt Securities' subcategory, the SSAP No. 26 description should be 'Bonds' and not 'Issuer Credit Obligations'.

Suggest adding some clarifying language in the instructions for the Backed by Mortgage Loans category to include SSAP No. 83 as follows: Backed by Mortgage Loans – collateral loans backed by mortgage loans that would be in scope of SSAP No. 37—Mortgage Loans <u>or SSAP No. 83—Mezzanine Real Estate Loans</u> if held directly.

IPs suggest creating 3 subcategories under the 'Non-collateral Loans' category to better clarify what is in each subcategory and to be consistent with the overall subcategories within Schedule BA: Related Party Loans; Other Unaffiliated Loans; Affiliated Loans. Related Party and Other Unaffiliated would be added into the 'Unaffiliated' subtotal and the Affiliated would be included in the 'Affiliated' subtotal. The 3 subcategories would be unique to Non-collateral Loans.

For consistency within the subcategories under Collateral Loans, IPs suggest renaming 'Collateral Loans – All Other' to 'Backed by Other Collateral Types.'

To clarify what should be included in the 'Backed by Other Collateral Types' subcategory, IPs suggest removing the last sentence in the 3rd paragraph of the instructions and add the following for enhanced clarity as to what should be included in this subcategory: *The Backed by Other Collateral Types subcategory shall include any other collateral which meets the definition of a qualifying invested asset which was not captured elsewhere. All collateral loans secured by collateral that does not qualify as an investment are required to be nonadmitted under SSAP No. 21. If a collateral loan secured by collateral that does not qualify as an investment is admitted, it shall be supported by a prescribed or permitted practice disclosure.*

For Columns 27 and 28, insert a line "Use only for the 'Collateral Loans – Reported by Collateral that Secures the Loan' category." to clarify that the 2 columns are only to be updated for Collateral Loans.

Based on the above comments, IPs respectfully request a re-exposure or deferral of this item to further address the proposed changes and related comments.

<u>*Recommendation:*</u>
NAIC staff recommends that the Working Group adopt agenda item 2023-28 with the proposed expansion of Schedule BA / AVR reporting lines for collateral loans, with communicated support to the Blanks (E) Working Group on the adoption of 2024-19BWG, with an effective date of Jan. 1, 2026, with the inclusion of certain modifications suggested by interested parties. (The Blanks proposal 2024-19BWG was exposed with revisions on March 6 for a comment period ending April 29.) Although many of the interested parties' proposed blanks changes are supported, it is recommended that the Working Group not support the deletion of the note disclosure that details collateral loans by investment category. This note disclosure is not duplicative to the Schedule BA reporting lines as it is more granular and separates collateral loans by the distinct type of qualifying collateral. This disclosure is captured in SSAP No. 21, and any action to remove the disclosure would need to first be considered as a revision to that SSAP.

The following items are specifically noted for support / modification in the Blanks Proposal:

- With the adoption / effective date of the collateral loan reporting lines in Schedule BA and AVR, this will reflect a permanent solution, therefore all collateral loans backed by mortgage loans shall be captured on these reporting lines. This means that reporting entities shall no longer follow the June 2024 interim provision that permitted collateral loans backed by mortgage loans to flow through AVR in lines 38-64 as an "Equity and other Invested Asset Component."

- Expansion of the description for collateral loans backed by mortgage loans to include loans that would be in scope of both *SSAP No. 37—Mortgage Loans* and *SSAP No. 83—Mezzanine Real Estate Loans* if held directly. (This change adds specific reference to SSAP No. 83.)

- Expansion of the reporting lines for "non-collateral loans" to separate affiliated and related party loans. This will result in reporting lines for Affiliated Loans, Related Party Loans and Other Unaffiliated Loans. This expansion was requested by interested parties as the original proposal had related party and affiliated loans in the same reporting line. As SSAP No. 25 provides specific guidance for assessing and admitting loans made to parents and loans made to all other related parties, identification of related party loans (and not just affiliated loans) is recommended in the reporting lines.

- Revisions to the "Collateral Loans – All Other" to reflect "Collateral Loans – Backed by Other Collateral Types." The description for this category is proposed as follows (modifications are shown from the interested parties' proposal). Modifications are necessary because if the collateral meets the definition of a qualifying invested asset, it would be admitted. As such, the description would cause confusion on the reporting for nonadmitted items.

> *The Backed by Other Collateral Types subcategory shall include ~~any other~~ collateral loans ~~which meets the definition of a qualifying invested asset~~ ~~which was~~ not captured in any other collateral loan reporting line ~~elsewhere~~. All collateral loans secured by collateral that does not qualify under SSAP No. 21 ~~as an investment~~ are required to be nonadmitted ~~under SSAP No. 21. If a collateral loan secured by collateral that does not qualify as an investment is admitted, it shall be~~ unless supported by a prescribed or permitted practice disclosure.*

An aggregate review of the 2024 collateral loan disclosure is as follows:
(This information is from the reported note only and does not include a comparison to Schedule BA.)

As shown in the detail below, collateral loans backed by "affiliated ICO bonds," unaffiliated mortgage loans" and "affiliated investments in joint ventures, LLCs and partnerships" are greater than 70% of the total.

Of the $27.8B in collateral loans, only $65M was disclosed as nonadmitted:

- Of the $10.6B reported as backed by JV, LLC or partnership investments, $3M was nonadmitted.
- Of the $309M reported as backed by affiliated other qualifying investments, $32.5M was nonadmitted.
- Of the $45.8M reported as backed by unaffiliated non-qualifying collateral, $28.5M was nonadmitted.

Collateral Backing Collateral Loan	**Note Disclosure Total**	**% of Total**
Unaffiliated Cash / CE & ST	$145,575,627	0.52%
Issuer Credit Obligations - Affiliated	**$3,286,243,783**	**11.79%**
Issuer Credit Obligations - Unaffiliated	$1,196,181,621	4.29%
Asset-Backed Securities - Affiliated	$1,292,104,481	4.63%
Asset-Backed Securities - Unaffiliated	$547,154,663	1.96%
Preferred Stocks - Affiliated	$25,000,000	0.09%
Preferred Stocks - Unaffiliated	$875,892,650	3.14%
Common Stocks - Affiliated	$10,089,663	0.04%
Common Stocks - Unaffiliated	$93,746,538	0.34%
Real Estate - Affiliated	$584,798,322	2.10%
Real Estate - Unaffiliated	$304,055,142	1.09%
Mortgage Loans - Affiliated	$377,120,058	1.35%
Mortgage Loans - Unaffiliated	**$5,966,730,875**	**21.40%**
JV, LLC & Partnerships - Affiliated	**$10,603,824,022**	**38.04%**
JV, LLC & Partnerships - Unaffiliated	$1,292,344,887	4.64%
Other Qualifying - Affiliated	$309,339,173	1.11%
Other Qualifying - Unaffiliated	$916,698,627	3.29%
Does Not Qualify - Affiliated	$4,912,141	0.02%
Does Not Qualify - Unaffiliated	$45,869,262	0.16%
Reported Note Total	**$27,877,681,535**	**100%**

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-07 (Jake)	**Reporting of Funds Withheld and Modco Assets**	**5 – Agenda item**	**Comments Received**	**IP – 4 APCIA – 2 UHC – 12**

Summary:

On August 13, 2024, the Working Group exposed this agenda item, for an extended comment period, which proposes to add a new part to the reinsurance Schedule S in the Life/Fraternal and Health annual statement blanks and Schedule F in the Property/Casualty and Title annual statement blanks. In response to comments submitted that indicated that non-trust assets could not be identified, the Working Group also specifically requested comments asking if the assets cannot be identified, then how are the numbers determined for the life risk-based capital charge reductions reported and the collateral fair value?

Interested Parties' Comments:

The proposal, Ref # 2024-07, Reporting of Funds Withheld and Modco Assets, originated from discussions among the IMR Ad Hoc Group, as they noted issues with identifying assets that are subject to funds withheld (FWH) or modified coinsurance (Modco) arrangements. Our understanding of the intent of the proposal is to have transparency in the Annual Statement into the reduction of Risk Based Capital (RBC) charges for ceded FWH and Modco assets in the life RBC formula.

Interested parties request that SAPWG reject the proposed new Schedule F - Part 7 to the property and casualty Annual Statement that would require special reporting for FWH and Modco assets and consider the proposed alternative to the proposed new Schedule S - Part 8 to the life and health Annual Statement as discussed below.

Property & Casualty:

Interested parties request that the SAPWG reject the proposed Schedule F - Part 7 for property and casualty FWH and Modco assets.

Reasons for Rejection:

1. Limited Applicability: Property and casualty insurers do not engage in Modco transactions. Moreover, due to the recognition of Certified Reinsurers and Reciprocal Jurisdictions, FWH provisions in reinsurance agreements have significantly decreased. Contracts with FWH provisions are typically in run-off and not substantive.

2. Lack of Specific Asset Identification and Use Restrictions: Past reinsurance agreements did not mandate specific identification or restrict the use of assets acquired with the withheld funds. Consequently, the assets are commingled with property and casualty insurers' general account assets and reported in cash and/or the appropriate investment schedule in the ceding insurer's annual statement. Additionally, FWH liabilities are either settled using general account assets or netted against amounts due from reinsurers. Currently, the amounts of FWH are reported in the aggregate on line 13 of the liabilities page of the annual statement balance sheet and in Schedule F - Part 3, column 20, by individual reinsurer.

Life Insurance

Reporting Format

As noted in the interested parties comment letter dated May 31, 2024, we are concerned that the disclosure of CUSIP-by-CUSIP information may create competitive harm or jeopardize the proprietary nature of reinsurance pricing strategies. Additionally, the presentation of this level of information does not seem relevant based on the stated objective of the accounting standard.

Given these concerns, we recommend that this proposed schedule follow the format of the AVR Schedule in the Annual Statement that shows summarized data by each asset class and rating category. This approach ties directly to the 20-category structure used by the RBC calculation which will allow software providers to easily program the asset totals to move through to the RBC calculation. FWH and Modco assets in this schedule would include Book/Adjusted Carrying Value (BACV) of General Account and Guaranteed Separate Account assets.

We have created a revised version of the exposed Schedule S – Part 8 (see attachment) utilizing the AVR Schedule format including ceded and assumed transactions. Given that this revised schedule is based on the AVR Schedules format, any future changes to the AVR schedules should be considered for Schedule S – Part 8.

We believe this solution would address regulators' goals with respect to RBC for FWH and Modco reinsurance transactions while addressing key industry concerns by creating a direct feed to the RBC formula. For cedants, the scope of reinsurance transactions subject to this reporting requirement would be where RBC credit is taken for asset risks transferred to the assuming entity. For assuming companies, the scope would include transactions where RBC asset charges are taken for asset risks assumed from the cedant.

Separate Account Assets

For Separate Account assets where there is no C-1 required capital, interested parties propose including the BACV of such FWH and Modco assets as a single line in the schedule. For example, reinsurance arrangements involving liabilities supported by Non-Guaranteed Separate Account assets are typically reinsured on a Modco basis, as the underlying assets are owned by the policyholders rather than the insurer. Consequently, they do not incur an RBC asset charge and are not recorded in an AVR schedule.

Timing

To facilitate the required reporting, commercial annual statement reporting vendors will need to build the new schedule into their software. Beyond that, many companies note additional work may be required to modify their investment and/or accounting systems to populate the proposed new schedules with the assets associated with FWH and Modco agreements. Others may not have the ability to make changes to their investment and/or accounting systems and would need to create manual processes including appropriate controls to meet the reporting obligations. This will all require significant time, effort, and cost. The ongoing bond definition project will compete for company resources. In spite of these challenges, the preliminary view of life interested parties is that a 2025 year-end implementation of a newly populated schedule S – Part 8 is likely achievable. However, process steps including Blanks Working Group adoption, RBC linkages, and software vendor requirements must be considered as well.

Interested parties acknowledge the importance of transparency in financial reporting for RBC with respect to assets backing FWH and Modco reinsurance transactions. We look forward to working with the SAPWG, as you further refine this proposal.

American Property Casualty Insurance Association (APCIA):
The American Property Casualty Insurance Association (APCIA) appreciates the opportunity to comment on Agenda Item 2024-07. We write to urge the Working Group to reject the proposed new Schedule F Part 7 to the property casualty Annual Statement that would require special reporting for funds withheld for reinsurance contracts. We participated in the discussions and endorse the comments of the industry's interested parties group on this item, but would like to raise several issues that are specific to property casualty insurers as there are significant differences in funds held arrangements between property casualty and life insurers.

The use of funds withheld arrangements in property and casualty reinsurance agreements has declined due to the recognition of Certified Reinsurers and Reciprocal Jurisdictions.
There are generally two types of arrangements in the property and casualty insurance industry where cash were "withheld" in past reinsurance transactions. The first is quota share arrangements where the cedent would hold back

cash as both a credit risk mitigant and to lessen the operational burden of funds being paid to/from the reinsurer. The second was cash received as collateral in lieu of a letter of credit or trust agreement to allow the ceding insurer to take credit for reinsurance. The cash withheld component of these agreements is generally no longer used due to changes in the reinsurance collateral rules with the introduction of Certified Reinsurers and Reciprocal Jurisdictions. As a result, the reinsurance agreements in which funds were withheld as collateral in the past are in runoff and thus the proposed reporting change would generally only apply to older reinsurance contracts where the cash withheld amounts are generally no longer significant.

No specifically identified assets
The proposed Schedule F-Part 7 requires specific identification and reporting of the assets comprising funds withheld. This is contrary to the manner in which property casualty reinsurance is conducted. Property casualty insurers do not use modified co-insurance (modco) and ceding companies generally hold cash in the funds withheld arrangement and the cash held is comingled with the ceding company's general cash account(s). There was no need to designate specific assets as supporting a funds withheld liability because the necessary amounts due the reinsurer are either paid from the ceding company's general account or are netted with amounts receivable from the reinsurer in satisfaction of amounts owed to the cedent. If the new Schedule F Part 7 requires companies to segregate assets to support funds withheld, this would require companies to attempt to track fungible cash from funds withheld to the investments made from those funds for reinsurance agreements that were generally entered into prior to the reinsurance collateral changes and are in runoff. In addition, such reporting would not be supported by any legal restriction on such cash (in fact, no such legal restriction exists).

Funds withheld already reported
Schedule F, Part 3 of the property casualty Annual Statement already requires ceding companies to report funds withheld with regard to each reinsurer with which the cedent does business. Funds withheld are further included in the analysis of credit risk in Part 3. Since funds withheld are not attributable to specific assets, there is no additional reporting to be made.

No significant effect on RBC
We understand that in the life insurance industry funds withheld and modco assets may be separately identified, and that such identification has RBC (risk-based capital) and/or IMR (interest maintenance reserve) consequences. The identity of funds withheld assets has no implications for property casualty insurers – the RBC charge for a particular type of asset is not affected by whether the asset relates to funds withheld or not. In other words, any asset will have the appropriate RBC charge whether it is a funds held asset or not.

Finally, we notice that the agenda item contains no rationale for imposing this requirement on property casualty insurers except that "funds withheld also exist for property/casualty insurance." This is not a sufficient reason to impose an unnecessary requirement that will require significant company resources for no solvency-related purposes. APCIA respectfully requests that this agenda item be amended to remove the proposed requirement for a new property casualty Part 7.

United Healthcare:
Thank you for the opportunity to comment on the above-referenced item that was re-exposed by the Statutory Accounting Principles (E) Working Group (SAPWG). The intent of this item was to make it easier to identify assets that are subject to a funds withheld or modified co-insurance arrangements through updated reporting in the financials.

Interested parties previously submitted comments in response to the initial exposure indicating that, under certain reinsurance arrangements, it would not be possible to identify or report specific assets for funds withheld as proposed in this exposure. To further clarify the point in the original comment letter, we would like to provide the following example, which is similar to several of our reinsurance arrangements:

An insurer may have a reinsurance arrangement transferring insurance risk whereby the terms of the agreement require funds to be withheld equal to the amount of ceded statutory reserves. The funds are withheld to permit statutory credit for nonadmitted reinsurance. The insurer's financial statements would reflect a ceded funds withheld liability. In this case, there is no investment risk being passed to the reinsurer and no specific assets separately identified. As such, the information proposed to be disclosed in the newly developed Schedule S page would not be applicable to this type of arrangement with these characteristics. This type of reinsurance arrangement is often seen for health insurance.

In the re-exposed item, SAPWG staff noted that the Life RBC formula reflects a reduction in RBC charges for modco and funds withheld assets. This reduction is by asset type and often by asset designation. SAPWG staff also indicated the fair value of the assets withheld is also reported in the reinsurance Schedule S and F as collateral. As such, SAPWG staff feels there may be a disconnect.

In response to these points, it is important to note that assets are only required to be identified for Life RBC calculation purposes if the insurer is passing investment risk to the reinsurer. For the types of arrangements with the characteristics described in our example above, this RBC reporting requirement does not apply. In addition, upon review of the instructions for Schedule S, we were unable to locate a place in Schedule S where we are required to report fair value of the assets withheld as collateral. The fair value reporting requirement applies to assets that are held in a trust or are otherwise placed on deposit by the reinsurer; however, in the example given above, the assets are simply investments within the ceding company's general account and are not segregated or separately identified.

We respectfully request the Working Group limits the application of this guidance and Schedule S reporting requirement to reinsurance arrangements under which investment risk is being passed to the reinsurer or where the terms of the reinsurance arrangement require a segregation or specific identification of assets used to collateralize the ceded reserves. Arrangements without such characteristics should be excluded from the reporting requirements as they are not applicable.

Recommendation:
NAIC staff recommends that the Working Group expose until May 2, the agenda item which includes an updated draft of Schedule S, Part 8 for only the Life/Fraternal blank. After reading the comments and holding discussions with interested parties, NAIC staff has removed Schedule F, Part 7 from the proposal, and will also not include a new Schedule S, Part 8, on the Health blank. The updated draft is closely in line with the recommendations from interested parties, and more closely aligns with AVR reporting. A corresponding SAPWG sponsored blanks proposal was exposed by the Blanks (E) Working Group on March 6. The full Schedule S, Part 8 blank and instructions is included in Exhibit 1 of the agenda item.

If Working Group members continue to support inclusion of comparable schedules in the P/C and Health blanks, NAIC staff can include those items in the exposure and direct their inclusion in the Blank proposal.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-20 (Julie)	**Restricted Asset Clarification**	**6 – Agenda item**	**Comments Received**	**IP – 32**

Summary:
On November 17, 2024, the Working Group moved this item to the active listing categorized as a SAP clarification and exposed revisions to SSAP No. 1 as well as corresponding proposed revisions to the Annual Statement instructions/template for the restricted asset disclosure in Note 5L to specify how Modco and FWH assets reported within a ceding company's financial statements shall be reported. The exposed revisions also include a new disclosure to identify whether Modco/FHW assets are pledged by the ceding entity as well as expanded disclosures to detail differences between what is reported in the restricted asset note and what is in the general interrogatories.

Interested Parties' Comments:
Interested parties appreciate the opportunity to comment on this item after it was re-exposed for comment by the Working Group during the NAIC Fall National Meeting in Denver.

We have split our comments below based on the section of instructions they refer to, following feedback comments related to the overall exposure.

General Feedback

Interested parties note that the instructions for SSAP No. 1, Note 5L, General Interrogatories (GI), and Risk Based Capital (RBC) do not indicate which values should be used for each of the disclosures (i.e., Book Adjusted Carrying Value (BACV), collateral amount, Fair Value). As such, we recommend that BACV be used for all disclosures to ensure consistency.

For example, in Note 5L, columns 8 & 9, Total Admitted/Nonadmitted Assets are reported using BACV, as the assets would appear in the Assets page under the Admitted and Nonadmitted Assets columns. In lines b and c, *Collateral held under security lending agreements* and *Subject to repurchase agreements*, may be reported as collateral amounts to match the General Interrogatory (GI). Combining BACV and collateral amounts could be misleading to the reader.

Interested parties recommend that changes to the *NAIC Accounting Practices and Procedures Manual* (AP&P manual) be made concurrent with any Blanks and RBC instruction updates to ensure that all reporting is consistent.

SSAP No. 1

We have no comment on the changes in SSAP No. 1 – *Accounting Policies, Risks & Uncertainties and Other Disclosures* other than the clarification of expected reporting values.

Notes to the Financial Statements - 5L

5L(1)
- Interested parties note that instructions are not included for the new columns and rows or the newly required reconciliation. Therefore, we recommend instructions be added to the Restricted Assets section.
- We note that this section still has line o titled: *Total restricted assets*, but the new chart shows that the total is now line r. We recommend instructions be updated with the new line titles.
- We note that changes to SSAP No. 1's requirements would also require Note 5L be updated for Health and Property & Casualty companies, which have slightly different formats than Life.

Illustrations to the Financial Statements - 5L

5L(1)
- The exposure should clarify what happens if assets are pledged and may show up as restricted assets in another row.
- Interested parties recommend the removal of the reference to SSAP No. 1 Paragraph 23.c from the Restricted Assets Category in lines o-q.
- We would like to confirm that line o should exclude collateral received from security lending and repurchase agreements as these items are already included in lines b-f. We recommend clarification language to call out the exclusions.

5L(2)

- Question: Is the amount of total assets pledged under derivative contracts supposed to be on the new line (*Amount of Total pledged under derivative contracts*) and not included above the current line "Total (c)"? If so, why would we need to remove that line from the new total line?
- We recommend that the new Total Excluding Derivatives include a formula showing it is Total (c) less Amt of total pledged under derivative contracts.
- We recommend Staff Note be included as a subnote to the table or included in the Note 5L instructions.
    - ✓ **Note: The amount of pledged under derivative contracts should agree to Schedule DB and agree to what is subtracted from the life RBC formula.**

5L(4)

- Interested parties would like clarification if the new Collateral/Modco/FWH Columns are independent of each other or are Modco/FWH subsets of the collateral amount.
- We note that the subnotes for Columns 3 and 4 were not updated and still state the formula is column 1 / Asset page. Column 1 refers to all data for BACV. The columns will need to be renumbered (i.e., 1.1 Collateral; 1.2 Modco; 1.3 FWH) and/or the subnotes for j and t would be updated.
- We note that row j currently should be column total lines, but the headers for the Separate Account (SA) section were added to the total line instead of a new row. We recommend a new line be added for the SA section headers. Line t should be numerical values rather than column headers.
- We would like to confirm that the "Recognized Obligation for Modco/FWH Assets" required in 5L(4)u and v are equal to the Modco/FWH reserve liabilities. If so, the language should be updated to read as such.

5L(4) – The second one should be renumbered to 5L(5)

- The exposure should clarify that this table applies only when the economic benefits received from pledging the asset stay with the cedant. Stated differently, if the benefit or cost associated with the restriction inures to the reinsurer, that would not be considered "purpose specific to the ceding insurance reporting entity." We recommend a principle be developed to apply the intended rules to a wide array of transactions.

Life RBC (E) Working Group Referral

Interested parties propose the following changes be made to the referral to the Life RBC (E) Working Group.

> *Basis of Factors*
> When the default risk in modified coinsurance (MODCO) and other reinsurance transactions with funds withheld is transferred, this transfer should be recognized by reducing the RBC for the ceding company and increasing it for the assuming company. In the event that the entire asset credit or variability in statement value risk associated with the assets supporting the business reinsured is not transferred to the assuming company for the entire duration of the reinsurance treaty, the RBC for the ceding company should not be reduced. For clarity, if the Modco/Funds Withheld reinsurance agreement asset held as of the year-end date has been used as a pledged asset concurrently with the pledged asset being included as a Modco/Funds Withheld reinsurance agreement asset for any purpose specific to the ceding insurance reporting entity at any time during the year, the RBC for the ceding company shall not be reduced. For example, if the Modco/Funds Withheld reinsurance agreement asset held as of the year-end date was the collateral in a securities lending, repurchase, or FHLB transaction executed for the benefit of ~~by~~ the ceding entity at any time over the year concurrently with the pledged asset being included as a Modco/Funds Withheld reinsurance agreement asset, then ~~the reporting entity cannot assert that they have transferred the asset risk or variability and~~ RBC shall not be reduced. In situations where the economic benefit received from pledging the assets inure to the reinsurer throughout the duration of the reinsurance treaty, the cedant is allowed to reduce its RBC for those assets.

Recommendation:

NAIC staff recommends that the Working Group adopt the exposed revisions to *SSAP No. 1—Accounting Policies, Risk & Uncertainties and Other Disclosures*, to be effective December 31, with minor modifications to replace "amount" with "book/adjusted carrying value (BACV)" in paragraph 23b and 23c as recommended by interested parties. (These are illustrated on the following pages.)

A corresponding SAPWG sponsored blanks proposal was exposed by the Blanks (E) Working Group on March 6. As many of the interested parties' comments focused on the draft mark-up of blanks changes / note illustrations within the SAPWG agenda item, those items were considered for inclusion in the blanks proposal prior to exposing. It is anticipated that Blanks (E) Working Group adoption consideration will occur on May 29 to allow for year-end 2025 data-capturing.

With adoption, it is recommended that the Working Group send a referral to the Life Risk-Based Capital (E) Working Group to clarify the guidance for when an RBC reduction can occur for modco and funds withheld reinsurance agreements. After considering the industry comments, NAIC staff recommends the referral include the proposed new language shown below for consideration by the Life RBC (E) Working Group in the instructions for "Modco or Funds Withheld Reinsurance Agreements" addressing pages LR045, LR046, LR047 and LR0148. This language has been revised to reflect most of the interested party proposed edits, but also with edits to clarify that the RBC reduction is not permissible if any portion of the modco / FWH asset has been pledged to prevent interpretations that pro-rata reductions are permitted.

MODCO OR FUNDS WITHHELD REINSURANCE AGREEMENTS
LR045, LR046, LR047 and LR048

References to MODCO and funds withheld reinsurance agreements apply to all treaties in effect.

Basis of Factors

When the default risk in modified coinsurance (MODCO) and other reinsurance transactions with funds withheld is transferred, this transfer should be recognized by reducing the RBC for the ceding company and increasing it for the assuming company. In the event that the entire asset credit or variability in statement value risk associated with the assets supporting the business reinsured is not transferred to the assuming company for the entire duration of the reinsurance treaty, the RBC for the ceding company should not be reduced. For clarity, if any portion of a Modco/Funds Withheld reinsurance agreement asset held as of the year-end date has been used as a pledged asset concurrently with the pledged asset being included as a Modco/Funds Withheld reinsurance agreement asset for any purpose specific to the ceding insurance reporting entity at any time during the year, the RBC for the ceding company shall not be reduced. For example, if any portion of a Modco/Funds Withheld reinsurance agreement asset held as of the year-end date was the collateral in a securities lending, repurchase, or FHLB transaction executed for the benefit of by the ceding entity at any time over the year concurrently with the pledged asset being included as a Modco/Funds Withheld reinsurance agreement asset, then RBC shall not be reduced. In situations where the economic benefit received from pledging the assets inure to the reinsurer throughout the duration of the reinsurance treaty, the cedant is allowed to reduce its RBC for those assets.

FAWG Referral: A referral from the Financial Analysis (E) Working Group has also been received requesting disclosure when a reporting entity's modco/FWH invested assets are affiliated with or related to a reinsurer. This referral is being addressed in agenda item Ref #2025-05 captured on the meeting agenda. The recommendation in that item is proposing an expansion of the restricted asset disclosures captured in this agenda item. It is likely that both items can be adopted and incorporated for year-end 2025 blanks reporting. However, if needed, the disclosures proposed in response to the FAWG referral can be considered on a separate timeline.

<u>Adoption Consideration: The exposed edits to SSAP No. 1 with the proposed changes shaded.</u>
(Edits are to reference BACV and to incorporate a Dec. 31, 2025 effective date):

23. Reporting entities shall disclose[1] the following information in the financial statements:

    a. Amounts not recorded in the financial statements that represent segregated funds held for others, the nature of the assets and the related fiduciary responsibilities associated with such assets. One example of such an item is escrow accounts held by title insurance companies; and

    b. The total combined (admitted and nonadmitted) <u>book/adjusted carrying value (BACV)</u>~~amount~~ of restricted assets by category, with separate identification of the admitted and nonadmitted restricted assets by category, and nature of any assets pledged to others as collateral or otherwise restricted (e.g., not under the exclusive control, assets subject to a put option contract, etc.)[2] in the general and separate accounts[3] by the reporting entity in comparison to total assets and total admitted assets. (Pursuant to SSAP No. 4, paragraph 6, all assets pledged as collateral or otherwise restricted shall be reported in this disclosure regardless if the asset is considered an admitted asset.) <u>Reporting entities shall also disclose differences in the amounts reported in this note versus the amounts reported for the same categories in the general interrogatories.</u> This disclosure shall include the following restricted asset categories:

        i. Reported assets subject to contractual obligation for which liability is not shown;

        ii. Collateral held under security lending agreements;

        iii. Assets subject to repurchase agreements;

        iv. Assets subject to reverse repurchase agreements;

        v. Assets subject to dollar repurchase agreements;

        vi. Assets subject to dollar reverse repurchase agreements;

        vii. Assets placed under option contracts;

        viii. Letter stock or securities restricted as to sale[4] – excluding FHLB stock;

        ix. FHLB capital stock;

        x. Assets on deposit with states;

        xi. Assets on deposit with other regulatory bodies;

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[1] Disclosure of restricted assets shall be included in the annual financial statements ~~-~~and, pursuant to the Preamble, in the interim financial statements if significant changes have occurred since the annual statement. If significant changes have occurred, the entire disclosure shall be reported in the interim financial statements.

[2] The aggregate information captured within this disclosure is intended to reflect the information reported in the Annual Statement Investment Schedules in accordance with the coding of investments that are not under the exclusive control of the reporting entity, including assets loaned to others and the information reported in the General Interrogatories, as well as information on restricted cash, cash equivalents and short-term investments.

[3] Restricted assets in the separate account are not intended to reflect amounts "restricted" only because they are insulated from the general account or because they are attributed to specific policyholders. Separate account assets shall be captured in this disclosure only if they are restricted outside of these characteristics.

[4] The nature, description and amount of the restriction are required in the disclosure.

xii. Pledged as collateral to the FHLB (including assets backing funding agreements);

xiii. Assets pledged as collateral not captured in other categories[FN1]; and

xiv. Other restricted assets.

New Footnote 1: Items captured in this category shall include assets reported within the financial statements that are pledged to a counterparty that have not been captured in other categories or within paragraph 23.c. Items reported should include, but not be limited to, assets pledged under derivative arrangements.

c. The book/adjusted carrying value (BACV)~~amount~~ and nature of any assets received as collateral or assets that are held under modified coinsurance or funds withheld reinsurance agreements, reflected as assets within the reporting entity's financial statements, for which there is a ~~and the~~ recognized liability to return these collateral assets or for the dedicated use of those assets under the modco/funds withheld agreement, in the general and separate accounts in comparison to total assets and admitted assets.

Effective Date and Transition

34. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The guidance in paragraphs 17-22, requiring evaluation and disclosure of substantial doubt about an entity's ability to continue as a going concern is effective December 31, 2016, and is required for interim and annual reporting periods thereafter. Early application is permitted. The update to Section 3, Summary Investment Schedule, of Appendix A-001 is effective January 1, 2019. Revisions to the restricted asset disclosure to include information on assets held under modified coinsurance and funds withheld reinsurance agreements, and to require the restricted asset disclosure in quarterly financial statements are effective December 31, 2025.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-21 (Julie)	**Investment Subsidiaries**	**7 – Agenda Item**	**Comments Received**	**IP - 35**

Summary:

On November 17, 2024, the Working Group moved this item to the active listing and exposed this concept agenda item requesting comments on options to clarify accounting guidelines and resulting reporting impacts for investment subsidiaries. The potential options were included as follows:

1) **Revisions to SSAP No. 97 to incorporate statutory accounting guidance for SCAs that hold assets on behalf of the reporting entity and affiliate (investment subsidiaries).** By incorporating in SSAP, consideration can be given as to prescribing the measurement method and potential nonadmittance thresholds if the assets within the investment subsidiary would be nonadmitted if held directly. (As detailed in the agenda item, the existing reference to measurement and nonadmittance in the instructions for D-6-1 would not overrule the guidance in SSAP No. 97. If the revisions to SSAP No. 97 are not supported, then the Working Group could consider sponsoring a blanks proposal to clarify the instructions in D-6-1 to prescribe allocation of the underlying investments in a manner that coincides with the SCA measurement and admittance under SSAP No. 97.)

2) **Sponsor blanks proposals to capture new investment schedules, or perhaps expansions to existing investment schedules, to detail the underlying assets held within an investment subsidiary.** As the RBC and AVR calculations require reporting entities to calculate RBC and AVR based on the underlying assets, this information should be readily available. If revisions are not incorporated into SSAP No. 97, these proposals can also clarify requirements for reporting as an investment subsidiary.

3) **Referrals to the Capital Adequacy (E) Task Force and related RBC Working Groups to incorporate details that allow regulators to verify the RBC calculation for the underlying assets in investment subsidiaries.** If blanks reporting revisions are incorporated that provide this detail, then the RBC formula can likely pull from those sources. If reporting revisions are not incorporated, then additional schedules or reporting lines would be necessary within the RBC formula.

Interested Parties Comments:
As background, investment subsidiaries are often used by insurers as operationally efficient investment vehicles and also may be used for various legal reasons (e.g., reinsurance transactions). Using a separate legal entity to own certain types of investments may be a lot more efficient than having the insurer own the assets outright. For example, insurers may use an investment subsidiary to own residential mortgage loans. This asset type usually requires the issuance of a high volume of loans to achieve the appropriate economies of scale so that the investment is cost-effective. Insurers may create a separate legal entity to allow for licensing to purchase loans in every state and that will engage a mortgage loan servicer to administer and service all the loans. Additionally, when insurers establish an investment subsidiary in the form of a trust with a national bank as trustee, the national bank trustee is either explicitly exempted from state lending licensing requirements or entitled to federal preemption from state lending license requirements. Using an investment subsidiary in this case would allow the insurance company to invest in large volumes of residential mortgages without significant burden on internal resources and internal operations while holding a capital charge on the underlying mortgages that is commensurate with the risk of each underlying mortgage loan.

With the background above, following are our comments to the potential actions included in the exposure draft.

1. **Proposal No. 1: Revisions to SSAP No. 97 to incorporate statutory accounting guidance for SCAs that hold assets on behalf of the reporting entity and affiliate (investment subsidiaries)**

   Interested parties agree with including guidance in SSAP No. 97 to address the following items:

   a. The definition of an investment subsidiary from Schedule D should be brought over into SSAP No. 97.

   b. Interested parties agree that clarification should be added on the accounting for these investments. We understand that these investments are to be reported using an equity method of accounting with U.S. GAAP audited financial statements required for admissibility. There is a current lack of clarity on how to apply the "imputed value" requirement in the investment subsidiary definition. There is inconsistency in practice as to whether the underlying investments are adjusted from a U.S. GAAP value to a U.S. SAP value in instances where U.S. GAAP and U.S. SAP differ from an investment valuation perspective. If the intent is for the investment subsidiary's assets to be recorded with a carrying value equal to what would be recorded if the assets were held directly by the insurer, more clear guidance should be included in SSAP No. 97 as to how this rule is intended to be applied.

   c. There should be clarification that in no instance the RBC charges applied to the underlying assets can be more beneficial than if the assets were held directly by the insurer. This should address the Working Group's concern regarding investment subsidiaries that own bonds that do not meet the new principles-based definition and would require an SVO designation for reporting. Interested parties also request clarification in the RBC instructions that the applicable charges be applied to the accounting basis used to determine the carrying value of the investment subsidiary.

2. **Proposal No. 2: Sponsor Blanks proposals to capture new investment Schedules or perhaps expansions to existing investment schedules, to detail the underlying assets held within an investment subsidiary**

   Interested parties believe that having to include a listing of each underlying asset of the investment subsidiary will take away some of the operational efficiency that is gained by having the investment subsidiary own the underlying assets. If this is a "must have" for the Working Group, perhaps we can work together on the most efficient way to provide the data. See additional suggestions under item 3 below.

3. **Proposal No. 3: Referrals to Capital the Capital Adequacy (E) Task Force and related RBC Working Groups to incorporate details that allow regulators to verify the RBC calculation for the underlying assets in investment subsidiaries**

   Interested parties agree with providing transparency for RBC purposes. Since listing each asset individually may take away some of the benefits of creating an investment subsidiary, perhaps the assets can be provided by groupings that match AVR/RBC schedules similar to the industry's recent response on the funds withheld assets exposure. Another option may be to include detail in a note to the financial statement that would be less onerous than including it in the actual Investment schedules.

In addition to providing responses above to the specific actions detailed in the Exposure Draft, interested parties would like to provide additional comments as follows:

1. We understand from the exposure draft that the concept of an investment subsidiary is intended to be limited to Schedule D common stock and preferred stock investments. However, it is not clear to us why the concept cannot be extended to investments in subsidiaries that are legally structured as limited partnerships (LPs) or limited liability companies (LLC). The legal form of the entity should not impact whether a subsidiary meets the criteria for investment subsidiary reporting as the accounting and reporting would follow substance over form. In fact, we understand that insurance law in some states already allows the concept of an investment subsidiary to be applied to any legal entity. For example, state statutes modeled on the NAIC Holding Company System Regulatory Act refer to investment subsidiaries as "entities organized as corporations, partnerships, associations, joint stock companies, trusts, unincorporated organizations that are engaged or organized to engage exclusively in the ownership and management of assets authorized as investments for the insurer." We understand that this would require some changes to Schedule BA to add a specific line item for investment subsidiaries, which will require additional work and new AVR/RBC mapping. Another option could be to require all investment subsidiaries, regardless of legal form, to be reported on Schedule D.

2. There are entities that are not legally structured as either a corporation or LP/LLC. However, the equity they issue is more akin to a common stock investment in a corporation than it is to an equity interest in an LP/LLC. This is the case for Delaware statutory trusts (DSTs). From a legal perspective, equity investments in these types of entities are treated similarly to common stock as investors in both DSTs and corporations have limited liability. Unlike LPs/LLCs, DSTs do not maintain separate capital accounts for each investor since the ownership interest is usually represented by shares/beneficial interests similar to ownership of equity in a corporation. Any new guidance added to SSAP No. 97 should allow for the reporting entity's assessment of whether the equity investment in the investment subsidiary is more akin to common stock (Schedule D reporting) or more akin to LP/LLC interests (Schedule BA reporting). Each reporting entity needs to assess individual facts and circumstances for each investment vehicle to determine guidance applicability and the appropriate schedule in which to report the investment subsidiary.

3. Some trusts are established to hold assets such as mortgage loans that allow for direct reporting on Schedule B. We understand that this is done by including legal language in the trust certificates that specifically state that ownership in the trust represents a participation in each mortgage loan owned by

the Trust. In these instances, the insurer has an undivided interest in each mortgage loan and it has the same rights as the lender of record with all proceeds from the loans as well as foreclosure rights being pari-passu with the lender of record. We believe that since ownership in the trust in this instance represents a participation in each loan as defined in SSAP No. 37, these loans are Schedule B eligible assets and are outside of the scope of the investment subsidiary guidance.

Recommendation:

NAIC staff recommends that the Working Group defer this item to allow for further consideration of Delaware Statutory Trusts (DSTs) holding residential mortgages loans, and whether specific statutory accounting parameters and guidance should be established.

As a general note, DSTs are distinct from common-law trusts as they are established under Delaware statutory trust laws, which allows for significant flexibility in structuring the trust. While holding real estate investments within a DST provides a number of structural and tax advantages, one of the most notable benefits is that it enables insurance companies to bypass the requirement of obtaining individual state lending licenses for each state where they hold residential mortgage investments. NAIC staff has concerns with the overall reporting of "investment subsidiaries" on Schedule D-6-1 and the potential RBC benefit that can occur without transparency to the regulators on the assets within an "investment subsidiary" and how the RBC is being calculated. From an interim discussion with interested parties, NAIC staff has an initial impression that the key industry focus is on developing accounting and reporting guidance for Delaware Statutory Trusts (DST) structures holding residential mortgage loans. Rather than retaining a generic reporting category that allows an RBC look-through without any parameters, which likely should have been eliminated when the concept of "investment subsidiaries" was deleted from SSAP No. 97 in 2005, NAIC staff recommends a project to assess DST structures holding residential mortgage loans and the potential establishment of specific accounting and reporting guidance. During this time, if there are other specific structures captured as "investment subsidiaries" on D-6-1 that warrant separate review, industry can present those dynamics to NAIC staff for further assessment. Once a Working Group decision is made for residential mortgage loans held in DSTs (potentially with new SAP guidance addressing structure requirements, accounting and reporting), then it would be recommended that the Working Group sponsor a blanks proposal to remove the concept of a generic "investment subsidiary" from Schedule D-6-1, along with referrals to remove that concept from related RBC formulas, to prevent future use of that generic reporting / RBC look-through. Going forward, if there are SSAP No. 97 structures for which look-through RBC is desired, NAIC staff would recommend that industry bring those structures to the attention of the Working Group for assessment.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-24 (Robin)	**Medicare Part D – Prescription Payment Program**	**8 – Agenda item 9 – INT 24-02 9a INT -24-02 10 – INT 05-05**	**Comments Received**	**AHIP BCBSA – 42**

Summary:

On February 25, 2025, the Statutory Accounting Principles (E) Working Group exposed additional revisions to tentative *Interpretation (INT) 24-02: Medicare Part D Prescription Payment Plans* and re-exposed the minor edits to *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage* for a shortened comment period ending on March 5, 2025, to allow for discussion at the Spring National Meeting. In addition, the Working Group directed NAIC staff to continue with the blanks proposals on this topic with the goal of incorporation into the 2025 annual statement instructions. The majority of the new revisions are terminology revisions which did not change the key provisions of the November 2024 exposure.

The Medicare Part D, Prescription Payment Plan adds to the voluntary outpatient prescription drug program (Part D), a new program to offer Part D enrollees the option to their out-of-pocket Part D prescription drug costs through monthly payments over the course of the plan year instead of at the pharmacy counter. This program, known as the

Medicare Prescription Payment Plan (MPPP), is effective on January 1, 2025. INT 24-02 was developed with input from health industry representatives and provides statutory accounting and reporting guidance for aspects of MPPP. Key components of the MPPP guidance include the following:

- Allows admitted asset treatment for receivables from MPPP participants which are less than 90 days overdue. with reporting on the on the Health care receivables asset line.
- MPPP recoverables from participants which are more than 90 days overdue based on program billing requirements are nonadmitted.
- MPPP recoverables are also subject to impairment analysis.
- Uncollectible receivables from MPPP participants which are written off as are reported as a Medicare prescription claims expense.

Blue Cross and Blue Shield Association / AHIP Comments:

Blue Cross and Blue Shield Association / AHIP provided recommended edits to paragraphs 1, 3, 5, 8, 9g,10, 11, 16, 20, 21, and 23. These proposed tracked revisions are shown in the comment's Attachment 13.

Recommendation:
NAIC staff recommends adoption of the exposed minor edits to *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage* and recommends adoption of the exposed revisions to *INT 24-02: Medicare Part D Prescription Payment Plans* with the addition of almost all of the modifications suggested by Blue Cross and Blue Shield Association and AHIP. The majority of the AHIP and BCBSA proposed revisions are minor wording clarifications. The revisions to paragraph 23 clarify differences in the medical loss ratio between the federal calculation and statutory accounting. In addition, NAIC staff proposed a correction to the illustration in scenario 2 to change an amount from negative to positive. The proposed revisions do not change the key accounting components. All revisions have been discussed with representatives of BCBSA and AHIP.

- **Attachment 9 illustrates the prior exposed revisions with additional proposed edits shaded.**
- **Attachment 9a illustrates only the new edits proposed for adoption, primarily from AHIP and BCBSA which are shown as tracked and shaded.**

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-04 (Julie)	**Conforming Repurchase Agreement Assets**	**11 – Agenda item**	**Comments Received**	**IP – 15**

Summary:
On August 13, 2024, the Working Group exposed this agenda item and a memorandum detailing accounting, reporting and RBC guidance for repurchase agreement and securities lending transactions with a request for feedback from regulators and interested parties on the documented processes and noted questions. This original exposure was until September 27, 2024, but a comment deadline extension was requested to December 16, 2024.

Interested Parties' Comments:
The interested parties duplicated the exposed memo detailing accounting, reporting and RBC guidance for repo and sec lending transactions in their comment letter with responses to the NAIC staff questions. This full response is included in the comment letter attachment. To save space, only the NAIC questions and interested parties' responses have been included below divided by section topic.

<u>Securities Lending – Reporting Entity Lends a Security and Receives Collateral in Exchange:</u>

1. ***Lending Entity Cannot Sell / Repledge Security Collateral Received:***

   <u>NAIC Note 1:</u> Should the type of collateral received in these programs be captured in a financial statement disclosure to allow for regulator verification of the "conforming" program guidelines? Additionally, it has been noted that the admittance calculation focuses solely on the fair value comparison of the collateral received to the security lent. However, there is no current guidance that assesses admittance based on the quality/type of collateral received. Under the current guidance, residuals or low-quality assets could be received and there is no documentation of this type of collateral for certain sec lending and repo programs. Even if these programs would not qualify as conforming, there is a question on whether admittance restrictions should exist based on the collateral received from the counterparty.

   <u>Interested parties' response</u>*: Given the deferral of the conforming repo proposal, only conforming sec lending programs will be subject to the conforming guidelines. In these programs, the insurer attests to the conforming criteria. One possible additional disclosure could be footnote like footnote 5.E.8 for repo, whereby the collateral received is specified by asset type.*

   In typical security lending programs, the insurer receives cash in these transactions, but the master agreement between the counterparties also allows the insurer to receive high-quality collateral – restrictively defined as "acceptable collateral" - which must be marked to market regularly for ongoing margining purposes. Regardless of whether the program is conforming or not, the combination of daily margining and the restrictive definition of "acceptable collateral" should provide NAIC with sufficient comfort that additional admittance restrictions on collateral received would be duplicative.

   <u>NAIC Note 2:</u> NAIC staff believes there is inconsistent application of the current guidance as there is a disconnect in language between RBC and the Blanks on whether the collateral received or the lent asset is identified as a restricted asset. The blanks instructions in GI 25.04 and GI 25.05 identify the "Amount of Collateral." The lines in RBC identify "Loaned to Others." This inconsistency in terminology likely causes confusion on whether the amount reported should be the lent security or the collateral received in exchange. NAIC staff suggest clarifying terminology for consistency purposes, clarifying that the loaned asset retained on book should be the amount reported as restricted that flows through all schedules.

   <u>Interested parties' response</u>: *We agree that consistent terminology should be established between Blanks and RBC to clarify that the loaned security is identified as a restricted asset. We suggest that Blanks references to "Amount of Collateral" in GI 25.04 and GI 25.05 should be changed to "Loaned to Others," consistent with RBC.*

2. ***Lending Entity Can Sell / Repledge Collateral Received – (Also Applies to Cash Collateral)***

   <u>NAIC Note 3</u>: As the collateral can be sold/repledged, there is a question on the application of the admittance provisions in paragraphs 91-92 of SSAP No. 103. That guidance is focused on the fair value of the original collateral received in comparison to the fair value of the security lent. Once the collateral has been reinvested, the reporting entity is responsible for the reinvestment risk and the counterparty is not responsible for fair value changes of the reinvested security. Although a position could be taken that the fair value of the collateral originally received should continue to be compared to the fair value of the lent security to determine if more collateral needs to be provided, with the current financial statement reporting, this information is not captured to allow assessments once the collateral has been reinvested allowing regulators to verify the admittance provisions.

   <u>Interested parties' response</u>: *We do not believe that there is any ongoing need to compare the fair value of the original collateral received in comparison to the fair value of the security lent. One salient feature of securities lending and repurchase agreement transactions is that exchange of variation margin covers the differences that* *emerge over time between the original market value of the security lent and the original market value of the collateral received. The margining process maintains equality between the market value of the collateral received – plus or minus any variation margin – and the market value of the security lent. This market structure obviates the need for regulators to generate an admittance test on whether the fair value of original collateral received compares with the fair value of the security lent.*

Existing disclosures also provide regulators with sufficient visibility:

1. *Footnote 5.E.5 b: The reinvestment portfolio acquired with cash received consisted principally of high quality, liquid, publicly traded long term bonds, short term investments, cash equivalents, or held in cash. If the securities sold or the reinvestment portfolio become less liquid, the Company has the liquidity resources of most of its general account available to meet any potential cash demands when securities are returned to the Company.*

2. *Footnote 5.E.5 provides a maturity schedule for the collateral received.*

3. *Schedule DL provides full transparency and look-through to the assets in the reinvestment portfolio.*

In summary, existing financial statements disclose the risk and maturity summary in the footnotes and provide a full schedule for reinvested assets. The fair value security lent and collateral received continue to be matched via the margining process.

NAIC Note 4: With regards to the admittance calculation, there is also a question on application when the original collateral still covers 100% of the BACV of the loaned security but does not meet the requirement for 100% of the loaned security's fair value. As an example, if the loaned security at amortized cost has a BACV of $90, but had a fair value of $100 when loaned, the guidance in paragraph 91 requires collateral of $102 at the onset of the transaction. If the original collateral was to decrease in fair value to $98, it would no longer comply with the guidance in paragraph 91 and nonadmittance of the loaned security for $2 is expected under the guidance ($100 - $98). However, as the loaned security is reported at BACV of $90, the collateral still covers the full reported value of the loaned security. If the counterparty was to default, the reporting entity would eliminate the loaned security ($90) and the liability to return the collateral ($98) from the books and retain the collateral asset as their own. This transaction would result in an $8 gain for the reporting entity. If the loaned security had been nonadmitted by $2 prior to the default due to the FV decline of the collateral, there would have been a surplus hit of $2 for the nonadmittance. Upon the counterparty default, in addition to the $8 gain, there would have then been a surplus bump of $2 with the elimination of the nonadmitted asset. *(It is noted that if the fair value for the collateral asset had been retained, the reporting entity would have had a greater gain, but they are still fully covered based on how the loaned asset is reported.)* NAIC staff requests confirmation of the admittance guidance and its application from regulators, particularly when the fair value of the collateral continues to cover the BACV of the loaned security.

Interested parties' response: *We agree with NAIC staff's recommendation that admittance calculations should be based on the fair value of the original collateral and loaned security, as opposed to book value. As discussed above, the margining provisions of these contracts ensures that market values, rather than book values, remain aligned over the term of each transaction.*

NAIC Note 5: As the collateral received can be sold/repledged, there is a question on the application of the "conforming security lending" collateral requirements. From a broad review of financial statements, collateral reported on Schedule DL was identified as outside of the conforming parameters, but the security lending program was identified as "conforming" with the lower RBC charge. NAIC staff recommend clarification on the application of the "conforming" requirements. Particularly, if the intent is to permit a lower RBC charge due to the liquidity / stability of certain types of collateral, then it may be appropriate to require the collateral to always comply with the "conforming" provisions regardless of if it has been reinvested by the reporting entity.

Interested parties' response: *We believe that the narrow definition of "acceptable collateral," which is intended to be applied **only** to the original collateral received against the lent security, has been misapplied to the reinvestment portfolio. Acceptable asset classes in the reinvestment portfolio are defined in the portfolio's Investment Guidelines, not by the "acceptable collateral" criteria. Applying the narrow definition of "acceptable collateral" to the reinvestment portfolio could disrupt the economic viability of these programs.*

3. Securities Borrowing – Entity Borrows a Security and Provides Collateral in Exchange

NAIC Note 6: A security borrowing transaction is the flipside of the security lending transaction, with the reporting entity operating on the opposite side as borrower instead of lender. With this dynamic, it is presumed that the same restricted asset categories, and whether it is a conforming program, would be determinants in reporting the restricted asset and in the resulting RBC charge. NAIC staff requests confirmation of this assessment. (A security borrowing is the transaction, and it is accounted for as a "secured borrowing" – this terminology can be confusing when discussing the design.)

Interested parties' comments on Notes 6-8: *From the insurer's perspective, securities borrowing transactions have a very different structure than securities lending transactions. Insurers have not, and do not anticipate, requesting the establishment of "conforming securities borrowing" programs with changes to RBC.*

Note 7: The guidance for a security borrowing could result with restricted asset reporting for both the collateral provided (if not cash collateral) as well as for the reinvested borrowed securities that the reporting entity has sold. NAIC staff notes that this could be a double hit of restricted asset charges and recommends comments on paragraph 94 of SSAP No. 103 on the elimination of the restricted asset requirement for the assets received from the sale of the borrowed security. It is noted that the reporting entity would already have a liability recognized to return the borrowed security to the counterparty.

See interested parties' comments above.

Note 8: For security borrowing transactions, it is identified that both a receivable and payable from the counterparty could be recognized. A receivable - if cash was originally provided as collateral for the return of the cash - and a payable - if the reporting entity sold the borrowed security for the obligation to return the security. This dynamic could result in a netting of the transactions under SSAP No. 64. If netted, then the regulators would not be able to identify these aspects within the financial statements, but the provisions that permit netting under SSAP No. 64 (legal right to offset) may be present.

See interested parties' comments above.

Repurchase Agreements***

4. Repurchase Agreement – Reporting Entity Sells Security and Receives Cash / Collateral

NAIC Note 9: Due to the similarities in overall function between securities lending and repurchase agreements, NAIC staff supports consistent accounting, reporting and disclosures. NAIC staff recommends expanding Schedule DL to capture repurchase agreements, and a reassessment of the repurchase agreement disclosures to determine whether the level of detail should be retained.

Interested parties' response: *Extending Schedule DL to repurchase agreements makes sense only for any future "conforming repo" programs that have segregated assets in the reinvestment portfolio. In certain cases, repo can be used for secured borrowing whereby the cash is used for alternative purposes and not explicitly reinvested. Since industry is no longer requesting the establishment of conforming repo programs, we believe that Schedule DL should not be extended to repo programs at this time.*

<u>NAIC Note 10:</u> The same concept issues exist for the nonadmittance of reported securities under repo transactions than what exist under the securities lending transactions. Under current guidance, if the fair value of the sold security was to increase, more proceeds (collateral) is required or the sold security is subject to nonadmittance. If collateral was reinvested, the comparison would have to be based on the original collateral received and not the reinvested collateral. Also, there is the question on nonadmittance when the collateral received still covers the BACV of the sold security.

<u>Interested parties' response (similar to Note 3):</u> *One salient feature of securities lending and repurchase agreement transactions is that exchange of variation margin covers the differences that emerge over time between the original market value of the security lent and the original market value of the collateral received. The margining process therefore aligns the* ***market value*** *of the collateral received – plus or minus any variation margin – with the* ***market value*** *of the security lent. This market structure obviates the need for regulators separately to test the market value of original collateral received in comparison with the fair value of the security lent. Additionally, repo funding proceeds may be used for purposes outside of a reinvestment portfolio which results in a lack of asset base to test against for nonadmittance.*

5. <u>Reverse Repurchase Agreement – Reporting Entity Buys Security and Provides Cash / Collateral</u>

<u>NAIC Note 11</u>: The SSAP No. 103 guidance for reverse repo transactions does not have an explicit nonadmittance component if the % threshold is not met. Clarification on what should occur if the adequate collateral is not received / retained is recommended. Additionally, it has been noted that there is no current guidance that assesses admittance based on the quality/type of collateral received. Under the current guidance, residuals or low-quality assets could be received and there is no documentation of this type of collateral for certain sec lending and repo programs. Even if these programs would not qualify as conforming, there is a question on whether admittance restrictions should exist based on the collateral received from the counterparty.

<u>Interested parties' comments on Notes 11-13:</u> *In terms of general quality of collateral received in reverse repo transactions, we do not believe there should be regulatory restrictions on the type of collateral that is eligible to be received, other than it being a permitted investment for the reporting entity. The yield earned on the transaction and haircut charged reflects the quality of the collateral.*

Maintenance of the collateralization threshold is governed by the legal document (MRA or MSLA) between the counterparts. While collateralization threshold is one of the criteria for a conforming securities lending program, there is no intention to establish conforming reverse repo programs. We believe that regulators should derive comfort on collateralization thresholds from the existing legal agreements between counterparts.

<u>NAIC Note 12:</u> SAP does not currently capture details on securities acquired upon the sale of the asset acquired under a reverse repo. The note disclosures only detail aggregate amounts.

See interested parties' comments on Notes 11-13 above.

<u>NAIC Note 13:</u> The guidance does not explicitly indicate that the short-term receivable recorded for reverse repurchase transactions should be coded as a restricted asset and taken to GI 26.23. However, as the restricted asset note detailed in SSAP No. 1 and GI 26.23 both capture "assets subject to reverse repurchase agreements," this reference can only refer to the short-term receivable as there is no other asset reported on the books from the transaction. Assessment may be warranted on identification of restricted assets on reverse repurchase transactions.

<u>Interested parties' comments:</u> *Interested parties do not believe that there is a cogent rationale for restricting the short-term lending receivable. Other short-term lending receivables - CDs, CP and Short-Term ABS – are not considered "restricted." Nothing in these short-term loans implies lack of exclusive control or encumbrances or third-party interests prohibiting the insurer from using these short-term loans (or the collateral obtained therefrom at 102% FMV or greater) to satisfy policyholder obligations.*

Recommendation:

NAIC staff greatly appreciate the responses from interested parties, as well as the interim discussions held with industry and regulators on repurchase and securities lending transactions. From the information received, it seems that certain aspects of guidance in SSAP No. 103 may not be relevant and/or may be inconsistently applied. Those discussions have identified that the structure / format of SSAP No. 103 (which mirrored an approach from FASB that was subsequently revised) is not easy to follow or to find information, particularly as the guidance for "secured borrowing" under GAAP (adopted in SSAP No. 103) is different from the statutory accounting method for securities lending and repo secured borrowing transactions when the secured party has the ability to sell or repledge collateral. Lastly, there have been questions raised on existing guidance restrictions (e.g., limiting admittance to short-term repos), the application of the "conforming" securities lending concept for reduced RBC, as well as the use of the detailed repo disclosures.

NAIC staff recommend that the Working Group direct staff to proceed with developing and presenting revisions to clarify the statutory accounting guidance, potentially with consideration of separating securities lending / repurchase guidance from SSAP No. 103 into a separate statement. Although the list of elements to review is lengthy, NAIC staff believes most of the items will only result in clarifications, with the potential for enhanced / consolidated disclosures.

Specific elements to review include, but are not limited to:

- **Review of the "conforming" provisions for securities lending transactions, including mechanisms in place to confirm compliance as well as verify regulator intent as to application**. For example, the industry position is that the conforming collateral provisions are only required at the onset of the transaction, and the classification of a conforming program should not be impacted if the reporting entity reinvests the received collateral into non-eligible assets. NAIC staff question this position, as the reduced RBC is contingent on the collateral being in specific categories or with an NAIC 1 designation. There is nothing in the current instruction that implies the threshold is only required at the beginning of the program, and the guidance refers to "collateral held" which implies that it would encompass currently-held collateral. NAIC staff notes that the conforming RBC guidance predates the current statutory guidance, which requires on-balance sheet reporting for collateral that can be sold or repledged, therefore a current review of this guidance is likely appropriate. Regardless of the re-invested collateral decision, further disclosure or documentation may be necessary to allow for regulator review and confirmation of the conforming status. (For this issue, the conforming guidance allows a lower RBC charge, so the findings / recommendations on this topic would be referred to the RBC groups.)

- **Review of the current admittance provisions based on ongoing comparisons to fair value.** Pursuant to comments received, industry believes the margining process (to the collateral original received) obviates any need for regulators to test the market value of collateral to the fair value of securities lent. There is a question as to whether nonadmittance should occur if the original collateral fair value covers the BACV of the loaned security, but not the loaned security's fair value (as the loaned security would be on the books at BACV). Although the comparison (and margining) should be completed at fair value, if there is a shortfall, nonadmittance when the reporting entity is still fully covered for the reported BACV results in anomalies in the financial statement presentation.

- **Review with the potential for enhanced guidance and/or disclosure for repo transactions that result in the received collateral being used as working capital (or other external uses).** The discussion with industry identified that collateral received from repo transactions does not need to be retained, even in the form of reinvested collateral, but can be used by the reporting entity for other business needs such as paying claims or for other obligations. NAIC staff does not believe there are disclosures or information available to the regulators to identify the extent to which collateral received in a repo transaction is no longer retained by the reporting entity where the return of the collateral to the counterparty will require use of other assets. (Industry identified that this is a dynamic for repo agreements only and not securities lending.)

- **Review of the existing disclosures for both repurchase and securities lending transactions with a goal to simplify and consolidate to the extent possible.** NAIC staff supports the use of Schedule DL to detail all held collateral for both securities lending and repurchase transactions. Although industry has not supported that position, their rationale is because the collateral received from repurchase transactions may not be retained or reinvested internally. Although this may be true, NAIC staff does not believe this hinders the use of the schedule for the collateral that is held (original or reinvested) with additional information on the repo collateral that has been used as working capital and not retained by the reporting entity.

- **Review of the restricted asset coding for sec lending and repo transactions as well as a review of the current short-term admittance provisions for repurchase transactions.** NAIC staff notes that the approach to report restricted assets is not clear and likely inconsistently applied. Further, although discussed and reaffirmed in 2015, there have been recent questions on the requirement for repo agreements to be short-term for admittance under SAP. In addition to questions on whether there should be a short-term restriction, inquiries have been received about the mechanics of nonadmittance based on which side of the transaction the insurers is on (cash taker or cash provider) and what should be nonadmitted in the financial statements. NAIC staff believe it would be beneficial to review the entries for these transactions to ensure a full understanding of the impact of nonadmittance and to establish consistency with recognition. NAIC staff suggest that the discussion also consider whether an insurer retains repo collateral (whether original or reinvested) or whether it is used for working capital. For example, an insurer with a long-term repo agreement with retained collateral may be considered differently by the regulators from a 5-year repo agreement where the insurer has used the collateral received and will rely on other assets to settle the transaction in 5-years to get a return of their asset.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-15 (Julie)	**ALM Derivatives**	**12 – Agenda Item**	**Comments Received**	**ACLI – 2 (Attachment 14)**

<u>*Summary:*</u>
On December 17, 2024, the Working Group received comments from the August 2024 exposure. Due to the extent of comments, and the complexity of the topic, the Working Group deferred directing staff to move forward with the development of new guidance for the deferral of realized gains/losses generated from non-accounting effective hedges. It was noted that this discussion would likely resume at the Spring National Meeting, along with a review of the data reported for IMR derivatives as that information will be data-captured for the year-end 2024 financial statements. This item was not formally re-exposed.

The information presented for the December 17 discussion has been duplicated within this agenda along with initial data results for derivatives captured in IMR as of year-end 2024. Note: Only a small number of companies are reporting a net negative IMR that includes derivative realized losses. This is because only companies that had a historical practice of deferring derivative gains in IMR are permitted under INT 23-01 to defer derivative losses and include those losses in an admitted net negative IMR balance. NAIC staff has heard that more companies want the ability to defer derivative losses, and admit those as assets, therefore the number of companies and impact of the derivative realized losses is expected to increase from what is shown as of year-end 2024.

<u>Key 2024 F/S Data – IMR Derivatives – General Account:</u>

- 26 Companies have Unamortized Derivative Gains and Losses Remaining in the General Account IMR:
    - Total Remaining Gains: $10,263,498,906
    - Total Remaining Losses: $15,225,131,590*

From this detail, there is net $4,961,632,684 of non-accounting effective derivative <u>losses</u> in the IMR reserve. With a total net negative general account IMR balance across all reporting entities of $14,079,297,653, the net unamortized derivative losses make up <u>35%</u> of the entire net negative IMR balance.

Of the 26 companies with unamortized general account derivative gains and losses, 1 company reported remaining gains without any remaining losses, and 5 companies reported losses without any remaining gains. The other companies reported both unamortized losses and gains.

NAIC staff noted that for 8 companies, the net derivative loss balance made up over 70% of their entire net negative IMR, including 4 companies with over 100%.

The full reconciliation of non-accounting effective derivative gains and losses in the GA IMR is as follows:

	Derivative Gains	Derivative Losses
Beginning Balance	10,016,926,590	(13,870,860,354)
Added in Current Year	788,339,533	(1,969,919,705)
Amortized Current Year	(541,767,217)	614,870,143
Remaining in IMR	10,263,498,906	(15,225,909,916)*

**NAIC staff knows that the total for derivative losses in the reconciliation does not agree to the total reported losses. This is because one company did not properly compute the total. That company's reported total is in the initial total, and NAIC staff adjusted the reconciliation so it would properly sum. Also, companies reported a mix of positive/negative numbers that were adjusted to make sure the summation was consistent across all companies.*

On August 13, 2024, the Working Group moved this item to the active listing, classified as a new SAP concept, and exposed this agenda item with a request for feedback on the items noted within the agenda item, which included an overall inquiry on the development of new guidance for the deferral of realized gains/losses for non-accounting effective hedges captured in *SSAP No. 86—Derivatives*. Discussion items captured in the agenda item included the following:

1) Do Working Group members support the development of statutory accounting guidance that would defer derivative gains/losses for structures that hedge interest rate risk with amortization over time into income? (These derivative programs would not qualify as accounting effective under SSAP No. 86 and are not captured within the specific variable annuity guarantee guidance in SSAP No. 108.)

2) If further development / consideration of guidance is supported, the following items are noted for discussion:

    a. Determination of effectiveness that permits the derivative program to qualify for the special accounting treatment.

    b. Discussion of whether net deferred losses (reported as assets) would be admissible, and if so, any admittance limitations.

c. Macro-limits on admittable net deferred losses (reported as assets) and other "soft" assets. (For example, capturing IMR and derivative deferred net losses, and then perhaps considering other soft assets, such as DTAs, EDP equipment and software, goodwill, etc.)

d. Timeframes over which deferred items are amortized into income.

e. Extent of application across the industry. (NAIC staff notes that SSAP No. 108 is only applied by 9 entities, and from a review of the derivative disclosures for INT 23-01, only 14 entities captured derivative gains/losses in the IMR balance.)

<u>*ACLI Comments:*</u>
We support the development of new statutory accounting guidance for interest-rate hedging derivatives that do not qualify for hedge accounting under *SSAP No. 86—Derivatives,* but that are used for asset-liability management (ALM), also referred to as "ALM Hedges". ACLI is very appreciative of the on-going dialogue with SAPWG and the IMR Ad Hoc Working Group and stands ready to continue working with the NAIC on this initiative.

Companies manage ALM programs to mitigate reinvestment, guarantee, and disintermediation risks, and to manage asset portfolios within limited ranges around a liability target duration. The new statutory accounting guidance is intended for derivative transactions that alter the interest rate characteristics of assets/liabilities under these types of risk mitigation programs. More specifically, "macro-hedging" ALM programs hedge risks that are often off-balance sheet risks given the "amortized cost" nature of statutory accounting, and therefore hedge accounting frameworks do not address this type of hedging construct. As discussed in our white paper "Derivatives and Hedging with Life Insurance" (included as Appendix I), this is because the duration and convexity of assets and liabilities may differ. When interest rates change, asset and liability durations may change by different amounts, making it nearly impossible to maintain the tight effectiveness assessment corridor requirements as the measurement criteria do not include metrics commonly used in these programs (e.g., duration). As a result, economically effective "macro-hedges" are generally considered hedges and carried at fair value, which misstates insurer solvency by causing surplus volatility or worse, can disincentivize prudent risk management. As further discussed in Appendix I, there is a critical need for developing appropriate accounting guidance.

Within the exposure, NAIC staff has identified several items for further discussion:

2) If further development / consideration of guidance is supported, the following items are noted for discussion:

a. Determination of effectiveness that permits the derivative program to qualify for the special accounting treatment.
b. Discussion of whether net deferred losses (reported as assets) would be admissible, and if so, any admittance limitations.
c. Macro-limits on admittable net deferred losses (reported as assets) and other "soft" assets. (For example, capturing IMR and derivative deferred net losses, and then perhaps considering other soft assets, such as DTAs, EDP equipment and software, goodwill, etc.)
d. Timeframes over which deferred items are amortized into income.
e. Extent of application across the industry. (NAIC staff notes that SSAP No. 108 is only applied by 9 entities, and from a review of the derivative disclosures for INT 23-01, only 14 entities captured derivative gains/losses in the IMR balance.)

The ACLI previously provided a detailed presentation entitled "ACLI Derivative IMR Solution Proposal" ("ACLI Solution," included as Appendix II) to the IMR Ad Hoc Working Group. Discussions of the ACLI solution at the NAIC Ad Hoc IMR WG were the impetus for this exposure. The solution addresses many of the exposure's components and ACLI would appreciate the opportunity to present to the full SAPWG membership and any additional interested regulators.

Additionally, the ACLI would like to provide specific comments regarding the admittance limitations identified in discussion points 2b and 2c. Although one of the methods within the ACLI Solution includes accounting which does not utilize the IMR, discussion of accounting treatment revisions for ALM Hedging arose within the context of derivatives and IMR. Therefore, our comments start with the "Definition of IMR" developed by the IMR Ad Hoc Working Group:

> NAIC Staff Note: Although discussed at the ad hoc group, the following definition has not been exposed or adopted by the SAPWG Discussion of the IMR definition is captured in agenda item Ref #2025-03.
>
> *IMR is a valuation adjustment to maintain consistency between insurance liabilities (the assumptions for which are often unchanged from origin) and the assets needed to support them (where the assumptions can essentially be revisited any time there are fixed income realizations).*
>
> *IMR defers and amortizes the recognition of non-economic gains or losses where investment activity, whether through fixed income investment sales or fixed income derivative hedging transactions, essentially unlock unrealized gains/losses for either assets or liabilities. IMR is not intended to defer economic gains and losses related to asset sales compelled by liquidity pressures that fund significant cash outflows (e.g., such as excess withdrawals and collateral calls).*
>
> *Specifically, the IMR valuation adjustment more appropriately reflects the impact to statutory surplus from fluctuations in interest rates and therefore provides a more accurate representation of solvency under the NAIC's statutory framework which often includes amortized cost valuation of fixed income investments and liability valuations with fixed assumptions in accordance with the Accounting Practices and Procedures and Valuation Manual.*

This definition is part of a broader document (see attached Appendix III) that provides foundational principles for the NAIC's statutory accounting framework.

As the document and definition of IMR states: fixed income investment assumptions can be more easily revised, that is "unlocked," when the investments are sold/purchased. Statutory reserve liability assumptions typically are not revised. Therefore, to avoid situations in which transitory interest rate related realized gains/losses caused inaccurate solvency reflections (which could disguise an insurer's true ability to pay claims), the IMR valuation adjustment was developed. Appendix III provides detailed examples in which this could occur. The IMR also remains a vital element of the statutory accounting framework and was incorporated in the methodology within other evolutions such as Principle-Based Reserving (PBR) and Asset Adequacy Testing (AAT).

The IMR is not an intangible asset, it is a valuation adjustment to reflect the company's true solvency position under statutory accounting. Therefore, equating negative IMR to an asset (tangible or intangible) with claims paying ability, is not logical or appropriate. Following this, imposing any limit on admittance would misconstrue an insurer's true solvency and would equate to a limit on unrealized losses on fixed income instruments more broadly, such as bonds where the unrealized losses are embedded within their amortized cost valuation; contrary to the purpose of the IMR and consistent valuation of assets and liabilities.

ACLI understands regulators may wish to separate ALM derivatives from IMR (both for recording unrealized during their lives and for recording any applicable realized gains/losses). However, ACLI emphasizes, in light of the previous, that:

1. Fixed income ALM hedges can be used to alter the interest rate characteristics of assets and/or liabilities, and therefore are another method of "unlocking" the fixed assumptions. Whether ALM hedge realized gains/losses are included in the IMR or a separate valuation adjustment, they will be theoretically aligned and maintain the intent of the IMR (see the definition of IMR discussed above); and

2. Any fixed income hedge unrealized gains/losses are not intangible assets. They represent the offset to the valuation of the derivative itself (the contract asset/liability) and equate to the value needed to close (settle) the derivative contract with the counterparty.

Any limits (or potential subsequent non-admittance) on these components would in fact equate to a limit on ALM hedging programs themselves, disincentivizing insurers from engaging in vital, prudent, fixed income hedging strategies. As discussed in Appendix I and II, ALM hedges are used to mitigate reinvestment, guarantee, and disintermediation risks, as well as managing asset portfolios within limited ranges around a liability target duration, all of which are shared goals between regulators and insurers.

Further limiting hedging programs through statutory accounting guidance creates significant regulatory redundancies given other existing, effective regulatory protections:

1. From a state perspective, insurer hedging programs are limited under individual state laws and insurer DUPs, such as the type(s) of derivative programs and/or derivative contract(s). Insurers are also prohibited from speculative derivatives.

2. From a federal perspective, most standard US agreements with derivative counterparties also require derivative trades to be collateralized through margin requirements.[5] Collateral agreements ensure each counterparty (both the insurer and the institution on the other side of the derivative) are able to financially fulfill the derivative contract (ie., pay the amount owed for the derivative's fair value) and/or reduce default risks incorporated in the contract for either party. In this case, any limit on the "valuation offset" is overly punitive when the insurer is legally required to post collateral to the counterparty.

Therefore, an aggregate cap for IMR and/or ALM derivatives is not appropriate, and it is not logical to call them intangible assets that cannot be used to pay claims. Rather, "negative" or "asset" valuation adjustments are simply explicitly shown on the balance sheet, whereas other unrealized losses are embedded in their amortized cost carrying values (i.e., bonds), both of which are required for consistent valuation of assets and liabilities so surplus properly reflects an insurers claims paying ability.

Turning to the macro cap on "soft assets," it is difficult to group these items as one category given their unique characteristics and purpose within the statutory accounting framework. Prudent business and risk decisions should not be disincentivized by the presence of completely unrelated economically viable assets or valuation adjustments on a company's balance sheet. To view these "soft assets" or intangibles in isolation from their broader purpose is also not appropriate. The NAIC's framework is an "amortized cost framework" with appropriate embedded conservatism, not a liquidation basis of accounting, for both assets and liabilities.

Deferred Tax Assets (DTAs) have appropriate conservatism by limiting reversals to 3-years as well as limiting carryback and carryforward potential. Further, DTAs represent real economic value to an insurer, and in fact does help pay claims by way of realizing tax benefits (i.e., reduction in tax payments).

Goodwill generally represents the difference between the cost of acquiring an entity and the reporting entity's share of the book value of the acquired entity. Within the acquisition, components of Goodwill could represent things of value such as costs acquiring a fully amortized building or an asset manager. Asset managers generally have limited balance sheet assets where its value is attributable to asset manager fees and directly proportional to assets under management (i.e., a not balance sheet metric).

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[5] Mandated by the Dodd Frank Act and related SEC and CFTC regulatory requirements.

Unlike US GAAP or IFRS, where Goodwill is not amortized because it is considered to have an indefinite useful life, until it is determined to be impaired, under statutory accounting Goodwill is conservatively amortized over a period not to exceed 10-years, as well as being subject to impairment testing.

DTAs and Goodwill also have percentage of surplus limitations, which serves as another layer of conservativism.

The common theme among all of these valuation adjustments and/or assets is that they either adjust values for consistent valuation of assets and liabilities to provide an accurate picture of claims paying ability or represent real economic value that help insurers pay claims. They are also all unique, with distinct purpose in the statutory accounting framework, so an aggregate limiting cap across other completely unrelated economically viable assets or valuation adjustments on a company's balance sheet is inappropriate.

Lastly, ACLI proposes a few brief comments on exposure item 2e regarding the extent of application in industry. From conversations with our members, use of SSAP No. 108 is limited due to its narrow scope (variable annuity guarantees only) and the relative rigor of guardrails that must be satisfied to implement (resource intensive, so the benefit must be substantial to justify the effort). However, we understand that the population of insurers who engage in macro-hedging programs is significantly larger and using the Negative IMR disclosures to gauge the population is not truly representative for several reasons, such as:

1. The interim solution did not allow insurers to engage in new hedging programs or to include any hedging programs that did not previously include realized gains within the IMR. There could be insurers who have had to adjust or start programs as the interest rate environment evolved, which may have disqualified them from using this guidance and therefore including their programs in the disclosure.

2. There is diversity in practice in insurer's interpretation of SSAP No. 86; not all insurers included gains/losses from interest rate related macro-hedging programs in the IMR, which also would have precluded them from using the interim guidance and included balances in the disclosure. Ensuring clear ALM hedging guidance would reduce diversity in practice and would likely lead to more insurers clearly identifying these programs in any future required disclosures.

Recommendation:
NAIC staff highlights that this exposure was focused on soliciting information from regulators on whether new statutory accounting guidance should be established that would allow the deferral of gains/losses for derivative transactions that do not qualify as accounting-effective hedges under *SSAP No. 86—Derivatives.* The ACLI has indicated support for the development of this guidance.

If the Working Group supports proceeding with this approach, NAIC staff recommend directions to proceed with developing statutory accounting guidance, working closely with Working Group members and ACLI representatives with development. NAIC staff anticipates that the guidance may be complex but will work to present updates and drafts to the Working Group for consideration if so directed. It is anticipated that to the extent feasible, NAIC staff may leverage guidance and the approach in *SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees*. **It is anticipated that final guidance will require sufficient guardrails on the types of hedging strategies, proving effectiveness and mechanisms for the regulators, all which will be components of the discussion in accounting guidance development if directed by the Working Group.**

NAIC staff notes there are several comments in the ACLI's letter indicating support for reporting realized losses as admitted assets, and comments opposing any limit as to the admittance of these realized losses (or an aggregate admittance limit on "soft assets"), that makes it appear that the detailed questions / inquiries are not necessary before proceeding with these allowances under statutory accounting. NAIC staff does not believe it is a given that these items should qualify as admitted assets or have unlimited admissibility, and believes distinct discussions by the Working Group are warranted for the following reasons:

- **Prior to the issuance of INT 23-01, net negative IMR was reported as a nonadmitted asset**. The INT guidance permitting admittance up to 10% of adjusted capital and surplus is a new, limited-time permission. It is up to the Working Group whether net negative IMR (which reflects realized losses) should be permitted as an admitted asset after the INT expiration, and if there should be a limit as to admittance. Prior to the August 2023 adoption of the INT, insurers that elected to engage in these derivative transactions with realized losses were unable to admit these losses. As such, it should not be viewed as a given under statutory accounting / derivative risk management to allow the admittance of these derivative losses. Additionally, some have acknowledged that IMR can be a managed item, with companies having the ability to select assets to sale in accordance with how it would impact the IMR balance (liability or asset) and overall financial statements. With the 2023 admittance of net negative IMR up to 10% adjusted capital and surplus, financial data show that companies are trending towards a net loss (asset) position up to the admitted asset parameters. This same dynamic could occur if derivative losses are permitted to be deferred within IMR and recognized as admitted assets.

- **Prior to the issuance of INT 23-01, state insurance regulators were unaware that some insurance companies were interpreting the annual statement instruction reference of "hedging" to permit capitalization of realized losses for non-accounting effective derivatives through IMR**. The guidance in *SSAP No. 86—Derivatives* is specific that such treatment was only permitted for accounting-effective hedges, as the offset between the hedged item and hedging instrument basically eliminated the impact to IMR. Reporting entities pointed to a generic reference in the A/S instructions as support for the inclusion of "non-accounting effective" hedges, but that was not the original intent of the adopted statutory accounting guidance. With the process that some companies currently follow, realized losses from non-accounting effective hedges are being repeatedly recognized (3-month derivatives) and the amortization timeframe companies support stretches over a significant period of time (years). With this approach, as long as the derivative arrangements result in realized losses, the amount of realized losses permitted to be presented as admitted assets (if further allowed) will just continue to increase as the amortization amount (over the longer timeframe) is much less than what is currently being recognized. As the realized loss balance builds, there would have to be derivative arrangements that result in substantial realized gains to reduce the balance timelier.

- **Deferring and amortizing gains and losses from derivative transactions is not permitted under U.S. GAAP. Under U.S. GAAP, all derivatives are reported at fair value, and all gains/losses are recognized immediately. It is only the location of the gain/loss, either directly through earnings or through other comprehensive income, that varies under U.S. GAAP based on whether the derivative is designated as hedging.** Under U.S. GAAP, derivative accounting is essentially an income-statement matching exercise where the gain/loss from the hedging instrument offsets the gain/loss for the hedged item. If the transaction does not qualify as hedged, the gain/loss is recognized currently in earnings**. In FAS 133, the FASB discussed decisions to require all derivatives to be reported at fair value, as well as their conclusion that only items that are assets or liabilities should be reported as such in the financials. Pursuant to this discussion (paragraph 229 of FAS 133), the FASB clarifies that gains and losses from derivative transactions are not separate assets or liabilities because they have none of the essential characteristics of assets or liabilities:**

> 229. Only items that are assets or liabilities should be reported as such in financial statements. Derivatives are assets or liabilities, and the Board decided that they should be reported in financial statements (fundamental decision 1) and measured at fair value (fundamental decision 2). If derivatives are measured at fair value, the losses or gains that result from changes in their fair values must be reported in the financial statements**. However, those losses or gains are not separate assets or liabilities because they have none of the essential characteristics of assets or liabilities as described in paragraph 218.** <u>**The act of designating a derivative as a hedging instrument does not convert a subsequent loss or gain into an asset or a liability. A loss is not an asset because no future economic benefit is associated with it. The loss cannot be exchanged for**</u>

<u>cash, a financial asset, or a nonfinancial asset used to produce something of value, or used to settle liabilities. Similarly, a gain is not a liability because no obligation exists to sacrifice assets in the future. Consequently, the Board concluded that losses or gains on derivatives should not be reported as assets or liabilities in a statement of financial position</u>.

- **Although industry compares unrecognized unrealized losses for bonds held at amortized cost to realized losses from the sale of bonds, some may disagree with this comparison**. While bonds held at amortized cost may have unrecognized fair value changes over time, when the bond matures, the insurer will receive the principal return. The unrecognized fair value fluctuations, unless there is a credit event, has no impact on what the insurer will receive at maturity and can use for policyholders. A realized loss from the sale of a bond is a definite action that monetizes a fair value change. Recovering that loss is contingent on actions to reinvest the sale proceeds to obtain a higher yield. If reinvestment does not occur, an action that is difficult to verify given the fungibility of cash flows, that realized loss will not be recovered. Therefore, while realized and unrealized losses can obtain equivalent economic results, there is much higher execution and verification risk associated with realized losses that requires significant guardrails to prevent the masking of economic losses.

  The ultimate objective of solvency regulation is to ensure that the policyholder, contract holder and other legal obligations are met when they come due and that companies maintain capital and surplus at all times and in such forms as required by statute to provide a margin of safety. Pursuant to the SAP recognition concept pursuant to paragraph 36 of the Preamble to the *Accounting Practices and Procedures Manual*, "the ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third-party interests should not be recognized on the balance sheet but rather should be charged against surplus when acquired or when availability otherwise becomes questionable." The Preamble here recognizes both current and future obligations as being relevant to the economic value of assets, hence supporting carrying bonds at amortized cost even when it exceeds their current marketable value. **A realized loss does not reflect an asset that is available for policyholder claims.** (Consistent with the U.S. FASB position, a realized loss does not qualify as an asset under SSAP No. 4 as there is no future benefit generated from the loss.) While a loss on an economic hedge does, in theory, represent a future value that is expected to be generated by incremental return on the invested assets, it does not have a direct, marketable value in accordance with the Preamble. **Although consideration can be given to permit admitted asset classification for realized derivative losses, such consideration would be a specific provision by the Working Group and is not consistent with the statutory accounting definition of an admitted asset (or as an asset under U.S. GAAP)**. Some have noted that, although this is being considered as a potential admitted asset" it should be thought of as an adjustment to the policy reserve to partially "unlock" the valuation rate. Ultimately, the prevalence of "soft" assets (and realized losses permitted as admitted assets) should be monitored and managed by regulators as they do not reflect the types of assets that can be directly utilized for policyholder claims. Establishing an aggregate admittance limit or getting aggregate disclosures on these items collectively, is within the purview of state insurance regulators and the oversight of insurer solvency.

- **Industry has argued that implementing an aggregate cap on "soft assets" would be inappropriate. However, specific regulatory caps and limits already exist for certain types of "soft assets," and it is consistent with statutory principles to apply an aggregate cap on the accumulation of such assets within the same framework.** Industry notes that the common theme for "soft assets" is that they either adjust values for consistent valuation of assets and liabilities to provide an accurate picture of claims paying ability or represent real economic value that help insurers pay claims. While NAIC staff does not necessarily disagree with this perspective, the economic value of these assets and valuation adjustments do not directly correspond to funds available for paying policyholder claims, and neither are they readily marketable as discussed in the prior paragraph. Furthermore, concentrations of such assets pose an increased solvency risk. However, the statutory caps currently in place take a narrow, individual view of the risks associated with these soft assets. If an insurer were to accumulate multiple types of soft assets and admit amounts up to the individual caps for each, the combined admitted value could significantly impact admitted surplus. While these financial instruments are distinct, they all represent abstractions of economic value in the context of the preamble recognition concept cited above. Implementing an aggregate cap to guard against the excessive accumulation of various kinds of "soft assets" would align with existing statutory principles and fall within the scope of regulatory oversight.

The comment letters are included in:

- **Attachment 13**: Comments Ref #2023-28 through Ref #2024-01 (48 pages)
- **Attachment 14**: 2024-15 ALM Derivatives Comments Only (52 pages)

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2025/03-24-25 Spring National Meeting/Hearing/00 - 03-24-25 - SAPWG Hearing Agenda.docx

Attachment One
Accounting Practices and Procedures (E) Task Force
11/18/24

Draft: 11/24/24

Statutory Accounting Principles (E) Working Group
Denver, Colorado
November 17, 2024

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met in Denver, CO, Nov. 17, 2024. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Kim Hudson (CA); William Arfanis and Michael Estabrook (CT); Rylynn Brown and Tom Hudson (DE); Cindy Andersen (IL); Bill Werner (LA); Judy Weaver and Steve Mayhew (MI); Doug Bartlett (NH); Bob Kasinow (NY); Diana Sherman (PA); Jamie Walker (TX); Doug Stolte and Jennifer Blizzard (VA); and Amy Malm (WI).

1. Adopted its Oct. 4, Sept. 12, and Summer National Meeting Minutes

Bruggeman said the Working Group met Oct. 4 and Sept. 12. On Oct. 4, the Working Group conducted an e-vote to expose an updated bond definition question and answer implementation guide (Q&A) with a comment period ending Oct. 28. The primary revisions to the Q&A were updates to include three additional topics addressing commercial mortgage-backed securities (CMBS) interest-only (IO) strips; commercial mortgage loan (CML) single asset, single borrower (SASB) investments; and hybrids. On Sept. 12, the Working Group conducted an e-vote to adopt revisions to the bond guidance adopted in *Statement of Statutory Account Principles* (SSAP) *No. 26—Bonds* (effective Jan. 1, 2025) and *Issue Paper No. 169—Principles-Based Bond Definition* to revise guidance that restricted issuer credit obligation classification to debt securities issued by U.S. Securities and Exchange Commission (SEC)-registered funds.

Additionally, the Working Group met Nov. 12, Oct. 15, and Oct. 9 in regulator-to-regulator session, pursuant to paragraph 3 (specific companies, entities, or individuals) and paragraph 6 (consultations with NAIC staff related to NAIC technical guidance) of the NAIC Policy Statement on Open Meetings, to discuss the Fall National Meeting agendas and Summer National Meeting exposures. No action was taken in those meetings.

Walker made a motion, seconded by Malm, to adopt the Working Group's Oct. 4 (Attachment One-A), Sept. 12 (Attachment One-B), and Summer National Meeting (*see NAIC Proceedings – Summer 2024, Accounting Practices and Procedures (E) Task Force, Attachment One*) minutes. The motion passed unanimously.

2. Reviewed Comments on Non-Contested Positions

The Working Group reviewed comments on non-contested positions (Attachment One-C).

A. Ref #2024-11

Bruggeman directed the Working Group to agenda item *Ref #2024-11: Accounting Standards Update (ASU) 2023-09, Improvements to Income Tax Disclosures* (Attachment One-D). William Oden (NAIC) stated that ASU 2023-09 was issued by the Financial Accounting Standards Board (FASB) to enhance the transparency and decision usefulness of income tax disclosures. This agenda item was developed to consider whether the ASU should be incorporated into the statutory accounting framework. Oden stated that interested parties had no comments on this item and that NAIC staff recommend the Working Group adopt revisions to reject ASU 2023-09 in *SSAP No. 101—Income Taxes* and adopt revisions to SSAP No. 101 to remove the disclosure detailed in paragraph 23b as it was determined to be no longer relevant to either U.S. generally accepted accounting principles (U.S. GAAP) or statutory accounting principles (SAPs).

B. Ref #2024-17

Bruggeman directed the Working Group to agenda item *2024-17: Clearly Defined Hedging Strategy* (Attachment One-E). Oden stated that, on Aug. 13, the Working Group exposed revisions to *SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees* to update the definition of a clearly defined hedging strategy (CDHS) to mirror the revised guidance to *Valuation Manual (VM)-01, Definitions for Terms in Requirements* (VM-01) adopted by the Life Actuarial (A) Task Force in 2022 and effective in 2023. Oden stated that interested parties have no comments and that NAIC staff recommend that the Working Group adopt the exposed revisions.

C. Ref #2024-18

Bruggeman directed the Working Group to agenda item *2024-18: Clarifications to NMTC Project* (Attachment One-F). Oden stated that on Aug. 13, the Working Group exposed revisions to clarify the accounting guidance in *SSAP No. 93—Investments in Tax Credit Structures* for recognizing allocated and purchased tax credits in relation to the journal entry example and *SSAP No. 94—State and Federal Tax Credits* to fix an inconsistency between the journal entry examples and the accounting guidance and updates a sentence in *SSAP No. 48—Joint* Ventures*, Partnerships, and Limited Liability Companies* which was inadvertently not updated for the New Markets Tax Credit Program (NMTC Program). Oden noted that interested parties had no comments on this agenda item. Oden stated that NAIC staff recommend that the Working Group adopt the exposed revisions, effective Jan. 1, 2025, to SSAP No. 93, SSAP No. 94, and SSAP No. 48. The effective date of Jan. 1, 2025, is necessary to mirror the effective date of the guidance adopted with 2022-14.

D. Ref #2024-19

Bruggeman directed the Working Group to agenda item *2024-19: ASU 2024-02, Codification Improvements—Amendments to Remove References to the Concepts Statements* (Attachment One-G). Oden stated that this agenda item was drafted in response to *ASU 2024-02, Codification Improvements—Amendments to Remove References to the Concepts Statements*, which removes references to FASB concept statements from the accounting standards codification (ASC) with the intent of simplifying the codification and drawing a clear distinction between authoritative and nonauthoritative literature. Oden noted interested parties had no comments on this agenda item and recommended that the Working Group adopt the exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject ASU 2024-02 as not applicable to statutory accounting.

Kim Hudson made a motion, seconded by Sherman, to adopt the SAP concepts and clarifications in the described non-contested positions. The motion passed unanimously.

3. Reviewed Comments on Exposed Items

The Working Group reviewed comments received on previously exposed items (Attachment One-C).

A. <u>Agenda Item 2019-21</u>

Bruggeman directed the Working Group to agenda item *2019-21: Principles-Based Bond Definition Implementation Questions and Answers*. Julie Gann (NAIC) stated that the Working Group exposed the draft Q&A for a comment period ending Sept. 27 to address issues of implementing the principles-based bond project that has been brought from industry to the bond/American Institute of Certified Public Accountants (AICPA) small group. The Q&A interprets how the SAP guidance should be applied to specific investment structures or investment characteristics.

Gann stated that, on Oct. 4, the Working Group exposed via e-vote an updated Q&A to incorporate three additional topics, including CMBS IO strips, CML SASB investments, and hybrids. Gann stated that three comment letters were received, including two from interested parties and one from Spectrum Asset Management. She stated that, with the Sept. 27 exposure, it was identified that interested parties had not provided comments on any of the prior bond implementation Q&As in the first exposure but had provided comments on the classification of issue papers in the statutory hierarchy. Gann stated that the updated Q&A included minor edits to paragraph 9.2 to eliminate this aspect from the Q&A without changing the intent of the guidance. She also noted that the Interpretation included the correct tracked edits, but the hearing agenda included a summary of the edits. The hearing agenda has a typo that references an edit in paragraph 3.3c which should note paragraph 3.1e.

Gann stated that no revisions were recommended from Spectrum Asset Management's comments, which said risk-based capital (RBC) impacts could occur for capital notes that are going to be classified in the scope of *SSAP No. 41—Surplus Notes.*

Gann recommended that the Working Group consider adoption of the exposed Q&A in a new *Interpretation (INT) 24-01: Principles-Based Bond Definition Implementation Questions and Answers* to *SSAP No. 21—Other Admitted Assets* and SSAP No. 26, with the edits suggested by interested parties and edits from the Oct. 4 comments. Gann stated that, in addition, NAIC staff recommend that the Working Group send a referral to the Property and Casualty Risk-Based Capital (E) Working Group and Health Risk-Based Capital (E) Working Group with information on the adopted revisions for the bond definition with identification that the non-bond debt securities will not have the opportunity for RBC based on Securities Valuation Office (SVO)-assigned designations. She stated that this referral will inquire whether the RBC working groups should consider more granular RBC reporting based on SVO-assigned designations in response to the Spectrum Asset Management comment letter.

Gann stated that in response to comments received from interested parties, NAIC staff recommend that the Working Group direct NAIC staff to work with the industry to develop an agenda item on SSAP No. 41 to consider slight revisions as requested by the small group and interested parties for the capital notes distinction for hybrids. She noted that capital notes are already in the scope of that statement.

Gann recommended that the Working Group also direct NAIC staff to move forward with a new agenda item to consider capturing issue papers in Level 5 of the statutory hierarchy. She noted that interested parties' recommendation was for Level 2 or Level 4 of the statutory hierarchy. She stated that NAIC staff is recommending a Level 5 classification to prevent unintended conflicts with other sources of statutory accounting.

Mike Reis (Northwestern Mutual), representing interested parties, noted a reference error in the hearing agenda that referenced a change made in INT 24:01 in paragraph 3.3c but had been made in paragraph 3.1e. Bruggeman agreed and noted that staff had confirmed that the change had been made in the correct paragraph in the interpretation, and this was only a reference error in the hearing agenda.

Bruggeman noted that some of the staff-directed agenda items may be ready for the Dec. 17 meeting. Bruggeman then reiterated that the principles-based bond definition, including this Q&A, would be fully effective starting Jan. 1, 2025, and hopefully, companies are far along with implementation. He noted the principles-based nature of the evaluations that will be occurring. Clark noted that the small group efficiently worked through some very complex questions in a productive manner.

Clark made a motion, seconded by Weaver, to: 1) adopt the exposed Q&A in a new interpretation with the edits suggested by interested parties (Attachment One-H); 2) direct NAIC staff to develop agenda items on SSAP No. 41 edits and on issue papers as Level 5 in the statutory hierarchy; and 3) send referrals to the Property and Casualty Risk-Based Capital (E) Working Group and Health Risk-Based Capital (E) Working Group. The motion passed unanimously.

B. <u>Agenda Item 2023-28</u>

Bruggeman directed the Working Group to agenda item *2023-28: Collateral Loan Reporting*. Gann stated that the Working Group exposed this agenda item with a request for comments on more granular Schedule BA collateral loan reporting lines. She stated that the Working Group also sponsored a blanks proposal to begin detailing the revisions to Schedule BA and the asset valuation reserve (AVR) that would occur with these changes. Gann stated that this action followed prior Working Group discussion and actions to allow, as an interim step, collateral loans with underlying mortgage loans to flow through AVR. She stated that this instructional change was supported by the Working Group on May 15, and corresponding RBC revisions were adopted on June 18. Correspondence to the Blanks (E) Working Group on this interim step was received on Aug. 7. She noted that comments on the interim step are requested.

Gann stated that NAIC staff recommend that the Working Group re-expose this agenda item without revisions and resume discussion once comments have been received on the Blanks (E) Working Group proposal, which was exposed on Nov. 6, 2024, for a 90-day comment period ending Feb. 6, 2025. She stated that the interested parties' comments predominantly addressed the presentation of changes within Schedule BA and the AVR schedule and not the overall category breakouts or concept for granularity with collateral loan reporting.

Kim Hudson made a motion, seconded by Walker, to re-expose this agenda item without revisions and resume discussion once comments have been received on the Blanks (E) Working Group proposal. The motion passed unanimously.

C. <u>Agenda Item 2024-16</u>

Bruggeman directed the Working Group to agenda item *2024-16: Repack and Derivative Investments*. Gann stated that on Aug. 13, the Working Group exposed revisions to *SSAP No. 86—Derivatives* with a proposal to require bifurcation of debt securities with derivative wrappers or components if the item did not reflect a structured note, as defined in SSAP No. 86. She stated that the exposed guidance then detailed the accounting and reporting for the bifurcated debt and derivative components. Gann stated that the detailed agenda item discussed the origination of credit repack notes, which are debt securities issued by a special purpose vehicle (SPV), that reflect a combined debt security and a derivative. The agenda item also detailed various statutory accounting and reporting aspects if the item was reported as a single debt instrument. Gann stated that a key aspect to note with the origination of the agenda item was how these debt securities would be accounted for under the principles-based bond definition.

Gann stated that the exposed agenda item proposed to revise the long-standing guidance in SSAP No. 86 that embedded derivatives shall not be separated from the host contract and accounted for separately as a derivative instrument and included proposed revisions to separate the debt securities and derivative components/wrappers in all instances, not just credit repacks. She stated that comments received from interested parties did not support the exposed revisions to bifurcate embedded derivatives from the host contracts. The comments indicated that holders of debt security structures should evaluate the securities in accordance with the principles-based bond definition.

Gann stated that NAIC staff recommends this proposal be modified to eliminate the exposed revisions to separate embedded derivatives. She recommended that this agenda item should be limited to sponsoring blanks revisions to clarify the guidance on the bond disposal/acquisition schedules to ensure that the sale of a security to an SPV for which a debt security is acquired back from the SPV with derivative wrappers or other components is shown as a disposal and acquisition. She stated that NAIC staff are not currently recommending revisions to encompass more disclosure or reporting codes to identify debt securities with derivative components that do not reflect structured notes and/or provide interpretative guidance under the bond definition. Gann recommended that the Working Group direct NAIC staff to proceed with drafting an annual statement blanks proposal to clarify reporting instructions for future discussion. Bruggeman noted that the instructions would clarify items that should be reflected as a disposal and an acquisition when the characteristics of the securities are changed.

Clark stated that the original request was from a limited number of parties, and he agreed with the reservations on bifurcation expressed by interested parties. He stated agreement with removing the bifurcation revisions from the agenda item. Gann affirmed that the recommendation was to remove the exposed revisions from the agenda item and develop reporting clarifications for the annual statement.

Clark made a motion, seconded by Weaver, to direct NAIC staff to modify the proposal to eliminate the exposed revisions to separate embedded derivatives and directed NAIC staff to sponsor a blanks proposal to clarify the guidance on the bond disposal/acquisition schedules (as shown in the agenda item) to ensure that the sale of a security to an SPV for which a debt security is acquired back from the SPV with derivative wrappers (or other components) is shown as a disposal and acquisition. The motion passed unanimously.

4. <u>Considered Maintenance Agenda—Pending Listing</u>

Malm made a motion, seconded by Sherman, to expose the following SAP concepts and clarifications to statutory accounting guidance for a public comment period ending Jan. 31, 2025, except for agenda item 2024-26EP, which was exposed for a public comment period ending Dec. 9, 2024. The motion passed unanimously.

A. <u>Agenda Item 2024-20</u>

Bruggeman directed the Working Group to agenda item *2024-20: Restricted Asset Clarification*. Gann explained that this agenda item clarifies how assets under modified coinsurance (modco) or funds withheld (FWH) agreements should be reported as restricted assets in Note 5L of statutory financial statements. She stated that it also proposes enhanced disclosures to identify the extent of restricted assets and differences between restricted asset disclosures and general interrogatories, which impact RBC formulas. Gann suggested revising life RBC instructions to clarify that if modco/FWH assets are used as collateral for purposes unrelated to the reinsurance agreement, they should not reduce RBC charges. She stated that this aligns with existing instructions that do not permit RBC credit when asset risk is not fully transferred to the assuming entity. Gann stated that the agenda item does not propose capturing modco/FWH assets in restricted asset reporting that affects general interrogatories and additional RBC charges. Instead, the agenda item suggests modifications to capture these assets in existing restricted asset disclosures, providing a complete view without additional RBC impact. She stated that NAIC staff support including these assets in restricted asset disclosures for consistency and comparability as this helps financial statement users assess available assets and borrowing capacity. She stated that the agenda item also proposes additional disclosures to identify differences between restricted assets in accordance with *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures* in Note 5L and the general interrogatories, addressing discrepancies and promoting uniform reporting practices.

She stated that if the proposal is adopted, there would be a recommended referral to specific RBC working groups. She stated that at the Fall National Meeting, there is only the recommendation to move to the active listing to expose the agenda item as a SAP clarification.

B. <u>Agenda Item 2024-21</u>

Bruggeman directed the Working Group to agenda item *2024-21: Investment Subsidiary Classification.* Gann stated that this agenda item addresses questions about classifying investments as investment subsidiaries in Schedule D-6-1 and the life RBC formula. She stated that historic *SSAP No. 46—Investments in Subsidiary, Controlled, and Affiliated Entities* defined investment subsidiaries as noninsurance subsidiary, controlled, or affiliated entities (SCAs) holding assets for the reporting entity's benefit, measured on a statutory basis. Gann stated that historic *SSAP No. 88—Investments in Subsidiary, Controlled, and Affiliated Entities* and later *SSAP No. 97—Investments in Subsidiary, Controlled, and Affiliated Entities* eliminated this concept, requiring SCAs to be reported based on audited U.S. GAAP equity value unless they are insurance subsidiaries or engage in specific activities and pass a revenue test.

She stated that under SSAP No. 97, SCAs that received U.S. GAAP with limited statutory adjustments entities must be insurance subsidiaries or engage pass a revenue and activity test, or they are reported based on audited U.S. GAAP equity value. She stated that *SSAP No. 25—Affiliates and Other Related Parties* still reflects the concept of an investment sub for non-economic transactions, where assets are transferred at fair value but gains are deferred until permanence is verified. Gann stated that NAIC staff recommend that the Working Group expose this concept agenda item with a request for comments on the options offered to clarify statutory accounting guidelines and resulting reporting impacts for investment subsidiaries. She stated that, except for possible revisions to SSAP No. 97, the other possible actions are to sponsor blanks proposals or send referrals to the Capital Adequacy (E) Task Force and related RBC working groups with a request for revisions.

Bruggman stated that sometimes entities created for liability protection are termed disregarded entities. He stated they did not want different conclusions if the assets are owned directly from when they are held by a disregarded or other similar entity. He noted that the possibility of different or unintended treatment should be considered when reviewing the exposed concept agenda item.

C. <u>Agenda Item 2024-22</u>

Bruggeman directed the Working Group to agenda item *2024-22: ASU 2024-01, Scope Application of Profits Interest and Similar Awards*. Oden stated that this agenda item was drafted in response to *ASU 2024-01, Scope Application of Profits Interest and Similar Awards* which was issued by FASB to clarify the application of stock compensation guidance on profits interest and similar awards. As profits interest holders only participate in future profits and/or equity appreciation and have no rights to the existing net assets of the partnership, FASB noted it can be complex to determine whether a profits interest award should be accounted for as a share-based payment arrangement (Topic 718) or similar to a cash bonus or profit-sharing arrangement (Topic 710, Compensation—General or Other Topics). Oden also noted that the proposed revisions to *SSAP No. 104—Share-Based Payments* do not include the illustrative examples added by ASU 2024-01 but do incorporate some of the guidance provided by the illustrative examples. Oden recommended that the Working Group move this item to the active listing and categorize it as a SAP clarification to adopt, with modification, ASU 2024-01 within SSAP No. 104.

D. <u>Agenda Item 2024-23</u>

Bruggeman directed the Working Group to agenda item *2024-23: Derivative Premium Clarifications.* Oden noted that this agenda item was developed to address two derivative premium issues noted by NAIC staff. Oden stated that the first issue was noted during internal reviews of SSAP No. 86 and the *Annual Statement Instructions*. It was noted that the terminology for derivative financing premium was inconsistent and that the guidance for derivative financing premiums could be further clarified.

Oden noted that the second issue was identified as part of the ongoing Interest Maintenance Reserve (IMR) Ad Hoc Group meetings. NAIC staff learned that there is some confusion within the industry regarding whether statutory accounting guidance allows for derivative premium costs to be captured in the calculation of realized losses for the derivative transaction. Oden stated that within SSAP No. 86 there are several sections that provide derivative-specific accounting guidance, and within these sections, the guidance is clear that companies are to amortize derivative premium costs over the life of the derivative contract. Per SSAP No. 86, derivative premiums represent the cost to acquire or write a derivative contract and are not an “underlying” in a derivative contract, and only the change in value attributable to the derivative underlying is allowed to be capitalized to IMR as a realized loss.

Since derivative premium costs are not a component of the derivative underlying, Oden noted that NAIC staff feel the guidance is clear that derivative premium costs should not be included in losses capitalized into IMR. To ensure that this is abundantly clear, revisions have been recommended to both the “Definitions” and “Derivative Premium” sections to add language that specifically states derivative premium costs cannot be capitalized into IMR. Oden stated that NAIC staff recommend that the Working Group expose revisions to SSAP No. 86 and the *Annual Statement Instructions* to ensure consistent terminology for derivative financing premiums and to further clarify that derivative premium costs are not to be capitalized to IMR.

E. <u>Agenda Item 2024-24</u>

Bruggeman directed the Working Group to agenda item *2024-24: Medicare Part D – Prescription Payment Plan*. Robin Marcotte (NAIC) stated that this agenda item proposes a new interpretation that would address the application of existing statutory accounting guidance to a new payment program added to the Medicare Part D prescription drug program which is effective starting in 2025. She stated that the Medicare Prescription Payment Program (MP3) requires Medicare Part D plans to pay pharmacies upfront for enrollee out-of-pocket costs (if the enrollee has opted into MP3). The enrollees then repay the Medicare Part D Plan in installments over the remaining policy term. She stated that the program does not decrease the enrollee’s total out-of-pocket costs, but it simply allows installment payments.

Marcotte stated that reporting and accounting guidance is needed on where to report initial payments to pharmacies, related installment receivables from enrollees, and how to account for these payments. She stated that health insurance industry groups, including AHIP and Blue Cross Blue Shield Association (BCBSA), have provided input and recommendations in a letter that is included with the comment letters (Attachment One-C).

Marcotte summarized key points for the tentative *INT 24-02: Medicare Part D Prescription Payment Plans*, including that the installment receivables would be admitted if they are less than 90 days overdue. The installment receivables would be reported in the lines for health care receivables and other amounts receivable. She stated that the recommendation is to report the uncollectible (written off) installment receivables in Medicare Part D claims as there will be estimates for these losses included in premium bids. She noted that this is different from the Centers for Medicare & Medicaid Services (CMS) treatment for the medical loss ratio because CMS considers this expense to be an administrative cost and, therefore, will report the amount in the denominator of the medical loss ratios (MLRs). She noted that this proposed reporting and difference in MLR calculation would necessitate additional annual statement revisions including revisions in the Supplemental Health Care Exhibit (SHCE) instructions. She also stated additional disclosures are proposed to be researched and developed in the interim.

Marcotte stated that NAIC staff recommend that the Working Group expose the draft INT 24-02 and expose minor edits to *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage*. She stated that the edits to INT 05-05 would add a reference to the proposed INT 24-02 regarding Medicare Part D prescription payment plans. She stated that the Working Group should also send notice of the exposure to the Health Insurance and Managed Care (B) Committee and the Health Risk-Based Capital (E) Working Group, and direct NAIC staff to coordinate with Blanks (E) Working Group staff to develop an annual statement blanks proposal in the interim and to develop disclosures for future inclusion in relevant SSAPs.

Bruggman noted that with the installment process, to the extent the amounts are not recovered from the enrollees, the recommendation to report as a claim makes some sense to him.

F. <u>Agenda Item 2024-25</u>

Bruggeman directed the Working Group to agenda item *2024-25: SSAP No. 16 ASU Clarification*. Jake Stultz (NAIC) stated that this agenda item was developed when staff noted instances in *SSAP No. 16—Electronic Data Processing Equipment and Software* where the FASB ASC topic has been referenced directly instead of the adopted ASU. When FASB adopts guidance, it is issued through an accounting standards update which formally adopts the guidance into the FASB accounting codification. The Working Group will then address the guidance in the ASU, which is the guidance at a moment in time, instead of the actual ASC, which represents guidance that will change over time as other ASUs are adopted. As the guidance stands now, a new ASU could be issued that impacts the ASC sections that are referenced in the SSAP, thereby changing statutory accounting guidance without the Working Group addressing and considering the issue. This agenda item proposes to add the effective ASUs to each of these references where it is missing in SSAP No. 16.

G. <u>Agenda Item 2024-26EP</u>

Bruggeman directed the Working Group to agenda item *2024-26EP: Fall 2024 Editorial Revisions.* Oden stated the disclosure in SSAP No. 26, paragraph 39e is an existing disclosure (pre-bond-definition revisions). However, the pre-bond-definition version of the disclosure included directions for disclosure by Schedule D broad reporting categories, with categories listed in the SSAP. These reporting categories were removed from the adopted revised SSAP No. 26 disclosure, effective Jan. 1, 2025. Although this disclosure is satisfied by the completion of Schedule D-1-1 and D-1-2 for statutory accounting purposes, comments have been made that the adopted revised language could require a listing of all bonds in the audited financial statements. As such, editorial revisions have been proposed to reinstate the prior language for receiving bond treatment. As adopted, revised *SSAP No. 43—Asset-Backed Securities*, paragraph 44m, points to this SSAP No. 26 disclosure for asset-backed securities (ABS) items and includes reference to reporting categories. A listing of the reporting categories is not deemed necessary within SSAP No. 26. Bruggeman stated support for this clarification.

5. Discussed Other Matters

A. Review of U.S. GAAP Exposures

Stultz identified two U.S. GAAP items currently exposed by the FASB (Attachment One-I). He stated that comments are not recommended at this time and that NAIC staff recommend a review of the final issued ASUs under the SAP maintenance process as detailed in *Appendix F—Policy Statements*.

B. Update on the IMR Ad Hoc Group

Marcotte stated that the IMR Ad Hoc group has met regularly since their first meeting in October 2023. Since the Summer National Meeting, the discussions have focused on IMR from reinsurance transactions. The reinsurance discussion is complex, and after assessing the application/interpretation of existing guidance, the group has directed a reassessment of guidance. With this approach, it is intended that principles for accounting/reporting of IMR in response to reinsurance transactions (including for the cedent, assuming entity, and in the event of recapture) will be established for application. Bruggeman stated that they have tried to group topics into four broad categories that can be brought to the Working Group for discussion in 2025.

C. Update on the Bond Project Implementation/Bond Small Group

Marcotte stated that the Bond Small Group has concluded its regular meetings. The group addressed the items presented and referred the Q&A to the Working Group. Based on issues or questions raised, the group may resume future discussions as necessary.

D. Use of Third-Party Vendors/Checklists to Determine Bond Definition Compliance/Classification

Bruggeman stated that vendors have developed tools or checklists to determine bond definitions and recommended that users exercise caution when using these resources. He reminded the group that this is a principle-based bond definition, and some tools might be more rule-based. If a tool provides direct inputs and outputs, it might be too rigid. Therefore, he urged caution and to "trust but verify." He stated that, if tools are available in this program, use them, but don't blindly accept the results.

Clark stated that they are not discouraging the use of technology for classification, as it is often necessary. However, he cautioned against tools that overpromise by claiming they can automatically classify pass versus fail for all investments. Given that this is a principles-based and judgmental standard, he advised using caution and ensuring ownership of the process.

E. Update on the IAIS AAWG

Marcotte stated that Gann and Maggie Chang (NAIC) monitor International Association of Insurance Supervisors (IAIS) discussions. There have been no significant discussions since the Summer National Meeting. Beginning in

November 2024, it is anticipated that NAIC staff will review the 200 pages of comments received on the exposed IAIS climate risk materials and propose revisions to the application paper.

F. Update on Reinsurance Exposures

Marcotte stated that three reinsurance-related agenda items *#2024-05: A-791, Paragraph 2c.*; *#2024-06: Risk Transfer Analysis on Combination Reinsurance Contracts*; and *#2024-07: Reporting of Funds Withheld and Modco Assets*, were exposed at the Summer National Meeting. Agenda items 2024-05 and 2024-06 are related to referrals from the Valuation Analysis (E) Working Group, and 2024-07 are for the new modco disclosures. All three of these items have had delayed comment deadlines at the request of the American Council of Life Insurers (ACLI), and the Working Group requested that they provide a short update at this meeting.

Carrie Haughawout (ACLI) stated that ACLI members continue to believe that the two proposals, agenda items 2024-05 and 2024-06, are inextricably linked and should be considered together. She stated that ACLI members have noted that maintaining the language in A-791, paragraph 2c, is helpful because it reflects the fact that each contract is evaluated using the applicable statutory accounting risk transfer guidance and the specific facts and circumstances inherent in the agreement including premium levels. She stated that if more specifics can be established in 2024-06, additional changes to 2024-05, as currently contemplated, may be more appropriate. She stated that, ultimately, the ACLI concern continues to be that without more guidance about how to apply this concept of risk transfer analysis, there may be a diversity of practice about how the regulation could be applied, leading to more inconsistency across the states rather than less. She stated that, as a result, the ACLI would suggest a small working group of regulators and industry with an agreed-upon timeline to help structure the necessary guidance.

Marc Altschull (ACLI) spoke about agenda item 2024-07. He stated that ACLI members have had productive conversations with NAIC staff and regulators on this proposal. He noted that ACLI members have concerns about reporting confidential, treaty-level information regarding assets and pricing in a public filing. Additionally, the timing of this requirement could cause a resource strain with the bond project currently being a priority for the industry and third-party vendors. He noted that they look forward to discussion with the Working Group. Bruggeman stated he looks forward to a constructive conversation on the topic on Dec. 17.

G. Lloyd’s Coordination

Stultz stated that NAIC staff have received questions on Lloyd’s removal of several syndicates, and it is causing some confusion on reinsurance schedule reporting. NAIC staff has had preliminary conversations and is coordinating with Lloyd’s staff to determine if any additional guidance needs to be shared with the Blanks (E) Working Group.

H. Dec. 17 Meeting

Bruggeman noted that the Working Group has scheduled a meeting for Dec. 17 for items with Nov. 8 and Dec. 9 comment deadlines.

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

SharePoint/NAIC Support Staff Hub/Committees/E CMTE/...

Draft: 12/30/24

Statutory Accounting Principles (E) Working Group
Virtual Meeting
December 17, 2024

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met Dec. 17, 2024. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Richard Russell (AL); Kim Hudson (CA); William Arfanis and Micheal Estabrook (CT); Rylynn Brown (DE); Cindy Andersen (IL); Melissa Gibson and Bill Werner (LA); Steve Mayhew (MI); Doug Bartlett (NH); Bob Kasinow (NY); Diana Sherman (PA); Jamie Walker (TX); Doug Stolte and Jennifer Blizzard (VA). Also participating was Rachel Hemphill (TX).

1. <u>Reviewed Comments on Exposed Items</u>

The Working Group met to review comments received (Attachment 1) on items exposed at the Summer and Fall National Meetings.

A. <u>Agenda Item 2024-10</u>

Bruggeman directed the Working Group to agenda item 2024-10: Book Value Separate Accounts. Julie Gann (NAIC) stated that at the 2024 Summer National Meeting, the Working Group exposed revisions to *Statement of Statutory Accounting Principles (SSAP) No. 56—Separate Accounts* to allow for review and consideration of potential changes to update measurement method guidance and specify the process to transfer assets for cash between the general account and book-value separate accounts. Gann stated that the American Council of Life Insurers (ACLI) supported much of the exposed guidance updates, especially for transfers between general and separate accounts. She stated that the ACLI had previously presented its interest maintenance reserve (IMR) proposal for transfers to the IMR Ad Hoc Group, which influenced this exposure. Gann stated that, while supporting most updates, ACLI proposed revisions to paragraph 18.b. Gann stated that NAIC staff recommended exposing updated revisions to SSAP No. 56 that reflect several of the ACLI's comments but did not include the ACLI recommendation to delete the example contracts that are expected under the book value measurement method. She stated that they have been noted to not be all-inclusive. Further, although the ACLI did not support codifying a specific approach for other transfers between the general account and separate account, the updated exposure language incorporates a fair value approach for these items.

In response to the staff inquiry on a potential referral to the Life Risk-Based Capital (E) Working Group, Bruggeman recommended not doing a referral at this time since the agenda item is still in the exposure stage. Also, in response to a staff inquiry on the definition of a guarantee, he stated that he does not want to consider changing the definition of a guarantee at this time.

Brad Caprari (Prudential Financial), on behalf of the ACLI, stated that it agrees with much of what was exposed. ACLI does have questions on extending the fair value to other transfers that it will provide in another comment letter. Clark stated that the separate account plans of operations that he had seen had not been overly detailed on the accounting process for other transfers; therefore, he supported the codification. He also stated that since these revisions would not be effective for year-end 2024, there should be time to make amendments to the plans of operations if there are conflicts with the use of fair value as well as further discussion. Clark requested the draft presented at the Spring National Meeting specifically identify a year-end 2025 effective date. Bruggeman also requested that the IMR discussion for other transfers that occur at fair value be presented to the IMR Ad Hoc Group for subsequent discussion.

Hudson made a motion, seconded by Clark, to expose revisions to SSAP No. 56 as discussed during the meeting. The comment deadline for the exposure is Jan. 31, 2025. The motion passed unanimously.

B. Agenda Item 2024-15

Bruggeman directed the Working Group to agenda item 2024-15: ALM Derivatives. Gann stated that at the 2024 Summer National Meeting, the Working Group exposed this agenda item with a request for feedback on specific questions, which included an overall inquiry on the development of new guidance for the deferral of realized gains and losses for non-accounting effective hedges captured in *SSAP No. 86—Derivatives*. Gann stated that the ACLI supported the development of new statutory accounting guidance for interest-rate hedging derivatives that do not qualify for hedge accounting under SSAP No. 86 but are used for asset-liability management (ALM). Gann stated that this exposure was focused on soliciting information from regulators on whether new statutory accounting guidance should be established that would allow the deferral of gains/losses for derivative transactions that do not qualify as accounting-effective hedges under SSAP No. 86. She stated that the ACLI has indicated support for new accounting guidance. Gann stated that, if the Working Group supports proceeding with this approach, NAIC staff would begin development, working closely with Working Group members and ACLI representatives. She stated that NAIC staff anticipate that the guidance may be complex but if directed, will work to present updates and drafts to the Working Group for consideration.

Gann then identified that several items and discussion points had been included in the agenda to address comments or points raised by the ACLI. She stated that with the extensive, complex information, as well as the limited time to review the comments and agenda, NAIC staff recommend deferring this item without receiving Working Group direction at this time and for the Working Group to continue discussions of this topic at the NAIC Spring National Meeting.

Bruggeman asked for Working Group opinions on whether to defer this topic for future discussion. Hudson stated that he prefers deferring this topic to allow time to review the documents. Walker stated that she would prefer to defer this topic for future discussion.

Mike Reis (Northwestern Mutual), on behalf of the ACLI, stated that this is a complex topic and that the IMR Ad Hoc Group has not finalized any recommendations to date. He stated that the ad hoc group is willing to have a session with regulators to discuss their letter and how these programs are important.

Bruggeman stated that a motion is not necessary for this agenda item since the Working Group decided to defer discussion and direction to a later date.

C. Agenda Item 2024-26EP

Bruggeman directed the Working Group to agenda item 2024-26EP: Fall 2024 Editorial Revisions. Gann stated that at the 2024 Fall National Meeting, the Working Group exposed editorial revisions to *SSAP No. 26—Bonds* to clarify an annual audited disclosure for assets receiving bond treatment, with clarification that the disclosure shall be completed by category and subcategory as reported in Schedule D, Part 1, Section 1, and Schedule D, Part 1, Section 2. She stated that this item was exposed with a shortened comment deadline ending Dec. 9, 2024. Gann stated that although the proposed revisions were drafted with interested parties' representatives, the interested parties' comment letter requests a deferral to further discuss concerns with the proposal. She stated that interested parties believe that the terms "category" and "subcategory" need clarification, as they have interpreted that "category" equates to issuer credit obligations (ICO) and asset-backed securities (ABS) and "subcategory" equates to examples such as Non-U.S. Sovereign Jurisdiction Securities and Other Non-Financial Asset-Backed Securities—Practical Expedient.

Gann stated that NAIC staff recommend adopting the exposed editorial change to SSAP No. 26. She stated that the proposed requirement is consistent with the current disclosure, just using broad terms to detail the reporting level rather than named categories. She stated that the agenda item was drafted as industry representatives raised concerns that the disclosure, which eliminated the named categories that currently exist in SSAP No. 26, could require a full listing of bonds in the audited financial statements. Gann stated that NAIC staff highlighted that the existing guidance in SSAP No. 26 requires a per-category disclosure breakdown, and although NAIC staff recognize that the categories have been expanded under the principles-based bond project, this has been done to ensure that regulators have more transparency of the investments held that are classified as bonds. Additionally, state regulators often rely on the work of auditors in the annual audit for verification, and NAIC staff have concerns that reliance on the revised reporting categories will be diminished if a more generic audit requirement is permitted.

Bruggeman reiterated that interested parties raised the question of what the reporting categories would be. Gann responded that the categories and subcategories would tie to the specific reporting lines for bonds in Schedule D. Clark asked what level of granularity this would go to, including affiliated versus unaffiliated. Gann stated that this would be broken down into every specific reporting line, which would include separate lines for affiliated and unaffiliated. She also noted that, if adopted by the Working Group at this time, subsequent proposals could be considered from the industry that continue to provide the assurance needed by the regulators.

Bruggeman stated that by adopting this agenda item, a full listing of bonds in the audit report will not be required.

Tip Tipton (Thrivent), on behalf of interested parties, stated that as the industry implements the bond project, they will provide feedback and suggestions. He stated that, as to Clark's comment, interested parties have discussed having a separate listing for all the unaffiliated and then having a grouping for affiliated since they are a small amount of the total.

Hudson made a motion, seconded by Arfanis, to adopt the exposed editorial change to agenda item 2024-26EP: Fall 2024 Editorial Revisions as of Jan. 1, 2025 (Attachment 2). The motion passed unanimously.

D. Agenda Item 2024-05

Bruggeman directed the Working Group to agenda item 2024-05: Appendix A-791 Paragraph 2c. Robin Marcotte (NAIC) stated that, at the 2024 Summer National Meeting, the Working Group noted that no written comments were received related to the 2024 Spring National Meeting exposure. She stated that, at the request of the ACLI, the Working Group re-exposed revisions to Appendix-791, paragraph 2.c.'s question and answer. She stated that the comment deadline on this agenda item was subsequently extended to Dec. 9. Marcotte provided a summary of the ACLI comments related to the exposure. She stated that the ACLI would like to retain the language in Appendix A-791, paragraph 2.c., which was exposed for deletion. She noted that ACLI comments indicated that Appendix A-791 already provides an objective standard by which to assess whether yearly renewable term (YRT) premiums are excessive. That is, premiums are considered excessive if they result in the deprivation of ceding insurer surplus. She also noted that the ACLI referenced its proposed revisions to agenda item 2024-06: Risk Transfer Analysis of Combination Reinsurance Contract as addressing its comments on this item.

Marc Altschull (ACLI) stated that ACLI believes the two proposals (2024-05 and 2024-06) are inextricably linked and should be considered together. He stated that the ACLI position is slightly different than described by Marcotte. He stated that if the ACLI proposed changes to agenda item 2024-06 are adopted, it would no longer have concerns with agenda item 2024-05.

Marcotte stated that NAIC staff continue to agree with the original Dec. 9, 2023, Valuation Analysis (E) Working Group referral to the Working Group which noted that the sentence in A-791, paragraph 2.c., is an unnecessary sentence. She stated that the sentence proposed for deletion is to contrast that individual life insurance is different in the question/answer about group term life. She stated that the reason that the Valuation Analysis (E) Working Group suggested deleting the sentence is that companies were misusing it to imply that the different individual life rules could incorrectly be used for group term life.

Bruggeman commented that the sentence proposed for deletion is a comparison statement to reference individual life reinsurance in a question and answer about group life reinsurance. He noted that he has a hard time seeing how that sentence should be referenced as a safe harbor for individual life reinsurance when it is trying to answer a question about group life reinsurance.

Hemphill stated that this item came up during actuarial reviews and was being interpreted by some companies as the converse of what was stated. For context, the sentence proposed to be deleted is "Unlike individual life insurance where reserves held by the ceding insurer reflect a statutorily prescribed valuation premium above which reinsurance premium rates would be considered unreasonable, group term life has no such guide." She noted that the sentence states that above the stated amount would be unreasonable. It does not say below the stated amount is reasonable. She said it was an aside and that regulators need to look at all the existing requirements. She stated that there is not just one statutorily prescribed valuation mortality method and that the *Valuation Manual* (in effect since 2020) provides specific instructions. She noted that the valuation mortality can change over time and from company to company. She noted that she supports removing the aside statement. Bruggeman asked if a new reinsurance agreement covered pre-2020 business. For example, would a block written in 2015 change the discussion on valuation mortality? Hemphill replied that she did not think it did because even prior to the *Valuation Manual's* effective date, there were other aspects of the framework that made it more complex than just one statutorily prescribed valuation mortality.

The Working Group deferred action on this agenda item to allow for a future discussion at a joint meeting with the Life Actuarial (A) Task Force along with agenda item 2024-06.

E. <u>Agenda Item 2024-06</u>

Bruggeman directed the Working Group to agenda item 2024-06: Risk Transfer Analysis of Combination Reinsurance Contracts. Marcotte stated that the Working Group exposed agenda item 2024-06 in March 2024 to address the risk transfer aspect of a December 2023 referral by the Valuation Analysis (E) Working Group. She stated that the exposed SSAP No. 61 revisions were narrowly focused and incorporated guidance noting that interdependent contract features such as shared experience refunds must be analyzed in the aggregate when determining risk transfer. Marcotte stated that at the 2024 Summer National Meeting, the Working Group reviewed two letters. She stated that one letter was in support of the exposed revisions and the ACLI comment letter requested further discussion. She stated that at the Summer National Meeting, the Working Group re-exposed the revisions previously exposed at the 2024 Spring National Meeting with a request for specific recommendations. She stated that the comment deadline on this agenda item was subsequently extended to Dec. 9, 2024, at the request of the ACLI.

Marcotte stated that the Working Group exposure is based on existing guidance that is in both U.S. generally accepted accounting principles (GAAP) and in *SSAP No. 62—Property and Casualty Reinsurance,* Exhibit A—Implementation Questions and Answers, question 10. She stated that the exposed guidance provides that contracts with interdependent features must be analyzed in the aggregate for risk transfer. She stated that, in addition, a reference to A-791, paragraph 6, which requires that the reinsurance contract include provisions that the contract shall constitute the entire agreement was proposed to be added to the existing required YRT criteria.

Marcotte stated that the Valuation Analysis (E) Working Group referral included an example of coinsurance and YRT combined in the same contract with a shared experience refund and the inability to independently cancel the coverages. The Valuation Analysis (E) Working Group recommended regulatory discussions and clarifications to be clear that interdependent contract features, such as a shared experience refund, must be analyzed for risk transfer in the aggregate. The Valuation Analysis (E) Working Group observed that the bifurcated risk transfer analysis was not adequate. The Working Group observed some overstated reserve credits and commented that some of the treaties resulted in coverage that was, in essence, non-proportional. As noted, the exposure focused on the interdependent contract features and aggregated risk transfer analysis.

Marcotte stated that the Working Group received comment letters from the ACLI and Jeffrey Stevenson (Stevenson Associates Inc.). She stated that, as all the parties who have commented agree that the entirety of the contract must be analyzed, NAIC staff continue to support the adoption of the exposed revisions with timing subject to the discretion of the Working Group. She stated that, if the Working Group wants to continue discussions on this topic, NAIC staff recommend a joint meeting of the Statutory Accounting Principles (E) Working Group and the Life Actuarial (A) Task Force because actuarial expertise would be beneficial in discussing some of the comments received on the actuarial risk transfer analysis.

Marcotte stated that NAIC staff do not recommend exposure of the ACLI proposed language, which proposes to require bifurcated risk transfer analysis in conjunction with another aggregate test of risk transfer using valuation mortality. The Valuation Analysis (E) Working Group has noted concerns with bifurcated analysis. NAIC staff also have concerns that because the valuation mortality can change over time, using that measure could still result in the ceding entity being deprived of surplus over time.

Altschull stated that the ACLI is still in the process of reviewing the comments on this topic. He stated that, through discussions and in the materials for today's discussion, the ACLI understands that regulators believe that some combination coinsurance and YRT agreements with interdependent features will pass risk transfer, and some will not. However, based on the ACLI review of the meeting materials, it is unclear how the NAIC proposed exposure directs them to differentiate between contracts that should pass and those that should fail compliance. He stated that, contrary to regulator intention, this lack of clarity is evidenced by interpretations by some that combination agreements are non-proportionate and should not provide reserve credit.

Altschull stated that the ACLI would like to clarify that their proposed framework includes a bifurcated analysis in conjunction with an aggregated analysis. Specifically, they suggest applying statutory accounting principle (SAP) guidance to each component and performing an overall assessment of the combined agreement to ensure that ceding insurer surplus is not deprived which would be consistent with its proposed fundamental principle. He stated that the ACLI believes this solution, including separate analyses of each treaty in isolation, provides a much stronger overall evaluation of co-YRT agreements than just relying on an aggregate analysis. He stated that, given these specific areas of misunderstanding and the limited time they have had to review the NAIC staff feedback, the ACLI would appreciate continued dialogue.

Stevenson stated that he shares the ACLI’s stated goal of identifying agreements that inappropriately preclude losses from reinsurance products being incurred because of excessive YRT premiums. However, he notes that the ACLI seems to have taken the position that if the aggregated risk transfer analysis results in even minimal amounts of risk transfer, then that eliminates any concerns. Stevenson noted that he does not think that is the appropriate approach for the risk transfer analysis, and he believes that analysis should be focused on whether the losses are appropriate for the reserves (credits) that are taken. He stated that one of the key principles of reinsurance is that when a reinsurer reinsures the business, if there is a covered loss, the reinsurer pays. He stated that under this key principle, the reserve credits are fine because the reinsurer is basically making a guarantee of those reserves that are left on the books. He stated that the reserves left on the books in some of the problematic contracts are probably insufficient to pay all the claims. He stated that there are two separate kinds of reinsurance agreements that are structurally different, proportional and nonproportional. When the two types of reinsurance are combined, the characteristics of the resulting underlying agreements can be changed. He stated that he agrees with the ACLI that some of these agreements will be fine, but there will be some that will not be fine. He stated concerns that there will be situations in which the reserves are deficient, and this will lead to further problems in the industry.

Bruggeman asked Stevenson for confirmation of his understanding that he agreed with part of the ACLI comments. Stevenson stated, "Yes," that he agreed that some of the combination contracts would be able to pass risk transfer, and some would not. Bruggeman noted that this topic is quite complex, and more time for discussion would be useful.

Hudson agreed that more discussion is needed and expressed support for a joint meeting with the Life Actuarial (A) Task Force. Bruggeman agreed with Hudson and requested that NAIC staff schedule a joint meeting between the Working Group and the Life Actuarial (A) Task Force in early 2025. Bruggeman noted that having more perspective from the regulatory actuaries would be useful.

Stevenson stated that one of the real issues at hand is that there are companies with direct reserves for business that are barely sufficient due to interest rate issues. Then the company adds a YRT component on top of that and uses that YRT component to say the reserve has now become sufficient, which is not the case. Stevenson also noted that coinsurance is proportional and YRT is nonproportional, and when companies put those two together, it fundamentally changes the nature of the agreement. He noted it can make the agreement function more like an excess of loss agreement.

Bruggeman noted that one of the difficulties on this issue is clearly determining whether a coinsurance YRT agreement will pass or not. As noted, there are some coinsurance YRT agreements that would pass without any issues, but others overload the contract and make it more akin to a YRT-only agreement.

Marcotte asked for verification that the Working Group is deferring and not re-exposing this agenda item. Clark stated that he does not support the re-exposure of this agenda item and, instead, would like the Working Group to continue to hear comments from actuaries.

Bruggeman stated support for Clark's suggestion to defer discussion. The agenda item was deferred for future discussion. Bruggeman stated that NAIC staff will pick a date for a joint meeting of the Working Group and the Life Actuarial (A) Task Force.

2. Considered the Maintenance Agenda—Pending List

   A. Agenda Item 2024-27

Bruggeman directed the Working Group to agenda item 2024-27: Issue Papers in Statutory Hierarchy. Gann stated this agenda item was drafted to capture issue papers in level 5 of the statutory hierarchy pursuant to the direction from the 2024 Fall National Meeting. She stated that revisions have been proposed to update the process to develop issue papers to reflect current Working Group practice. For example, historical guidance references issue papers as the first step of a new SSAP/new SAP concept, but current practice most often has issue papers developed after statutory accounting revisions to detail discussions and decisions for historical reference. She stated that the revisions in the agenda item include reference to statutory issue papers in level 5 of the statutory hierarchy, guidance on issue papers in Appendix E—Issue Papers introduction, guidance on issue papers in the

"How to Use This Manual" section, and reference to issue papers in the NAIC Policy Statement on Maintenance of Statutory Accounting Principles.

B. Agenda Item 2024-28

Bruggeman directed the Working Group to agenda item 2024-28: Holders of Capital Notes. Gann stated that this agenda item was prepared in response to the direction of the Working Group during the Fall National Meeting with the adoption of *Interpretation* (*INT) 24-01: Principles-Based Bond Definition Implementation Questions and Answers*. She stated that with the adoption of the INT and the guidance for reporting certain debt securities as capital notes in the scope of *SSAP No. 41—Surplus Notes*, the industry identified that slight revisions may be necessary to reflect the capital note distinctions. Gann stated that the Working Group directed NAIC staff to work with the industry in this review and identify necessary changes. She stated that revisions have been proposed to incorporate a definition and/or reference to the INT for capital notes, clarifying the admittance restrictions, clarifying the guidance for NAIC designations, and updating the impairment guidance to refer to capital notes. She stated that, in addition to these items, it was identified that an existing disclosure for surplus notes, which requires disclosures of holders for registered surplus notes, is likely an administrative burden and, as a narrative disclosure only, is difficult to query by regulators. Gann stated that from a review of the disclosure, it predates the issuance of SSAP No. 41, and there are questions as to its purpose or use. She stated that NAIC staff have proposed to eliminate this aspect of the disclosure but retain the disclosure focusing on surplus notes with affiliates. Gann stated that NAIC staff recommend the Working Group expose changes to incorporate the presented revisions to SSAP No. 41 and incorporate changes to clarify the reporting categories in the annual statement instructions. She stated that this agenda item recommends a corresponding blanks proposal for concurrent exposure of the annual statement instructions revisions.

3. Considered the Active Maintenance Agenda

A. Agenda Item 2024-16

Bruggeman directed the Working Group to agenda item 2024-16: Repack and Derivative Investments. Gann stated that during the Fall National Meeting, the Working Group elected not to proceed with the proposed edits to SSAP No. 86 to require bifurcation of debt securities with derivative wrappers or components. She stated that, with this action, debt securities with derivative components that reflect structured notes will be retained in SSAP No. 86, and all other debt securities with derivative components and wrappers shall be assessed in accordance with the principles-based bond definition. She stated that debt securities that do not qualify as bonds under the principles-based bond definition should be reported as non-bond debt securities in the scope of *SSAP No. 21—Other Admitted Assets* and on Schedule BA. Gann stated that the Working Group agreed to proceed with the clarifications in the investment acquisition and disposal schedules and the sponsoring of a blanks proposal to ensure that a debt security sold to a special purpose vehicle (SPV) and reacquired with derivative components is shown as a disposal and an acquisition in the investment schedules. She stated that NAIC staff recommend that the Working Group expose this item to be concurrent with a blanks exposure to update the investment disposal schedules.

Clark made a motion, seconded by Hudson, to expose agenda items 2024-27: Issue Papers in Statutory Hierarchy, 2024-28: Holders of Capital Notes, and 2024-16: Repack and Derivative Investments with an exposure period ending Jan. 31, 2025. The motion passed unanimously.

4. Discussed Other Matters

Gann stated that four agenda items were exposed until Dec. 16, 2024. Although comments have been received, they are not planned for discussion until 2025, either at an interim meeting or at the 2025 Spring National Meeting.

Gann stated that the most recent statutory accounting update recording is available from the NAIC Education Department, and it includes a quiz that can result in continuing education credits.

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

SharePoint/NAIC Support Staff Hub/Committees/E CMTE/APPTF/2025 Spring/Minutes and Summary/SAPWG/SAPWG Minutes 12.17.24.docx

Draft: 3/5/25

Statutory Accounting Principles (E) Working Group
Virtual Meeting
February 25, 2025

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met Feb. 25, 2025. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Sheila Travis and Richard Russell (AL); Kim Hudson (CA); William Arfanis and Micheal Estabrook (CT); Rylynn Brown (DE); Cindy Andersen (IL); Shantell Taylor (LA); Steve Mayhew and Kristin Hynes (MI); Doug Bartlett (NH); Bob Kasinow (NY); Diana Sherman (PA); Jamie Walker (TX); Doug Stolte and Jennifer Blizzard (VA); and Amy Malm and Levi Olson (WI).

1. Notice of Extended Exposure of Agenda Item 2023-23

Bruggeman discussed agenda item 2023-23: Current Expected Credit Losses (CECL). Wil Oden (NAIC) stated that on Aug. 13, 2024, the Working Group exposed a draft issue paper documenting pre-CECL U.S. generally accepted accounting principles (GAAP) impairment guidance for historical purposes. The comment deadline was initially set for Nov. 8, 2024, but was extended to Dec. 16, 2024.

Interested parties requested more time to ensure accurate descriptions of U.S. GAAP practice versus statutory accounting. On Dec. 19, 2024, the Working Group chair extended the comment period to May 2, 2025, allowing more review time post-2024 year-end statutory filings and the NAIC Spring National Meeting. No further action is needed at this time.

2. Adopted Non-Contested Positions

A. Agenda Item 2024-16

Bruggeman directed the Working Group to agenda item 2024-16: Repacks and Derivative Instruments. Julie Gann (NAIC) stated that on Dec. 17, 2024, the Working Group exposed proposed annual statement instructions to clarify that held debt securities sold to a special purpose vehicle (SPV) and then reacquired with added derivative components should be reported as a disposal and reacquisition in the investment schedules. The Blanks (E) Working Group will also expose a related proposal sponsored by the Working Group. She stated that interested parties had no comments on this item.

Malm made a motion, seconded by Hudson, to adopt agenda item 2024-16 (Attachment 1) and indicated support for the Blanks (E) Working Group proposal to clarify the disposal and acquisition reporting for investments that are transferred to an SPV and then reacquired with derivative wrappers or components. The motion passed unanimously.

B. Agenda Item 2024-22

Bruggeman directed the Working Group to agenda item 2024-22: ASU 2024-01, Scope Application of Profits Interest and Similar Awards. Oden stated that agenda item 2024-22 was drafted in response to *Accounting Standards Update (ASU) 2024-01, Compensation—Stock Compensation (Topic 718), Scope Application of Profits Interest and Similar Awards*, which was issued by the Financial Accounting Standards Board (FASB) to clarify the application of stock compensation guidance on profits interest and similar awards. He stated that profits interest holders only participate in future profits and/or equity appreciation and have no rights to the existing net assets of the company. Oden stated that this ASU was drafted to help companies determine whether a profits interest award should be accounted for as a share-based payment arrangement (Topic 718) or similar to a cash bonus or profit-sharing arrangement (Topic 710, Compensation, or other Topics).

Hudson made a motion, seconded by Clark, to adopt the revisions as exposed, which adopt with modification ASU 2024-01, within *Statement of Statutory Account Principles (SSAP) No. 104—Share-Based Payments* (Attachment 2). The motion passed unanimously.

C. Agenda Item 2024-25

Bruggeman directed the Working Group to agenda item 2024-25: SSAP No. 16 Clarifications. Jake Stultz (NAIC) stated that on Nov. 17, 2024, the Working Group moved this item to the active listing, categorized it as a statutory accounting principle (SAP) clarification, and exposed revisions to *SSAP No. 16—Electronic Data Processing Equipment and Software* to clarify the references to the U.S. GAAP Accounting Standards Codification (ASC). He stated that interested parties agreed with the updated references in this agenda item.

Hudson made a motion, seconded by Sherman, to adopt the revisions, as exposed, to clarify the references to the U.S. GAAP ASC (Attachment 3). The motion passed unanimously.

3. Review of Comments on Exposed Items

A. Agenda Item 2022-14

Bruggeman directed the Working Group to agenda item 2022-14: Tax Credits Project. Oden stated that on Aug. 13, 2024, the Working Group exposed draft *Issue Paper No. 170—Tax Credits Project,* providing a historical record detailing the revisions and discussion for the adopted revisions to *SSAP No. 93—Investments in Tax Credit Structures* and *SSAP No. 94—State and Federal Tax Credits*. Oden stated that since its last exposure, the issue paper was updated for additional developments in the Tax Credits Project. He stated that the comment deadline was extended from Nov. 8, 2024, to Dec. 16, 2024. He stated that interested parties had no comments on the initially exposed draft or the new updated revisions that were recommended by NAIC staff to be made on the issue paper.

Travis made a motion, seconded by Bartlett, to adopt the exposed draft of Issue Paper 170, including additional minor updates proposed by NAIC staff (Attachment 4). The motion passed unanimously.

B. Agenda Item 2024-10

Bruggeman directed the Working Group to agenda item 2024-10: SSAP No. 56 Book Value and Separate Accounts. Gann stated that the Working Group first exposed updated revisions to *SSAP No. 56—Separate Accounts* at the 2024 Summer National Meeting. She stated that, at the 2024 Fall National Meeting, the Working Group exposed updated revisions to reflect key comments received by the American Council of Life Insurers (ACLI) with a comment period that ended Jan. 31, 2025. She stated that additional comments received have been incorporated into the documents.

Gann provided the following summary of the comments received:

- In paragraph 24, guidance was simplified to refer to paragraph 18 instead of explaining the contracts in scope. She stated that all revisions were tracked, with the new edit being a single line shaded in paragraph 24.
- An effective date of Jan. 1, 2026, was proposed to allow companies to modify their memorandum of understanding to conform to the new statutory accounting guidance without needing a prescribed or permitted practice.
- Two additional comments were received from interested parties regarding paragraphs 34.c. and 39.f. The comments suggested that the additional disclosures in the original version were unnecessary or duplicative. Gann stated that NAIC staff disagrees, believing the disclosures would benefit state insurance regulators. She stated that the disclosures are similar, one in the general account and one in the separate account, identifying contracts with an inherent or ultimate guarantee back to the general account.

Bruggeman asked whether the Working Group needed to re-expose the edits to paragraphs 22 and 24. He stated that the edits enhance clarity, and the intent remains the same. He said he would not ask for an additional exposure unless someone wanted to do an exposure for those edits.

Gann stated that she had heard informal comments stating that exposure was unnecessary.

Brad Caprari (Prudential Financial), speaking on behalf of interested parties, stated that they did not feel an additional exposure was needed. Rose Albrizio (Equitable), speaking on behalf of interested parties, agreed with Caprari's comment.

Clark made a motion, seconded by Hynes, to adopt revisions to SSAP No. 56 with an effective date of Jan. 1, 2026, with early adoption permitted (Attachment 5). The motion passed.

The revisions clarify the measurement method guidance and prescribe guidance for how transfers to/from the general account and separate account shall be recognized. The revisions were adopted with limited changes from the prior exposure, as detailed below:

- Paragraph 22 was revised to incorporate language for the treatment of Interest maintenance reserve (IMR), referring to the language in paragraphs 20 and 21.
- Paragraph 24 was revised to exclude contracts captured in paragraph 18 instead of referring to products that would be captured as separate accounts products under U.S. GAAP.
- Paragraph 49 was added to incorporate the effective date language.

C. Agenda Item 2024-23

Bruggeman directed the Working Group to agenda item 2024-23: Derivative Premium Clarifications. Oden stated that the Working Group exposed this agenda item at the 2024 Fall National Meeting and proposed revisions to *SSAP No. 86—Derivatives* to clarify two issues: 1) to clarify language regarding financing premiums; and 2) clarify the calculation of realized losses in relation to derivative premium. He stated that interested parties provided comments on the proposal. Bruggeman suggested that the proposed revisions for Issue 2 (calculation of realized losses in relation to derivative premium) be captured in the discussion of *Ref #2024-15: ALM Derivatives*. Oden stated that NAIC staff agreed with industry on this point as the Working Group's ongoing discussions on IMR and asset-liability management (ALM) derivatives may significantly impact the treatment of derivative premium costs when calculating realized losses. He stated that NAIC staff recommended the Working Group adopt the exposed revisions to SSAP No. 86 related to financing premium (Issue 1). He stated that the revisions recommended for adoption only included the revisions recommended for financing premium. Oden stated that NAIC staff also recommended that the previously exposed revisions regarding clarifications on the calculation and recognition of realized losses from derivative premium costs be combined with agenda item 2024-15.

Bruggeman stated it was exposed as a change but only related to the financing premium. He asked whether the revisions to paragraph 63.h.i. are also related to the issue and will be considered part of agenda item 2024-15.

Oden stated that the track changes would be related to the financing premium and that the last sentence is to clarify that for the purpose of this statement, sometimes financing premiums are called unpaid or deferred premiums. He stated that the edits are to clarify that they may be called different things, but unpaid or deferred premiums are still financing premiums. He stated that every edit was related to the finance and premium changes and that items related to clarifying the calculation of realized losses when deferred premium costs are not included in this recommended adoption.

Hudson made a motion, seconded by Travis, to adopt SAP clarification revisions to SSAP No. 86 (Attachment 6) and the annual statements related to financing premium (Issue 1).The motion passed unanimously. The Working Group also directed NAIC staff to incorporate the previously exposed revisions regarding clarifications on the calculation and recognition of realized losses from derivative premium (Issue 2) into agenda item 2024-15: ALM Derivatives for further consideration. The rationale for this movement was based on discussions with interested parties, where it was noted that there are several complicating factors when trying to clarify this calculation but also that the main concern on the inclusion of derivative premium costs in the calculation of realized losses was that it could be capitalized into IMR and deferred.

D. <u>Agenda Item 2024-24</u>

Bruggeman directed the Working Group to agenda item 2024-24: Medicare Part D – Prescription Payment Plan. Robin Marcotte (NAIC) stated that, at the 2024 Fall National Meeting, the Working Group exposed the tentative *Interpretation (INT) 24-02: Medicare Part D Prescription Payment Plans* as well as minor edits to *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage*. She stated that the Working Group also directed notice of the exposure to the Health Insurance and Managed Care (B) Committee and the Health Risk-Based Capital (E) Working Group and directed NAIC staff to coordinate the annual statement blanks proposals and develop disclosures for future discussions. Marcotte stated that the Medicare prescription payment plan (MPPP) is a new program that offers Medicare Part D enrollees the option to pay their out-of-pocket prescription drug costs through monthly payments over the course of the year instead of all at once at the pharmacy counter.

INT 24-02 was developed with input from health industry representatives and provides statutory accounting and reporting guidance for aspects of MPPP. Key components of the MPPP guidance include the following:

- Allows admitted asset treatment for receivables from MPPP participants that are less than 90 days overdue with reporting on the health care receivables asset line.
- MPPP recoverables from participants which are more than 90 days overdue based on program billing requirements are nonadmitted.
- MPPP recoverables are also subject to impairment analysis.
- Uncollectible receivables from MPPP participants that are written off are reported as a Medicare prescription claims expense.

Marcotte stated that interested parties indicated that they supported the comment letter from AHIP and the Blue Cross Blue Shield Association (BCBSA), which provided extensive comments. She stated that NAIC staff recommended a shortened exposure until March 5, 2025, to allow for discussion of the updated INT 24-02 and the previously exposed (unchanged) minor edits to INT 05-05 at the 2025 Spring National Meeting. She stated that most of the revisions AHIP and the BCBSA suggested have been incorporated, with a few additional clarifications. She stated that the revisions do not change the key accounting provisions. She stated that NAIC staff request comments relating to the methodology of recording a contract claim expense. She stated that the comments received suggested that it be optional, and while NAIC staff agree that it is not the only way to do it, the illustration does not work without it. So, comments are requested regarding whether there is an alternative preferred methodology.

Marcotte stated that a disclosure Form A will be included in the 2025 Spring National Meeting materials and a related blanks proposal on the disclosures.

Tom Finnell (AHIP) stated that AHIP is supportive of the exposure and appreciates the NAIC staff's engagement in reviewing additional terminology revisions. He stated that many of the changes are not substantive and that the key substantive conclusions are that assets are admitted subject to admission and impairment testing and, when written off, go to claims costs. He stated that AHIP had no comments on those points and is happy with them. He said AHIP supports the suggestion to re-expose it for a brief period. He stated that, regarding the last item about alternative accounting methods, AHIP consulted its companies, and they are supportive of the version in the INT 24-02. He stated that AHIP will not propose an alternative option.

Bruggeman stated that the INT 24-02 is for a unique program to help apply statutory accounting. He stated that providing the example at the end was an ideal way to ensure consistency across the industry. He stated that, if that seems to be working, he favors a short exposure period of about eight days so the Working Group can review it again at the 2025 Spring National Meeting and finalize it for the industry. He stated that this program started in January 2025, and industry wants as much direction as possible for first-quarter reporting.

Hudson made a motion, seconded by Hynes, to re-expose the revised INT 24-02: *Medicare Part D Prescription Payment Plans* and the previously exposed minor edits to INT 05-05*: Accounting for Revenues Under Medicare Part D Coverage* for a shortened comment period ending on March 5 to allow for discussion at the 2025 Spring National Meeting. In addition, the NAIC staff was directed to continue with the blanks proposals on this topic with the goal of incorporation into the 2025 annual statement instructions.

E. <u>Agenda Item 2024-27</u>

Bruggeman directed the Working Group to agenda item 2024-27: Issue Papers in the Statutory Hierarchy. Gann stated that on Dec. 17, 2024, the Working Group exposed revisions to classify issue papers as Level 5 of the statutory hierarchy. She stated that, currently, they are not in the statutory hierarchy. Gann stated that comments were received in response to the bond definition guidance, inquiring whether issue papers should be named in the hierarchy. She stated that NAIC staff agreed and proposed Level 5 placement, indicating they can be followed as guidance but should be subsequent to all other adopted statutory accounting guidance. She stated that issue papers are not updated after initial adoption; therefore, any subsequent revisions should be considered more pertinent or authoritative than the original issue paper guidance. Gann stated that comments from interested parties suggested placing them in Level 4, but NAIC staff still recommend Level 5. She stated that NAIC staff recommend the revisions detailed in the *Accounting Practices and Procedures Manual (*AP&P), including the Preamble, the introduction to Appendix E - Issue Papers, the guidance titled "How to Use this Manual," and the NAIC Policy Statement on Maintenance of Statutory Accounting Principles, to incorporate issue papers in Level 5.

Bruggeman supported the NAIC staff's logical thought process in settling on Level 5. He noted that this made a lot of sense, especially when incorporating CECL, an old U.S. GAAP topic, into an issue paper. He stated that, at that time, issue papers did not exist in the hierarchy. He stated that placing them in Level 5, like non-authoritative U.S. GAAP guidance and literature, seemed the most appropriate.

Hudson stated that California supports placing issue papers in Level 5.

Keith Bell (Travelers Companies Inc. – Travelers), representing interested parties, stated that the placement of the issue papers in the statutory accounting hierarchy is unclear as to the intent. He stated that, additionally, interested parties were concerned that the change might undercut the statutory accounting framework by placing a deliberative body of work that the Working Group produced, which provides the basis for many of the various SSAPs, at the bottom of the hierarchy. He stated that historically, the statutory hierarchy was put in place when statutory accounting was codified and was based on the U.S. GAAP hierarchy that existed at that time, which came from *Statement on Auditing Standards (SAS) No. 69, The Meaning of "Present Fairly in Conformity With Generally Accepted Accounting Principles" in the Independent Auditor's Report*. He stated that the hierarchy was intended to provide guidance when there is conflicting guidance from different sources.

Bell stated that, in the updated background materials for the meeting, it was noted that some users perceived the site issue paper guidance as authoritative, particularly once the issue paper had been posted on the NAIC website, even though the guidance had been replaced by more recent statutory accounting guidance. He stated that, in reviewing the wording in the preamble, the guidance in paragraph 42 is clear that if there is a conflict between the guidance and the levels of the hierarchy, the preparer, regulator, or auditor should follow the treatment specified by the source and the higher level. He stated that if companies or others are misapplying this guidance, that risk will continue no matter the level at which issue papers are placed. He stated that interested parties believe the issue papers fit well in Level 4, along with the SAP Preamble and the statement of concepts. He stated that the rationale for that placement is that it provides the conclusions for all of the SSAPs and the guidance that ended up in the SSAPs, analogous to the basis of conclusions that the FASB used to include in its financial accounting standards. Bell stated that the recent examples of why they think this is appropriate are, as previously cited, the bond issue paper, CECL, and, more recently, the adoption today of Issue Paper No. 170. He stated that interested parties thought a better approach to address the concerns included in the materials was to include the issue papers in Level 4 and add a note to Level 4 of the table emphasizing that more recent SSAPs may supersede certain guidance in the issue papers. He stated that this would also address the problem of having to update an issue paper every time a change to an SSAP is adopted.

Bruggeman stated that issue papers previously were not defined anywhere, and placing them in Level 4 with comments seems to overlook the established hierarchy. He stated that if the issue paper is a historical record of what happened, especially during codification, many of these issue papers are almost identical to the adopted SAPs. He stated that if the SAP was amended later, the issue paper would not always be updated, particularly within several years of the effective date of codification. He stated that issue papers were meant to document the historical context, especially moving from the old life and health and property/casualty (P/C) books into codification.

Bell stated that no matter which level they are placed in, it would be helpful to add a note under the table to point out that the issue papers may have obsolete guidance in relation to more recent SSAPs.

Gann stated that an editorial note could be prepared for future discussion to clarify that the issue papers may be out of date. Bell stated that there is currently nothing in the notes that addresses the issue papers because the issue papers were not included there previously.

Bruggeman stated that the Working Group should keep issue papers in Level 5 for now and not try to wordsmith anything on the call. He stated that they could look at it afterward and, if necessary, provide an update at the 2025 Spring National Meeting and discuss it briefly at that time if warranted.

Hudson made a motion, seconded by Walker, to adopt the exposed revisions to classify issue papers in Level 5 of the statutory hierarchy (Attachment 7). The motion passed unanimously.

F. Agenda Item 2024-28

Bruggeman directed the Working Group to agenda item 2024-28: Holders of Capital Notes. Gann stated that on Dec. 17, 2024, the Working Group exposed revisions to *SSAP No. 41—Surplus Notes* to incorporate changes clarifying capital note references and guidance. She stated that, although capital notes were previously included in SSAP No. 41, there was not much discussion on these instruments and that the focus was primarily on surplus notes. She stated that, with the principle-based bond definition and clarification of certain instruments, updating the definitions and guidance for capital notes was deemed necessary.

Gann stated that the Working Group exposed revisions and received some comments from interested parties, with most edits being minor. First, there was a question regarding paragraph 9.a. of SSAP No. 41, which addresses the admittance of surplus notes and capital notes based on equity limits. She stated that when NAIC staff reviewed this, it did not make sense in the accounting guidance since there were no admittance limits on equity items. Whether this guidance was specific to identifying limits according to state investment laws was considered. She stated that, with the exposure, NAIC staff recommended two options: deleting the paragraph entirely or incorporating proposed revisions to reference state investment laws. She stated that today, NAIC staff recommend deleting paragraph 9.a., consistent with comments received from interested parties and feedback from state insurance regulators who support the deletion. Gann stated that if the Working Group chooses not to delete paragraph 9.a., NAIC staff recommend leaving it unchanged and not incorporating the proposed edits, as the comments indicate these do not align with state investment laws. She stated that the Working Group would need to revisit this paragraph in a separate agenda item to tailor it correctly to refer to the original intent. Gann stated that, additionally, there are edits to paragraphs 18.c. and 21 as recommended by interested parties. She stated that paragraph 21 was a disclosure exposed with edits deemed no longer necessary, as the disclosure would be challenging to complete. She stated that interested parties noted that paragraph 18.c. was similar in this regard, and NAIC staff agreed. She stated that NAIC staff proposed deleting paragraph 18.c. and adding a reference to related parties in paragraph 21. Gann stated that all these disclosures are narrative only and are not data captured. Gann stated that the last comments received related to paragraph 9.b., which addresses non-admittance if a surplus note or capital note is no longer paid. She stated that the guidance was revised to clarify that capital notes should be non-admitted if payments for principal or interest are halted. She stated that interested parties did not support this language but that NAIC staff believed it should be retained under the concept of conservatism. Gann stated that the guidance already indicates that once payment resumes, the capital note can be admitted again. She stated that non-admittance would only occur when payment is halted under paragraph 9.b. She stated that NAIC staff recommend adopting the exposed edits to SSAP No. 41 with the deletion of paragraph 9.a. and the edits to paragraphs 18.c. and 21. She stated that NAIC staff do not recommend changes to the exposed edits for paragraph 9.b.

Bruggeman stated that the proposal essentially moves paragraph 18.c. into paragraph 21, which eliminates some redundancy. He stated that regarding paragraph 9.b., non-admitting rather than doing an other temporary impairment, which would be a write-down, provides more flexibility. He stated that if payments resume, a write-down cannot be reversed. However, non-admittance is conservative and offers flexibility, as once the principal or interest payments resume, the value can be restored accordingly. He stated that it is up to the Working Group to determine how many capital notes are out there and the significance of the regulatory authority to halt principal and interest payments. He also noted that the original paragraph 9.a., part of the original books, was carried over into SSAP No. 41 without much comment during the codification process. Bruggeman stated that if it is causing issues and not serving a purpose, it makes sense to delete it.

Mike Reis (Northwestern Mutual), representing interested parties, stated that they found it onerous to not admit the capital notes if interest was paused for a year or two. He mentioned that he understood the rationale but wanted to make this note.

Clark stated that this approach is consistent with the treatment of surplus notes, which was used as a rationale for scoping these similar instruments. He mentioned that trying to measure an other-than-temporary impairment (OTTI) when a state insurance regulator is exercising their discretion on whether to allow payments to continue would be difficult to do reliably. He stated that, from a company perspective, they are not evaluating the entity's financial strength or collateral values but rather trying to predict regulatory decisions. This is why non-admittance likely makes sense for this type of investment.

Clark made a motion, seconded by Sherman, to adopt SAP clarification revisions to *SSAP No. 41—Surplus Notes* (Attachment 8). The motion passed with limited changes from the exposure.

Comments reviewed are included in Attachment 9.

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

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2025/03-24-25 Spring National Meeting/Hearing/03 - Meeting Minutes 02-25-25.docx

Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Collateral Loan Reporting

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue: This agenda item has been developed to propose an expansion of reporting for collateral loans on Schedule BA to enable regulators the ability to quickly identify the type of collateral in support of admittance of collateral loans in scope of *SSAP No. 21—Other Admitted Assets*. This agenda item has been drafted in response to comments that the current reporting detail on Schedule BA does not provide sufficient clarity on the type of collateral used in support of admittance of collateral loans. Furthermore, with the adoption of agenda item 2022-11, the statutory accounting guidance has been clarified that the collateral must reflect a qualifying investment, meaning that it would qualify for admittance if held directly by the insurer. This amendment further clarified that collateral that represents an investment in scope of *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* or *SSAP No. 97—Investments in Subsidiary, Controlled or Affiliated Entities* is required to be audited consistent with the admittance requirements of those SSAPs.

As detailed within, this agenda item proposes new disclosure requirements in SSAP No. 21 for collateral loans. The new disclosure requirement is proposed to be satisfied by an expansion of the reporting on Schedule BA, so that the collateral loans are separated by the type of collateral investment that secures the loan. Additionally, a new aggregated data-captured note is proposed to identify the admitted and nonadmitted collateral loans by the type of collateral that secures the loan.

Existing Authoritative Literature:

- **SSAP No. 21—Other Admitted Assets - (Tracking shows the edits adopted on Oct. 23, 2023.)**

4. Collateral loans are unconditional obligations[1] for the payment of money secured by the pledge of a qualifying investment[2] and meet the definition of assets as defined in SSAP No. 4 and are admitted assets to the extent they conform to the requirements of this statement. The outstanding principal balance on the loan and any related accrued interest shall be recorded as an admitted asset subject to the following limitations:

a. Loan Impairment—Determination as to the impairment of a collateral loan shall be based on current information and events. When it is considered probable that any portion of amounts due under the contractual terms of the loan will not be collected the loan is considered impaired. The impairment shall be measured based on the fair value of the collateral less estimated costs to obtain and sell the collateral. The difference between the net value of the collateral and the recorded asset shall be written off in accordance with *SSAP No. 5—Liabilities, Contingencies and Impairments of Assets*;

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. To support the admissibility of collateral loans, reporting entities shall maintain documentation sufficient to support the reasonableness of the fair value measurement of the underlying collateral, which shall be made available to the applicable domiciliary regulator and independent audit firm upon request.

Footnote 1: For purposes of determining a collateral loan in scope of this statement, a collateral loan does not include investments captured in scope of other statements. For example, *SSAP No. 26—Bonds* includes securities (as defined in that statement) representing a creditor relationship whereby there is a fixed schedule for one or more future payments. Investments captured in SSAP No. 26 that are also secured with collateral shall continue to be captured within scope of SSAP No. 26.

Footnote 2: A qualifying ~~I~~investment defined as those assets listed in Section 3 of *Appendix A-001—Investments of Reporting Entities*, which would, if held by the insurer, qualify for admittance. For example, if the collateral would not qualify for admittance under SSAP No. 4 due to encumbrances or other third-party interests, then it does not meet the definition of "qualifying" and the collateral loan, or any portion thereof which is not adequately collateralized, is not permitted to be admitted. In the cases where the collateral is an equity/unit investment in a joint venture, partnership, limited liability company, and/or SCA is pledged as collateral in a collateral loan, audited financial statements on a consistent annual basis are always required in accordance with SSAP No. 48 and/or SSAP No. 97.

Effective Date and Transition

22. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors. The guidance for structured settlements when the reporting entity acquires the legal right to receive payments is effective December 31, 2018. The clarification regarding audits of qualifying collateral pledged for collateral loans in the footnote 2 to paragraph 4 requires applicable audits to be obtained for the 2023 reporting period in the subsequent year. In periods after year-end 2023, the audits of equity collateral pledged for collateral loans are required to be obtained for the reporting year in which it was pledged and annually thereafter. The annual audit lag shall be consistent from period to period.

- **A/S Blank and Instructions** *(This reflects what is proposed to be adopted in 2023-12BWG.)*

Collateral Loans
Unaffiliated..3199999
Affiliated..3299999

Collateral Loans

Include: Refer to *SSAP No. 21—Other Admitted Assets* for a definition of collateral loans. Loans that are backed by any form of collateral, regardless of if the collateral is sufficient to fully cover the loan, shall be captured in this category. Guidance in SSAP No. 21 shall be followed to determine nonadmittance.

In the description column, the name of the actual borrower and state if the borrower is a parent, subsidiary, affiliate, officer or director. Also include the type of collateral held.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

- Agenda Item 2022-11: Collateral for Loans clarified guidance on the criteria for collateral in order for a collateral loan to qualify as an admitted asset.

- Blanks Agenda Item 2023-12BWG incorporates revisions as part of the bond project to capture debt securities that do not qualify as bonds on Schedule BA. The revisions within this blanks item incorporate minor revisions to the instructions for collateral loans.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group: None

Convergence with International Financial Reporting Standards (IFRS): N/A

Recommendation:

NAIC staff recommend that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose this agenda item with proposed revisions to incorporate a new disclosure to SSAP No. 21, for initial reporting as of year-end 2024, and to sponsor a blanks proposal for a new data-captured disclosure and to expand the reporting lines on Schedule BA to separate collateral loans by the type of collateral that secures the loan. NAIC staff recommends that the Working Group direct a corresponding blanks proposal to allow for concurrent exposure.

Proposed Revisions to SSAP No. 21*: (Only new edits are tracked. Prior adopted revisions are shown clean.)*

4. Collateral loans are unconditional obligations[1] for the payment of money secured by the pledge of a qualifying investment[2] and meet the definition of assets as defined in SSAP No. 4 and are admitted assets to the extent they conform to the requirements of this statement. The outstanding principal balance on the loan and any related accrued interest shall be recorded as an admitted asset subject to the following limitations:

a. Loan Impairment—Determination as to the impairment of a collateral loan shall be based on current information and events. When it is considered probable that any portion of amounts due under the contractual terms of the loan will not be collected the loan is considered impaired. The impairment shall be measured based on the fair value of the collateral less estimated costs to obtain and sell the collateral. The difference between the net value of the collateral and the recorded asset shall be written off in accordance with *SSAP No. 5—Liabilities, Contingencies and Impairments of Assets*;

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. To support the admissibility of collateral loans, reporting entities shall maintain documentation sufficient to support the reasonableness of the fair value measurement of the underlying collateral, which shall be made available to the applicable domiciliary regulator and independent audit firm upon request.

5. Collateral loans shall be reported based on the type of qualifying investment that secures the loan. An aggregate note disclosure shall identify the total amount of collateral loans and the collateral loans admitted and nonadmitted by qualifying investment type.

Footnote 1: For purposes of determining a collateral loan in scope of this statement, a collateral loan does not include investments captured in scope of other statements. For example, *SSAP No. 26—Bonds* includes securities (as defined in that statement) representing a creditor relationship whereby there is a fixed schedule for one or more future payments. Investments captured in SSAP No. 26 that are also secured with collateral shall continue to be captured within scope of SSAP No. 26.

Footnote 2: A qualifying investment defined as those assets listed in Section 3 of *Appendix A-001—Investments of Reporting Entities* which would, if held by the insurer, qualify for admittance. For example, if the collateral would not qualify for admittance under SSAP No. 4 due to encumbrances or other third-party interests, then it does not meet the definition of "qualifying" and the collateral loan, or any portion thereof which is not adequately collateralized, is not permitted to be admitted. In the cases where the collateral is an equity/unit investment in a joint venture, partnership, limited liability company, and or SCA is pledged as collateral in a collateral loan, audited financial statements on a consistent annual basis are always required in accordance with SSAP No. 48 and or SSAP No. 97.

Proposed Schedule BA Reporting Changes*:*

Collateral Loans – Reported by Qualifying Investment Collateral that Secures the Loan

Cash, Cash Equivalent & Short-Term Investments (SSAP No. 2)
Unaffiliated...
Affiliated..

Bonds (SSAP No. 26)
Unaffiliated...
Affiliated..

Asset-Backed Securities (SSAP No. 43)
Unaffiliated...
Affiliated..

Preferred Stocks (SSAP No. 32)
Unaffiliated...
Affiliated..

Common Stocks (SSAP No. 30)
Unaffiliated...
Affiliated..

Mortgage Loans (SSAP No. 37)
Unaffiliated...
Affiliated..

Real Estate (SSAP No. 40)
Unaffiliated...
Affiliated..

Joint Venture, Partnerships or Limited Liability Companies (SSAP No. 48)
Unaffiliated...
Affiliated..

Subsidiary, Controlled or Affiliated Investment (SSAP No. 97)
Unaffiliated...
Affiliated..

Other Qualifying Investment Category
Unaffiliated...
Affiliated..

Collateral Does Not Qualify as an Investment
Unaffiliated...
Affiliated...

Collateral Loans

Include: Refer to *SSAP No. 21—Other Admitted Assets* for a definition of collateral loans. Loans that are backed by any form of collateral, regardless of if the collateral is sufficient to fully cover the loan, shall be captured in this category. Guidance in SSAP No. 21 shall be followed to determine nonadmittance.

In the description column, the name of the actual borrower and state if the borrower is a parent, subsidiary, affiliate, officer or director. Also include the type of collateral held.

Classify the collateral loan in accordance with the type of collateral held, such that if the loan was to default and the collateral was to be claimed by the reporting entity, where it would be captured (investment type by SSAP) as a directly-held investment. If more than one form of collateral secures the loan, classification should occur based on the primary collateral source. The other qualifying investment category shall only be used to capture collateral loans secured by collateral in the form of contract loans, derivatives, other invested assets not separately reported, receivables for securities, securities lending, and any investments that would qualify as a write-in for invested assets.

Proposed Data-Captured Disclosure*:*

Aggregate Collateral Loans by Qualifying Investment Collateral:

Collateral Type	**Aggregate Collateral Loan**	**Admitted**	**Nonadmitted**
Cash, Cash Equivalents & ST Investments			
Bonds			
Asset-Backed Securities			
Preferred Stocks			
Common Stocks			
Real Estate			
Mortgage Loans			
Joint Ventures, Partnerships, LLC			
Subsidiary, Affiliated and Controlled Entities			
Other Qualifying Investments			
Collateral Does not Qualify as an Investment			
Total			

Pursuant to SSAP No. 21, nonadmittance of a collateral loan is required when the fair value of the collateral is not sufficient to cover the collateral loan or if the collateral securing the loan is not a qualifying investment. This includes situations in which collateral in form of joint ventures, partnerships, LLCs or SCAs is not supported by an audit as required by SSAP No. 48 or SSAP No. 97.

The other qualifying investment category shall only be used to capture collateral loans secured by collateral in the form of contract loans, derivatives, other invested assets not separately reported, receivables for securities, securities lending and any investments that would qualify as a write-in for invested assets. All collateral loans secured by collateral that does not qualify as an investment are~~is~~ required to be nonadmitted under SSAP No. 21.

Staff Review Completed by: Julie Gann - NAIC Staff, September 2023

Status:
On December 1, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification and exposed revisions to incorporate a new disclosure to SSAP No. 21 for initial reporting as of year-end 2024, and to sponsor a blanks proposal for a new data-captured disclosure and to expand the reporting lines on Schedule BA to separate collateral loans by the type of collateral that secures the loan. Comments are requested on whether any of the proposed reporting lines should be combined.

On February 20, 2023, the Statutory Accounting Principles (E) Working Group took the following two actions:

1) The Working Group **adopted** the exposed revisions to SSAP No. 21 incorporating a collateral loan disclosure for year-end 2024. With this adoption, the Working Group sponsored a blanks proposal to data-capture the disclosure. Adopted revisions to SSAP No. 21 are shown below:

   5. Collateral loans shall be reported based on the type of qualifying investment that secures the loan. An aggregate note disclosure shall identify the total amount of collateral loans, and the collateral loans admitted and nonadmitted by qualifying investment type.

2) The Working Group exposed proposed reporting lines to Schedule BA for collateral loans with a comment deadline of April 19, 2024. Although the exposure does not contain AVR reporting revisions, the Working Group is specifically requesting feedback from regulators and industry on whether collateral loans backed by certain types of collateral should flow through AVR for RBC impact. Additionally, the Working Group directed a referral to the Life Risk-Based Capital (E) Working Group on the proposed reporting lines and the AVR mapping/RBC impact for collateral loans.

February 20, 2024, Exposed Schedule BA Reporting Changes*:*
(Tracking shows changes from the prior exposure.)

Collateral Loans – Reported by Qualifying Investment Collateral that Secures the Loan

~~Cash, Cash Equivalent & Short-Term Investments (SSAP No. 2R)~~
~~Unaffiliated...~~
~~Affiliated...~~

Bonds and Asset-Backed Securities (SSAP No. 26 & SSAP No. 43)
Unaffiliated...
Affiliated...

~~Asset-Backed Securities (SSAP No. 43R)~~
~~Unaffiliated...~~
~~Affiliated...~~

Preferred Stocks (SSAP No. 32)
Unaffiliated...
Affiliated...

Common Stocks (SSAP No. 30)
Unaffiliated...

Affiliated...

Mortgage Loans (SSAP No. 37)
Unaffiliated...
Affiliated...

Real Estate (SSAP No. 40)
Unaffiliated...
Affiliated...

Joint Venture, Partnerships or Limited Liability Companies (SSAP No. 48)
Fixed Income Investments (Unaffiliated) ....
Fixed Income Investments (Affiliated) ....

Common Stocks (Unaffiliated) ....
Common Stocks (Affiliated) ....

Real Estate (Unaffiliated) ....
Real Estate (Affiliated) ....

Mortgage Loans (Unaffiliated) ....
Mortgage Loans (Affiliated) ....

Other (Unaffiliated) ....
Other (Affiliated) ....
~~Unaffiliated...~~
~~Affiliated...~~

~~Subsidiary, Controlled or Affiliated Investment (SSAP No. 97)~~
~~Unaffiliated...~~
~~Affiliated...~~

Other ~~Qualifying~~ Investment Category
Cash, Cash Equivalent and Short-Term Investments (Unaffiliated) ....
Cash, Cash Equivalent and Short-Term Investments (Affiliated) ....

Other Long-Term Invested Assets (Unaffiliated) ....
Other Long-Term Invested Assets (Affiliated) ....
~~Unaffiliated...~~
~~Affiliated...~~

~~Collateral Does Not Qualify as an Investment~~
~~Unaffiliated...~~
~~Affiliated...~~

Non-Collateral Loans

Related Party/Affiliated Loans
All Other Non-Collateral Loans
~~Unaffiliated...~~
~~Affiliated...~~

On May 15, 2024, the Statutory Accounting Principles (E) Working Group took the following two actions:

1) Directed NAIC staff to prepare a memo to the Blanks (E) Working Group to incorporate an instructional change to the AVR instructions that allows collateral loans backed by mortgages to flow through AVR as an "Other Invested Asset with Underlying Characteristics of Mortgage Loans" as an interim step while further consideration occurs on the reporting of collateral loans and how collateral loans should flow through AVR. The Working Group noted that this memo to blanks is contingent on the adoption of the exposed editorial change by the Life Risk-Based Capital (E) Working Group. This Life RBC editorial change adjusts the amount reported as collateral loans to be in "in part" so that the reduction for what is backed by mortgage loans could be removed from the collateral loan total, as they would be captured in a different category. If this Life RBC change does not get adopted, while the blanks memo moves forward, then collateral loans backed by mortgage loans would get captured in two places in the RBC formula.

2) Directed NAIC staff to proceed with sponsoring a blanks proposal for the reporting of collateral loans, using the reporting lines shown in the agenda item modified to reflect a majority of the interested parties' comments. NAIC staff notes that specific comments were not received on whether certain collateral loans should flow through AVR, so NAIC staff will be working in the interim with regulators and RBC staff to develop a proposal for initial consideration. (With this direction, this agenda item was not re-exposed. The agenda item will likely be exposed when the proposed blanks changes are drafted.)

2024 Summer National Meeting Updated Recommendation:

As detail of all collateral types will be collected in the data-captured disclosure, NAIC staff proposes only limited reporting lines on Schedule BA reporting lines focusing on categories for which look-through to underlying collateral for AVR and RBC purposes is warranted. The proposed categories shown below reflect where separate reporting and AVR/RBC consideration has been suggested. With the receipt of the 2024 data-captured disclosure, an assessment will occur to determine whether additional Schedule BA reporting lines should be considered based on the extent certain types of investments are backed by collateral loans. **NAIC staff recommend exposure of this agenda item with a request for comments on the following potential Schedule BA collateral loan reporting lines. With exposure, NAIC staff recommends sponsoring a blanks proposal to begin detailing the revisions to Schedule BA and AVR that would occur with these changes. As the resulting AVR and RBC factors would be contingent on the actions of the Capital Adequacy (E) Task Force (and its RBC Working Groups), NAIC staff recommend Working Group direction to notify those groups of this action.**

(Although the effective date of revisions is always contingent on the direction of the Working Group, it is currently anticipated that a Jan. 1, 2026, effective date would be considered. This would allow the revisions to begin at the start of a statutory filing year. Revisions would need to be adopted by August 2025 to meet that timeframe.)

Proposed Schedule BA Revisions:
(The existing collateral loan line will be deleted.)

Collateral Loans – Reported by Collateral that Secures the Loan

Backed by Mortgage Loans
Unaffiliated...
Affiliated...

(Collateral loans backed by mortgage loans that would be in scope of SSAP No. 37 if held directly.)

Backed by Investments in Joint Ventures, Partnerships or Limited Liability Companies
Unaffiliated...
Affiliated...

(Collateral loans backed by an investment that would be in scope of SSAP No. 48 if held directly.)

Backed by Residual Interests
Unaffiliated..
Affiliated..

(Collateral loans backed by an investment that would be in SSAP No. 21 as a residual if held directly.)

Backed by Debt Securities
Unaffiliated..
Affiliated..

(Collateral loans backed by an investment that would be assessed under SSAP No. 26 for bond reporting. This classification does not require confirmation that the debt security would qualify as a bond.)

Backed by Real Estate
Unaffiliated..
Affiliated..

(Collateral loans backed by an investment that would be captured in scope of SSAP No. 40 if held directly.)

Collateral Loans – All Other
Unaffiliated..
Affiliated..

(Collateral loans not captured in the specific reporting lines.)

With the inclusion of these new reporting lines, this recommendation also supports the inclusion of the following Schedule BA electronic-only columns for all collateral loan investments:

- Fair Value of Collateral Backing the Collateral Loan
- Percentage of Collateral to the Collateral Loan

Proposed AVR Revisions:
This exposure suggests a new category within the AVR Reporting Schedule to capture collateral loans. This is currently proposed to be a new category inserted after "residuals" (AVR lines 81-93) and before "All Other Investments" (AVR lines 94-99). The following illustrates the simple proposed addition to the schedule.

The following elements are requested for feedback during the exposure:

1) Should collateral loans backed by mortgage loans be included in the new collateral loan category, or should those continue to flow through the "Investments with the Underlying Characteristics of Mortgage Loans" permitted during the interim as the long-term resolution? If captured in the new collateral loan AVR category, to what extent should the underlying characteristic lines detailing quality / past due / foreclosure status (AVR lines 38-64) be duplicated?

2) What additional reporting lines (breakouts) of the proposed AVR categories are necessary to ensure appropriate look-through for RBC assessment purposes?

RESIDUAL TRANCHES OR INTERESTS

81 Fixed Income Instruments – Unaffiliated.....
82 Fixed Income Instruments – Affiliated ....
83 Common Stock – Unaffiliated.....................
84 Common Stock – Affiliated ....
85 Preferred Stock – Unaffiliated.....................
86 Preferred Stock – Affiliated ....
87 Real Estate – Unaffiliated ....
88 Real Estate – Affiliated ....
89 Mortgage Loans – Unaffiliated ....
90 Mortgage Loans – Affiliated ....
91 Other – Unaffiliated ....
92 Other – Affiliated ....
93 Total Residual Tranches or Interests (Sum of Lines 81 through 92)

COLLATERAL LOANS
Backed by Mortgage Loans – Unaffiliated
Backed by Mortgage Loans – Affiliated
Backed by SSAP No. 48 Investments – Unaffiliated
Backed by SSAP No. 48 Investments – Affiliated
Backed by Residuals – Unaffiliated
Backed by Residuals – Affiliated
Backed by Debt Securities – Unaffiliated
Backed by Debt Securities – Affiliated
Backed by Real Estate – Unaffiliated
Backed by Real Estate – Affiliated
All Other – Unaffiliated
All Other – Affiliated

(Renumbering will Occur Based on the Resulting Lines)

ALL OTHER INVESTMENTS
94 NAIC 1 Working Capital Finance Investments
95 NAIC 2 Working Capital Finance Investments
96 Other Invested Assets - Schedule BA ....
97 Other Short-Term Invested Assets - Schedule DA
98 Total All Other (Sum of Lines 94, 95, 96 and 97)
99 Total Other Invested Assets - Schedules BA & DA
(Sum of Lines 29, 37, 64, 70, 74, 80, 93 and 98)

On August 13, 2024, the Statutory Accounting Principles (E) Working Group exposed this agenda item with the proposed reporting lines for Schedule BA and AVR as shown above under the 2024 Summer National Meeting recommendation. Additionally, the Working Group directed NAIC staff to proceed with sponsoring a blanks proposal and to notify the Capital Adequacy (E) Task Force and related RBC Working Groups of this action. The RBC factors for the Schedule BA and AVR reporting lines will be contingent on the action of the Task Force. This item was exposed until September 27, 2024 to allow for consideration at the 2024 Fall National Meeting.

On November 17, 2024, the Statutory Accounting Principles (E) Working Group re-exposed this agenda item detailing the proposed reporting lines for Schedule BA and AVR. This item was re-exposed to allow for concurrent exposure with blanks proposal 2024-19BWG. Comments received by the Blanks (E) Working Group and the SAPWG will be reviewed collectively.

Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Reporting of Funds Withheld and Modco Assets

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue: During 2023, as a result of rising interest rates, the Statutory Accounting Principles (E) Working Group addressed the issue of net negative (disallowed) interest maintenance reserve for statutory accounting with *Interpretation (INT) 23-01 Negative (Disallowed) Interest Maintenance Reserve*, as a short-term solution. Later in 2023, the IMR Ad Hoc Group was formed to find a more permanent solution to address IMR for statutory accounting. During the IMR Ad Hoc Group's review process and discussions, it was noted that there were issues with identifying assets that are subject to funds withheld or modified coinsurance (modco) arrangements within the financial statements and reporting schedules. The intent of this agenda item is to make it easier to identify assets that are subject to a funds withheld or modco arrangements through updated reporting in the financials. This agenda item does not intend to change statutory accounting for these arrangements.

Funds withheld and modco arrangements are defined in the glossary to *SSAP No. 61—Life, Deposit-Type and Accident and Health Reinsurance*:

- Funds withheld assets - "*Assets that would normally be paid over to a reinsurer but are withheld by the ceding entity to permit statutory credit for nonadmitted reinsurance, to reduce a potential credit risk, or to retain control over investments. Under certain conditions, the reinsurer may withhold funds from the ceding entity*."

- Modco arrangements - "*Indemnity life insurance that differs from coinsurance only in that the reserves are retained by the ceding entity, which represents a prepayment of all or a portion of the reinsurer's future obligation. Periodically an adjustment is made to the mean reserve on deposit with the ceding entity. This is usually done quarterly but may be done more frequently. If the reserve increases, the increase in mean reserve less interest on the mean reserve held at the end of the previous accounting period is paid by the reinsurer to the ceding entity. If the mean reserve decreases, the decrease and interest are paid by the ceding entity to the reinsurer. The appropriate interest rate is defined in the treaty*."

Although this issue of clarity of reporting of funds withheld and modco assets was raised as part of the IMR project, which is focused on life insurance, funds withheld also exist for property/casualty insurance, so this agenda item proposes to add this updated reporting to all the annual statement blanks.

The initial recommendation is to add a new part to the reinsurance Schedule S in the Life/Fraternal and Health annual statement blanks and Schedule F in the Property/Casualty and Title annual statement blanks. The new part would be similar in structure to Schedule DL and would include all assets held under a funds withheld arrangement and would include a separate signifier for modco assets.

Existing Authoritative Literature:
Funds withheld and modco arrangements are noted in *SSAP No. 61—Life, Deposit-Type and Accident and Health Reinsurance*. Funds withheld are also discussed in *SSAP No. 62—Property and Casualty Reinsurance* and Appendix A-785 Credit for Reinsurance.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group: None

Convergence with International Financial Reporting Standards (IFRS): None

Staff Recommendation:
NAIC staff recommend that the Working Group move this item to the active listing of the maintenance agenda categorized as a SAP clarification and expose the recommendation to add a new part to the reinsurance Schedule S in the Life/Fraternal and Health annual statement blanks and Schedule F in the Property/Casualty and Title annual statement blanks, that is similar in structure to Schedule DL and would include all assets held under a funds withheld arrangement and would include a separate signifier for modco assets.

Staff Review Completed by: Jake Stultz, NAIC Staff—February 2024

Summer 2024 Updated Staff Recommendation:

NAIC staff recommend that the Working Group expose the draft of the new reporting schedules (included in Exhibit 1 of this Form A), which add a new part to the reinsurance Schedule S in the Life/Fraternal and Health annual statement blanks and Schedule F in the Property/Casualty and Title annual statement blanks and direct NAIC staff to continue working with interest parties on this proposal.

The Life RBC formula reflects a reduction in RBC charges for modco and funds withheld assets. This reduction is by asset type and often by asset designation. The fair value of the assets withheld is also reported in the reinsurance Schedules S and F as collateral. Accordingly, to accomplish both things, asset-by-asset identification is necessary. Therefore, some of the submitted comments regarding not being able to identify assets withheld which are not held in trust would indicate a disconnect. <u>Comments are requested regarding if the assets cannot be identified, then how are the numbers determined for the life risk-based capital charge reductions reported and the collateral fair value.</u>

Spring 2025 Updated Staff Recommendation:

NAIC staff recommend that the Working Group expose the draft of the new reporting schedule (included in Exhibit 1 of this Form A), which add a new part to the reinsurance Schedule S in the Life/Fraternal. After reviewing the comment letters received and discussions with interested parties, the updated draft of the schedule follows closely with the recommendations that were received. There is now only a new Schedule S, Part 8 for the Life/Fraternal Instructions and Blank, and these new disclosures will not be required for Health companies or for P&C and Title companies. Additionally, the new draft schedule includes aggregated data and follows closely with AVR reporting. A corresponding SAPWG sponsored blanks proposal was exposed by the Blanks (E) Working Group on March 6. The full Schedule S, Part 8 blank and instructions is included in Exhibit 1 below.

If Working Group members continue to support inclusion of comparable schedules in the P/C and Health blanks, NAIC staff can include those items in the exposure and direct their inclusion in the Blank proposal.

Status:
On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed a project which proposes to add a new part to the reinsurance Schedule S in the Life/Fraternal and Health annual statement blanks and Schedule F in the Property/Casualty (P/C) and Title annual statement blanks, which is similar in structure to Schedule DL

and would include all assets held under a funds withheld arrangement and would include a separate signifier for modified coinsurance assets.

On August 13, 2024, the Statutory Accounting Principles (E) Working Group exposed this agenda item which proposes to add a new part to the reinsurance Schedule S in the Life/Fraternal and Health annual statement blanks and Schedule F in the Property/Casualty and Title annual statement blanks as illustrated on the following pages. In response to comments submitted that indicated that non-trust assets could not be identified, the Working Group also specifically requested comments asking if the assets cannot be identified, then how are the numbers determined for the life risk-based capital charge reductions reported and the collateral fair value?

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2025/03-24-25 Spring National Meeting/Hearing/05 - 24-07 - Modco Reporting.docx

Exhibit 1, Draft Schedule S, Part 8 Instructions and Blanks

Note: Exhibit 1, which included the original draft changes to the Annual Statement Instructions and Blanks from the prior exposure has been removed from this version for clarity. The Spring 2025 exposure is only a new Schedule S, Part 8 for the Life/Fraternal Blanks.

Life/Fraternal Instructions

SCHEDULE S – PART 8

FUNDS WITHHELD AS OF DECEMBER 31, CURRENT YEAR

This section should include data on all modified coinsurance (MODCO) and other reinsurance transactions with funds withheld as of December 31, current year.

If a reporting entity's detail lines report any of the following required categories, it shall report the subtotal amount of the corresponding category, with the specified subtotal line number appearing in the same manner and location as the pre-printed total line and number.

Column 1 & 2 – Ceded General Account Assets

Report the FWH and MODCO ceded amounts for the reporting entity's general account.

Column 3 & 4 – Ceded Guaranteed Separate Account Assets

Report the FWH and MODCO ceded guaranteed amounts for the reporting entity's separate account.

Column 5 & 6 – Total Ceded Assets

Report the Total Ceded Assets for the reporting entity's general and separate account.

Column 5 should equal Column 1 plus Column 3
Column 6 should equal Column 2 plus Column 4

Column 7 & 8 – Assumed General Account Assets

Report the FWH and MODCO assumed general account amounts by the reporting entity.

Column 9 & 10 – Assumed Guaranteed Separate Account Assets

Report the FWH and MODCO assumed general account guaranteed amounts by the reporting entity.

Column 11 & 12 – Total Assumed Assets

Report the Total Assumed Assets by the reporting entity.

Column 11 should equal Column 7 plus Column 9
Column 12 should equal Column 8 plus Column 10

Attachment 5
Ref #2024-07

SCHEDULE S PART 8
FUNDS WITHHELD AS OF DECEMBER 31, CURRENT YEAR
DEFAULT COMPONENT

		Ceded General Account Assets		Ceded Guaranteed Separate Account Assets		Total Ceded Assets		Assumed General Account Assets		Assumed Guaranteed Separate Account Assets		Total Assumed Assets	
		1	2	3	4	5	6	7	8	9	10	11	12
		FWH B/ACV	Modco B/ACV	FWH B/ACV	Modco B/ACV	FWH B/ACV Col 1+3	Modco B/ACV Col 2+4	FWH B/ACV	Modco B/ACV	FWH B/ACV	Modco B/ACV	FWH B/ACV Col 7+9	Modco B/ACV Col 8+10
	LONG-TERM BONDS												
1	Exempt Obligations												
2.1	NAIC Designation Category 1.A												
2.2	NAIC Designation Category 1.B												
2.3	NAIC Designation Category 1.C												
2.4	NAIC Designation Category 1.D												
2.5	NAIC Designation Category 1.E												
2.6	NAIC Designation Category 1.F												
2.7	NAIC Designation Category 1.G												
2.8	Subtotal NAIC 1 (2.1+2.2+2.3+2.4+2.5+2.6+2.7)												
3.1	NAIC Designation Category 2.A												
3.2	NAIC Designation Category 2.B												
3.3	NAIC Designation Category 2.C												
3.4	Subtotal NAIC 2 (3.1+3.2+3.3)												
4.1	NAIC Designation Category 3.A												
4.2	NAIC Designation Category 3.B												
4.3	NAIC Designation Category 3.C												
4.4	Subtotal NAIC 3 (4.1+4.2+4.3)												
5.1	NAIC Designation Category 4.A												
5.2	NAIC Designation Category 4.B												
5.3	NAIC Designation Category 4.C												
5.4	Subtotal NAIC 4 (5.1+5.2+5.3)												
6.1	NAIC Designation Category 5.A												
6.2	NAIC Designation Category 5.B												
6.3	NAIC Designation Category 5.C												
6.4	Subtotal NAIC 5 (6.1+6.2+6.3)												
7	NAIC 6												
8	Total Unrated Multi-Class Securities Acquired by Conversion												
9	Total Long-Term Bonds (Sum of Lines 1+2.8+3.4+4.4+5.4+6.4 +7+8)												
	PREFERRED STOCKS												
10	Highest Quality												
11	High Quality												
12	Medium Quality												
13	Low Quality												
14	Lower Quality												
15	In or Near Default												
16	Affiliated Life with AVR												
17	Total Preferred Stocks (Sum of Lines 10 through 16)												

SCHEDULE S PART 8 (Continued)
FUNDS WITHHELD AS OF DECEMBER 31, CURRENT YEAR
DEFAULT COMPONENT

		Ceded General Account Assets		Ceded Guaranteed Separate Account Assets		Total Ceded Assets		Assumed General Account Assets		Assumed Guaranteed Separate Account Assets		Total Assumed Assets	
		1	2	3	4	5	6	7	8	9	10	11	12
		FWH B/ACV	Modco B/ACV	FWH B/ACV	Modco B/ACV	FWH B/ACV Col 1+3	Modco B/ACV Col 2+4	FWH B/ACV	Modco B/ACV	FWH B/ACV	Modco B/ACV	FWH B/ACV Col 7+9	Modco B/ACV Col 8+10
	SHORT-TERM BONDS												
18	Exempt Obligations												
19.1	NAIC Designation Category 1.A												
19.2	NAIC Designation Category 1.B												
19.3	NAIC Designation Category 1.C												
19.4	NAIC Designation Category 1.D												
19.5	NAIC Designation Category 1.E												
19.6	NAIC Designation Category 1.F												
19.7	NAIC Designation Category 1.G												
19.8	Subtotal NAIC 1 (19.1+19.2+19.3+19.4+19.5+19.6+19.7)												
20.1	NAIC Designation Category 2.A												
20.2	NAIC Designation Category 2.B												
20.3	NAIC Designation Category 2.C												
20.4	Subtotal NAIC 2 (20.1+20.2+20.3)												
21.1	NAIC Designation Category 3.A												
21.2	NAIC Designation Category 3.B												
21.3	NAIC Designation Category 3.C												
21.4	Subtotal NAIC 3 (21.1+21.2+21.3)												
22.1	NAIC Designation Category 4.A												
22.2	NAIC Designation Category 4.B												
22.3	NAIC Designation Category 4.C												
22.4	Subtotal NAIC 4 (22.1+22.2+22.3)												
23.1	NAIC Designation Category 5.A												
23.2	NAIC Designation Category 5.B												
23.3	NAIC Designation Category 5.C												
23.4	Subtotal NAIC 5 (23.1+23.2+23.3)												
24	NAIC 6												
25	Total Short-Term Bonds (18+19.8+20.4+21.4+22.4+23.4+24)												
	DERIVATIVE INSTRUMENTS												
26	Exchange Traded												
27	Highest Quality												
28	High Quality												
29	Medium Quality												
30	Low Quality												
31	Lower Quality												
32	In or Near Default												
33	Total Derivative Instruments												
34	Total (Lines 9+ 17+ 25+ 33)												

SCHEDULE S PART 8 (Continued)
FUNDS WITHHELD AS OF DECEMBER 31, CURRENT YEAR
DEFAULT COMPONENT

		Ceded General Account Assets		Ceded Guaranteed Separate Account Assets		Total Ceded Assets		Assumed General Account Assets		Assumed Guaranteed Separate Account Assets		Total Assumed Assets	
		1	2	3	4	5	6	7	8	9	10	11	12
		FWH B/ACV	Modco B/ACV	FWH B/ACV	Modco B/ACV	FWH B/ACV Col 1+3	Modco B/ACV Col 2+4	FWH B/ACV	Modco B/ACV	FWH B/ACV	Modco B/ACV	FWH B/ACV Col 7+9	Modco B/ACV Col 8+10
	MORTGAGE LOANS												
	In Good Standing:												
35	Farm Mortgages – CM1 – Highest Quality												
36	Farm Mortgages – CM2 – High Quality												
37	Farm Mortgages – CM3 – Medium Quality												
38	Farm Mortgages – CM4 – Low Medium Quality												
39	Farm Mortgages – CM5 – Low Quality												
40	Residential Mortgages – Insured or Guaranteed												
41	Residential Mortgages – All Other												
42	Commercial Mortgages – Insured or Guaranteed												
43	Commercial Mortgages – All Other – CM1 – Highest Quality												
44	Commercial Mortgages – All Other – CM2 – High Quality												
45	Commercial Mortgages – All Other – CM3 – Medium Quality												
46	Commercial Mortgages – All Other – CM4 – Low Medium Quality												
47	Commercial Mortgages – All Other – CM5 – Low Quality												
	Overdue, Not in Process:												
48	Farm Mortgages												
49	Residential Mortgages – Insured or Guaranteed												
50	Residential Mortgages - All Other												
51	Commercial Mortgages - Insured or Guaranteed												
52	Commercial Mortgages - All Other												
	In Process of Foreclosure:												
53	Farm Mortgages												
54	Residential Mortgages - Insured or Guaranteed												
55	Residential Mortgages - All Other												
56	Commercial Mortgages - Insured or Guaranteed												
57	Commercial Mortgages - All Other												
58	Total Schedule B Mortgages (Sum of Lines 35 through 57)												

SCHEDULE S PART 8
FUNDS WITHHELD AS OF DECEMBER 31, CURRENT YEAR
EQUITY AND OTHER INVESTED ASSET COMPONENT

		Ceded General Account Assets		Ceded Guaranteed Separate Account Assets		Total Ceded Assets		Assumed General Account Assets		Assumed Guaranteed Separate Account Assets		Total Assumed Assets	
		1	2	3	4	5	6	7	8	9	10	11	12
		FWH B/ACV	Modco B/ACV	FWH B/ACV	Modco B/ACV	FWH B/ACV Col 1+3	Modco B/ACV Col 2+4	FWH B/ACV	Modco B/ACV	FWH B/ACV	Modco B/ACV	FWH B/ACV Col 7+9	Modco B/ACV Col 8+10
	COMMON STOCK												
1	Unaffiliated Public												
2	Unaffiliated Private												
3	Federal Home Loan Bank												
4	Affiliated Life with AVR												
	Affiliated Investment Subsidiary:												
5	Fixed Income Exempt Obligations												
6	Fixed Income Highest Quality												
7	Fixed Income High Quality												
8	Fixed Income Medium Quality												
9	Fixed Income Low Quality												
10	Fixed Income Lower Quality												
11	Fixed Income In or Near Default												
12	Unaffiliated Common Stock Public												
13	Unaffiliated Common Stock Private												
14	Real Estate												
15	Affiliated-Certain Other (See SVO Purposes & Procedures Manual)												
16	Affiliated - All Other												
17	Total Common Stock (Sum of Lines 1 through 16)												
	REAL ESTATE												
18	Home Office Property (General Account only)												
19	Investment Properties												
20	Properties Acquired in Satisfaction of Debt												
21	Total Real Estate (Sum of Lines 18 through 20)												
	OTHER INVESTED ASSETS INVESTMENTS WITH THE UNDERLYING CHARACTERISTICS OF BONDS												
22	Exempt Obligations												
23	Highest Quality												
24	High Quality												
25	Medium Quality												
26	Low Quality												
27	Lower Quality												
28	In or Near Default												
29	Total with Bond Characteristics (Sum of Lines 22 through 28)												

SCHEDULE S PART 8 (Continued)
FUNDS WITHHELD AS OF DECEMBER 31, CURRENT YEAR
EQUITY AND OTHER INVESTED ASSET COMPONENT

		Ceded General Account Assets		Ceded Guaranteed Separate Account Assets		Total Ceded Assets		Assumed General Account Assets		Assumed Guaranteed Separate Account Assets		Total Assumed Assets	
		1	2	3	4	5	6	7	8	9	10	11	12
		FWH B/ACV	Modco B/ACV	FWH B/ACV	Modco B/ACV	FWH B/ACV Col 1+3	Modco B/ACV Col 2+4	FWH B/ACV	Modco B/ACV	FWH B/ACV	Modco B/ACV	FWH B/ACV Col 7+9	Modco B/ACV Col 8+10
	INVESTMENTS WITH THE UNDERLYING CHARACTERISTICS OF PREFERRED STOCKS												
30	Highest Quality												
31	High Quality												
32	Medium Quality												
33	Low Quality												
34	Lower Quality												
35	In or Near Default												
36	Affiliated Life with AVR												
37	Total with Preferred Stock Characteristics (Sum of Lines 30 through 36)												
	INVESTMENTS WITH THE UNDERLYING CHARACTERISTICS OF MORTGAGE LOANS												
	In Good Standing Affiliated:												
38	Mortgages – CM1 – Highest Quality												
39	Mortgages – CM2 – High Quality												
40	Mortgages – CM3 – Medium Quality												
41	Mortgages – CM4 – Low Medium Quality												
42	Mortgages – CM5 – Low Quality												
43	Residential Mortgages – Insured or Guaranteed												
44	Residential Mortgages – All Other												
45	Commercial Mortgages – Insured or Guaranteed												
	Overdue, Not in Process Affiliated:												
46	Farm Mortgages												
47	Residential Mortgages – Insured or Guaranteed												
48	Residential Mortgages – All Other												
49	Commercial Mortgages – Insured or Guaranteed												
50	Commercial Mortgages –- All Other												
	In Process of Foreclosure Affiliated:												
51	Farm Mortgages												
52	Residential Mortgages – Insured or Guaranteed												
53	Residential Mortgages – All Other												
54	Commercial Mortgages – Insured or Guaranteed												
55	Commercial Mortgages – All Other												
56	Total Affiliated (Sum of Lines 38 through 55)												
57	Unaffiliated – In Good Standing With Covenants												
58	Unaffiliated – In Good Standing Defeased With Government Securities												
59	Unaffiliated – In Good Standing Primarily Senior												
60	Unaffiliated – In Good Standing All Other												
61	Unaffiliated – Overdue, Not in Process												
62	Unaffiliated – In Process of Foreclosure												
63	Total Unaffiliated (Sum of Lines 57 through 62)												
64	Total with Mortgage Loan Characteristics (Lines 56 + 63)												

SCHEDULE S PART 8 (Continued)

FUNDS WITHHELD AS OF DECEMBER 31, CURRENT YEAR

EQUITY AND OTHER INVESTED ASSET COMPONENT

		Ceded General Account Assets		Ceded Guaranteed Separate Account Assets		Total Ceded Assets		Assumed General Account Assets		Assumed Guaranteed Separate Account Assets		Total Assumed Assets	
		1	2	3	4	5	6	7	8	9	10	11	12
		FWH B/ACV	Modco B/ACV	FWH B/ACV	Modco B/ACV	FWH B/ACV Col 1+3	Modco B/ACV Col 2+4	FWH B/ACV	Modco B/ACV	FWH B/ACV	Modco B/ACV	FWH B/ACV Col 7+9	Modco B/ACV Col 8+10
	INVESTMENTS WITH THE UNDERLYING CHARACTERISTICS OF COMMON STOCK												
65	Unaffiliated Public												
66	Unaffiliated Private												
67	Affiliated Life with AVR												
68	Affiliated Certain Other (See SVO Purposes & Procedures Manual)												
69	Affiliated Other - All Other												
70	Total with Common Stock Characteristics (Sum of Lines 65 through 69)												
	INVESTMENTS WITH THE UNDERLYING CHARACTERISTICS OF REAL ESTATE												
71	Home Office Property (General Account only)												
72	Investment Properties												
73	Properties Acquired in Satisfaction of Debt												
74	Total with Real Estate Characteristics (Sum of Lines 71 through 73)												
	INVESTMENTS IN TAX CREDIT STRUCTURES												
75	Yield Guaranteed State Tax Credit Investments												
76	Qualifying Federal Tax Credit Investments												
77	Qualifying State Tax Credit Investments												
78	Other Tax Credit Investments												
79	Total Tax Credit Investments (Sum of Lines 75 through 78)												
	RESIDUAL TRANCHES OR INTERESTS												
80	Bonds – Unaffiliated												
81	Bonds – Affiliated												
82	Common Stock – Unaffiliated												
83	Common Stock – Affiliated												
84	Preferred Stock – Unaffiliated												
85	Preferred Stock – Affiliated												
86	Real Estate – Unaffiliated												
87	Real Estate – Affiliated												
88	Mortgage Loans – Unaffiliated												
89	Mortgage Loans – Affiliated												
90	Other – Unaffiliated												
91	Other – Affiliated												
92	Total Residual Tranches or Interests (Sum of Lines 80 through 91)												
	INVESTMENTS WITH THE UNDERLYING CHARACTERISTICS OF SURPLUS NOTES AND CAPITAL NOTES												
93	Highest Quality												
94	High Quality												
95	Medium Quality												
96	Low Quality												
97	Lower Quality												
98	In or Near Default												
99	Total with Bond Characteristics (Sum of Lines 93 through 98)												
	ALL OTHER INVESTMENTS												
100	NAIC 1 Working Capital Finance Investments												
101	NAIC 2 Working Capital Finance Investments												
102	Other Invested Assets - Schedule BA												
103	Other Short-Term Invested Assets - Schedule DA												
104	Total All Other (Sum of Lines 94, 95, 96 and 97)												
105	Total Other Invested Assets - Schedules BA & DA (Sum of Lines 29, 37, 64, 70, 74, 79, 92, 99 and 105)												
106	Total Non-guaranteed Separate Account Assets	XXX	XXX	XXX	XXX			XXX	XXX	XXX	XXX		
107	Total Assets including Non-guaranteed Separate Account Assets	XXX	XXX	XXX	XXX			XXX	XXX	XXX	XXX		

Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Restricted Asset Disclosure Clarification

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue: This agenda item has been prepared to clarify how assets held under modified coinsurance (Modco) or funds withheld (FWH) agreements shall be reflected within the restricted asset disclosure in paragraph 23 of *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures* and in the corresponding disclosures in Note 5L of the statutory financial statements. It also proposes enhanced disclosures to fully identify the extent of restricted assets reported on balance sheet within a single disclosure as well as identify differences between the "restricted asset" annual statement disclosure and the amount reported in the general interrogatories, which is pulled directly into the RBC formulas. Lastly, this agenda item suggests a referral to propose revisions to the life RBC instructions to clarify that if the reporting entity uses any assets held under a modco or FWH agreement as collateral or as a pledged asset for a purpose unrelated to the reinsurance agreement (securing an exposure that has not been ceded to the reinsurer), then the reporting entity should not take any Modco/FWH reduction in RBC charges (credit) for those assets in the life RBC formula. This clarification is consistent with the existing life RBC instruction that does not permit RBC credit when the asset risk has not been transferred to the assuming entity for the entire duration of the reinsurance treaty. This referral to life RBC intends to make it clear that if the insurance entity has utilized Modco/FWH assets as collateral or as a pledged item for their own repurchase agreements, securities lending transactions, FHLB agreements/borrowings, or any other purpose specific to the ceding insurer's use, then the asset risk/benefit has not been sufficiently transferred to the assuming entity warranting RBC credit for those assets.

As a key item to note, this agenda item does not propose to capture modco/FWH assets in the restricted asset reporting that flows through to the general interrogatories (GI) that results with an additional "noncontrolled" asset RBC charge. As the RBC formula allows credit for modco/FWH assets held, if these were included in the "noncontrolled asset" category, more complexity and adjustments to the RBC formula would be required to also provide credit against the additional noncontrolled asset charge. Instead, as detailed within, this agenda item proposes modifications to capture modco/FWH assets in the existing restricted asset disclosure (SSAP No. 1, paragraph 23c) that currently focuses on collateral received reported on balance sheet for when there is an corresponding liability reported. By including at this location and expanding disclosures to provide a complete view of restricted assets in comparison to total assets and total admitted assets, there is no additional RBC impact and regulators have a better picture of the assets that are restricted as pledged, not under the exclusive control of the reporting entity or that are earmarked (such as modco/FWH) for a specific purpose.

NAIC staff is aware that some companies report modco/FWH assets held in the existing restricted asset disclosure as "pledged collateral not captured in other categories" or as "other restricted assets," but not all companies report these assets as restricted. (In the RBC formulas, there are adjustments for these assets that are reported that incur additional "noncontrolled" asset RBC.) This agenda item specifies the disclosure location and category to promote consistency and comparability across insurers in the reporting of these assets. NAIC staff supports the inclusion of these assets in the restricted asset disclosure (even when an offsetting liability is reported), as it allows for a full comparison of such assets to total assets. NAIC staff believes the total restricted assets may be considered by financial statement users when assessing available assets, and this disclosure could impact the extent to which borrowing is permitted. If Modco/FWH assets are not captured, it may present a picture of available assets that is not accurate.

As noted in the introduction, this agenda item also proposes additional disclosures to identify differences between what is captured as restricted in SSAP No. 1, paragraph 23b, in Note 5L(1), and what is captured in the general interrogatories. Although the categories are identical, NAIC staff is aware that amounts are reported differently between the two locations. NAIC staff believes this is due to the amounts that are reported in the GI are pulled for the additional noncontrolled asset RBC charge. Over time NAIC staff has received information that these discrepancies may be directed by the domiciliary state regulator for situations that have been identified not to warrant the additional "restricted asset" / "noncontrolled asset" RBC charge. Since the amount is pulled directly from the GI to the RBC formula it is not considered a permitted practice in RBC, however, it results in a mismatch between the note disclosure and the GI although the categories are identical. (NAIC staff has not identified any permitted practices for the differences between the Note and GI reporting. Regulator comments are requested on whether the two reporting locations are interpreted to have different parameters as the language appears identical in both locations.) At this time, this proposal is strictly a disclosure element to make it easy to identify variations and the explanation between the Note and GI reporting so that future assessments can occur. If certain restricted assets are supported for general exclusion from the GI reporting (and the RBC factor), then those situations should be considered by the Working Group so that all insurers are following the same provisions.

The following paragraphs detail how the existing disclosure in SSAP No. 1, paragraph 23b (reported in Note 5L(1)) compares to the information reported in the GI:

- As detailed in SSAP No. 1, paragraph 23b and in Note 5L(1), admitted and nonadmitted assets that are pledged or otherwise restricted in the general account and separate account are to be disclosed along with a comparison of the total restricted assets to total assets and total admitted assets. With specific categories for certain uses, the note also includes broad categories for "pledged as collateral not captured in other categories" and "other restricted assets" to capture items not covered within the specific lines. Note 5L(2) and 5L(3) captures information on these generic categories, and includes examples of reinsurance and derivatives contracts on what should be captured. This disclosure instruction indicates that contracts that share similar characteristics (such as reinsurance and derivatives) are to be reported in the aggregate.

- The restricted asset categories in Note 5L(1) are duplicated in the annual statement general interrogatories (GI), and the amounts reported in the GI are pulled directly into the RBC formula and incur an additional "noncontrolled asset" RBC charge. NAIC staff is aware that there are discrepancies between the amounts of restricted assets reported in Note 5L(1) and what is captured in the same categories within the GI. (These are lines 25.04, 25.05 and 26.21-26.32 in the GI.)

The following details how these items are pulled into RBC from the general interrogatories:

- In the life formula, the restricted assets captured in the GI are pulled directly from the GI to LR017. The standard "noncontrolled asset" charge on that page is 0.0126, except for conforming security lending programs which receive a charge of 0.0020. (Assets pledged as collateral to the FHLB are adjusted in the formula based on various factors.)

- In the P/C and health RBC formula, the restricted assets captured in the GI are pulled directly to PR014 and XR005 respectively, with a 0.010 charge except for conforming security lending programs which receive a 0.002 charge.

The specific excerpts from SSAP No. 1, Note 5L, the applicable GIs and RBC formulas have been captured in the authoritative language section. The categories are also listed in the table below. The terminology at each location is also included below to show the intended consistency in classifications.

Assets identified as "Not Controlled" or "Restricted Assets":

- SSAP No. 1: Restricted Assets / Not Under Exclusive Control: Defined in paragraph 23b as "not under the exclusive control, subject to a put option contract, etc." Footnote 3 of SSAP No. 1 includes the following: The aggregate information captured within this disclosure is intended to reflect the information reported in the Annual Statement Investment Schedules in accordance with the coding of investments **that are not under the exclusive control of the reporting entity, including assets loaned to others and the information reported in the General Interrogatories, as well as information on restricted cash, cash equivalents and short-term investments**.

- Note 5L: Matches terminology and language as SSAP No. 1.

- General Interrogatories: Exclusive Control: GI 25 asks if the company has "exclusive control" over all securities, other than securities lending detailed in 25.03. The instructions define this guidance as "exclusive control means that the company has the exclusive right to dispose of the investment at will, without the necessity of making a substitution therefore." GI 26 that captures the statement value of investments that are not under the exclusive control of the reporting entity. **These categories mirror what is captured in SSAP No. 1 and Note 5L.**

- RBC: Noncontrolled Assets: The RBC instructions have separate lines to capture collateral from conforming and non-conforming securities lending programs and "noncontrolled assets." **The instructions indicate "noncontrolled assets are any assets reported on the balance sheet that are not under the exclusively under the control of the company, or assets that have been sold or transferred subject to put option contract currently in force."** *(Although not detailed in this agenda item, the RBC instructions include specific guidance on what to include (or exclude). Examples include assets related to the Federal Reserve's Asset Loan Facility (TALF) and for restricted assets in excess of FHLB borrowing.)*

	SSAP No. 1	*Note 5L*	*GI*	*Life RBC*[2]
23.a	Amounts not in the financial statements that represent segregated funds held for others.	None	None	None
23.b.i	Subject to contractual obligation for which liability is not shown	5.L(1)a	None	None
23.b.ii	Collateral Under Security Lending[1]	5.L(1)b	25.0 4 & 25.05	LR017 (1) & LR017 (2)
23.b.iii	Subject to Repurchase Agreements	5.L(1)c	26.21	LR017 (3)
23.b.iv	Subject to Reverse Repurchase Agreements	5.L(1)d	26.22	LR017 (4)
23.b.iv	Subject to Dollar Repurchase	5.L(1)e	26.23	LR017 (5)
23.b.v	Subject to Dollar Reverse Repurchase	5.L(1)f	26.24	LR017 (6)
23.b.vi	Placed Under Option Contracts	5.L(1)g	26.25	LR017 (7)
23.b.vii	Stock or Securities Restricted as to Sale – Excluding FHLB	5.L(1)h	26.26	LR017 (8)
23.b.ix	FHLB Capital Stock	5.L(1)i	26.27	LR017 (9)
23.b.x	On Deposits with States	5.L(1)j	26.28	LR017 (10)
23.b.xi	On Deposit with Regulatory Bodies	5.L(1)k	26.29	LR017 (11)
23.b.xii	Pledged Collateral to FHLB	5.L(1)l	26.31	LR017 (13)
23.b.xiii	Pledged Collateral Not Captured in Other Categories	5.L(1)m	26.30	LR017 (12.1)
	Less Derivative Collateral Pledged[3]			LR017 (12.2)
23.b.xiv	Other Restricted Assets	5.L(1)n	26.32	LR017 (14)
23.c	Assets received as collateral, reflected as assets within the F/S and the recognized liability to return.	5.L(4)		
	1 – In the life blank, this reads “loaned to others,” but the RBC instructions indicate “collateral.” This agenda item proposes to update this terminology in the life blank for consistency.			
	2 – These items are duplicated in the P/C and Health RBC blank on page PR014 and XR005, except for 3) below.			
	3 – This reduction is in the RBC Life Formula Only. Derivative collateral pledged is subject to a lower RBC charge of .0039 and is captured separately.			

Existing Authoritative Literature:

SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures

Other Disclosures

23. Reporting entities shall disclose[1] the following information in the financial statements:

a. Amounts not recorded in the financial statements that represent segregated funds held for others, the nature of the assets and the related fiduciary responsibilities associated with such assets. One example of such an item is escrow accounts held by title insurance companies; and

b. The total combined (admitted and nonadmitted) amount of restricted assets by category, with separate identification of the admitted and nonadmitted restricted assets by category, and nature of any assets pledged to others as collateral or otherwise restricted (e.g., not under the exclusive control, assets subject to a put option contract, etc.)[2] in the general and separate accounts[3] by the reporting entity in comparison to total assets and total admitted assets. (Pursuant to SSAP No. 4, paragraph 6, all assets pledged as collateral or otherwise restricted shall be reported in this disclosure regardless if the asset is considered an admitted asset.) This disclosure shall include the following restricted asset categories:

i. Reported assets subject to contractual obligation for which liability is not shown;

ii. Collateral held under security lending agreements;

iii. Assets subject to repurchase agreements;

iv. Assets subject to reverse repurchase agreements;

v. Assets subject to dollar repurchase agreements;

vi. Assets subject to dollar reverse repurchase agreements;

vii. Assets placed under option contracts;

viii. Letter stock or securities restricted as to sale[4] – excluding FHLB stock;

ix. FHLB capital stock;

x. Assets on deposit with states;

xi. Assets on deposit with other regulatory bodies;

xii. Pledged as collateral to the FHLB (including assets backing funding agreements);

xiii. Assets pledged as collateral not captured in other categories; and

[1] Disclosure of restricted assets shall be included in the annual financial statements and, pursuant to the Preamble, in the interim financial statements if significant changes have occurred since the annual statement. If significant changes have occurred, the entire disclosure shall be reported in the interim financial statements.

[2] The aggregate information captured within this disclosure is intended to reflect the information reported in the Annual Statement Investment Schedules in accordance with the coding of investments that are not under the exclusive control of the reporting entity, including assets loaned to others and the information reported in the General Interrogatories, as well as information on restricted cash, cash equivalents and short-term investments.

[3] Restricted assets in the separate account are not intended to reflect amounts "restricted" only because they are insulated from the general account or because they are attributed to specific policyholders. Separate account assets shall be captured in this disclosure only if they are restricted outside of these characteristics.

[4] The nature, description and amount of the restriction are required in the disclosure.

xiv. Other restricted assets.

c. The amount and nature of any assets received as collateral, reflected as assets within the reporting entity's financial statements, and the recognized liability to return these collateral assets, in the general and separate accounts in comparison to total assets and admitted assets.

2024 Annual Statement Instructions – Note 5L: Restricted Assets

L. Restricted Assets

(1) Restricted Assets (Including Pledged)

Disclose the total gross (admitted and nonadmitted) amount of restricted assets by category, with separate identification of the admitted and nonadmitted restricted assets by category and nature of any assets pledged to others as collateral or otherwise restricted (e.g., not under the exclusive control, assets subject to a put option contract, etc.) by the reporting entity. Provide the gross amount of restricted assets (total general account, general account assets supporting separate account activity, total separate account, separate account assets supporting general account activity and sum of the general account and the separate account for current year, prior year and the change between years), the total admitted of restricted assets and the percentage the restricted asset amount (gross and admitted) is of the reporting entity's total assets amount reported on Line 28 of the asset page (gross and admitted respectively) by the following categories:

a. Subject to contractual obligation for which liability is not shown

b. Collateral held under security lending agreements

c. Subject to repurchase agreements

d. Subject to reverse repurchase agreements

e. Subject to dollar repurchase agreements

f. Subject to dollar reverse repurchase agreements

g. Placed under option contracts

h. Letter stock or securities restricted as to sale – excluding FHLB capital stock

i FHLB capital stock

j. On deposit with states

k. On deposit with other regulatory bodies

l. Pledged collateral to FHLB (including assets backing funding agreements)

m. Pledged as collateral not captured in other categories

n. Other restricted assets

o. Total restricted assets

(2) Detail of Assets Pledged as Collateral Not Captured in Other Categories

For assets pledged as collateral not captured in other categories reported in aggregate in Note 5L(1) above, provide the gross (admitted and nonadmitted) amount of restricted assets (total general account, general account assets supporting separate account activity, total separate account, separate account assets supporting general account activity and sum of the general account and the separate account for current year, prior year and the change between years), the total admitted of restricted assets and the percentage the restricted asset amount (gross and admitted) is of the reporting entity's total assets amount reported on Line 28 of the asset page (gross and admitted respectively) with a narrative summary of each collateral agreement included in the aggregate number in Note 5L(1) above. Contracts that share similar characteristics, such as reinsurance and derivatives, are to be reported in the aggregate. (Note: This would be the detail for what was reported as “Pledged as Collateral Not Captured in Other Categories” for 5L(1) above.)

(3) Detail of Other Restricted Assets

For other restricted assets reported in aggregate in Note 5L(1) above, provide the gross (admitted and nonadmitted) amount of restricted assets (total general account, general account assets supporting separate account activity, total separate account, separate account assets supporting general account activity and sum of the general account and the separate account for current year, prior year and the change between years), the total admitted of restricted assets and the percentage the restricted asset amount (gross and admitted) is of the reporting entity’s total assets amount reported on Line 28 of the asset page (gross and admitted respectively) with a description of each of the other restricted assets included in the aggregate number in Note 5L(1) above. Contracts that share similar characteristics, such as reinsurance and derivatives, are to be reported in the aggregate. (Note: This would be the detail for what was reported as “Other Restricted Assets” for 5L(1) above.)

(4) Collateral Received and Reflected as Assets Within the Reporting Entity’s Financial Statements

Disclose the following for the general account and separate account:

- Nature of any assets received as collateral reflected as assets within the reporting entity’s financial statements
- Book/adjusted carrying value (BACV) of the collateral
- Fair value of the collateral
- The recognized liability to return these collateral assets
- The percentage the collateral asset BACV amount (gross and admitted) is of the reporting entity’s total assets amount reported on Line 26 of the asset page (gross and admitted, respectively).

NOTE: The information captured within this disclosure is intended to aggregate the information reported in the Annual Statement Investment Schedules in accordance with the coding of investments that are not under the exclusive control of the reporting entity, including assets loaned to others, and the information reported in the General Interrogatories.

Restricted assets in the separate account are not intended to capture amounts “restricted” only because they are insulated from the general account or because they are attributed to specific policyholders. Separate account assets shall be captured in this disclosure only if they are restricted outside of these characteristics.

(1) Restricted Assets (Including Pledged)

	Gross (Admitted & Nonadmitted) Restricted						
	Current Year					6	7
	1	2	3	4	5		
Restricted Asset Category	Total General Account (G/A)	G/A Supporting S/A Activity (a)	Total Separate Account (S/A) Restricted Assets	S/A Assets Supporting G/A Activity (b)	Total (1 plus 3)	Total From Prior Year	Increase/ (Decrease) (5 minus 6)
a. Subject to contractual obligation for which liability is not shown	$	$	$	$	$	$	$
b. Collateral held under security lending agreements	....		....				
c. Subject to repurchase agreements	....		....				
d. Subject to reverse repurchase agreements	....		....				
e. Subject to dollar repurchase agreements	....		....				
f. Subject to dollar reverse repurchase agreements	....		....				
g. Placed under option contracts	....		....				
h. Letter stock or securities restricted as to sale – excluding FHLB capital stock	....		....				
i. FHLB capital stock	....		....				
j. On deposit with states	....		....				
k. On deposit with other regulatory bodies	....		....				
l. Pledged as collateral to FHLB (including assets backing funding agreements)	....		....				
m. Pledged as collateral not captured in other categories	....		....				
n. Other restricted assets	....		....				
o. Total Restricted Assets (Sum of a through n)	$	$	$	$	$	$	$

(a) Subset of Column 1
(b) Subset of Column 3

	Current Year			
	8	9	Percentage	
			10	11
Restricted Asset Category	Total Nonadmitted Restricted	Total Admitted Restricted (5 minus 8)	Gross (Admitted & Nonadmitted) Restricted to Total Assets (c)	Admitted Restricted to Total Admitted Assets (d)
a. Subject to contractual obligation for which liability is not shown			%	%
b. Collateral held under security lending agreements				
c. Subject to repurchase agreements				
d. Subject to reverse repurchase agreements				
e. Subject to dollar repurchase agreements				
f. Subject to dollar reverse repurchase agreements				
Placed under option contracts				
h. Letter stock or securities restricted as to sale – excluding FHLB capital stock				
i. FHLB capital stock				
j. On deposit with states				
k. On deposit with other regulatory bodies				
l. Pledged as collateral to FHLB (including assets backing funding agreements)				
m. Pledged as collateral not captured in other categories				
n. Other restricted assets				
o. Total Restricted Assets (Sum of a through n)			%	%

(c) Column 5 divided by Asset Page, Column 1, Line 28
(d) Column 9 divided by Asset Page, Column 3, Line 28

(2) Detail of Assets Pledged as Collateral Not Captured in Other Categories (Contracts that Share Similar Characteristics, Such as Reinsurance and Derivatives, Are Reported in the Aggregate)

	Gross (Admitted & Nonadmitted) Restricted							8	Percentage	
	Current Year					6	7		9	10
	1	2	3	4	5					
Description of Assets	Total General Account (G/A)	G/A Supporting S/A Activity (a)	Total Separate Account (S/A) Restricted Assets	S/A Assets Supporting G/A Activity (b)	Total (1 plus 3)	Total From Prior Year	Increase/ (Decrease) (5 minus 6)	Total Current Year Admitted Restricted	Gross (Admitted & Nonadmitted) Restricted to Total Assets	Admitted Restricted to Total Admitted Assets
....	$	$	$	$	$	$	$	$	...........%	............%
....	....	....	....	....	....	....	....	....	....	....
....	....	....	....	....	....	....	....	....	....	....
Total (c)	$	$	$	$	$	$	$	$	...........%	............%

(a) Subset of column 1
(b) Subset of column 3
(c) Total Line for Columns 1 through 7 should equal 5L(1)m Columns 1 through 7 respectively and Total Line for Columns 8 through 10 should equal 5L(1)m Columns 9 through 11 respectively

(3) Detail of Other Restricted Assets (Contracts that Share Similar Characteristics, Such as Reinsurance and Derivatives, Are Reported in the Aggregate)

	Gross (Admitted & Nonadmitted) Restricted							8	Percentage	
	Current Year					6	7		9	10
	1	2	3	4	5					
Description of Assets	Total General Account (G/A)	G/A Supporting S/A Activity (a)	Total Separate Account (S/A) Restricted Assets	S/A Assets Supporting G/A Activity (b)	Total (1 plus 3)	Total From Prior Year	Increase/ (Decrease) (5 minus 6)	Total Current Year Admitted Restricted	Gross (Admitted & Nonadmitted) Restricted to Total Assets	Admitted Restricted to Total Admitted Assets
....	$	$	$	$	$	$	$	$	...........%	............%
....	....	....	....	....	....	....	....	....	....	....
....	....	....	....	....	....	....	....	....	....	....
Total (c)	**$ ....**	**$ ....**	**$ ....**	**$ ....**	**$ ....**	**$ ....**	**$ ....**	**$ ....**	**...........%**	**............%**

(a) Subset of column 1
(b) Subset of column 3
(c) Total Line for Columns 1 through 7 should equal 5L(1)n Columns 1 through 7 respectively and Total Line for Columns 8 through 10 should equal 5L(1)n Columns 9 through 11 respectively

(4) Collateral Received and Reflected as Assets Within the Reporting Entity's Financial Statements

	1	2	3	4
Collateral Assets	Book/Adjusted Carrying Value (BACV)	Fair Value	% of BACV to Total Assets (Admitted and Nonadmitted *	% of BACV to Total Admitted Assets **
General Account:				
a. Cash, Cash Equivalents and Short-Term Investments	$	$	.................%	.................%
b. Schedule D, Part 1	....	....	.................%	.................%
c. Schedule D, Part 2, Section 1	....	....	.................%	.................%
d. Schedule D, Part 2, Section 2	....	....	.................%	.................%
e. Schedule B	....	....	.................%	.................%
f. Schedule A	....	....	.................%	.................%
g. Schedule BA, Part 1	....	....	.................%	.................%
h. Schedule DL, Part 1	....	....	.................%	.................%
i. Other			%	%
j. Total Collateral Assets (a+b+c+d+e+f+g+h+i)	$	$	%	%
Separate Account:				
k. Cash, Cash Equivalents and Short-Term Investments	$	$	.................%	.................%
l. Schedule D, Part 1	....	....	.................%	.................%
m. Schedule D, Part 2, Section 1	....	....	.................%	.................%
n. Schedule D, Part 2, Section 2	....	....	.................%	.................%
o. Schedule B	....	....	.................%	.................%
p. Schedule A	....	....	.................%	.................%
q. Schedule BA, Part 1	....	....	.................%	.................%

r. Schedule DL, Part 1	....	....	.................%	.................%
s. Other			%	%
t. Total Collateral Assets (k+l+m+n+o+p+q+r+s)	$	$	%	%

* j = Column 1 divided by Asset Page, Line 26 (Column 1)
t = Column 1 divided by Asset Page, Line 27 (Column 1)

** j = Column 1 divided by Asset Page, Line 26 (Column 3)
t = Column 1 divided by Asset Page, Line 27 (Column 3)

	1	2
	Amount	% of Liability to Total Liabilities *
u. Recognized Obligation to Return Collateral Asset (General Account)	$	%
v. Recognized Obligation to Return Collateral Asset (Separate Account)	$	%

* u = Column 1 divided by Liability Page, Line 26 (Column 1)
v = Column 1 divided by Liability Page, Line 27 (Column 1)

ANNUAL STATEMENT GENERAL INTERROGATORIES

Instructions – Part 1 – Common Interrogatories

INVESTMENT

25. For the purposes of this interrogatory, “exclusive control” means that the company has the exclusive right to dispose of the investment at will, without the necessity of making a substitution thereof. For purposes of this interrogatory, securities in transit and awaiting collection, held by a custodian pursuant to a custody arrangement or securities issued subject to a book entry system are considered to be in actual possession of the company.

If bonds, stocks and other securities owned December 31 of the current year, over which the company has exclusive control are: (1) securities purchased for delayed settlement, or (2) loaned to others, the company should respond “NO” to 25.01 and “YES” to 26.1.

25.03 Describe the company’s securities lending program, including value for collateral and amount of loaned securities, and whether the collateral is held on- or off-balance sheet. Note 17 of Notes to Financial Statement provides a full description of the program.

25.04 Report amount of collateral for conforming programs as outlined in the Risk-Based Capital Instructions.

25.05 Report amount of collateral for other programs.

25.091 The fair value amount reported should equal the grand total of Schedule DL, Part 1, Column 5 plus Schedule DL, Part 2, Column 5. The fair value amount reported amount should also equal the fair value amount reported in Note 5E(5)a1(m).

25.092 The book adjusted/carrying value amount reported should equal the grand total of Schedule DL, Part 1,
Column 6 plus Schedule DL, Part 2, Column 6.

25.093 The payable for securities lending amount reported should equal current year column for payable for securities lending line on the liability page.

26. Disclose the statement value of investments that are not under the exclusive control of the reporting entity within the categories listed in 26.2.

Excerpt – Annual Statement Blank

25.01 Were all the stocks, bonds and other securities owned December 31 of current year, over which the reporting entity has exclusive control, in the actual possession of the reporting entity on said date? (other than securities lending programs addressed in 25.03) Yes [ ] No [ ]

25.02 If no, give full and complete information, relating thereto ....

25.03 For securities lending programs, provide a description of the program including value for collateral and amount of loaned securities, and whether collateral is carried on or off-balance sheet. (an alternative is to reference Note 17 where this information is also provided) ....

25.04 For the reporting entity's securities lending program, report amount of collateral for conforming programs as outlined in the Risk-Based Capital Instructions. $ ____________

25.05 For the reporting entity's securities lending program, report amount of collateral for other programs. $ ____________

25.06 Does your securities lending program require 102% (domestic securities) and 105% (foreign securities) from the counterparty at the outset of the contract? Yes [ ] No [ ] N/A [ ]

25.07 Does the reporting entity non-admit when the collateral received from the counterparty falls below 100%? Yes [ ] No [ ] N/A [ ]

25.08 Does the reporting entity or the reporting entity's securities lending agent utilize the Master Securities Lending Agreement (MSLA) to conduct securities lending? Yes [ ] No [ ] N/A [ ]

25.09 For the reporting entity's securities lending program, state the amount of the following as of December 31 of the current year:

25.091 Total fair value of reinvested collateral assets reported on Schedule DL, Parts 1 and 2 $ ____________

25.092 Total book/adjusted carrying value of reinvested collateral assets reported on Schedule DL, Parts 1 and 2 $ ____________

25.093 Total payable for securities lending reported on the liability page $ ____________

26.1 Were any of the stocks, bonds or other assets of the reporting entity owned at December 31 of the current year not exclusively under the control of the reporting entity or has the reporting entity sold or transferred any assets subject to a put option contract that is currently in force? (Exclude securities subject to Interrogatory 21.1 and 25.03). Yes [ ] No [ ]

26.2 If yes, state the amount thereof at December 31 of the current year:

26.21 Subject to repurchase agreements $ ____________
26.22 Subject to reverse repurchase agreements $ ____________
26.23 Subject to dollar repurchase agreements $ ____________
26.24 Subject to reverse dollar repurchase agreements $ ____________
26.25 Placed under option agreements $ ____________
26.26 Letter stock or securities restricted as to sale – excluding FHLB Capital Stock $ ____________
26.27 FHLB Capital Stock $ ____________
26.28 On deposit with states $ ____________
26.29 On deposit with other regulatory bodies $ ____________
26.30 Pledged as collateral – excluding collateral pledged to an FHLB $ ____________
26.31 Pledged as collateral to FHLB – including assets backing funding agreements $ ____________
26.32 Other $ ____________

26.3 For category (26.26) provide the following:

1 Nature of Restriction	2 Description	3 Amount

<u>Excerpt from Life RBC Instructions – Bolded for Emphasis</u>

MODCO OR FUNDS WITHHELD REINSURANCE AGREEMENTS
LR045, LR046, LR047 and LR048

References to MODCO and funds withheld reinsurance agreements apply to all treaties in effect.

Basis of Factors
When the default risk in modified coinsurance (MODCO) and other reinsurance transactions with funds withheld is transferred, this transfer should be recognized by reducing the RBC for the ceding company and increasing it for the assuming company. **In the event that the entire asset credit or variability in statement value risk associated with the assets supporting the business reinsured is not transferred to the assuming company for the entire duration of the reinsurance treaty, the RBC for the ceding company should not be reduced.**

Assets
The total RBC related to assets (i.e., bonds, mortgages, unaffiliated preferred and common stock, separate accounts, real estate and other long-term assets) in MODCO or Funds Withheld reinsurance agreements, should be reduced (increased) by the amounts of RBC ceded (assumed). There is a separate line in each asset section to achieve this reduction (i.e., "Reduction in RBC for MODCO or Funds Withheld reinsurance ceded agreements")**.** The amount ceded is determined using the assets supporting the ceded liabilities as of Dec. 31. (In some instances, there may be assets in a trust that exceed the amount needed to support the liabilities; only the portion of assets used to support the ceded liabilities is used to determine the ceded RBC).

The ceding company will need to supply the assuming company with sufficient information in order for the assuming company to determine the amount of RBC assumed. With the exception of the impact of the size factor, the amount of RBC ceded should be equal to the amount of RBC assumed. Put another way, there should be "mirror
imaging" of RBC, except for the impact of the size factor. For MODCO or Funds Withheld reinsurance agreements, there will be no specific, line-by-line inventory of ceded assets and corresponding ceded RBC; however, ceding and assuming companies must keep detailed records and be prepared to produce those records upon request. The ceding company is required to supply the assuming company with sufficient information in order for the assuming company to determine the amount of RBC assumed.

A reinsurer that has not received such information shall calculate MODCO adjustments for reinsurance assumed as follows:

- If the reinsurer has received data for periods prior to the effective date of the RBC filing, a "MODCO liability ratio" will be developed by comparing the MODCO liabilities at the filing date to the MODCO liabilities as of the last date for which data were received. The required capital for MODCO assumed is the required capital as calculated based on these data multiplied by the "MODCO liability ratio."
- • If the reinsurer has never received data from the ceding company, a "MODCO liability ratio" will be developed by comparing the MODCO liabilities at the filing date to the reinsurer's total invested assets (Page 2, Line 12 of the blue blank, or its equivalent). The required capital for MODCO assumed is the reinsurer's required capital as calculated prior to MODCO ceded and assumed adjustments multiplied by the "MODCO liability ratio."

Adjustments for MODCO or Funds Withheld reinsurance agreements should be based on pre-tax factors.

Size Factor
Companies with MODCO or Funds Withheld reinsurance agreements should adjust the company's year-end size factors according to the way the bonds are handled in the treaties. The assuming company includes the bonds that support its share of the liabilities; the ceding company includes the bonds that support its share of the liabilities. No adjustment is made for bonds purchased subsequent to June 30 of the valuation year and that solely support ceded liabilities.

Mortgages
The amount of RBC for mortgages is based upon the ceding company's calculation for the mortgages, or portion of these mortgages, which support the ceded liabilities. Thus, the amount of RBC ceded is equal to the amount of RBC assumed.

Specific Instructions for Application of the Formula

MODCO OR FUNDS WITHHELD REINSURANCE AGREEMENTS
Reinsurance Ceded - Bonds C-1o
LR045

Column 4: Enter by reinsurer, the amount of C-1o RBC the insurance company has ceded that is attributable to bonds. The "total" should equal the total amount of the reduction in C-1o RBC shown on Line (19) of page LR002 Bonds.

MODCO OR FUNDS WITHHELD REINSURANCE AGREEMENTS
Reinsurance Assumed - Bonds C-1o
LR046

Column 4: Enter by ceding company, the amount of C-1o RBC the insurance company has assumed that is attributable to bonds. The "total" should equal the total amount of the increase in C-1o RBC shown on Line (20) of page LR002 Bonds.

MODCO OR FUNDS WITHHELD REINSURANCE AGREEMENTS
Reinsurance Ceded – All Other Assets C-0, C-1o And C-1cs
LR047

Column 4: Enter by reinsurer, the amount of C-0, C-1o And C-1cs RBC the company has ceded that is attributable to all assets except bonds. The "total" should equal the total amount of the reduction of C-0, C-1o And C-1cs RBC attributable to all assets except bonds for MODCO and funds withheld agreements.

MODCO OR FUNDS WITHHELD REINSURANCE AGREEMENTS
Reinsurance Assumed – All Other Assets C-0, C-1o And C-1cs
LR048

Column 4: Enter by ceding company, the amount of C-0, C-1o And C-1cs RBC the insurance company has assumed that is attributable to all assets except bonds. The "total" should equal the total amount of the increase in C-0, C-1o And C-1cs RBC attributable to all assets except bonds for MODCO and funds withheld agreements.

Excerpt from Health RBC (Identical to P/C RBC)

Confidential when Completed

OFF-BALANCE SHEET AND OTHER ITEMS

		Annual Statement Source	(1) Bk/Adj Carrying Value	(2) Factor	(3) RBC Requirement	(4) Yes/No Response
	Noncontrolled Assets					
(1)	Loaned to Others - Conforming Securities Lending Programs	General Interrogatories Part 1 Line 25.04		0.002		
(2)	Loaned to Others - Securities Lending Programs - Other	General Interrogatories Part 1 Line 25.05		0.010		
(3)	Subject to Repurchase Agreements	General Interrogatories Part 1 Line 26.21		0.010		
(4)	Subject to Reverse Repurchase Agreements	General Interrogatories Part 1 Line 26.22		0.010		
(5)	Subject to Dollar Repurchase Agreements	General Interrogatories Part 1 Line 26.23		0.010		
(6)	Subject to Reverse Dollar Repurchase Agreements	General Interrogatories Part 1 Line 26.24		0.010		
(7)	Placed Under Option Agreements	General Interrogatories Part 1 Line 26.25		0.010		
(8)	Letter Stock or Securities Restricted as to Sale - Excluding FHLB Capital Stock	General Interrogatories Part 1 Line 26.26		0.010		
(9)	FHLB Capital Stock	General Interrogatories Part 1 Line 26.27		0.010		
(10)	On Deposit with States	General Interrogatories Part 1 Line 26.28		0.010		
(11)	On Deposit with Other Regulatory Bodies	General Interrogatories Part 1 Line 26.29		0.010		
(12)	Pledged as Collateral - Excluding Collateral Pledged to an FHLB	General Interrogatories Part 1 Line 26.30		0.010		
(13)	Pledged as Collateral to FHLB (Including Assets Backing Funding Agreements)	General Interrogatories Part 1 Line 26.31		0.010		
(14)	Other	General Interrogatories Part 1 Line 26.32		0.010		
(15)	Total Noncontrolled Assets	Sum of Lines (1) through (14)				
(16)	Guarantees for Affiliates	Notes to Financial Statements 14A(03C1), Column 2		0.010		
(17)	Contingent Liabilities	Notes to Financial Statements 14A(1), Column 2		0.010		
(18)	Is the entity responsible for filing the U.S. Federal income tax return for the reporting insurer a regulated insurance company?	"Yes", "No" or "N/A" in Column (4)				
(19)	SSAP No. 101 Paragraph 11a Deferred Tax Assets	Notes to Financial Statements, Item 9A2(a), Column 3		†		
(20)	SSAP No. 101 Paragraph 11b Deferred Tax Assets	Notes to Financial Statements, Item 9A2(b), Column 3		0.010		
(21)	Total Miscellaneous Off-Balance Sheet and Other Items	Lines (15) + (16) + (17) + (19) + (20)				

† If Line (18) Column (4) is "Yes", then the factor is 0.005. If Line (18) Column (4) is "No", then the factor is 0.010. If Line (18) Column (4) is "N/A", then the factor is 0.000.

Denotes items that must be manually entered on filing software.

Excerpt from Life RBC

OFF-BALANCE SHEET AND OTHER ITEMS

		Annual Statement Source	(1) Statement Value	(2) Less Noncontrolled Assets Funding Guaranteed Separate Accounts, Synthetic GIC's and Certain FHLB Liabilities	(3) Subtotal	(4) Factor	(5) RBC Requirement
	Noncontrolled Assets						
(1)	Loaned to Others - Conforming Securities Lending Program	General Interrogatories Part 1 Line 25.04	$0	$0	$0	X 0.002	= $0
(2)	Loaned to Others - Securities Lending Programs - Other	General Interrogatories Part 1 Line 25.05	$0	$0	$0	X 0.0126	= $0
(3)	Subject to Repurchase Agreements	General Interrogatories Part 1 Line 26.21	$0	$0	$0	X 0.0126	= $0
(4)	Subject to Reverse Repurchase Agreements	General Interrogatories Part 1 Line 26.22	$0	$0	$0	X 0.0126	= $0
(5)	Subject to Dollar Repurchase Agreements	General Interrogatories Part 1 Line 26.23	$0	$0	$0	X 0.0126	= $0
(6)	Subject to Reverse Dollar Repurchase Agreements	General Interrogatories Part 1 Line 26.24	$0	$0	$0	X 0.0126	= $0
(7)	Placed Under Option Agreements	General Interrogatories Part 1 Line 26.25	$0	$0	$0	X 0.0126	= $0
(8)	Letter Stock or Other Securities Restricted as to sale - excluding FHLB Capital Stock	General Interrogatories Part 1 Line 26.26	$0	$0	$0	X 0.0126	= $0
(9)	FHLB Capital Stock	General Interrogatories Part 1 Line 26.27	$0	$0	$0	X 0.0126	= $0
(10)	On Deposit with States	General Interrogatories Part 1 Line 26.28	$0	$0	$0	X 0.0126	= $0
(11)	On Deposit with Other Regulatory Bodies	General Interrogatories Part 1 Line 26.29	$0	$0	$0	X 0.0126	= $0
(12.1)	Pledged as Collateral - excluding Collateral Pledged to an FHLB	General Interrogatories Part 1 Line 26.30	$0	$0	$0		
(12.2)	Less Derivative Collateral Pledged	Schedule DB Part D Section 2 Column 7, Line 0199999999	$0	$0	$0	X 0.0039	= $0
(12.3)	Pledged as Collateral - excluding Collateral Pledged to an FHLB Less Derivatives Collateral Pledged	Line (12.1) - (12.2)	$0	$0	$0	X 0.0126	= $0
(13)	Pledged as Collateral to FHLB - including Assets Backing Funding Agreements	General Interrogatories Part 1 Line 26.31	$0	$0 †	$0	X 0.000 #	= $0
(14)	Other	General Interrogatories Part 1 Line 26.32	$0	$0	$0	X 0.0126	= $0
(15)	Total Noncontrolled Assets	Sum of Lines (1) through (11) Plus Lines (12.2) through (14)	$0	$0	$0		$0

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group: None

Convergence with International Financial Reporting Standards (IFRS): N/A

Staff Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing and expose SAP clarification revisions to SSAP No. 1 as well as corresponding proposed revisions to the Annual Statement (A/S) instructions/template for the restricted asset disclosure in Note 5L to more clearly identify how Modco and FWH assets reported within a ceding company's financial statements shall be captured.

In addition to the revisions that explicitly address Modco/FWH, the A/S revisions propose a new component to the existing disclosure to identify and explain differences between the note and what is captured in the general interrogatories. Although it was originally anticipated that the note and the GI would agree, NAIC staff is aware that there are often differences and that in some instances domiciliary states have directed specific items to be removed from the GI reporting because of the resulting RBC pull / factor impact. This disclosure will highlight those differences to ensure ease of regulator comparisons as well as allow NAIC staff to assess consistency across companies and enable future discussions. NAIC staff recommends that the SAPWG sponsor a blanks proposal to incorporate the Annual Statement instruction revisions.

Although there is a separate agenda item to identify Modco and FWH assets with more granularity, and to assist with RBC impact, this clarification of the aggregate restricted asset disclosure has been recommended to move forward to ensure the restricted asset disclosure is consistently reported.

Upon adoption of the revisions, this agenda item recommends a referral to the Life RBC (E) Working Group to clarify that Modco assets held by a ceding entity that at any time during the year are pledged or used by the ceding entity for their own purpose, such as being used in assets reported to or as collateral to the FHLB or in a repurchase or securities lending agreement, are not permitted to be reported as an RBC charge reduction from the RBC formula for invested assets. Such uses would reflect circumstances in which the "entire asset credit or variability in statement value risk associated with the assets supporting the business reinsurance was not transferred to the assuming company for the entire duration of the reinsurance treaty." This referral will also identify the direction to capture modco/FWH assets in SSAP No. 1, paragraph 23c, therefore these assets should not be captured in the RBC reporting of "noncontrolled assets," therefore the existing elements in the RBC formula to adjust modco/FWH from the "noncontrolled" reporting lines may no longer be necessary.

Proposed Revisions:

SSAP No. 1—Accounting Policies, Risks & Uncertainties and Other Disclosures

23. Reporting entities shall disclose[5] the following information in the financial statements:

[5] Disclosure of restricted assets shall be included in the annual financial statements and, pursuant to the Preamble, in the interim financial statements if significant changes have occurred since the annual statement. If significant changes have occurred, the entire disclosure shall be reported in the interim financial statements.

a. Amounts not recorded in the financial statements that represent segregated funds held for others, the nature of the assets and the related fiduciary responsibilities associated with such assets. One example of such an item is escrow accounts held by title insurance companies; and

b. The total combined (admitted and nonadmitted) amount of restricted assets by category, with separate identification of the admitted and nonadmitted restricted assets by category, and nature of any assets pledged to others as collateral or otherwise restricted (e.g., not under the exclusive control, assets subject to a put option contract, etc.)[6] in the general and separate accounts[7] by the reporting entity in comparison to total assets and total admitted assets. (Pursuant to SSAP No. 4, paragraph 6, all assets pledged as collateral or otherwise restricted shall be reported in this disclosure regardless if the asset is considered an admitted asset.) Reporting entities shall also disclose differences in the amounts reported in this note versus the amounts reported for the same categories in the general interrogatories. This disclosure shall include the following restricted asset categories:

   i. Reported assets subject to contractual obligation for which liability is not shown;

   ii. Collateral held under security lending agreements;

   iii. Assets subject to repurchase agreements;

   iv. Assets subject to reverse repurchase agreements;

   v. Assets subject to dollar repurchase agreements;

   vi. Assets subject to dollar reverse repurchase agreements;

   vii. Assets placed under option contracts;

   viii. Letter stock or securities restricted as to sale[8] – excluding FHLB stock;

   ix. FHLB capital stock;

   x. Assets on deposit with states;

   xi. Assets on deposit with other regulatory bodies;

   xii. Pledged as collateral to the FHLB (including assets backing funding agreements);

   xiii. Assets pledged as collateral not captured in other categories[FN1]; and

   xiv. Other restricted assets.

[6] The aggregate information captured within this disclosure is intended to reflect the information reported in the Annual Statement Investment Schedules in accordance with the coding of investments that are not under the exclusive control of the reporting entity, including assets loaned to others and the information reported in the General Interrogatories, as well as information on restricted cash, cash equivalents and short-term investments.

[7] Restricted assets in the separate account are not intended to reflect amounts "restricted" only because they are insulated from the general account or because they are attributed to specific policyholders. Separate account assets shall be captured in this disclosure only if they are restricted outside of these characteristics.

[8] The nature, description and amount of the restriction are required in the disclosure.

New Footnote 1: Items captured in this category shall include assets reported within the financial statements that are pledged to a counterparty that have not been captured in other categories or within paragraph 23.c. Items reported should include, but not be limited to, assets pledged under derivative arrangements.

c. The amount and nature of any assets received as collateral or assets that are held under modified coinsurance or funds withheld reinsurance agreements, reflected as assets within the reporting entity's financial statements, for which there is a ~~and the~~ recognized liability to return these collateral assets or for the dedicated use of those assets under the modco/funds withheld agreement, in the general and separate accounts in comparison to total assets and admitted assets.

Note to the Financial Statements – 5L

(1) Restricted Assets (Including Pledged)

Disclose the total gross (admitted and nonadmitted) amount of restricted assets by category, with separate identification of the admitted and nonadmitted restricted assets by category and nature of any assets pledged to others as collateral or otherwise restricted (e.g., not under the exclusive control, assets subject to a put option contract, etc.) by the reporting entity. Provide the gross amount of restricted assets (total general account, general account assets supporting separate account activity, total separate account, separate account assets supporting general account activity and sum of the general account and the separate account for current year, prior year and the change between years), the total admitted of restricted assets and the percentage the restricted asset amount (gross and admitted) is of the reporting entity's total assets amount reported on Line 28 of the asset page (gross and admitted respectively) by the following categories:

a. Subject to contractual obligation for which liability is not shown
b. Collateral held under security lending agreements
c. Subject to repurchase agreements
d. Subject to reverse repurchase agreements
e. Subject to dollar repurchase agreements
f. Subject to dollar reverse repurchase agreements
g. Placed under option contracts
h. Letter stock or securities restricted as to sale – excluding FHLB capital stock
i FHLB capital stock
j. On deposit with states
k. On deposit with other regulatory bodies
l. Pledged collateral to FHLB (including assets backing funding agreements)
m. Pledged as collateral not captured in other categories
n. Other restricted assets
o. Total restricted assets

Note: Items captured "pledged as collateral not captured in other categories" shall include, but not be limited to, assets pledged under derivative arrangements.

(2) Detail of Assets Pledged as Collateral Not Captured in Other Categories

For assets pledged as collateral not captured in other categories reported in aggregate in Note 5L(1) above, provide the gross (admitted and nonadmitted) amount of restricted assets (total general account, general account assets supporting separate account activity, total separate account, separate account assets supporting general account activity and sum of the general account and the separate account for current year, prior year and the change between years), the total admitted of restricted assets and the percentage the restricted asset amount (gross and admitted) is of the reporting entity's total assets amount reported on Line 28 of the asset page (gross and admitted respectively) with a narrative summary of each collateral agreement included in the aggregate number in Note 5L(1) above. Contracts that share similar characteristics, such as reinsurance and derivatives, are to be reported in the aggregate. (Note: This would be the detail for what was reported as "Pledged as Collateral Not Captured in Other Categories" for 5L(1) above.)

(3) Detail of Other Restricted Assets

For other restricted assets reported in aggregate in Note 5L(1) above, provide the gross (admitted and nonadmitted) amount of restricted assets (total general account, general account assets supporting separate account activity, total separate account, separate account assets supporting general account activity and sum of the general account and the separate account for current year, prior year and the change between years), the total admitted of restricted assets and the percentage the restricted asset amount (gross and admitted) is of the reporting entity's total assets amount reported on Line 28 of the asset page (gross and admitted respectively) with a description of each of the other restricted assets included in the aggregate number in Note 5L(1) above. Contracts that share similar characteristics, such as reinsurance and derivatives, are to be reported in the aggregate. (Note: This would be the detail for what was reported as "Other Restricted Assets" for 5L(1) above.)

(4) Collateral Received and Assets Held under Modco/Funds Withheld Reinsurance Agreements Reflected as Assets Within the Reporting Entity's Financial Statements

Disclose the following for the general account and separate account regarding collateral received and assets held under modco/funds withheld reinsurance agreements under SSAP No. 1, paragraph 23c:

- Nature of ~~any~~ assets ~~received as collateral~~ reflected ~~as assets~~ within the reporting entity's financial statements

- Book/adjusted carrying value (BACV) of the ~~collateral~~assets

- Fair value of the ~~collateral~~assets

- The recognized liability to return ~~these~~ collateral assets or obligation under the Modco/Funds Withheld Reinsurance Agreements

- The percentage the ~~collateral~~ asset BACV amount (gross and admitted) is of the reporting entity's total assets amount reported on Line 26 of the asset page (gross and admitted, respectively).

Illustrations to the Financial Statements – 5L

This illustration includes the presentation of all restricted assets reported on the financial statements for a total comparison to total assets. This includes the items captured in SSAP No. 1, paragraphS 23.b. and 23.c. (Items captured in paragraph 23.c. should have a corresponding liability recognized, therefore there is no capture within the general interrogatories or capture as a noncontrolled asset in the RBC formula.)

		Current Year						
		8	9	Percentage				
				10	11			
	Restricted Asset Category	Total Nonadmitted Restricted	Total Admitted Restricted (5 minus 8)	Gross (Admitted & Nonadmitted) Restricted to Total Assets (c)	Admitted Restricted to Total Admitted Assets (d)	12 Amount Reported in General Interrogatories	13 Difference from Note and GI	14 GI Ref
a.	Subject to contractual obligation for which liability is not shown	$	$	.....................%	.... %			
b.	Collateral held under security lending agreements	....	....	....	....			25.04+25.05
c.	Subject to repurchase agreements	....	....	....	....			26.21
d.	Subject to reverse repurchase agreements	....	....	....	....			26.22
e.	Subject to dollar repurchase agreements	....	....	....	....			26.23
f.	Subject to dollar reverse repurchase agreements	....	....	....	....			26.24
g.	Placed under option contracts	....	....	....	....			26.25
h.	Letter stock or securities restricted as to sale – excluding FHLB capital stock	....	....	....	....			26.26
i.	FHLB capital stock	....	....	....	....			26.27
j.	On deposit with states	....	....	....	....			26.28
k.	On deposit with other regulatory bodies	....	....	....	....			26.29
l.	Pledged as collateral to FHLB (including assets backing funding agreements)	....	....	....	....			26.31
m.	Pledged as collateral not captured in other categories	....	....	....	....			26.30
n.	Other restricted assets	....	....	....	....			26.32
o.	Collateral Assets Received and on Balance Sheet *(SSAP 1. Paragraph 23.c)*					XXX	XXX	N/A
p.	Assets held under Modco Reinsurance Agreements *(SSAP 1. Paragraph 23.c)*					XXX	XXX	N/A
q.	Assets held under Funds Withheld Reinsurance Agreements. *(SSAP 1. Paragraph 23.c)*					XXX	XXX	N/A
~~o~~r.	Total Restricted Assets (Sum of a through n)	$	$	.....................%	.... %	XXX	XXX	

(c) Column 5 divided by Asset Page, Column 1, Line 28
(d) Column 9 divided by Asset Page, Column 3, Line 28

Reporting entities shall explain the differences between amounts reported in Note 5L(1) and the general interrogatories. This shall include all instances in which an amount is reported in column 13 above.

GI Reference	Difference between Note and GI (Per Column 12 above)	Explanation
25.04+25.05		
26.21		
26.22		

26.23		
26.24		
26.25		
26.26		
26.27		
26.28		
26.29		
26.31		
26.30		
26.32		

(2) Detail of Assets Pledged as Collateral Not Captured in Other Categories (Contracts that Share Similar Characteristics, Such as Reinsurance (excluding modco/FWH) and Derivatives, Are Reported in the Aggregate)

	Gross (Admitted & Nonadmitted) Restricted							8	Percentage	
	Current Year					6	7		9	10
	1	2	3	4	5					
Description of Assets	Total General Account (G/A)	G/A Supporting S/A Activity (a)	Total Separate Account (S/A) Restricted Assets	S/A Assets Supporting G/A Activity (b)	Total (1 plus 3)	Total From Prior Year	Increase/ (Decrease) (5 minus 6)	Total Current Year Admitted Restricted	Gross (Admitted & Nonadmitted) Restricted to Total Assets	Admitted Restricted to Total Admitted Assets
....	$	$	$	$	$	$	$	$	.... %	...........%
....	....	....	....	....	....	....	....	....	....	....
....	....	....	....	....	....	....	....	....	....	....
Total (c)	$	$	$	$	$	$	$	$	.... %	...........%
Amount of Total pledged under derivative contracts										
Total Excluding Derivative Collateral										

(a) Subset of column 1
(b) Subset of column 3
(c) Total Line for Columns 1 through 7 should equal 5L(1)m Columns 1 through 7 respectively and Total Line for Columns 8 through 10 should equal 5L(1)m Columns 9 through 11 respectively

Staff Note – The amount pledged under derivative contracts should agree to Schedule DB and agree to what is subtracted from the life RBC formula.

(3) Detail of Other Restricted Assets (Contracts that Share Similar Characteristics, Such as Reinsurance (exclude modco/FWH) and Derivatives, Are Reported in the Aggregate)

	Gross (Admitted & Nonadmitted) Restricted							8	Percentage	
	Current Year					6	7		9	10
	1	2	3	4	5					
Description of Assets	Total General Account (G/A)	G/A Supporting S/A Activity (a)	Total Separate Account (S/A) Restricted Assets	S/A Assets Supporting G/A Activity (b)	Total (1 plus 3)	Total From Prior Year	Increase/ (Decrease) (5 minus 6)	Total Current Year Admitted Restricted	Gross (Admitted & Nonadmitted) Restricted to Total Assets	Admitted Restricted to Total Admitted Assets
....	$	$	$	$	$	$	$	$	.... %	...........%
....	....	....	....	....	....	....	....	....	....	....
....	....	....	....	....	....	....	....	....	....	....
Total (c)	**$ ....**	**$ ....**	**$ ....**	**$ ....**	**$ ....**	**$ ....**	**$ ....**	**$ ....**	**........... %**	**...........%**

(a) Subset of column 1
(b) Subset of column 3
(c) Total Line for Columns 1 through 7 should equal 5L(1)n Columns 1 through 7 respectively and Total Line for Columns 8 through 10 should equal 5L(1)n Columns 9 through 11 respectively

Staff Question – Are there other broad categories that should be captured in aggregate subtotals?

(4) Collateral Received and Assets Held under Modco/Funds Withheld (FWH) Reinsurance Agreements Reflected as Assets Within the Reporting Entity's Financial Statements

	1			2			3	4
~~Collateral~~ Assets	Book/Adjusted Carrying Value (BACV)			Fair Value			% of BACV to Total Assets (Admitted and Nonadmitted *	% of BACV to Total Admitted Assets **
	Collateral	Modco	FWH	Collateral	Modco	FWH		
General Account:								
a. Cash, Cash Equivalents and Short-Term Investments	$			$			%	%
b. Schedule D, Part 1				....			%	%
c. Schedule D, Part 2, Section 1				....			%	%
d. Schedule D, Part 2, Section 2				....			%	%
e. Schedule B				....			%	%
f. Schedule A				....			%	%
g. Schedule BA, Part 1				....			%	%
h. Schedule DL, Part 1	....			....			%	%
i. Other							%	%
j. Total ~~Collateral~~ Assets (a+b+c+d+e+f+g+h+i)	Collateral	Modco	FWH	Collateral	Modco	FWH	%	%
Separate Account:								
k. Cash, Cash Equivalents and Short-Term Investments	$			$			%	%
l. Schedule D, Part 1	....			....			%	%
m. Schedule D, Part 2, Section 1	....			....			%	%
n. Schedule D, Part 2, Section 2	....			....			%	%
o. Schedule B	....			....			%	%
p. Schedule A	....			....			%	%
q. Schedule BA, Part 1	....			....			%	%
r. Schedule DL, Part 1	....			....			%	%
s. Other							%	%
t. Total ~~Collateral~~ Assets	Collateral	Modco	FWH	Collateral	Modco	FWH	%	%

(k+l+m+n+o+p+q+r +s)								

* j = Column 1 divided by Asset Page, Line 26 (Column 1)
t = Column 1 divided by Asset Page, Line 27 (Column 1)

** j = Column 1 divided by Asset Page, Line 26 (Column 3)
t = Column 1 divided by Asset Page, Line 27 (Column 3)

	1 Amount	2 % of Liability to Total Liabilities *
u. Recognized Obligation to Return Collateral Asset (General Account)	$	%
v. Recognized Obligation to Return Collateral Asset (Separate Account)	$	%

* u = Column 1 divided by Liability Page, Line 26 (Column 1)
v = Column 1 divided by Liability Page, Line 27 (Column 1)

u. Recognized Obligation for Modco assets (General Account)	$	%
v. Recognized Obligation for Modco assets (Separate Account)	$	%

* u = Column 1 divided by Liability Page, Line 26 (Column 1)
v = Column 1 divided by Liability Page, Line 27 (Column 1)

u. Recognized Obligation for FWH (excluding Modco) assets (General Account)	$	%
v. Recognized Obligation for FWH (excluding Modco) assets (Separate Account)	$	%

* u = Column 1 divided by Liability Page, Line 26 (Column 1)
v = Column 1 divided by Liability Page, Line 27 (Column 1)

(4) Disclose whether any of the assets held as collateral or under modified coinsurance (Modco) or funds withheld reinsurance (FWH) agreements have been pledged for another purpose specific to the insurance reporting entity. For example, if the insurance reporting entity has used these assets as the collateral in a securities lending agreement, a repo transaction, pledged as collateral to the FHLB, etc. (For Modco/FWH assets, items pledged on behalf of the reinsurer shall not be captured.)

	Collateral Held	**Modco**	**FWH**
a. Securities Lending	....		
b. Repo / repurchase Agreements	....		
c. Placed under option contracts	....		
d. On deposit with states	....		
e. On deposit with other regulatory bodies	....		
f. Pledged as collateral to FHLB (including assets backing funding agreements)	....		

g. Pledged as collateral not captured in other categories	....		
Total			

Proposed Language for a Referral to the Life RBC (E) Working Group:

MODCO OR FUNDS WITHHELD REINSURANCE AGREEMENTS
LR045, LR046, LR047 and LR048

References to MODCO and funds withheld reinsurance agreements apply to all treaties in effect.

Basis of Factors
When the default risk in modified coinsurance (MODCO) and other reinsurance transactions with funds withheld is transferred, this transfer should be recognized by reducing the RBC for the ceding company and increasing it for the assuming company. **In the event that the entire asset credit or variability in statement value risk associated with the assets supporting the business reinsured is not transferred to the assuming company for the entire duration of the reinsurance treaty, the RBC for the ceding company should not be reduced. For clarity, if the Modco/Funds Withheld reinsurance agreement asset held as of the year-end date has been used as a pledged asset for any purpose specific to the ceding insurance reporting entity at any time during the year, the RBC for the ceding company shall not be reduced. For example, if the Modco/Funds Withheld reinsurance agreement asset held as of the year-end date was the collateral in a securities lending, repurchase or FHLB transaction by the ceding entity at any time over the year, then the reporting entity cannot assert that they have transferred the asset risk or variability and RBC shall not be reduced.**

Staff Review Completed by: Julie Gann, NAIC Staff—October 2024

On November 17, 2024, the Statutory Accounting Principles (E) Working Group moved this item to the active listing categorized as a SAP clarification and exposed revisions illustrated in the recommendation above to SSAP No. 1 as well as corresponding proposed revisions to the Annual Statement instructions/template for the restricted asset disclosure in Note 5L to specify how Modco and FWH assets reported within a ceding company's financial statements shall be reported. The exposed revisions also include a new disclosure to identify whether Modco/FHW assets are pledged by the ceding entity as well as expanded disclosures to detail differences between what is reported in the restricted asset note and what is in the general interrogatories.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2025/03-24-25 Spring National Meeting/Hearing/06 - 24-20 - Restricted Asset Clarification.docx

Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Investment Subsidiary Classification

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue: This agenda item has been prepared as questions have been received on the classification of investments as "investment subsidiaries" in schedule D-6-1: Valuation of Shares of Subsidiary, Controlled or Affiliated Companies and in the Life RBC formula on pages LR042, LR043 and LR044.

For background, the concept of an investment subsidiary was reflected in *SSAP No. 46—Investments in Subsidiary, Controlled and Affiliated Entities* as "investments in noninsurance subsidiary, controlled or affiliated (SCA) entities that have no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates." For these SCAs, the guidance in SSAP No. 46 required an equity measurement method adjusted to the statutory basis of accounting. With this adjustment to the statutory basis of accounting, the measurement of the SCA under SSAP No. 46 was intended to be consistent to the accumulated measurement of the underlying assets if they had been held directly. SSAP No. 46 was superseded by SSAP No. 88 as of Jan. 1, 2005, and the concept of an "investment subsidiary" (or a subsidiary designed to hold assets for the entity) was eliminated from statutory accounting guidance. SSAP No. 88 was then superseded by SSAP No. 97 as of Dec. 31, 2007, and is the current authoritative guidance for SCAs. Similar to SSAP No. 88, the concept of an "investment subsidiary" (or an SCA designed just to hold assets for the benefit of the reporting entity and its affiliates) is not in SSAP No. 97.

Under current guidance in SSAP No. 97, the concept of an SCA that simply holds assets is not reflected. Unless the SCA is an insurance subsidiary or engages in specific transactions on behalf of the entity, the SCA will be captured under paragraph 8.b.iii in SSAP No. 97 and reported based on the audited US GAAP equity value. Admittance is permitted if the parameters of the SSAP are met, which includes an audited financial statement supporting the US GAAP equity value. It is noted that the concept of an investment sub is still reflected in *SSAP No. 25—Affiliates and Other Related Parties*. The example of an entity only holding assets for the benefit of the insurer is an example of a non-economic transaction, where the assets are transferred/recognized at fair value, but any gain from the transfer is deferred until permanence can be verified.

From questions received and a review of financial statement reporting, the following list identifies issues:

- Situations have been identified in which companies have reported Schedule BA items (in scope of SSAP No. 48) as "investment subs" for RBC look through although those investments should not be captured within the classification. The concept for an "investment subsidiary" is for items reported as SCAs in scope of SSAP No. 97 with common and/or preferred stock ownership.

- Questions have been raised on whether companies can utilize the concept of an "investment sub" to avoid statutory accounting provisions for underlying assets but receive favorable RBC impact as if the SSAP criteria had been met. (For example, whether a company utilize the bond RBC factors for a debt security held within an investment subsidiary without verifying that the debt security would qualify as a bond under SSAP No. 26 or use CRP ratings to determine RBC when the asset may have required an SVO-assigned designation if held directly.)

- Questions have been received on how companies comply with Life RBC LR044 instruction for Affiliate Type 4 "*The risk-based capital charge for the ownership of an investment subsidiary is based on the risk-based capital of the underlying assets, pro-rated for the degree of ownership. The basis for this calculation is the assumption that the charge should be the same as it would be if the life insurer held the assets directly."* Specifically, the measurement method for the SCA pursuant to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* (audited U.S. GAAP equity) would not be consistent with the measurement of the assets if the assets were held directly (statutory basis). Questions arise whether the underlying assets within the investment subsidiary are converted to statutory basis of accounting prior to computation of RBC charge. In addition, there were questions as to how the RBC after covariance is calculated for investment subsidiaries.

- According to Annual Statement instructions, investment subsidiaries also need to apply a "look-through" approach in Asset Valuation Reserve (AVR) calculation. However, diversity in practice has been observed and for companies that utilize Lines 5 – 14 of the AVR Equity and Other Invested Asset Component table to calculate AVR, the computation is not transparent.

- Questions have been raised on the current annual statement instructions for D-6-1 regarding the "imputed value on a statutory basis" and the direction for nonadmittance of the excess or reclassification in the "all other affiliates" category. Schedule D-6-1 does not determine the amount reported on balance sheet, as that amount is pulled from *Schedule D-2-2, Common Stocks*. Further, the A/S instructions for D-6-1 would not override the SSAP guidance that prescribes the measurement and admittance requirement as that is governed by SSAP No. 97, which is higher in the statutory hierarchy. These A/S instructions regarding the "imputed statutory value" appear to come from historical RBC guidance, and it is assumed that the calculation of the "imputed statutory value" was intended to be a pre-requisite for classifying as an investment sub. However, as the A/S guidance does not override SSAP, and what is captured would seemingly create a disconnect from what is reported on balance sheet, it seems to be causing confusion on application, as companies are not consistently reporting "investment subsidiaries" throughout the schedule, AVR and the RBC formula.

- From a review of the financial statements, the amounts reported for "investment subsidiaries" vary between D-6-1, AVR and RBC. From the 2023 filing, the amount reported in the RBC formula (which allows company RBC calculation based on the underlying assets) is significantly greater than the amount reported on D-6-1 and what is reported through the equity component of AVR.

The RBC background was noted from the 1995 "Raising the Safety Net" publication for RBC for P/C Insurance Companies is included as follows:

> The general principle in determining the RBC of … investment affiliates is to do so as if the affiliate were fully consolidated with the insurer. The committee recognizes that there is not necessarily any legal obligation for a parent to assist a subsidiary nor maintain adequate capital in the subsidiary; vice versa, a parent which wishes to remove excess capital from a subsidiary might sometimes face barriers in doing so. Nonetheless, the committee believes that the consolidation approach is the best way to measure the RBC of the parent, particularly when both the parent and the affiliate are going concerns. One particular advantage of this approach is that where there is a choice of whether to have ownership of an asset or placement of particular insurance business in either the parent or the subsidiary, the RBC calculation for the parent remains the same whichever choice is made. The committee believes that this makes the RBC calculation less manipulable with respect to affiliate transactions.
>
>> D. Investment Affiliates - Investment affiliates are investment conduits whose function it is to hold and invest assets of the insurance company.* Note that money management subsidiaries are not investment affiliates for this purpose. The RBC for an investment conduit is determined on a

consolidated or "see through" basis by applying the appropriate asset factors to the assets owned by the affiliate.

* An affiliate qualifies as an investment conduit if the following criteria are met:

i. 95 percent or more of the affiliate's assets would qualify as admitted assets if directly owned by the insurer.
ii. 95 percent or more of the affiliate's liabilities are paid-in capital, retained earnings or debt.
iii. Combining the prorata ownership share of the asset so fall the investment conduit affiliates with the owning insurer's assets does not violate any state requirements concerning diversification of investments or limitations on investments in a single entity.
iv. The investment conduit's statement value does not exceed the imputed value of the investment conduit using statutory accounting methodology admit the excess or move the affiliate to the "All Other Affiliated Common Stock" category.

Although the RBC calculation is within the purview of the Capital Adequacy (E) Task Force and its related RBC Working Groups, with the questions received for “investment subsidiaries,” as well as the current lack of detail on the underlying assets used to determine RBC, this agenda item proposes the following potential actions:

1) Revisions to SSAP No. 97 to incorporate statutory accounting guidance for SCAs that hold assets on behalf of the reporting entity and affiliate (investment subsidiaries). By incorporating in SSAP, consideration can be given as to prescribing the measurement method and potential nonadmittance thresholds if the assets within the investment subsidiary would be nonadmitted if held directly. (As detailed within, the existing reference to measurement and nonadmittance in the instructions for D-6-1 would not overrule the guidance in SSAP No. 97. If the revisions to SSAP No. 97 are not supported, then the Working Group could consider sponsoring a blanks proposal to clarify the instructions in D-6-1 to prescribe allocation of the underlying investments in a manner that coincides with the SCA measurement and admittance under SSAP No. 97. (For example, if the equity measurement reported on balance sheet per SSAP No. 97 is $100, but the imputed statutory value would be lower at $80 (or higher at $120), what should be reported on D-6-1 and how should that flow to RBC?)

2) Sponsor blanks proposals to capture new investment schedules, or perhaps expansions to existing investment schedules, to detail the underlying assets held within an investment subsidiary. As the RBC and AVR calculations require reporting entities to calculate RBC and AVR based on the underlying assets, this information should be readily available. If revisions are not incorporated into SSAP No. 97, these proposals can also clarify requirements for reporting as an investment subsidiary.

3) Referrals to the Capital Adequacy (E) Task Force and related RBC Working Groups to incorporate details that allow regulators to verify the RBC calculation for the underlying assets in investment subsidiaries. If blanks reporting revisions are incorporated that provide this detail, then the RBC formula can likely pull from those sources. If reporting revisions are not incorporated, then additional schedules or reporting lines would be necessary within the RBC formula.

Existing Authoritative Literature:

SSAP No. 46—Investments in Subsidiary, Controlled and Affiliated Entities –
Superseded by SSAP No. 88 as of Jan. 1, 2005.

7.b.ii Investments in noninsurance SCA entities that have no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates, shall be recorded based on the underlying equity of the respective entity's financial statements adjusted to a statutory basis of accounting and the resultant proportionate share of the subsidiary's adjusted surplus, adjusted for unamortized goodwill as provided for in SSAP No. 68. Examples include but are not limited to: (i) an insurer and a SCA entity that leases autos, furniture, office equipment, or computer equipment to the insurer; (ii) an insurer and a SCA entity that owns real estate property that is leased to the insurer for office space; and (iii) an insurer and an SCA entity that holds investments that an insurer could acquire directly (i.e., "look through" investment subsidiary);

SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities –

The current guidance requirement prescribes measurement based on the market value approach (8a) or an equity method (8b). The following guidance is divided as follows: 8bi: insurance subsidiaries, 8.b.ii: non-insurance subsidiaries that meet the activity and revenue test, 8bii: non-insurance subsidiaries not captured in 8a or 8bii, and 8biv: foreign insurance subsidiaries. There is no current guidance for an "investment subsidiary" and those SCAs would be captured under 8.b.iii and measured at the audited US GAAP equity.

8. The admitted investments in SCA entities shall be valued using either the market valuation approach (as described in paragraph 8.a.), or one of the equity methods (as described in paragraph 8.b.) adjusted as appropriate in accordance with the guidance in *SSAP No. 25—Affiliates and Other Related Parties*, paragraph 18.d.

a. In order to use the market valuation approach for SCA entities, the following requirements apply:

i. The subsidiary must be traded on one of the following major exchanges: (1) the New York Stock Exchange, (2) the NASDAQ, or (3) the Japan Exchange Group;

ii. The reporting entity must submit subsidiary information to the NAIC SCA analysts for calculation of the subsidiary's market value. Such calculation could result in further discounts in market value above the established base discounts based on ownership percentages detailed below;

iii. Ownership percentages for determining the discount rate shall be measured at the holding company level;

iv. If an investment in a SCA results in an ownership percentage between 10% and 50%, a base discount percentage between 0% and 20% on a sliding scale basis is required;

v. If an investment in a SCA results in an ownership percentage greater than 50% up to and including 80%, a base discount percentage between 20% and 30% on a sliding scale basis is required;

vi. If an investment in a SCA results in an ownership percentage greater than 80% up to and including 85%, a minimum base discount percentage of 30% is required.

vii. Further, the SCA must have at least two million shares outstanding, with a total market value of at least $50 million in the public's control; and

viii. Any ownership percentages exceeding 85% will result in the SCA being recorded on an equity method.

b. If a SCA investment does not meet the requirements for the market valuation approach in paragraph 8.a. or, if the requirements are met, but a reporting entity elects not to use that approach, the reporting entity's proportionate share of its investments in SCAs shall be recorded as follows:

i. Investments in U.S. insurance SCA entities shall be recorded based on either 1) the underlying audited statutory equity of the respective entity's financial statements, adjusted for any unamortized goodwill as provided for in SSAP No. 68—Business Combinations and Goodwill1 or 2) the underlying audited statutory equity of the respective entity's financial statements, adjusted for any unamortized goodwill, modified to remove the impact of any permitted or prescribed accounting practices that depart from the NAIC Accounting Practices and Procedures Manual. Reporting entities shall record investments in U.S. insurance SCA entities on at least a quarterly basis, and shall base the investment value on the most recent quarterly information available from the SCA. Entities may recognize their investment in U.S. insurance SCA entities based on the unaudited statutory equity in the SCAs year-end annual statement if the annual SCA audited financial statements are not complete as of the filing deadline. The recorded statutory equity shall be adjusted for audit adjustments, if any, as soon as the annual audited financial statements have been completed. Annual consolidated or combined audits are allowed if completed in accordance with the Model Regulation Requiring Annual Audited Financial Reports as adopted by the SCA's domiciliary state;

ii. Investments in both U.S. and foreign noninsurance SCA entities that are engaged in the following transactions or activities:

(a) Collection of balances as described in *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*

(b) Sale/lease or rental of EDP Equipment and Software as described in *SSAP No. 16—Electronic Data Processing Equipment and Software*

(c) Sale/lease or rental of furniture, fixtures, equipment or leasehold improvements as described in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements*

(d) Loans to employees, agents, brokers, representatives of the reporting entity or SCA as described in *SSAP No. 20—Nonadmitted Assets*

(e) Sale/lease or rental of automobiles, airplanes and other vehicles as described in *SSAP No. 20—Nonadmitted Assets*

(f) Providing insurance services on behalf of the reporting entity including but not limited to accounting, actuarial, auditing, data processing, underwriting, collection of premiums, payment of claims and benefits, policyowner services

(g) Acting as an insurance or administrative agent or an agent for a government instrumentality performing an insurance function (e.g. processing of state workers compensations plans, managing assigned risk plans, Medicaid processing etc).

(h) Purchase or securitization of acquisition costs

[1] If the insurance SCA employs accounting practices that depart from the NAIC accounting practices and procedures, and the reporting insurance entity has not adjusted the valuation of the insurance SCA to be consistent with the NAIC accounting practices and procedures, (i.e., retains the effect of the permitted or prescribed practice in its valuation), disclosure about those accounting practices that affect the insurance SCA's net income and surplus shall be made pursuant to paragraph 37. If the reporting entity has adjusted the investment in the insurance SCA with the resulting valuation being consistent with the accounting principles of the AP&P Manual, the disclosures in paragraph 37 are not required.

and if 20% or more of the SCA's revenue is generated from the reporting entity and its affiliates, then the underlying equity of the respective entity's audited U.S. Generally Accepted Accounting Principles (GAAP) financial statements shall be adjusted to a limited statutory basis of accounting in accordance with paragraph 9. For purposes of this section, revenue means GAAP revenue reported in the audited U.S. GAAP financial statements excluding realized and unrealized capital gains/losses. Foreign SCA entities are defined as those entities incorporated or otherwise legally formed under the laws of a foreign country. Paragraphs 22-27 provide guidance for investments in holding companies;

iii. Investments in both U.S. and foreign noninsurance SCA entities that do not qualify under paragraph 8.b.ii., shall be recorded based on the audited U.S. GAAP equity of the investee. Foreign SCA entities are defined as those entities incorporated or otherwise legally formed under the laws of a foreign country. Additional guidance on investments in downstream holding companies is included in paragraphs 22-27. Additional guidance on the use of audited foreign GAAP basis financial statements for the U.S. GAAP equity valuation amount is included in paragraph 23.b.

iv. Investments in foreign insurance SCA entities shall be recorded based on the underlying U.S. GAAP equity from the audited U.S. GAAP basis financial statements, adjusted to a limited statutory basis of accounting in accordance with paragraph 9, if available. If the audited U.S. GAAP basis financial statements are not available, the investment can be recorded on the audited foreign statutory basis financial statements of the respective entity adjusted to a limited statutory basis of accounting in accordance with paragraph 9 and adjusted for reserves of the foreign insurance SCA with respect to the business it assumes directly and indirectly from a U.S. insurer using the statutory accounting principles promulgated by the NAIC in the *Accounting Practices and Procedures Manual*. The audited foreign statutory basis financial statements must include an audited footnote that reconciles net income and equity on the foreign statutory basis of accounting to the U.S. GAAP basis. Foreign insurance SCA entities are defined as alien insurers formed according to the legal requirements of a foreign country.

2024 Annual Statement Instructions – Schedule D-6-1

If a reporting entity has any common stock or preferred stock reported for any of the following required categories or subcategories, it shall report the subtotal amount of the corresponding category or subcategory, with the specified subtotal line number appearing in the same manner and location as the pre-printed total or grand total line and number:

Category	Line Number
Preferred Stocks:	
Parent	0199999
U.S. Property & Casualty Insurer	0299999
U.S. Life Insurer	0399999
U.S. Health Entity #	0499999
Alien Insurer	0599999
Non-Insurer Which Controls Insurer	0699999
***Investment Subsidiary**	**0799999**
Other Affiliates	0899999
Subtotals – Preferred Stocks	0999999
Common Stocks:	
Parent	1099999
U.S. Property & Casualty Insurer	1199999
U.S. Life Insurer	1299999
U.S. Health Entity #	1399999
Alien Insurer	1499999

Non-Insurer Which Controls Insurer 1599999
***Investment Subsidiary 1699999**
Other Affiliates 1799999
Subtotals – Common Stocks 1899999
Totals – Preferred and Common Stocks 1999999

*NOTE: Investment Subsidiary shall mean any subsidiary, other than a holding company, engaged or organized primarily in the ownership and management of investments for the reporting entity. An investment subsidiary shall not include any broker dealer or a money management fund managing funds other than those of the parent company. The following criteria are applicable:

1. 95% or more of the investment subsidiary's assets would qualify as admitted assets;
2. The investment subsidiary's total liabilities are 5% or less of total assets;
3. Combining the pro-rata ownership shares of the assets of all the investment subsidiaries with the owning reporting entity's assets does not violate any state requirements concerning diversification of investments or limitations on investments in a single entity; and
4. **The investment subsidiary's book/adjusted carrying value does not exceed the imputed value on a statutory accounting basis. If the book/adjusted carrying value does exceed the imputed statutory value, the reporting entity may either nonadmit the excess or categorize such subsidiary in the "All Other Affiliates" category.**

<u>2023 RBC Forecasting and Instructions:</u>

AFFILIATED/SUBSIDIARY STOCKS – LR042, LR043, and LR044

(Only key excerpts included – bolded for emphasis.)

Affiliated/Subsidiary investments fall into two broad categories: (A) Insurance Affiliates/Subsidiaries that are Subject to risk-based capital; and (B) Affiliates/Subsidiaries that are Not Subject to risk-based capital. The risk-based capital for these two broad groups differs. **Investment subsidiaries are a subset of category A in that they are subject to a risk-based capital charge that includes the life RBC risk factors applied only to the investments held by the investment subsidiary for its parent insurer.** Publicly traded insurance affiliates/subsidiaries held at market value have characteristics of both broader categories. As a result, there is a two-part RBC calculation. The general treatment for each is explained below.

4. Investment Subsidiaries

An investment subsidiary is a subsidiary that exists only to invest the funds of the parent company. The term "investment subsidiary" is defined in the NAIC's Annual Statement Instructions as any subsidiary, other than a holding company, engaged or organized primarily to engage in the ownership and management of investments for the insurer. An investment subsidiary shall not include any broker-dealer or a money management fund managing funds other than those of the parent company. **The risk-based capital charge for the ownership of an investment subsidiary is based on the risk-based capital of the underlying assets, pro-rated for the degree of ownership. The basis for this calculation is the assumption that the charge should be the same as it would be if the life insurer held the assets directly.** Report information regarding any investment subsidiaries. Subsidiaries reported in this section will be assigned an affiliate code of "4" for investment subsidiaries. The amount of reported common stock should be the same as Schedule D, Part 6, Section 1, Line 1699999. Preferred stock information should be the same as Schedule D, Part 6, Section 1, Line 0799999.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:

None

Convergence with International Financial Reporting Standards (IFRS): N/A

Staff Recommendation:
NAIC staff recommend that the Working Group move this item to the active listing and expose this agenda item with a request for comments on the options offered to clarify statutory accounting guidelines (and resulting reporting impacts) for investment subsidiaries. As noted, with the exception of possible revisions to SSAP No. 97, the other possible actions are to sponsor blanks proposals or send referrals to the Capital Adequacy (E) Task Force and related RBC groups with a request for revisions. (Determination on whether this is a SAP classification or a new SAP concept will be based on the action directed.)

Potential Actions:

1) **Revisions to SSAP No. 97 to incorporate statutory accounting guidance for SCAs that hold assets on behalf of the reporting entity and affiliate (investment subsidiaries).** By incorporating in SSAP, consideration can be given as to prescribing the measurement method and potential nonadmittance thresholds if the assets within the investment subsidiary would be nonadmitted if held directly. (As detailed within, the existing reference to measurement and nonadmittance in the instructions for D-6-1 would not overrule the guidance in SSAP No. 97. If the revisions to SSAP No. 97 are not supported, then the Working Group could consider sponsoring a blanks proposal to clarify the instructions in D-6-1 to prescribe allocation of the underlying investments in a manner that coincides with the SCA measurement and admittance under SSAP No. 97.)

2) **Sponsor blanks proposals to capture new investment schedules, or perhaps expansions to existing investment schedules, to detail the underlying assets held within an investment subsidiary.** As the RBC and AVR calculations require reporting entities to calculate RBC and AVR based on the underlying assets, this information should be readily available. If revisions are not incorporated into SSAP No. 97, these proposals can also clarify requirements for reporting as an investment subsidiary.

3) **Referrals to the Capital Adequacy (E) Task Force and related RBC Working Groups to incorporate details that allow regulators to verify the RBC calculation for the underlying assets in investment subsidiaries.** If blanks reporting revisions are incorporated that provide this detail, then the RBC formula can likely pull from those sources. If reporting revisions are not incorporated, then additional schedules or reporting lines would be necessary within the RBC formula.

Staff Review Completed by: Julie Gann, NAIC Staff—November 2024

On November 17, 2024, the Statutory Accounting Principles (E) Working Group moved this item to the active listing and exposed this concept agenda item requesting comments on options to clarify accounting guidelines and resulting reporting impacts for investment subsidiaries.

Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Medicare Part D – Prescription Payment Program

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue:
This agenda item has been drafted to develop statutory accounting guidance in response to changes to the Medicare Part D (Part D) prescription drug program which goes into effect in 2025. At a high level, the Medicare Prescription Payment Program (MP3) requires insurers to pay pharmacies at the point of sale the out-of-pocket costs of enrollees who have opted into the MP3. The enrollees then have the remaining policy term to make installment payments to the insurer. (The policy term typically goes from January through December, so a cost incurred in March, would be repaid through installments ending in December.)

Interpretation (INT) 05-05: Accounting for Revenues Under Medicare Part D Coverage provides high-level accounting guidance on the current Part D program. INT 05-05 includes some basic guidance, but primarily provides guidance by referring to existing statements for specific aspects of the program.

A unique aspect of the updated program is having the insurer pay the pharmacy at the point of sale and seek reimbursement from enrollees. Most of the existing statutory accounting guidance on amounts recoverable from enrollees contemplates premium receivables or amounts due from a governmental payor.

Statutory accounting questions include, 1) where to report the initial point of sale payment to the pharmacy and the related installment receivables, 2) how to account for the prescription drug point of sale payments, and 3) when to write-off and or nonadmit overdue amounts.

Starting with plan year 2025, any Part D enrollee may opt into the program. Enrollees can also opt out of the program and will have differing options to repay their outstanding balance.

The program does not change the Part D enrollee's total out of pocket costs. If a participant fails to pay the amount, they are billed by the Part D sponsor and their participation in the program may be terminated following a required two-month grace period. The Medicare Part D plan sponsor is not permitted to terminate the individual's enrollment in the Part D plan due to failure to pay MP3 bills. Part D plan sponsors must also have a reinstatement process in place to allow individuals to resume participation in the MP3 in the same plan year.

Part D sponsors are required to treat any unsettled balances owed by enrollees under the MP3 as plan losses; Centers for Medicare & Medicaid Services (CMS) considers these unsettled balances as part of the plan's administrative costs. Costs of implementing the MP3 program and program collections are included in the administrative expenses of the Part D plan and are not included in the claim expenses or claim adjustment expenses.
CMS requires several reporting requirements and ongoing monitoring.

CMS has specific guidance on the treatment of unsettled balances in the medical loss ratio (MLR). MLR is the share of revenue used for incurred claims and quality improvement activities, rather than the share of revenue used for administrative costs and profit. Therefore, **excluding unsettled balances from the numerator of the MLR calculation is consistent** with the statutory direction to treat unsettled balances as plan losses and CMS' approach to other administrative expenses incurred by Part D sponsors.

The CMS guidance notes that unsettled balances **are included in the denominator of the MLR calculation**. The Act requires Part D sponsors to treat any unsettled balances owed by participants under the MP3 as plan losses and allows Part D sponsors to include unsettled balances assumed as losses in their premium bids. Consequently, Part D sponsors will receive revenue covering these assumed losses through their direct subsidy and premium payments, which should be included in the denominator of the MLR.

Health insurance industry trades, America's Health Insurance Plans (AHIP) and Blue Cross Blue Shield Association (BCBSA) have also coordinated with NAIC staff and submitted information on the programs.

Existing Authoritative Literature:
INT 05-05: Accounting for Revenues Under Medicare Part D Coverage is an interpretation of the following statements. It provides guidance that primarily references existing guidance in the SSAPs interpreted.

- *SSAP No. 47—Uninsured Plans*
- *SSAP No. 54—Individual and Group Accident and Health Contracts*
- *SSAP No. 66—Retrospectively Rated Contracts*
- *SSAP No. 84—Health Care and Government Insured Plan Receivables*

The CMS website has several guidance documents on the updates to the program.
https://www.cms.gov/inflation-reduction-act-and-medicare/part-d-improvements/medicare-prescription-payment-plan

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group: None

Convergence with International Financial Reporting Standards (IFRS): None

Staff Review Completed by: Robin Marcotte **-** NAIC Staff October 2024

Staff Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and take the actions listed below:

1. Expose the draft interpretation *INT 24-02: Medicare Part D Prescription Payment Program* and expose minor edits to *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage* as illustrated in the attachment. The edits to INT 05-05 adds reference to the new INT 24-02 regarding Medicare Part D prescription payment plans, but does not otherwise change the guidance in INT 05-05.
2. Send notice of the exposure to the Health Insurance (B) Committee and Health Risk-Based Capital (E) Working Group
3. Direct NAIC staff to coordinate with the Blanks (E) Working Group to develop an annual statement blanks proposal in the interim and to develop disclosures for future inclusion in relevant SSAPs. Preliminary recommendations would include the list below, but more research on CMS reporting may also identify other relevant items:
   a. Amounts recoverable on Medicare Part D installments due from enrollees.
   b. Aging of Medicare Part D installments due from enrollees more than 90 days overdue in categories similar to what is used for premium receivables.
   c. Information nonadmitted Medicare Part D installments due from enrollees.
   d. Information on write-offs of Medicare Part D installments due from enrollees.

On November 17, 2024, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as SAP clarification, and exposed tentative *Interpretation (INT) 24-02: Medicare Part D Prescription Payment Plans* as well as minor edits to *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage*, as described above. The Working Group directed notice of the exposures to the Health Insurance (B) Committee and Health Risk-Based Capital (E) Working Group. In addition, NAIC staff were directed to coordinate on the annual statement blanks proposals and to develop disclosures for future discussion.

On February 25, 2025, the Statutory Accounting Principles (E) Working Group exposed additional revisions to tentative *Interpretation (INT) 24-02: Medicare Part D Prescription Payment Plans* and re-exposed the minor edits to *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage* for a shortened comment period ending on March 5, 2025 to allow for discussion at the Spring National Meeting. In addition, the Working Group directed NAIC staff to continue with the blanks proposals on this topic with the goal of incorporation into the 2025 annual statement instructions.

The additional revisions to INT 24-02 incorporated most of the revisions suggested by health industry trade representatives NAIC has also included a few additional clarifications, however, the three entirely new proposed paragraphs suggested in the comment letter were not incorporated and an existing paragraph was deleted as redundant. The exposure also did not incorporate the optional guidance wording that was proposed for the initial paragraph on recording of out-of-pocket MPPP pharmacy payments as it proposed that the methodology be optional, which would be inconsistent with the illustration. However, more comments are requested on other possible methodologies that do not record a contra claim expense which is not recognized until the receivable is determined to be uncollectible and is written-off as an incurred claims expense. If additional language is recommended, modifications to the illustration are also requested.

The majority of the new revisions are terminology revisions which did not change the key provisions of the prior exposure. The revised INT 24-02 retains the key points noted in the summary section above includes the following key terminology revisions:

a. MP3 to MPPP
b. Member to enrollee (in Part D Plan)
c. Part D plan to Part D plan sponsor
d. MP3 enrollee to MPPP participant
e. Enrollee balance to recoverable from MPPP participant.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2025/03-24-25 Spring National Meeting/Hearing/08 - 24-24 Medicare D RX.docx

Interpretation of the Statutory Accounting Principles (E) Working Group

INT 24-02T: Medicare Part D Prescription Payment Plan~~s~~

Drafting Note: Tracked changes reflect February 25, 2025, revisions from the November exposure which are exposed until March 5, 2025, to allow for 2025 Spring National Meeting discussion. Shaded revisions were primarily suggested by health industry trades are planned for Spring discussion.

INT 24-02T Dates Discussed

November 17, 2024; February 25, 2025; March 24, 2025

INT 24-02T References

Current:

- *SSAP No. 47—Uninsured Plans*
- *SSAP No. 54—Individual and Group Accident and Health Contracts*
- *SSAP No. 66—Retrospectively Rated Contracts*
- *SSAP No. 84—Health Care and Government Insured Plan Receivables*
- *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage*

INT 24-024T Issue

1. The Inflation Reduction Act of 2022 introduced changes to Medicare Part D, which is the voluntary outpatient prescription drug program (Part D), including a new program to ~~help~~ offer Part D enrollees the option to pay ~~manage~~ their out-of-pocket Part D prescription drug costs through monthly payments over the course of the plan year instead of paying the full amount upfront at the pharmacy counter. This program, known as the Medicare Prescription Payment Plan (MPPP~~3~~), ~~will become~~is effective on January 1, 2025.

~~1.~~2. The purpose of this interpretation is to provide statutory accounting and reporting guidance for aspects of the ~~MP3~~MPPP ~~program~~. This interpretation specifically addresses the ~~MP3~~MPPP components of Medicare Part D and does not intend to alter the guidance in *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage*, which offers high-level accounting guidance on the current Medicare Part D program.

~~MP3~~MPPP Program Overview

3. ~~MP3~~The MPPP ~~is a new program that~~ requires all Medicare prescription drug plans (Part D plan~~s~~ sponsors), including both standalone Medicare prescription drug plans and Medicare Advantage plans with prescription drug coverage, to offer ~~its~~ ~~members~~enrollees the option to pay their out-of-pocket prescription drug costs through monthly payments to the Part D plan sponsor over the remainder of the plan year, as opposed to paying the full amount upfront to the pharmacy.

~~2.~~4. Part D plan ~~members~~enrollees who elect to participate in the ~~MP3~~MPPP (~~MP3~~MPPP ~~enrollees~~participants) will pay $0 to the pharmacy for covered Part D drugs. ~~The~~Instead, the Part D plan sponsor is required to fully pay the pharmacy the total of an ~~enrollee's~~ MPPP participant's applicable out-of-pocket amount and the Part D plan sponsor's portion of the payment in accordance with Part D prompt payment requirements. Subsequently, the Part D plan sponsor will bill the ~~MP3~~MPPP participant ~~enrollee~~ monthly for any cost-sharing incurred while enrolled in the ~~MP3~~MPPP.

5. ~~MP3 enrollees~~ MPPP ~~participants~~ will not ~~save money~~ reduce ~~on the~~ total out-of-pocket costs ~~of~~ for participants' prescription drug purchases for a plan year ~~(there are other Part D programs in place to help qualifying Part D plan members with affordability issues)~~. ~~MP3~~The MPPP simply spreads MPPP participants' out-of-pocket Part D costs into monthly payments over the remaining term of the plan year which may help ~~many~~ some ~~Part D plan~~MPPP ~~members~~participants to better manage their monthly cash flow.

~~3.~~6. Unlike other existing aspects of Medicare Part D~~,~~ ~~programs~~ which involve funds due from the federal government ~~(~~for which payment is effectively assured~~)~~, ~~MP3~~MPPP installment balance recoverables are due from individual ~~enrollees~~MPPP participants. Consequently, Part D plans may pay pharmacies for ~~MP3~~MPPP ~~enrollees'~~ participants' out-of-pocket pharmacy claim costs, but some amounts billed to the ~~enrollee~~ MPPP participants might be uncollectible~~, determined~~. ~~Reasons for the amount being uncollectable could include leaving enrollment in the Part D plan or an inability or unwillingness to pay the full outstanding balance.~~ That could occur when an MPPP participant does not pay the full outstanding balance after the required grace period. This raises statutory accounting concerns regarding potential nonadmittance of overdue amounts and impairment of ~~such~~ unpaid outstanding recoverables from MPPP participants.

~~4.~~7. To help cover potential uncollectible balances, the Centers for Medicare and Medicaid Services (CMS) allows Part D plan sponsors to include an ~~MP3 loss~~ estimate for MPPP related losses in their ~~premium~~ plan bids. However, for the initial years, Part D plan sponsors ~~have no~~lack directly relevant prior experience in estimating the ~~MP3~~MPPP program's potential ~~expenses~~ for uncollectible amounts.

~~5.~~8. The government is responsible for the estimated ~~MP3~~MPPP ~~losses~~ losses to the extent they are included in ~~premium~~ plan bids by Part D plan sponsors. Part D plan sponsors receive additional premium revenue from the government, which helps to cover uncollectible balances ~~resulting~~ from ~~MP3~~MPPP ~~enrollees~~participants. Part D plan sponsors face pricing/underwriting risk relating to the prescription needs of enrollees and may inaccurately estimate the amounts of uncollectible balances to include in ~~losses in the premium~~ plan bids. In addition, there are risks that the costs of uncollectible amounts and other aspects of implementing the ~~payment plan~~MPPP will vary from amounts that had been factored into ~~premium rates~~plan bids. ~~According to CMS guidance any losses in excess of the loss estimates included in the premium bids are the responsibility of the Part D plan sponsor.~~

~~MP3~~MPPP Program Requirements for Unpaid Balances

~~6.~~9. ~~The MP3~~ Under the MPPP, ~~Program requires~~ Part D plan sponsors ~~to~~ take on the risk for ~~of~~ uncollectible balances not covered by the plan bid. The program rules prohibit or limit many of the common methods used to mitigate loss from uncollectible ~~MP3~~MPPP balances~~. MP3 is a mandated program benefit imposed by federal law and CMS rules, with different implications for statutory accounting purposes~~. Examples of such prohibitions or limitations ~~Other key program requirements for MP3 balances~~ include the following:

a. **Late Fees, Etc. –** Under ~~MP3~~the MPPP, late fees, interest payments, or other fees, such as for different payment mechanisms, are not allowed.

b. **Billing and Payment Procedures –** Part D plan sponsors can design their own billing and payment procedures for ~~MP3~~the MPPP. However, they must prioritize payments towards Part D plan premiums to avoid an enrollee losing their Part D coverage. This rule applies when it is unclear if an enrollee intended a submitted payment to cover their outstanding Part D plan premium or their ~~MP3~~MPPP balance.

c. **Pharmacies Not Responsible for Balances –** Participation in ~~MP3~~the MPPP is considered an arrangement between the Part D plan sponsor and the ~~MP3 enrollee~~MPPP participant. Pharmacies are not responsible for ~~an enrollee's unsettled~~losses attributed to the uncollectibility of MPPP participants' balances or for collecting unpaid balances from the ~~MP3 enrollee~~MPPP participant on the Part D plan sponsor's behalf.

d. **Termination of Participation –** A Part D plan sponsor must terminate an enrollee's participation in ~~MP3~~the MPPP if the enrollee fails to pay their monthly billed amount. An ~~MP3 enrollee~~ MPPP participant will be considered to have failed to pay their monthly billed amount only after ~~the~~ a required grace period of at least two months. The Part D plan sponsor cannot terminate ~~the~~ an enrollee~~'s membership in~~from the Part D plan for nonpayment of any of their ~~MP3~~MPPP billed amounts. Part D plan s~~S~~ponsors must continue billing amounts owed under the program in monthly amounts up to the maximum monthly cap based on the statutory formula for the remaining duration of the plan year after an enrollee has been terminated.

e. **Reinstatement of Enrollees** - Part D plan sponsors must reinstate terminated ~~MP3 enrollees~~MPPP participants if the individual demonstrates good cause for failure to pay the program billed amount within the grace period and pays all overdue amounts billed.

f. **Preclusion from Subsequent Enrollment** - A Part D plan sponsor may prevent an individual from opting in~~-~~to the ~~MP3~~MPPP program in a subsequent year if the individual owes an overdue balance to that Part D plan sponsor or to another Part D plan sponsor with the same ~~ultimate~~ parent organization. In other words, an individual who owes an overdue MPPP balance ~~under the program~~to a Part D plan sponsor cannot be barred from enrolling in ~~MP3~~ the MPPP in a subsequent year ~~by~~ through a different Part D plan sponsor that does not have the same parent organization.

g. **Compliance with Federal and State Laws -** Part D plan sponsors (and any third parties ~~that~~ with whom Part D plan sponsors contract) collecting unpaid balances related to the program must follow other applicable federal and state laws and requirements, including those related to other types of payment plans, credit reporting, and debt collection.

Medical Loss Ratio

~~7.~~10. The current Public Health Act outlines how to calculate medical loss ratio (MLR) rebates, which are generally based on a comparison of incurred health claims and quality improvement activities to premium revenue, considering various factors and adjustments, as prescribed by CMS. *SSAP No. 66—Retrospectively Rated Contracts* provides disclosures related to the MLR. The CMS MLR requirements are separate from the statutory accounting reporting requirements for the MPPP~~. However, statutory accounting differences from CMS requirements~~ which create the need ~~for~~to report~~ing adjustments~~ differences between them in the annual statement *Supplemental Health Care Exhibit.*

~~8.~~11. According to the CMS guidance, the losses related to uncollectible MPPP participants' ~~outstanding~~ balances ~~owed by MP3 enrollees~~are considered for MLR purposes as part of the Part D plan sponsor's administrative expenses. CMS guidance excludes ~~unsettled~~ losses attributed to uncollectible MPPP participants' balances from the numerator of the MLR calculation, ~~aligning with~~~~this~~which is consistent with CMS' treatment in the MLR of other administrative expenses incurred by Part D sponsors. The CMS guidance states that ~~unsettled balances are~~the additional premium revenue attributable to the estimates of MPPP uncollectible amounts included in the Part D plan sponsor plan bids are included in the MLR calculation denominator~~ and allows Part D sponsors to account for these balances as losses in their premium bids~~. ~~The inclusion of Including enrollee lossesthe additional premium revenue in the denominator aligns with reporting the revenue estimated to offsets these losses also captured in the MLR denominator.~~

> *Drafting Note: The ~~MP3~~MPPP program considers uncollectible ~~MP3~~ recoverables from MPPP participants as incurred plan administrative costs and does not include these amounts in the MLR numerator, so reporting guidance for other adjustments to the Supplemental Health Care Exhibit will be needed. Such reporting revisions are not addressed in this interpretation but would be anticipated to be in the annual statement reporting revisions submitted to the Blanks (E) Working Group.*

INT 24-02T Discussion

Statutory Accounting and Reporting Considerations for ~~MP3~~MPPP

~~9.~~12. The Working Group reached the following tentative consensus for ~~MP3~~MPPP statutory accounting and reporting guidance. In addition, Appendix 1 illustrates some basic journal entries which help to show the intended financial statement results.

~~MP3~~ Recoverables from MPPP Participants

~~10.~~13. ~~MP3~~ ~~R~~recoverables from MPPP participants ~~enrollees~~ shall be accrued and reported as an asset on the ~~asset~~ asset page in the line ~~24,~~ for *Health care and other amounts receivable*, when the related payment is made by the Part D plan sponsor to the pharmacy for the out-of-pocket ~~payment~~costs ~~is~~ incurred on behalf of the MPPP participant.

~~11.~~14. Current ~~MP3MPPP~~ recoverables from MPPP participants, meaning those that are less than and up to 90 days overdue, are admitted assets to the extent that they comply with the guidance in this interpretation. ~~Repayment by MP3 enrolleesMPPP participants represents a probable future economic benefit to the Part D plan sponsor resulting from past transactions or events (i.e., paying the MP3 enrollee'sMPPP participants out-of-pocket costs to the pharmacy).~~ ~~MP3~~ ~~R~~recoverables from MPPP participants are also subject to impairment analysis.

~~12.~~15. Uncollected ~~MP3~~MPPP recoverables more than 90 days overdue are nonadmitted. The due date for aging of the ~~MP3~~MPPP recoverables shall follow the program billing guidelines.

~~13.~~16. If a~~n~~ ~~MP3~~ recoverable from an MPPP participant is fully collected, ~~it will~~the amounts received by the Part D plan sponsor will equal the corresponding out-of-pocket payment it made for a pharmaceutical claim ~~payment~~. In those cases, there will not be an income statement impact regarding claims (or claims adjusting expenses) ~~if the MP3MPPP recoverable is fully collected~~.

Impairments

~~14.~~17. Uncollected ~~MP3~~ recoverables from ~~enrollees~~ MPPP participants are subject to an impairment analysis which shall be assessed using the evaluation guidelines in *SSAP No. 5—Liabilities, Contingencies, and Impairment of Assets*. However, when ~~impairments for~~ uncollectible ~~MP3~~ recoverables from MPPP participants are ~~recorded~~written off, the expense ~~for the impairment~~ shall be reflected ~~in~~ as an incurred Medicare Part D prescription drug claims in the statutory income statement.

Out-of-Pocket ~~MP3~~MPPP Pharmacy Payments

~~15.~~18. When the Part D plan sponsor pays out-of-pocket drug claims to the pharmacy, a claims expense, a contra claims expense, and a contra claims expense account recoverable are recorded. The contra claims expense, or similar mechanism, is recorded to prevent initial claims expense recognition in the income statement so there is zero initial impact to the income statement. This is because there is an amount recoverable from the ~~enrollee~~MPPP participant, and to the extent that the ~~enrollee~~ MPPP participant pays in full, there should not be any claims recognition. This is analogous to the handling of anticipated pharmaceutical rebates or anticipated subrogation recoveries.

~~16.~~19. If the ~~enrollee~~ MPPP participant pays the amount due in full, there will be no income statement impact in claims expenses resulting from the Part D plan sponsor's payment of the ~~MP3~~MPPP participants out-of-pocket costs to the pharmacy. This is because the MPPP participant's ~~payment and enrollee~~subsequent monthly payments to the Part D plan sponsor have fully offset the initial pharmacy payments. In such cases, the ~~MP3~~MPPP recoverable will be reduced as payments are collected and there would be no income statement impact.

~~17.~~20. If the MPPP participant's ~~enrollee~~ balance ~~recoverable~~ is not repaid in whole or in part, there will be an income statement impact to reflect the paid amount in claims expense for the ~~amount of the~~uncollectible ~~MP3~~MPPP ~~recoverable~~ balance~~s that are~~ which ~~have~~has been evaluated ~~for~~ as impaired~~impairmented~~ and written off. Since there is a~~n~~ ~~MP3~~ recoverable from the ~~enrollee,~~MPPP participant there should be no income statement amount for an incurred claim until the related ~~MP3~~MPPP recoverable is written off as uncollectible based on ~~for~~ impairment analysis.

~~18.~~21. When the ~~MP3~~ recoverable from the MPPP participant is evaluated ~~for~~ as impair~~ment~~ed, the contra claims expense is decreased by the amount of the ~~MP3~~MPPP recoverable that is written off. This results in the incurred Medicare prescription claim reported reflecting the uncollectible ~~MP3~~ recoverable from MPPP participants for statutory reporting. The premium to offset these claims is included in Medicare premium bids, so reporting the ~~incurred~~ uncollectible ~~MP3~~MPPP amounts as losses allows the statutory accounting loss ratio to reflect incurred Medicare Part D prescription costs, including the ~~which include MP3~~MPPP uncollectible amounts which have been impaired and written off.

~~19. Reporting uncollectible and impaired MP3 recoverables in statutory filings as claims incurred is different than the CMS treatment of which reports such amounts as administrative expense for MLR purposes.~~

Administrative Costs

~~20.~~22. Other c~~C~~osts, e.g., those incurred by Part D plan sponsors in ~~of~~ implementing ~~the MP3~~and administering the MPPP program and ~~program~~related collections, are included in the administrative expenses of the Part D plan sponsor and are not included in the claim expenses or claim adjustment expenses.

MLR Reporting Difference

~~21.~~23. Note that the statutory reporting of the ~~uncollectible~~written off (impaired) ~~MP3~~ recoverable from MPPP participants in Medicare prescription claims is different from CMS treatment of such amounts in the MLR. The CMS requires Part D plan sponsors to report losses from impairment write-offs ~~treatment~~ of uncollectible ~~MP3~~ recoverables from MPPP participants ~~reports such amounts~~ as administrative amounts and, thus, such losses are excluded from the numerator in the CMS MLR. For loss ratios determined under statutory accounting, and pursuant to the guidance in this INT 24-02, such amounts are reported as claims expense and included in the numerator of the loss ratio. ~~These administrative amounts are included in the denominator of the MLR by CMS.~~

INT 24-02T Status

~~22.~~24. This interpretation is tentatively effective March 30, 2025.

~~23.~~25. Further discussion is planned.

Appendix 1 - Illustrative Journal Entries

Medicare Prescription Payment Plan Scenarios			
	Claims	**Receivable**	**Cash**
Initial entries for all scenarios *Assumed to have been recorded by the ~~insurance company~~Part D plan sponsor prior to Scenarios 1 – 3.*			
DR Claims Expense *To represent claims expenses incurred on behalf of the ~~enrollee~~MPPP participant.*	$ 2,000		
CR Cash *To represent the $2,000 paid by the ~~insurance company~~Part D plan sponsor to the pharmacy on behalf of the ~~enrollee~~MPPP participant.*			$ (2,000)
DR Healthcare Receivable *To represent the amount due to the ~~insurance company~~Part D plan sponsor from the ~~enrollee~~MPPP participant, which the ~~enrollee~~MPPP participant must pay over the policy term.*		$ 2,000	
CR Claims A/R (contra-claims expense) *To be reported within the claims expense line, essentially a contra-claims expense, and represents the amount due to the ~~insurance company~~Part D plan sponsor from the ~~enrollee~~MPPP participant which the ~~enrollee~~MPPP participant must pay over the policy term. This offsets the claims expense amount, so results in a current net $0 impact ~~to~~on the income statement, but both the DR and CR on the income statement are in claims expense.*	$ (2,000)		
Scenario 1 - The ~~enrollee~~MPPP participant pays their full amount of $2,000 to the ~~insurance company~~Part D plan sponsor.			
DR Cash *To record receipt of the ~~enrollee~~MPPP participant's payment in full.*			$ 2,000
CR Healthcare Receivable *The net income statement impact remains at $0, because the original claims expense was offset by the contra-claims expense (Claims A/R), and since the full $2,000 was received from the ~~enrollee~~MPPP participant, there are no further income statement journal entry impacts.*		$ (2,000)	
Scenario 1 Net result on Financial Statements	**$ -**	**$ -**	**$ -**
Scenario 2 ~~-~~– The ~~enrollee~~MPPP participant pays $1,500 out of the $2,000 to the ~~insurance company~~Part D plan sponsor and ~~doesn't~~does not pay the remaining $500.			
DR Cash			$ 1,500

To record receipt of ~~enrollee~~MPPP participant partial payment of outstanding balance.			
CR Healthcare receivable *To reduce ~~enrollee~~MPPP participant receivable for amounts paid.*		$ (1,500)	
DR Claims A/R (contra-claims expense) *To represent the write-off of the receivable. This results in the ~~insurance company~~Part D plan sponsor having a total income statement impact debit to claims expense of $500, represented as the initial $2,000 claims expense for the out-of-pocket~~-~~ paid to the pharmacy by the ~~insurance company~~Part D plan sponsor, offset by the $1,500 received from the ~~enrollee~~MPPP participant.*	$ ~~(~~500~~)~~		
CR Healthcare receivable *To write-off the remaining uncollectible amount as impaired*		$ (500)	
Scenario 2 Net result on Financial Statements	**$ 500**	**$**	**$ (500)**
Scenario 3 - The ~~enrollee~~MPPP participant does not pay any of the $2,000 owed to the ~~insurance company~~Part D plan sponsor.			
DR Claims A/R (contra-claims expense) *To represent the write-off of the amount anticipated to be paid by the ~~enrollee~~MPPP participant. This results in the income statement impact to the ~~insurance company~~Part D plan sponsor being a debit of $2,000, for the amount paid to the pharmacy by the ~~insurance company~~Part D plan sponsor and not reimbursed by the ~~enrollee~~MPPP participant.*	$ 2,000		
CR Healthcare receivable *To represent the write-off of the $2000 receivable.*		$ (2,000)	
Scenario 3 Net result on Financial Statements	**$ 2,000**	**$ -**	**$ (2,000)**

Interpretation of the Statutory Accounting Principles (E) Working Group

INT 24-02T: Medicare Part D Prescription Payment Plan~~s~~

Drafting Note: -February 25, 2025, revisions from the November exposure have been accepted -and shaded tracked new revisions were primarily suggested by health industry trades are planned for Spring discussion.

INT 24-02T Dates Discussed

November 17, 2024; February 25, 2025; March 24, 2025

INT 24-02T References

Current:
- *SSAP No. 47—Uninsured Plans*
- *SSAP No. 54—Individual and Group Accident and Health Contracts*
- *SSAP No. 66—Retrospectively Rated Contracts*
- *SSAP No. 84—Health Care and Government Insured Plan Receivables*
- *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage*

INT 24-024T Issue

1. The Inflation Reduction Act of 2022 introduced changes to Medicare Part D, which is the voluntary outpatient prescription drug program (Part D), including a new program to offer Part D enrollees the option to pay their out-of-pocket Part D prescription drug costs through monthly payments over the course of the plan year instead of paying the full amount upfront at the pharmacy counter. This program, known as the Medicare Prescription Payment Plan (MPPP), is effective on January 1, 2025.

2. The purpose of this interpretation is to provide statutory accounting and reporting guidance for aspects of the MPPP. This interpretation specifically addresses the MPPP components of Medicare Part D and does not intend to alter the guidance in *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage*, which offers high-level accounting guidance on the current Medicare Part D program.

MPPP Program Overview

3. The MPPP requires all Medicare prescription drug plans (Part D plan sponsors), including both standalone Medicare prescription drug plans and Medicare Advantage plans with prescription drug coverage, to offer ~~its~~ enrollees the option to pay their out-of-pocket prescription drug costs through monthly payments to the Part D plan sponsor over the remainder of the plan year, as opposed to paying the full amount upfront to the pharmacy.

4. Part D plan enrollees who elect to participate in the MPPP (MPPP participants) will pay $0 to the pharmacy for covered Part D drugs. Instead, the Part D plan sponsor is required to fully pay the pharmacy the total of an MPPP participant's applicable out-of-pocket amount and the Part D plan sponsor's portion of the payment in accordance with Part D prompt payment requirements. Subsequently, the Part D plan sponsor will bill the MPPP participant monthly for any cost-sharing incurred while enrolled in the MPPP.

5. MPPP ~~participants~~will not reduce total out-of-pocket costs for participants' prescription drug purchases for a plan year. The MPPP simply spreads MPPP participants' out-of-pocket Part D costs into monthly payments over the remaining term of the plan year which may help some to better manage their monthly cash flow.

6. Unlike other existing aspects of Medicare Part D, which involve funds due from the federal government for which payment is effectively assured, MPPP installment balance recoverables are due from individual MPPP participants. Consequently, Part D plans may pay pharmacies for MPPP participants' out-of-pocket pharmacy claim costs, but some amounts billed to the MPPP participants might be uncollectible. That could occur when an MPPP participant does not pay the full outstanding balance after the required grace period. This raises statutory accounting concerns regarding potential nonadmittance of overdue amounts and impairment of unpaid outstanding recoverables from MPPP participants.

7. To help cover potential uncollectible balances, the Centers for Medicare and Medicaid Services (CMS) allows Part D plan sponsors to include an estimate for MPPP related losses in their plan bids. However, for the initial years, Part D plan sponsors lack directly relevant prior experience in estimating the MPPP program's potential for uncollectible amounts.

8. The government is responsible for the estimated MPPP losses to the extent they are included in plan bids by Part D plan sponsors. Part D plan sponsors receive additional premium revenue from the government, which helps to cover uncollectible balances from MPPP participants. Part D plan sponsors face pricing/underwriting risk relating to the prescription needs of enrollees and may inaccurately estimate the amounts of uncollectible balances to include in plan bids. In addition, there are risks that the costs of uncollectible amounts and other aspects of implementing the MPPP will vary from amounts that had been factored into plan bids.

MPPP Program Requirements for Unpaid Balances

9. Under the MPPP, Part D plan sponsors take on the risk for uncollectible balances not covered by the plan bid. The program rules prohibit or limit many of the common methods used to mitigate loss from uncollectible MPPP balances. Examples of such prohibitions or limitations include the following:

a. **Late Fees, Etc. –** Under the MPPP, late fees, interest payments, or other fees, such as for different payment mechanisms, are not allowed.

b. **Billing and Payment Procedures –** Part D plan sponsors can design their own billing and payment procedures for the MPPP. However, they must prioritize payments towards Part D plan premiums to avoid an enrollee losing their Part D coverage. This rule applies when it is unclear if an enrollee intended a submitted payment to cover their outstanding Part D plan premium or their MPPP balance.

c. **Pharmacies Not Responsible for Balances –** Participation in the MPPP is considered an arrangement between the Part D plan sponsor and the MPPP participant. Pharmacies are not responsible for losses attributed to the uncollectibility of MPPP participants' balances or for collecting unpaid balances from the MPPP participant on the Part D plan sponsor's behalf.

d. **Termination of Participation –** A Part D plan sponsor must terminate an enrollee's participation in the MPPP if the enrollee fails to pay their monthly billed amount. An MPPP participant will be considered to have failed to pay their monthly billed amount only after a required grace period of at least two months. The Part D plan sponsor cannot terminate an enrollee from the Part D plan for nonpayment of any of their MPPP billed amounts. Part D plan sponsors must continue billing amounts owed under the program in monthly amounts up to the maximum monthly cap based on the statutory formula for the remaining duration of the plan year after an enrollee has been terminated.

e. **Reinstatement of Enrollees -** Part D plan sponsors must reinstate terminated MPPP participants if the individual demonstrates good cause for failure to pay the program billed amount within the grace period and pays all overdue amounts billed.

f. **Preclusion from Subsequent Enrollment -** A Part D plan sponsor may prevent an individual from opting into the MPPP program in a subsequent year if the individual owes an overdue balance to that Part D plan sponsor or to another Part D plan sponsor with the same parent organization. In other words, an individual who owes an overdue MPPP balance to a Part D plan sponsor cannot be barred from enrolling in the MPPP in a subsequent year through a different Part D plan sponsor that does not have the same parent organization.

g. **Compliance with Federal and State Laws -** Part D plan sponsors (and any third parties ~~that~~ with whom Part D plan sponsors contract) collecting unpaid balances related to the program must follow other applicable federal and state laws and requirements, including those related to other types of payment plans, credit reporting, and debt collection.

Medical Loss Ratio

10. The current Public Health Act outlines how to calculate medical loss ratio (MLR) rebates, which are generally based on a comparison of incurred health claims and quality improvement activities to premium revenue, considering various factors and adjustments, as prescribed by CMS. *SSAP No. 66—Retrospectively Rated Contracts* provides disclosures related to the MLR. The CMS MLR requirements are separate from the statutory accounting reporting requirements for the MPPP~~. However, statutory accounting differences from CMS requirements~~ which create the need ~~for~~to report differences between them in the annual statement *Supplemental Health Care Exhibit*.

11. According to the CMS guidance, the losses related to uncollectible MPPP participants' balances are considered for MLR purposes as part of the Part D plan sponsor's administrative expenses. CMS guidance excludes losses attributed to uncollectible MPPP participants' balances from the numerator of the MLR calculation, ~~this~~which is consistent with CMS' treatment in the MLR of other administrative expenses incurred by Part D sponsors. The CMS guidance states that the additional premium revenue attributable to the estimates of MPPP uncollectible amounts included in the Part D plan sponsor plan bids are included in the MLR calculation denominator.

Drafting Note: The MPPP program considers uncollectible recoverables from MPPP participants as incurred plan administrative costs and does not include these amounts in the MLR numerator, so reporting guidance for other adjustments to the Supplemental Health Care Exhibit will be needed. Such reporting revisions are not addressed in this interpretation but would be anticipated to be in the annual statement reporting revisions submitted to the Blanks (E) Working Group.

INT 24-02T Discussion

Statutory Accounting and Reporting Considerations for MPPP

12. The Working Group reached the following tentative consensus for MPPP statutory accounting and reporting guidance. In addition, Appendix 1 illustrates some basic journal entries which help to show the intended financial statement results.

Recoverables from MPPP Participants

13. Recoverables from MPPP participants shall be accrued and reported as an asset on the asset page in the line for *Health care and other amounts receivable*, when the related payment is made by the Part D plan sponsor to the pharmacy for the out-of-pocket costs incurred on behalf of the MPPP participant.

14. Current recoverables from MPPP participants, meaning those that are less than and up to 90 days overdue, are admitted assets to the extent that they comply with the guidance in this interpretation. Recoverables from MPPP participants are also subject to impairment analysis.

15. Uncollected MPPP recoverables more than 90 days overdue are nonadmitted. The due date for aging of the MPPP recoverables shall follow the program billing guidelines.

16. If a recoverable from an MPPP participant is fully collected, ~~it will~~the amounts received by the Part D plan sponsor will equal the corresponding out-of-pocket payment it made for a pharmaceutical claim ~~payment~~. In those cases, there will not be an income statement impact regarding claims (or claims adjusting expenses).

Impairments

17. Uncollected recoverables from MPPP participants are subject to an impairment analysis which shall be assessed using the evaluation guidelines in *SSAP No. 5—Liabilities, Contingencies, and Impairment of Assets*. However, when uncollectible recoverables from MPPP participants are written off, the expense shall be reflected as an incurred Medicare Part D prescription drug claims in the statutory income statement.

Out-of-Pocket MPPP Pharmacy Payments

18. When the Part D plan sponsor pays out-of-pocket drug claims to the pharmacy, a claims expense, a contra claims expense, and a contra claims expense account recoverable are recorded. The contra claims expense, or similar mechanism, is recorded to prevent initial claims expense recognition in the income statement so there is zero initial impact to the income statement. This is because there is an amount recoverable from the MPPP participant, and to the extent that the MPPP participant pays in full, there should not be any claims recognition. This is analogous to the handling of anticipated pharmaceutical rebates or anticipated subrogation recoveries.

19. If the MPPP participant pays the amount due in full, there will be no income statement impact in claims expenses resulting from the Part D plan sponsor's payment of the MPPP participants out-of-pocket costs to the pharmacy. This is because the MPPP participant's subsequent monthly payments to the Part D plan sponsor have fully offset the initial pharmacy payments. In such cases, the MPPP recoverable will be reduced as payments are collected and there would be no income statement impact.

20. If the MPPP participant's balance is not repaid in whole or in part, there will be an income statement impact to reflect the paid amount in claims expense for the uncollectible MPPP balance~~s~~ which ~~have~~has been evaluated ~~for~~ as impaired~~impairmented~~ and written off. Since there is a recoverable from the MPPP participant there should be no income statement amount for an incurred claim until the related MPPP recoverable is written off as uncollectible based on impairment analysis.

21. When the recoverable from the MPPP participant is evaluated ~~for~~ as impair~~ment~~ed, the contra claims expense is decreased by the amount of the MPPP recoverable that is written off. This results in the incurred Medicare prescription claim reported reflecting the uncollectible recoverable from MPPP participants for statutory reporting. The premium to offset these claims is included in Medicare premium bids, so reporting the uncollectible MPPP amounts as losses allows the statutory accounting loss ratio to reflect incurred Medicare Part D prescription costs, including the MPPP uncollectible amounts which have been impaired and written off.

Administrative Costs

22. Other costs, e.g., those incurred by Part D plan sponsors in implementing and administering the MPPP program and related collections, are included in the administrative expenses of the Part D plan sponsor and are not included in the claim expenses or claim adjustment expenses.

MLR Reporting Difference

23. Note that the statutory reporting of the written off (impaired) recoverable from MPPP participants in Medicare prescription claims is different from CMS treatment of such amounts in the MLR. The CMS requires Part D plan sponsors to report losses from impairment write-offs of uncollectible recoverables from MPPP participants as administrative amounts and, thus, such losses are excluded from the numerator in the CMS MLR. For loss ratios determined under statutory accounting, and pursuant to the guidance in this INT 24-02, such amounts are reported as claims expense and included in the numerator of the loss ratio. ~~These administrative amounts are included in the denominator of the MLR by CMS.~~

INT 24-02T Status

24. This interpretation is tentatively effective March 30, 2025.

25. No f~~F~~urther discussion is planned.

Appendix 1 - Illustrative Journal Entries

Medicare Prescription Payment Plan Scenarios			
	Claims	**Receivable**	**Cash**
Initial entries for all scenarios *Assumed to have been recorded by the Part D plan sponsor prior to Scenarios 1 – 3.*			
DR Claims Expense *To represent claims expenses incurred on behalf of the MPPP participant.*	$ 2,000		
CR Cash *To represent the $2,000 paid by the Part D plan sponsor to the pharmacy on behalf of the MPPP participant.*			$ (2,000)
DR Healthcare Receivable *To represent the amount due to the Part D plan sponsor from the MPPP participant, which the MPPP participant must pay over the policy term.*		$ 2,000	
CR Claims A/R (contra-claims expense) *To be reported within the claims expense line, essentially a contra-claims expense, and represents the amount due to the Part D plan sponsor from the MPPP participant which the MPPP participant must pay over the policy term. This offsets the claims expense amount, so results in a current net $0 impact on the income statement, but both the DR and CR on the income statement are in claims expense.*	$ (2,000)		
Scenario 1 - The MPPP participant pays their full amount of $2,000 to the Part D plan sponsor.			
DR Cash *To record receipt of the MPPP participant's payment in full.*			$ 2,000
CR Healthcare Receivable *The net income statement impact remains at $0, because the original claims expense was offset by the contra-claims expense (Claims A/R), and since the full $2,000 was received from the MPPP participant, there are no further income statement journal entry impacts.*		$ (2,000)	
Scenario 1 Net result on Financial Statements	**$ -**	**$ -**	**$ -**
Scenario 2 - The MPPP participant pays $1,500 out of the $2,000 to the Part D plan sponsor and does not pay the remaining $500.			
DR Cash *To record receipt of MPPP participant partial payment of outstanding balance.*			$ 1,500

CR Healthcare receivable *To reduce MPPP participant receivable for amounts paid.*		$ (1,500)	
DR Claims A/R (contra-claims expense) *To represent the write-off of the receivable. This results in the Part D plan sponsor having a total income statement impact debit to claims expense of $500, represented as the initial $2,000 claims expense for the out-of-pocket paid to the pharmacy by the Part D plan sponsor, offset by the $1,500 received from the MPPP participant.*	$ ~~(~~500~~)~~		
CR Healthcare receivable *To write-off the remaining uncollectible amount as impaired*		$ (500)	
Scenario 2 Net result on Financial Statements	**$ 500**	**$**	**$ (500)**
Scenario 3 - The MPPP participant does not pay any of the $2,000 owed to the Part D plan sponsor.			
DR Claims A/R (contra-claims expense) *To represent the write-off of the amount anticipated to be paid by the MPPP participant. This results in the income statement impact to the Part D plan sponsor being a debit of $2,000, for the amount paid to the pharmacy by the Part D plan sponsor and not reimbursed by the MPPP participant.*	$ 2,000		
CR Healthcare receivable *To represent the write-off of the $2000 receivable.*		$ (2,000)	
Scenario 3 Net result on Financial Statements	**$ 2,000**	**$ -**	**$ (2,000)**

Interpretation of the Emerging Accounting Issues (E) Working Group and Statutory Accounting Principles (E) Working Group

INT 05-05: Accounting for Revenues Under Medicare Part D Coverage

INT 05-05 Dates Discussed

September 28, 2005; December 3, 2005; March 24, 2018; August 4, 2018; November 17, 2024; February 25, 2025; March 24, 2025

INT 05-05 References

Current:
SSAP No. 47—Uninsured Plans
SSAP No. 54—Individual and Group Accident and Health Contracts
SSAP No. 66—Retrospectively Rated Contracts
SSAP No. 84—Health Care and Government Insured Plan Receivables
INT 24-02: Medicare Part D Prescription Payment Plan

INT 05-05 Issue

1. The Medicare Modernization Act of 2003 (MMA) created a new program, commonly known as Medicare Part D, whereby Medicare recipients may obtain prescription coverage offered by insurers who have been approved by the Centers for Medicare and Medicaid Services (CMS). Insurers who offer Medicare Part D coverage will, starting in January 2006, receive several different types of funds relating to the program. Some of these funds relate to portions of the coverage that require an annual reconciliation, resulting in the return of any excess funds received. Other funds may be received (or may be required to be returned) to offset experience that is especially unfavorable (or, respectively, favorable).

2. How should the various components of the funds received or receivable by an insurer from Medicare Part D coverage be accounted for?

INT 05-05 Discussion

3. The attached appendix provides a listing of terms to which the CMS ascribes a specific meaning. This list has been enhanced to include other terms in order to facilitate consistent application for accounting and the NAIC's risk-based capital (RBC) formula. It should be noted that the terms included in the attached appendix are, for the most part, defined by the CMS. Consequently, the term "reinsurance payment" does not represent actual reinsurance as defined by *SSAP No. 61—Life, Deposit-Type and Accident and Health Reinsurance*.

4. The Emerging Accounting Issues (E) Working Group reached a consensus to adopt the following guidance as it applies to the various funds to be received under the Medicare Part D program. The funds should be accounted for in accordance with one of the three SSAP's outlined below:

   a. Specific funds received as reimbursements (or advance payments) for uninsured claims under a partially uninsured plan should be accounted for under SSAP No. 47. These funds include "reinsurance payments," "Coverage Gap Discount Program" payments and "low-income subsidy (cost-sharing portion)." These funds are paid by the government for a portion of claims above the out-of-pocket threshold or relate to prescription drug plan (PDP) payments for all or a portion of the deductible, the coinsurance and the co-payment amounts for low-income beneficiaries. The CMS provides advance funding to the Part D sponsors. The Part D sponsor uses those advances to provide point-of-sale drug discounts to participants. The CMS invoices the prescription drug manufacturers. The payment reconciliation process ensures that the Part D sponsor is paid dollar for dollar for coverage gap discounts advanced at the point of sale, based on accepted prescription drug event (PDE) data, and that any unused excess advances from the government are repaid. The Coverage Discount Gap Program does not apply to low-income beneficiaries.

b. Specific funds received by the PDP sponsor from either the Medicare Part D enrollee or the government as payment for standard coverage that will be subject to retrospective premium adjustments should be accounted for under SSAP No. 66. These funds include "direct subsidy," "low-income subsidy (premium portion)," "beneficiary premium (standard coverage portion)," "Part D payment demonstration" and "risk corridor payment adjustment." The funds noted above have a final policy amount that is calculated based on the loss experience of the insured during the term of the policy, therefore should be treated as such.

c. Specific funds received as premiums for coverage that is not retrospectively rated should be accounted for under SSAP No. 54. These funds include "beneficiary premium (supplemental benefit portion)" as these payments are considered to be standard premium payments that do not meet the definitions under SSAP No. 47 or SSAP No. 66 as defined in paragraph 4.a. and paragraph 4.b. of this interpretation.

d. The Medicare Part D Prescription Payment Plan shall follow the guidance in *INT 24-02: Medicare Prescription Payment Plan*.

5. The collectibility and any nonadmission of amounts receivable from the government insured or uninsured plans are addressed in SSAP No. 84, paragraph 22, and SSAP No. 47, paragraph 10 and paragraph 11, respectively.

INT 05-05 Status

6. On August 4, 2018, the Statutory Accounting Principles (E) Working Group updated this interpretation to add a description of the Coverage Gap Discount Program, amend existing guidance on program payments and update definitions. On March 24, 2025, the Working Group updated this interpretation to reference guidance in INT 24-02.

7. No further discussion is planned.

Appendix – Commonly Used Terms for Medicare Part D Coverage

The federal Centers for Medicare and Medicaid Services (CMS) oversees the Medicare Part D prescription drug coverage, including coverage provided through a stand-alone prescription drug plan (PDP) and coverage provided as part of a Medicare Advantage plan. The CMS ascribed specific meaning to most of the following terms. Other terms have been defined below in order to facilitate consistent application.

Beneficiary Premium (Standard Coverage Portion) – The amount received from the Part D enrollee (directly, or from the CMS after being withheld from Social Security benefits) as payment for the standard coverage. This includes any late enrollment penalties that the PDP sponsor receives for an enrollee. The beneficiary premium is accounted for as health premium.

Beneficiary Premium (Supplemental Benefit Portion) – The amount received from the Part D enrollee (directly, or from the CMS after being withheld from Social Security benefits) as payment for supplemental benefits. The beneficiary premium is accounted for as health premium.

Coverage Gap Discount Program – The federal Affordable Care Act amended the Health Care and Education Act of 2010 (H. R. 4872) (HCERA) in 2011 to establish a discount program that would make manufacturer discounts available to applicable Medicare beneficiaries receiving applicable covered Part D drugs while in the coverage gap. Part D sponsors must provide the discounts for the applicable drugs in the coverage gap at point-of-sale. The CMS coordinates the collection of discount payments from manufacturers and payment to Part D sponsors that provided the discount to applicable beneficiaries through a contractor. The coordination involves a standard process for paying Part D sponsors based on new information submitted to the CMS on prescription drug event data. The Coverage GAP Discount Program is reconciled quarterly.

Coverage Year Reconciliation – A reconciliation made after the close of each calendar year to determine the amounts that a PDP sponsor is entitled to for the low-income subsidy (cost-sharing portion), the reinsurance payment, and the risk corridor payment adjustment. To the extent that interim payments (if any) from the CMS exceeded the amounts determined by the reconciliation, the PDP sponsor must return the excess to the government; to the extent that interim payments (if any) from the CMS fell short of the amounts determined by the reconciliation, the government will make an additional payment to the PDP sponsor. The coverage year reconciliation results in the low-income subsidy (cost-sharing portion) and the reinsurance payment being essentially a self-insured (by the government) component of the Part D coverage, subject to SSAP No. 47. The coverage year reconciliation also results in the treatment of the risk corridor payment adjustment as a retrospective premium adjustment, subject to SSAP No. 66.

Direct Subsidy – The amount the government pays to the PDP sponsor for the standard coverage. These payments are accounted for as health premium.

Low-Income Subsidy (Cost-Sharing Portion) – The amount the government pays to the PDP sponsor for additional benefits provided to low-income enrollees. The additional benefits may include payment for some or all of the deductible, the coinsurance, and the co-payment above the out-of-pocket threshold. These payments are accounted for as payments made under a self-insured plan.

Low-Income Subsidy (Premium Portion) – The amount the government pays to the PDP sponsor for low-income enrollees in lieu of part or all of the beneficiary premium (standard coverage portion). These payments are accounted for as health premium.

PDP Sponsor – The entity that provides stand-alone Part D coverage (as opposed to Part D coverage provided through a Medicare Advantage plan).

Reinsurance Payment – An amount paid by the government for benefit costs above the out-of-pocket threshold (see "Standard Coverage"). Generally, when costs exceed the out-of-pocket threshold, the government pays a specified percentage of the costs, the enrollee pays a percentage (or the specified co-payments which are updated based on cost trends for generic and for brand-name prescriptions), and the PDP sponsor pays the remainder. The amount paid by the government is treated as a claim payment made by a self-insured benefit plan rather than as revenue to the PDP sponsor, and the claims do not flow through the PDP sponsor's income statement. In cases where the government prepays the reinsurance payment on an estimated basis, the prepayment is treated as a deposit, which again does not pass through the PDP sponsor's income statement. The amount paid by the enrollee is paid directly to the pharmacy; therefore there is no required accounting for this amount by the PDP sponsor.

Part D Payment Demonstration – A payment from the government to a PDP sponsor participating in the CMS's Part D Payment Demonstration. The payment demonstration is a special arrangement in which the PDP sponsor receives a predetermined per-enrollee capitation payment and the government no longer provides reinsurance for the specified percentage (example 80%) of costs in excess of the out-of-pocket threshold. Rather, the PDP sponsor assumes the risk for the specified percentage (example 80%) of costs, in addition to its normal percentage (example 15%) share of costs in excess of this threshold. However, risk corridor protection does still apply to this specified percentage (example 80%) share of costs. These payments are accounted for as health premium.

Reinsurance Coverage – The Medicare Part D provision under which the PDP sponsor may receive a reinsurance payment. This does not include payments under the Part D Payment Demonstration.

Risk Corridor Payment Adjustment – An amount by which the government adjusts its payments to the PDP sponsor, based on how actual benefit costs vary from the costs anticipated in the PDP sponsor's bid for the Part D contract (the "target amount" of costs). The government establishes thresholds for symmetric risk corridors around the target amount, using percentages of the target amount. If actual costs exceed the target amount but are less than the first threshold upper limit, then no adjustment is made. Risk corridor payment adjustments are accounted for as retrospective premium adjustments on retrospectively rated contracts.

Risk Corridor Protection – The Medicare Part D provision under which the PDP sponsor may receive (or pay) a Risk Corridor Payment Adjustment. Most employer plans providing Medicare Part D are not eligible for Risk Corridor Protection.

Standard Coverage – The Part D benefit design that conforms to certain standards prescribed by the government. The standard coverage comprises: no coverage for an annual initial deductible; coverage net of a coinsurance provision (the percentage of costs are payable by the insured) for costs up to an initial coverage limit; a range beyond the initial coverage limit (sometimes called the "coverage gap") in which the insured drug manufacturers and the PDP sponsor (for example, by 2020 insureds who are eligible for drug manufacturer discounts will pay 25% for qualifying brand and generic drugs, the PDP sponsor will be responsible for 25% of qualifying brand and 75% of generic drugs, and the drug manufacturer will be responsible for 50% of qualifying brand drugs); and an annual out-of-pocket threshold above which the insured pays the greater of a specified co-payment or a specified percentage of the drug cost. The various limits and thresholds are set at specified dollar amounts, which will be increased in later years based on the growth in drug expenditures. Wherever the term "standard coverage" is used as part of these instructions, the same treatment would be applied to coverage that has been approved as actuarially equivalent coverage. With respect to amounts above the out-of-pocket threshold, see the definitions of "Reinsurance Payment" and "Part D Payment Demonstration."

Supplemental Benefits – Benefits in excess of the standard coverage. These benefits typically will cover some portion of the deductible, the co-payments, or the coverage gap between the initial coverage limit and the out-of-pocket threshold. Supplemental benefits are part of an enrollee's Part D coverage, so they are not placed in the "Other" category in the RBC formula. However, they are not subject to either the reinsurance payment or the risk corridor payment adjustment, so they receive less favorable RBC treatment than the standard coverage.

Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Conforming Repurchase Agreements

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue: This agenda item has been developed in response to the January 2024 referral received from the Life Risk-Based Capital (E) Working Group in response to the American Council of Life Insurers (ACLI) request to modify the treatment of repurchase agreements in the life risk-based capital (RBC) formula to converge with treatment for securities lending programs. As detailed within their ACLI-sponsored life RBC proposal, the request is to incorporate a concept of "conforming programs" for repurchase agreements, with the collateral attributed to these programs assigned a 0.2% (.0020) factor instead of a 1.26% (0.0126%) factor. Pursuant to the Statutory Accounting Principles (E) Working Group referral response dated Feb. 8, 2024, it was identified that the statutory accounting and reporting for securities lending and repurchase agreements are currently different. As a result, the SAPWG requested that the LRBCWG defer consideration of the proposal until the SAPWG has time to assess the differences and consider converging revisions (if deemed appropriate) before modifying the RBC formula.

This agenda item identifies initial statutory differences between securities lending and repurchase agreements as well as other items that should be reviewed for potential clarification on the "conforming agreement" securities lending concept currently captured in the general interrogatories. These items are summarized as follows:

- Documentation of Securities Lending Collateral: Securities lending collateral is detailed in Schedule DL: Securities Lending Collateral Asset for 1) collateral that an entity has received and reinvested and 2) collateral received that the entity has not reinvested but for which the entity has the ability to sell or repledge. This schedule currently does not include repurchase agreement collateral. As detailed within the ACLI proposal, the ACLI identifies that repurchase agreements and securities lending transactions are similar forms of short-term collateralized funding for life insurers, with counterparties reflecting the key difference between the two funding structures. With these similarities, consistent reporting of the collateral may be appropriate to ensure financial regulators receive comparable information regardless of the legal form of the agreement. Furthermore, a review of year-end 2022 data identified that securities associated with securities lending transactions are declining, whereas securities associated with repurchase agreements are increasing.

- Blanks Reporting Revisions: Blanks reporting revisions will be required to incorporate a new general interrogatory to capture repurchase collateral from conforming programs and for that data to be pulled directly into the RBC formula. Additionally, the current guidance on what reflects a "conforming program" for securities lending is captured in the RBC instructions. To ensure consistency in reporting, consideration should occur on incorporating the guidance into the annual statement instructions. This would ensure that financial statement preparers, who may not have the RBC instructions, have the guidelines to properly assess whether a program should be classified as conforming or nonconforming.

- Assessment of Conforming Provisions: From a review of year-end 2022 financial statements, very few reporting entities reported any securities lending collateral as part of a nonconforming program. Although the instructions identify what is permitted as "acceptable collateral," from a review of the collateral reported on Schedule DL, reporting entities are classifying programs as conforming even though the reported

Schedule DL collateral is outside the parameters of acceptable collateral. From initial assessments, it appears that there may be interpretation differences on whether the "acceptable collateral" requirement encompasses only the collateral received from the counterparty and not what the reporting entity currently holds due to reinvestment of the original collateral. From this information, clarification of the intent of the guidelines and what is conforming or nonconforming is proposed to be considered. It is also noted that the provisions to separate conforming and nonconforming programs in the RBC formula was incorporated before the great financial crisis, and significant changes to the accounting and reporting (Schedule DL) were incorporated because of how securities lending transactions impacted certain reporting entities during the crisis. For example, prior to Schedule DL, most of the security lending collateral was off-balance sheet, and now only collateral that an entity cannot sell or repledge is off-balance sheet. From a review of the detail, reporting entities are combining any off-balance sheet (which is limited) with what is captured on Schedule DL for inclusion in the "conforming program" securities lending general interrogatory.

Existing Authoritative Literature:

- ***SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities***

The guidance in SSAP No. 103R provides guidance for sales and secured borrowings and is extensive. Only the guidance for secured borrowings is included below. Most securities lending and repurchase transactions are accounted for as secured borrowings and not sales. Also, the guidance below includes information for repurchase and reverse repurchase agreements but does not include the guidance for repurchase financings or dollar-repurchase agreements. Lastly, the guidance in SSAP No. 103R was structured to mirror the issuance of U.S. GAAP guidance in FAS 166, so has the broad concepts, followed by disclosures, and then specific application guidance. For ease of review, the quoted segments below have been grouped first with the guidance followed by disclosures.

Secured Borrowing

14. If a transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset does not meet the conditions for a sale in paragraph 8, or if a transfer of a portion of an entire financial asset does not meet the definition of a participating interest (paragraph 7), the transferor and transferee shall account for the transfer as a secured borrowing with pledge of collateral (paragraph 19). The transferor shall continue to report the transferred financial assets in its statement of financial position with no change in their measurement (that is, basis of accounting).

Secured Borrowings and Collateral

19. A debtor may grant a security interest in certain assets to a lender (the secured party) to serve as collateral for its obligation under a borrowing, with or without recourse to other assets of the debtor. An obligor under other kinds of current or potential obligations, for example, interest rate swaps, also may grant a security interest in certain assets to a secured party. If collateral is transferred to the secured party, the custodial arrangement is commonly referred to as a pledge. Secured parties sometimes are permitted to sell or repledge (or otherwise transfer) collateral held under a pledge. The same relationships occur, under different names, in transfers documented as sales that are accounted for as secured borrowings (paragraph 14). The accounting for noncash[1] collateral by the debtor (or obligor) and the secured party depends on whether the secured party or its agent has the right to sell or repledge the collateral and on whether the debtor has defaulted. (Paragraphs 85-121 provide application guidance for securities lending, securities borrowing and repurchase agreements.)

a. If the secured party (transferee) or its agent has the right by contract or custom to sell or repledge the collateral, then the debtor (transferor) shall report that asset in its balance sheet.

[1] Cash "collateral," sometimes used, for example, in securities lending transactions, shall be derecognized by the payer and recognized by the recipient, not as collateral, but rather as proceeds of either a sale or a borrowing.

b. If the secured party (transferee) sells collateral pledged to it, it shall recognize the proceeds from the sale and its obligation to return the collateral. The sale of the collateral is a transfer subject to the provisions of this statement.

c. If the debtor (transferor) defaults under the terms of the secured contract and is no longer entitled to redeem the pledged asset, it shall derecognize the pledged asset, and the secured party (transferee) shall recognize the collateral as its asset initially measured at fair value or, if it has already sold the collateral, derecognize its obligation to return the collateral.

d. Except as provided in paragraph 19.c., the debtor (transferor) shall continue to carry the collateral as its asset, and the secured party (transferee) shall not recognize the pledged asset.

20. Reporting entities may enter into certain transactions that require the granting of a security interest in certain assets to another party to serve as collateral for their performance under a contract. If the assets pledged are recorded as admitted assets under *SSAP No. 4—Assets and Nonadmitted Assets* and *INT 01-31: Assets Pledged as Collateral* and are not impaired under the provisions of *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*, the pledging entity records the collateral as an admitted asset until committing a contract default that has not been cured in accordance with the contract provisions. At the time of an uncured default, the provisions of paragraph 19 shall be used to determine the appropriate accounting treatment for the collateral. If the secured party utilizes collateral to offset all or a portion of the liability owed by the pledging entity as a result of the default, then the collateral amount utilized to offset the liability shall be removed from the balance sheet. At the same time, the amount of the liability that was offset shall be removed from the balance sheet since that obligation has been satisfied through the secured party's utilization of that collateral. To the extent that an uncured default remains without the secured party utilizing the collateral to offset the obligation, the pledging insurer shall only record an admitted asset for the amount of collateral that it can redeem.

Securities Lending Transactions

85. Securities lending transactions are generally initiated by broker-dealers and other financial institutions that need specific securities to cover a short sale or a customer's failure to deliver securities sold. Securities lending transactions typically extend less than one year. Transferees (borrowers) of securities generally are required to provide collateral to the transferor (lender) of securities, commonly cash but sometimes other securities or standby letters of credit, with a value slightly higher than that of the securities borrowed. If the collateral is cash, the transferor typically earns a return by investing that cash at rates higher than the rate paid or rebated to the transferee. If the collateral is other than cash, the transferor typically receives a fee. Securities custodians or other agents commonly carry out securities lending activities on behalf of clients. Because of the protection of collateral (typically valued daily and adjusted frequently for changes in the market price of the securities transferred) and the short terms of the transactions, most securities lending transactions in themselves do not impose significant credit risks on either party. Other risks arise from what the parties to the transaction do with the assets they receive. For example, investments made with cash collateral impose market and credit risks on the transferor.

86. If the criteria conditions in paragraph 8 (sales criteria) are met, securities lending transactions shall be accounted for:

a. By the transferor as a sale of the "loaned" securities for proceeds consisting of the cash collateral[2] and a forward repurchase commitment.

[2] If the "collateral" in a transaction that meets the criteria in paragraph 8 is a financial asset that the holder or its agent is permitted by contract or custom to sell or repledge, that financial asset is proceeds of the sale of the "loaned" securities. To the extent that the "collateral" consists of letters of credit or other financial instruments that the holder or its agent is not permitted by contract or custom to sell or repledge, a securities lending transaction does not satisfy the sale criteria and is accounted for as a loan of securities by the transferor to the transferee.

b. By the transferee as a purchase of the "borrowed" securities in exchange for the collateral and a forward resale commitment. During the term of that agreement, the transferor has surrendered control over the securities transferred and the transferee has obtained control over those securities with the ability to sell or transfer them at will. In that case, creditors of the transferor have a claim only to the "collateral" and the forward repurchase commitment.

87. Many securities lending transactions are accompanied by an agreement that entitles and obligates the transferor to repurchase or redeem the transferred financial assets before their maturity under which the transferor maintains effective control over those financial assets (paragraphs 51-52). Those transactions shall be accounted for as secured borrowings, in which cash (or securities that the holder or its agent is permitted by contract or custom to sell or repledge) received as collateral is considered the amount borrowed, the securities loaned are considered pledged as collateral against the cash or securities borrowed and reclassified as set forth in paragraph 19.a., and any rebate paid to the transferee of securities is interest on the cash or securities the transferor is considered to have borrowed.

88. The transferor of securities being "loaned" accounts for cash received in the same way whether the transfer is accounted for as a sale or a secured borrowing. The cash received shall be recognized as the transferor's asset – as shall investments made with that cash, even if made by agents or in pools with other securities lenders – along with the obligation to return the cash. If securities that may be sold or repledged are received, the transferor of the securities being "loaned" accounts for those securities in the same way as it would account for cash received.

89. The transferor of securities being "loaned" accounts for collateral received in the same way whether the transfer is accounted for as a sale or a secured borrowing. The collateral received shall be recognized as the transferor's asset – as shall investments made with that collateral, even if made by agents or in pools with other securities lenders – along with the obligation to return the collateral. If securities that may be sold or repledged are received by the transferor or its agent, the transferor of the securities being "loaned" accounts for those securities in the same way as it would account for collateral received. Collateral which may be sold or repledged by the transferor or its agent is reflected on balance sheet, along with the obligation to return the asset3. Collateral received which may not be sold or repledged by the transferor or its agent is off balance sheet4. For collateral on the balance sheet, the reporting is determined by the administration of the program.

a. Securities lending programs where the collateral received by the reporting entity's unaffiliated agent that can be sold or repledged is reported on the balance sheet. The collateral received and reinvestment of that collateral by the reporting entity's unaffiliated agent shall be reflected as a one-line entry on the balance sheet (Securities Lending Collateral) and a detailed schedule will be required each quarter and at year-end to list the description of the collateral asset. This description shall include the NAIC designation, fair value; book adjusted carrying value and maturity date. A separate liability shall also be established to record the obligation to return the collateral (Collateral from Securities Lending Activities).

b. Securities lending programs where the collateral received by the reporting entity that can be sold or repledged is reported on the balance sheet. If the reporting entity is the administrator of the program, then, the collateral received and any reinvestment of that collateral is reported with the invested assets of the reporting entity based on the type of investment (i.e. bond, common stock, etc.). A separate liability shall also be established to record the obligation to return the collateral (Collateral from Securities Lending Activities).

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[3] If cash is received by the transferor or its agent and reinvested or repledged it is reported on balance sheet. It is explicitly intended that when the lender bears reinvestment risk, that collateral is on balance sheet.

[4] An example of collateral which is off balance sheet is when securities are received by the transferor or its agent in which the collateral must be held and returned, without the ability to transfer or repledge the collateral. This would involve limited situations in which the transferor or agent is prohibited from reinvesting the collateral.

c. Securities lending programs where the collateral received by the reporting entity's affiliated agent can report using either one-line reporting (paragraph 89.a.) or investment schedule reporting (paragraph 89.b.).

90. Reinvestment of the collateral by the reporting entity or its agent shall follow the same impairment guidance as other similar invested assets reported on the balance sheet. Any fees received by the transferor for loaning the securities shall be recorded as miscellaneous investment income.

Securities Lending Transactions – Collateral Requirements[5]

91. The reporting entity shall receive collateral having a fair value as of the transaction date at least equal to 102 percent of the fair value of the loaned securities at that date. If at any time the fair value of the collateral received from the counterparty is less than 100 percent of the fair value of the loaned securities, the counterparty shall be obligated to deliver additional collateral by the end of the next business day, the fair value of which, together with the fair value of all collateral then held in connection with the transaction at least equals 102 percent of the fair value of the loaned securities. If the collateral received from the counterparty is less than 100 percent at the reporting date, the difference between the actual collateral and 100 percent will be nonadmitted. Collateral value is measured and compared to the loaned securities in aggregate by counterparty.

92. In the event that foreign securities are loaned and the denomination of the currency of the collateral is other than the denomination of the currency of the loaned foreign securities, the amount of collateral shall be at least equal to 105 percent of the fair value of the loaned securities at that date. If at any time the fair value of the collateral received from the counterparty is less than 102 percent of the fair value of the loaned securities, the reporting entity must obtain additional collateral by the end of the next business day, the fair value of which together with the fair value of all collateral then held in connection with the transaction at least equals 105 percent of the fair value of the loaned securities. If the collateral received from the counterparty is less than 100 percent at the reporting date, the difference between the actual collateral and 100 percent will be nonadmitted. Collateral value is measured and compared to the loaned securities in aggregate by counterparty.

Securities Borrowing Transactions – Sale Criteria is Not Met (Secured Borrowing)

93. In addition to being the transferor of securities being loaned and receiving collateral under a securities lending arrangement, reporting entities may be a transferee of borrowed securities, and provide collateral under a securities borrowing arrangement.

94. A transferee that sells borrowed securities shall recognize the proceeds from the sale of the securities and an obligation, at fair value, to return the borrowed securities to the transferor. If cash proceeds from the sale of borrowed securities are invested into other assets, or if non-cash proceeds are received from the sale, the assets acquired shall be shown as assets on the reporting entity's (transferee's) financial statements and accounted and reported in accordance with the SSAP for the type of assets acquired. For all instances in which the transferee sells borrowed securities, the reporting entity shall designate restricted assets equivalent to the fair value of the obligation to return the borrowed securities to the transferor.

95. A reporting entity transferee that borrows securities captured under this section (sale criteria is not met) and uses the borrowed securities to settle a short sale transaction shall eliminate the contra-asset recognized under the short sale (paragraph 83) and establish a liability to return the borrowed security. The liability to return the borrowed security shall remain on the books until the reporting entity acquires the security to return to the transferor. The accounting/reporting for the short sale and the secured borrowing transaction shall be separately reflected within the financial statements. As such, use of the borrowed asset for the short sale would be similar to recognizing "proceeds" from selling a borrowed asset, as such, if the borrowed asset is used to settle a short sale, the reporting entity shall recognize the borrowed asset and the obligation to return the asset under the secured borrowing agreement until the asset has been returned under the secured borrowing transaction. and recognize an obligation, at fair value, to return the borrowed securities.

[5] The collateral requirements are required for determining admitted assets under statutory accounting, but the receipt of collateral is not a factor in determining whether the transferor has effective control over the loaned assets in accordance with paragraph 51.

Repurchase Agreements and "Wash Sales"

96. Government securities dealers, banks, other financial institutions, and corporate investors commonly use repurchase agreements to obtain or use short-term funds. Under those agreements, the transferor ("repo party") transfers a security to a transferee ("repo counterparty" or "reverse party") in exchange for cash6 and concurrently agrees to reacquire that security at a future date for an amount equal to the cash exchanged plus a stipulated "interest" factor. Repurchase agreements, reverse repurchase agreements and dollar repurchase agreements meet the definition of assets as defined in SSAP No. 4—Assets and Nonadmitted Assets and are admitted assets to the extent they conform to the requirements of this statement.

97. Repurchase agreements can be affected in a variety of ways. Some repurchase agreements are similar to securities lending transactions in that the transferee or its agent has the right to sell or repledge the securities to a third party during the term of the repurchase agreement. In other repurchase agreements, the transferee does not have the right to sell or repledge the securities during the term of the repurchase agreement. For example, in a tri-party repurchase agreement, the transferor transfers securities to an independent third-party custodian that holds the securities during the term of the repurchase agreement. Also, many repurchase agreements are for short terms, often overnight, or have indefinite terms that allow either party to terminate the arrangement on short notice. However, other repurchase agreements are for longer terms, sometimes until the maturity of the transferred financial asset. Some repurchase agreements call for repurchase of securities that need not be identical to the securities transferred.

98. If the conditions in paragraph 8 are met, the transferor shall account for the repurchase agreement as a sale of financial assets and a forward repurchase commitment, and the transferee shall account for the agreement as a purchase of financial assets and a forward resale commitment. Other transfers that are accompanied by an agreement to repurchase the transferred financial assets that may be accounted for as sales include transfers with agreements to repurchase at maturity. (Repurchase financing is addressed in paragraphs 105-110.)

99. Furthermore, "wash sales" that previously were not recognized if the same financial asset was purchased within 30 days before or after the sale shall be accounted for as sales under this statement. Unless there is a concurrent contract to repurchase or redeem the transferred financial assets from the transferee, the transferor does not maintain effective control over the transferred financial assets.

100. As with securities lending transactions, under many agreements to repurchase transferred financial assets before their maturity the transferor maintains effective control over those financial assets. Repurchase agreements that do not meet all the conditions in paragraph 8 shall be treated as secured borrowings. Fixed-coupon and dollar-roll repurchase agreements, and other contracts under which the securities to be repurchased need not be the same as the securities sold, qualify as borrowings if the return of substantially the same (paragraph 52) securities as those concurrently transferred is assured. Therefore, those transactions shall be accounted for as secured borrowings by both parties to the transfer.

101. If a transferor has transferred securities to an independent third-party custodian, or to a transferee, under conditions that preclude the transferee from selling or repledging the assets during the term of the repurchase agreement (as in most tri-party repurchase agreements), the transferor has not surrendered control over those assets.

Repurchase Agreements

102. Repurchase agreements are defined as agreements under which a reporting entity sells securities and simultaneously agrees to repurchase the same or substantially the same securities at a stated price on a specified date. For securities to be substantially the same, the criteria defined in paragraph 52 must be met, and for mortgage-backed securities excluding mortgage pass-through securities, the projected cash flows of the securities must be substantially the same under multiple scenario prepayment assumptions.

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[6] Instead of cash, other securities or letters of credit sometimes are exchanged. Those transactions are accounted for in the same manner as securities lending transactions (paragraphs 85-92).

103. For repurchase agreements that are accounted for as collateralized borrowings in accordance with paragraph 100 of this statement, the underlying securities shall continue to be accounted for as an investment owned by the reporting entity. The proceeds from the sale of the securities shall be recorded as a liability, and the difference between the proceeds and the amount at which the securities will be subsequently reacquired shall be reported as interest expense, calculated on the straight-line method or the scientific interest (constant yield) method, over the term of the agreement.

104. Reporting entities generally take possession of the underlying collateral under repurchase agreements and in many cases may obtain additional collateral when the estimated fair value of such securities falls below their current contract value. However, to the extent that the current fair value of the collateral is less than the recorded amount, the shortfall shall reduce the admitted asset value of the repurchase agreement.

Reverse Repurchase Agreements

111. Reverse repurchase agreements are defined as agreements under which a reporting entity purchases securities and simultaneously agrees to resell the same or substantially the same securities at a stated price on a specified date. For securities to be substantially the same, the criteria defined in paragraph 52 must be met, and for mortgage-backed securities excluding mortgage pass-through securities, the projected cash flows of the securities must be substantially the same under multiple scenario prepayment assumptions.

112. For reverse repurchase agreements that are accounted for as collateralized lendings in accordance with paragraph 100 of this statement, the underlying securities shall not be accounted for as investments owned by the reporting entity. The amount paid for the securities shall be reported as a short-term investment, and the difference between the amount paid and the amount at which the securities will be subsequently resold shall be reported as interest income, calculated on the straight-line method or the scientific interest (constant yield) method, over the term of the agreement.

Collateral Requirements – Repurchase and Reverse Repurchase Agreements[7]

113. The collateral requirements for repurchase and reverse repurchase agreements are as follows:

Repurchase Transaction

a. The reporting entity shall receive collateral having a fair value as of the transaction date at least equal to 95 percent of the fair value of the securities transferred by the reporting entity in the transaction as of that date. If at any time the fair value of the collateral received from the counterparty is less than 95 percent of the fair value of the securities so transferred, the counterparty shall be obligated to deliver additional collateral by the end of the next business day the fair value of which, together with the fair value of all collateral then held in connection with the transaction, at least equals 95 percent of the fair value of the transferred securities. If the collateral is less than 95 percent at the reporting date, the difference between the actual collateral and 95 percent will be nonadmitted.

Reverse Repurchase Transaction

b. The reporting entity shall receive as collateral transferred securities having a fair value at least equal to 102 percent of the purchase price paid by the reporting entity for the securities. If at any time the fair value of the collateral is less than 100 percent of the purchase price paid by the reporting entity, the counterparty shall be obligated to provide additional collateral, the fair value of which, together with fair value of all collateral then held in connection with the transaction, at least equals 102 percent of the purchase price.

Disclosures

(Disclosures are detailed in paragraph 28 of SSAP No. 103R. Only relevant subparagraphs are reflected.)

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[7] The collateral requirements are required for determining admitted assets under statutory accounting, but the receipt of collateral is not a factor in determining whether the transferor has effective control over the loaned assets in accordance with paragraph 50.

28. A reporting entity shall disclose the following[8]:

a. For Repurchase and Reverse Repurchase Agreements:

i. If the entity has entered into repurchase or reverse repurchase agreements, information regarding the company policy or strategies for engaging in repo programs, policy for requiring collateral, as well as whether transactions have been accounted for as secured borrowings or as sale transactions. This disclosure shall include the terms of reverse repurchase agreements whose amounts are included in borrowing money. The following information shall be disclosed by type of agreement:

(a) Whether repo agreements are bilateral and/or tri-party trades;

(b) Maturity time frame divided by the following categories: open or continuous term contracts for which no maturity date is specified, overnight, 2 days to 1 week, from 1 week to 1 month, greater than 1 month to 3 months, greater than 3 months to 1 year, and greater than 1 year[9];

(c) Aggregate narrative disclosure of the fair value of securities sold and/or acquired that resulted in default. (This disclosure is not intended to capture "failed trades", which are defined as instances in which the trade did not occur as a result of an error and was timely corrected. Rather, this shall capture situations in which the non-defaulting party exercised their right to terminate after the defaulting party failed to execute.)

ii. For repurchase transactions accounted for as secured borrowings[10], the maximum amount and end balance as of each reporting period (quarterly and annual) for the following:

(a) Fair value of securities sold. (Book adjusted carrying value shall be provided as an end balance only.) This information is required in the aggregate, and by type of security categorized by NAIC designation, with identification of nonadmitted assets. Although legally sold as a secured borrowing, these assets are still reported by the insurer and shall be coded as restricted pursuant to the annual statement instructions, disclosed in accordance with *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures*, reported in the general interrogatories, and included in any other statutory schedules or disclosure requirements requesting information for restricted assets.

(b) Cash collateral and the fair value of security collateral (if any) received. This information is required in the aggregate and by type of security categorized by NAIC designation with identification of collateral securities received that do not qualify as admitted assets.

(1) For collateral received, aggregate allocation of the collateral by the remaining contractual maturity of the repurchase agreements (gross): overnight and continuous, up to 30 days, 30-90 days, greater than 90

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[8] All repurchase and reverse repurchase transactions (collectively referred to as "repos"), and securities borrowing and securities lending transactions shall be reported gross for disclosure purposes and when detailed on the respective investment schedules. However, repurchase and reverse repurchase transactions, and securities borrowing and securities lending transactions may be reported net in the financial statements (pages 2 and 3 of the statutory financial statements) in accordance with *SSAP No. 64—Offsetting and Netting of Assets and Liabilities* when a valid right to offset exists. When these transactions are offset in accordance with SSAP No. 64 and reported net in the financial statements, the disclosure requirements in SSAP No. 64, paragraph 6, shall be followed.

[9] Only short-term repo agreements (with a stated short-term maturity date) are allowed as admitted assets. Long-term repo agreements (agreements with maturity dates in excess of 365 days) are nonadmitted.

[10] For secured borrowing repurchase transactions, the insurance reporting entity is selling a security, and receiving collateral (generally cash) in an exchange that does not qualify as a sale.

days. This disclosure shall also include a discussion of the potential risks associated with the agreements and related collateral received, including the impact arising changes in the fair value of the collateral received and/or the provided security and how those risks are managed.

(2) For cash collateral received that has been reinvested, the total reinvested cash and the aggregate amortized cost and fair value of the invested asset acquired with the cash collateral. This disclosure shall be reported by the maturity date of the invested asset: under 30 days, 60 days, 90 days, 120 days, 180 days, less than 1 year, 1-2 years, 2-3 years and greater than 3 years. To the extent that the maturity dates of the liability (collateral to be returned) does not match the invested assets, the reporting entity shall explain the additional sources of liquidity to manage those mismatches.

(c) Liability recognized to return cash collateral, and the liability recognized to return securities received as collateral as required pursuant to the terms of the secured borrowing transaction.

iii. For reverse repurchase transactions accounted for as secured borrowings[11], the maximum amount and end balance as of each reporting period (quarterly and annual) for the following:

(a) Fair value of securities acquired. This information shall be reported in the aggregate, and by type of security categorized by NAIC designation, with identification of whether acquired assets would not qualify as admitted assets.

(b) Cash collateral and the fair value of security collateral (if any) provided. (If security collateral was provided, book adjusted carrying value shall be provided as an end balance only.) Disclosure shall identify the book adjusted carrying value of any nonadmitted securities provided as collateral. For collateral pledged, the aggregate allocation of the collateral by the remaining contractual maturity of the reverse-repurchase agreements (gross): overnight and continuous, up to 30 days, 30-90 days, greater than 90 days. This disclosure shall also include a discussion of the potential risks associated with the agreements and related collateral pledged, including obligations arising from a decline in the fair value of the collateral pledged and how those risks are managed.

(c) Recognized receivable for the return of collateral. (Generally cash collateral, but including securities provided as collateral as applicable under the terms of the secured borrowing transaction. Receivables are not recognized for securities provided as collateral if those securities are still reported as assets of the reporting entity.)

(d) Recognized liability to return securities acquired under the reverse-repurchase agreement as required pursuant to the secured borrowing transaction. (Generally, a liability is required if the acquired securities are sold.)

iv. For repurchase transactions accounted for as a sale[12], the maximum amount and end balance as of each reporting period (quarterly and annual) for the following:

[11] For secured borrowing reverse repurchase transactions, the insurance reporting entity is buying a security and providing collateral (generally cash) in an exchange that does not qualify as a sale.

[12] For sale repurchase transactions, the insurance reporting entity sold a security and received “proceeds” in exchange. With a sale transaction, the insurer removes the asset from their financial statements and recognizes the proceeds from the sale. This transaction requires recognition of a forward repurchase commitment.

(a) Fair value of securities sold (derecognized from the financial statements). (Book adjusted carrying value shall be provided as an end balance only, reflecting the amount derecognized from the sale transaction.) This information is required in the aggregate, and by type of security categorized by NAIC designation, with information on the book adjusted carrying value of nonadmitted assets sold.

(b) Cash and the fair value of securities (if any) received as proceeds and recognized in the financial statements. This information is required in the aggregate and by type of security categorized by NAIC designation, with identification of received assets nonadmitted in the financial statements. All securities received shall be coded as restricted pursuant to the annual statement instructions, disclosed in accordance with SSAP No. 1, reported in the general interrogatories, and included in any other statutory schedules or disclosure requirements requesting information for restricted assets.

(c) The forward repurchase commitment recognized to return the cash or securities received. Amount reported shall reflect the stated repurchase price under the repurchase transaction.

v. For reverse repurchase transactions accounted for as sale[13], the maximum amount and end balance as of each reporting period (quarterly and annual):

(a) Fair value of securities acquired and recognized on the financial statements. (Book adjusted carrying value shall be provided as an end balance only.) This information shall be reported in the aggregate, and by type of security categorized by NAIC designation. The disclosure also requires the book adjusted carrying value of nonadmitted assets acquired.

(b) Cash collateral and the fair value of security collateral (if any) provided. (If security collateral was provided, book adjusted carrying value shall be provided as an end balance only.) Disclosure shall also identify whether any nonadmitted assets were provided as collateral (derecognized from the financial statements).

(c) The forward resale commitment recognized (stated repurchase price) to sell the acquired securities.

b. Collateral:

i. If the entity has entered into securities lending transactions, its policy for requiring collateral or other security and the fair value of the loaned security;

ii. If the entity has pledged any of its assets as collateral that are not reclassified and separately reported in the statement of financial position pursuant to paragraph 19.a., the carrying amounts and classifications of both those assets and associated liabilities as of the date of the latest statement of financial position presented, including qualitative information about the relationship(s) between those assets and associated liabilities. For example, if assets are restricted solely to satisfy a specific obligation, the carrying amounts of those assets and associated liabilities, including a description of the nature of restrictions placed on the assets, shall be disclosed.

iii. If the entity or its agent has accepted collateral that it is permitted by contract or custom to sell or repledge, the fair value as of the date of each statement of financial position presented of that collateral and of the portion of that collateral that it has sold or repledged,

[13] For sale reverse repurchase transactions, the insurance reporting entity has purchased a security and provided “proceeds” in exchange. With a sale transaction, the insurer reports the acquired asset in their financial statements and removes the proceeds provided. This transaction requires recognition of a forward resale commitment.

and information about the sources and uses of that collateral. Additionally, the reporting entity shall disclose the aggregate amount of contractually obligated open collateral positions (aggregate amount of securities at current fair value or cash received for which the borrower may request the return of on demand) and the aggregate amount of contractually obligated collateral positions under 30-day, 60-day, 90-day, and greater than 90-day terms.

iv. If the entity has accepted collateral that it is not permitted by contract or custom to sell or repledge, provide detail on these transactions, including the terms of the contract, and the current fair value of the collateral.

v. For all securities lending transactions, disclose collateral for transactions that extend beyond one year from the reporting date; and

vi. For securities lending transactions administered by an affiliated agent in which "one-line" reporting (paragraph 89.a.) of the reinvested collateral per paragraph 89.c. is optional, at the discretion of the reporting entity, disclose the aggregate value of the reinvested collateral which is "one line" reported and the aggregate value of items which are reported in the investment schedules (paragraph 89.b.). Identify the rationale between the items which are one line reported and those that are investment schedule reported and if the treatment has changed from the prior period and

vii. For securities lending transactions, include separately, the amount of any loaned securities within the separate account and if the policy and procedures for the separate account differ from the general account.

c. The reporting entity shall provide the following information by type of program (securities lending or dollar repurchase agreement) with respect to the reinvestment of the cash collateral and any securities which it or its agent receives as collateral that can be sold or repledged.

i. The aggregate amount of the reinvested cash collateral (amortized cost and fair value). Reinvested cash collateral shall be broken down by the maturity date of the invested asset – under 30 days, 60 days, 90 days, 120 days, 180 days, less than 1 year, 1-2 years, 2-3 years and greater than 3 years.

ii. To the extent that the maturity dates of the liability (collateral to be returned) does not match the invested assets, the reporting entity shall explain the additional sources of liquidity to manage those mismatches.

Blanks/Notes Reporting – Securities Lending: *(Only data-captured notes included)*

- **Schedule DL – Part 1: Securities Lending Collateral Assets:** This schedule includes collateral currently held as part of a securities lending program administered by the reporting entity's agent that can be sold or repledged. This is currently held collateral, meaning original collateral if still in original form received or the new invested asset resulting from the disposal and/or reinvestment of the original collateral. This collateral reported on DL - Part 1 is not reported on the specific investment schedules, but is captured on the assets page, line 10.

- **Schedule DL – Part 2: Securities Lending Collateral Assets:** This schedule includes collateral currently held as part of a securities lending program administered by the reporting entity that can be sold or repledged. This is currently held collateral, meaning original collateral if still in original form received or the new invested asset resulting from the disposal and/or reinvestment of the original collateral. This collateral reported on DL -Part 2 should be reported on the specific investment schedules.

- **Note 5E(3):** Aggregate fair value of securities or cash received that a borrower may request on demand (open positions) and the amount of obligated positions under 30-day, 60-day, 90-day and greater than 90-day terms.

- **Note 5E(5):** Aggregated amount of the reinvested cash collateral (amortized cost and fair value) divided by the maturity date of the invested asset – under prescribed timeframes.

- **Note 5E(7):** Collateral for transactions that extend beyond one year from the reporting date.

Notes Disclosure – Repurchase Transactions:

- **Note 5F – Repurchase Agreement Transactions Accounted for as Secured Borrowings:** This note disclosure includes items noted below, but it does not include details of current collateral held.
    - Fair value of aggregate securities sold and by type of security / NAIC designation.
    - Cash collateral and fair value of security collateral received in aggregate and by type of security / NAIC designation.
    - Aggregate allocation of collateral by remaining contractual maturity.
    - Total of reinvested cash collateral with amortized cost and fair value of the asset acquired with the cash collateral by maturity date of the invested asset.
    - Liability to return cash collateral and liability to return securities received as collateral pursuant to the terms of the secured borrowing transaction.

Blanks – General Interrogatories:

Note – Lines 25.04 and 25.05 include the securities lending conforming and nonconforming programs. All other restricted assets, including repurchase agreements, are detailed in lines 26.21-26.32.

INVESTMENT

25.01 Were all the stocks, bonds and other securities owned December 31 of current year, over which the reporting entity has exclusive control, in the actual possession of the reporting entity on said date? (other than securities lending programs addressed in 25.03) Yes [ ] No [ ]

25.02 If no, give full and complete information, relating thereto ....

25.03 For securities lending programs, provide a description of the program including value for collateral and amount of loaned securities, and whether collateral is carried on or off-balance sheet. (an alternative is to reference Note 17 where this information is also provided) ....

....

25.04 For the reporting entity's securities lending program, report amount of collateral for conforming programs as outlined in the Risk-Based Capital Instructions. $ ________

25.05 For the reporting entity's securities lending program, report amount of collateral for other programs. $ ________

25.06 Does your securities lending program require 102% (domestic securities) and 105% (foreign securities) from the counterparty at the outset of the contract? Yes [ ] No [ ] N/A [ ]

25.07 Does the reporting entity non-admit when the collateral received from the counterparty falls below 100%? Yes [ ] No [ ] N/A [ ]

25.08 Does the reporting entity or the reporting entity's securities lending agent utilize the Master Securities Lending Agreement (MSLA) to conduct securities lending? Yes [ ] No [ ] N/A [ ]

25.09 For the reporting entity's securities lending program, state the amount of the following as of December 31 of the current year:

25.091 Total fair value of reinvested collateral assets reported on Schedule DL, Parts 1 and 2 $ ________

25.092 Total book/adjusted carrying value of reinvested collateral assets reported on Schedule DL, Parts 1 and 2 $ ________

25.093 Total payable for securities lending reported on the liability page $ ________

26.1 Were any of the stocks, bonds or other assets of the reporting entity owned at December 31 of the current year not exclusively under the control of the reporting entity or has the reporting entity sold or transferred any assets subject to a put option contract that is currently in force? (Exclude securities subject to Interrogatory 21.1 and 25.03). Yes [ ] No [ ]

26.2 If yes, state the amount thereof at December 31 of the current year:

26.21	Subject to repurchase agreements	$ ________
26.22	Subject to reverse repurchase agreements	$ ________
26.23	Subject to dollar repurchase agreements	$ ________
26.24	Subject to reverse dollar repurchase agreements	$ ________
26.25	Placed under option agreements	$ ________
26.26	Letter stock or securities restricted as to sale – excluding FHLB Capital Stock	$ ________
26.27	FHLB Capital Stock	$ ________
26.28	On deposit with states	$ ________
26.29	On deposit with other regulatory bodies	$ ________
26.30	Pledged as collateral – excluding collateral pledged to an FHLB	$ ________
26.31	Pledged as collateral to FHLB – including assets backing funding agreements	$ ________
26.32	Other	$ ________

26.3 For category (26.26) provide the following:

1 Nature of Restriction	2 Description	3 Amount

RBC Instructions – Securities Lending Conforming Agreements:

- **LR017: Off-Balance Sheet and Other Items Instructions:**

  Line (1) Securities lending programs that have all of the following elements are eligible for a lower off-balance sheet charge:

  1. A written plan adopted by the Board of Directors that outlines the extent to which the insurer can engage in securities lending activities and how cash collateral received will be invested.

  2. Written operational procedures to monitor and control the risks associated with securities lending. Safeguards to be addressed should, at a minimum, provide assurance of the following:

     a. Documented investment guidelines, including, where applicable, those between lender and investment manager with established procedure for review of compliance.

     b. Investment guidelines for cash collateral that clearly delineate liquidity, diversification, credit quality, and average life/duration requirements.

     c. Approved borrower lists and loan limits to allow for adequate diversification.

     d. Holding excess collateral with margin percentages in line with industry standards, which are currently 102% (or 105% for cross currency loans).

     e. Daily mark-to-market of lent securities and obtaining additional collateral needed to ensure that collateral at all times exceeds the value of the loans to maintain margin of 102% of market.

     f. Not subject to any automatic stay in bankruptcy and may be closed out and terminated immediately upon the bankruptcy of any party.

  3. A binding securities lending agreement (standard “Master Lending Agreement” from Securities Industry and Financial Markets Association) is in writing between the insurer, or its agent on behalf of the insurer, and the borrowers.

  4. Acceptable collateral is defined as cash, cash equivalents, direct obligations of, or securities that are fully guaranteed as to principal and interest by, the government of the United States or any agency of the United States, or by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation and NAIC 1-designated securities. Affiliate-issued collateral would not be deemed acceptable. In all cases the collateral held must be permitted investments in the state of domicile for the respective insurer.

  Collateral included in General Interrogatories, Part 1, Line 24.04 of the annual statement should be included on Line (1).

  Line (2) Collateral from all other securities lending programs should be reported General Interrogatories, Part 1, Line 24.05 and included in Line (2).

Staff Note: From a review 2022 financials and comparing the information on Schedule DL, collateral reported with NAIC designations below NAIC 1 and not within the other permitted parameters detailed as acceptable collateral under number 4 above is being reported as part of a “conforming program” Also, these RBC instructions are detailed within the “Off-Balance Sheet” RBC schedule, but the majority of security lending collateral is captured on balance sheet, either in the direct investment schedules or on line 10 of the asset page. There is no other location in the general interrogatory to report securities lending collateral, so if

the intent was for the "conforming/non-conforming" provisions to only include off-balance sheet collateral, revisions would be required to separately capture the restricted asset risk for securities lending collateral reporting on balance sheet.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

- The Working Group directed a referral response to the Life Risk-Based Capital (E) Working Group on February 20, 2024, requesting time to assess accounting and reporting differences between securities lending and repurchase agreements before moving forward with RBC factor changes for repurchase agreements. This agenda is in response to the initial LRBCWG referral.

- Agenda item 2023-26 developed in response to *ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative*, proposes new disclosures for repos and reverse repos, including on counterparty risk arising from these transactions.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:
None

Convergence with International Financial Reporting Standards (IFRS): N/A

Staff Recommendation:
NAIC staff recommend that the Working Group move this item to the active listing of the maintenance agenda categorized as a SAP clarification with direction to work with industry in determining current application and interpretation differences on the reporting of securities lending collateral and repurchase agreement collateral.

Staff Review Completed by: Julie Gann, NAIC Staff—February 2024

Status:
On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed this agenda item and directed NAIC staff to work with industry in determining current application/interpretation differences on the reporting of securities lending collateral and repurchase agreement collateral for possible consistency revisions.

On August 13, 2024, the Statutory Accounting Principles (E) Working Group exposed this agenda item and a memorandum detailing accounting, reporting and RBC guidance for repurchase agreement and securities lending transactions with a request for feedback from regulators and interested parties on the documented processes and noted questions. This exposure is until September 27, 2024, to allow for discussion at the 2024 Fall National Meeting.

Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Asset Liability Management Derivatives

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	☐	☐	☐
New Issue or SSAP	☒	☒	☒
Interpretation	☐	☐	☐

Description of Issue: This agenda item has been developed to consider new statutory accounting guidance that prescribes guidance for interest-rate hedging derivatives that do not qualify as effective hedges under *SSAP No. 86—Derivatives*, but that are used for asset-liability management (ALM). Specifically, industry has proposed two assessment metrics for macro-hedges, the "ALM Risk Reduction Approach," which is a hedging approach to reduce mismatches between identified assets and liabilities and the "ALM Target Management Approach," which is a hedging approach to keep an asset portfolio aligned with a liability target. These programs do not qualify for effective hedge treatment under SSAP No. 86 (or any accounting regime) as they reflect macro-hedges.

This agenda item originated from discussions at the IMR Ad Hoc Group, noting that full Working Group discussion is needed on this topic. Industry has communicated that these hedging derivatives, although not accounting effective under SSAP No. 86, are economically effective (meaning effective in achieving the hedge intent). With this industry assessment, and their interpretation of the Annual Statement Instructions, the fair value fluctuations reported as unrealized gains and losses while the derivative is open have been allocated by some life entities to the interest maintenance reserve (IMR) upon derivative termination. This approach essentially reverses the surplus impact from the unrealized position and defers the realized impact from these derivative structures through the IMR formula with subsequent amortization into income over time.

INT 23-01: Net Negative (Disallowed) IMR, allows losses for interest-rate hedging derivatives that do not qualify for "hedge accounting" under SSAP No. 86 to continue to be allocated to IMR (and admitted if IMR is net negative) if the company has historically followed the same process for interest-rate hedging derivatives that were terminated in a gain position. The guidance does not permit entities to allocate current derivative losses to IMR without evidence illustrating the historical treatment for gains. This INT was established to provide limited-time exception guidance while IMR is further discussed and is effective through Dec. 31, 2025, with automatic nullification on Jan. 1, 2026. The treatment of the gains and losses from these non-accounting effective hedges is a key element in the long-term guidance for clarifying IMR.

SSAP No. 86 provides guidance on designations that hedge a variety of exposures, with assessments of effectiveness adopted from U.S. GAAP. Derivatives that qualify as "highly effective hedges" are permitted "hedge accounting treatment," which means that the measurement method of the derivative mirrors the measurement method of the hedged item. (This measurement method is different than US GAAP, which requires all derivatives to be at fair value. This different measurement method is necessary under SAP to prevent a measurement mismatch between the hedged item and derivative, which would result in surplus volatility for accounting effective hedges.) Derivatives that do not qualify as "highly effective hedges" under SSAP No. 86 are reported at fair value, which does mirror the measurement method under U.S. GAAP. Pursuant to the IMR Ad Hoc Group discussion, this item is focused on hedges that address interest-rate risk exposure used in macro-hedges, that would not qualify under the effective hedge requirements under SSAP No. 86.

If the Working Group wants to pursue accounting guidance for macro-hedges focused on hedging interest-rate risk that results with different treatment than what is detailed in SSAP No. 86, the guidance is anticipated to detail:

1) The requirements for the interest-rate hedging derivatives, including effectiveness assessments.

2) The accounting for the derivatives and the resulting gains/losses (including amortization if those gains/losses are deferred from immediate recognition), and

3) Disclosure and reporting requirements for the derivatives.

If developing new guidance, it is anticipated that the concepts of *SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees* will be followed to the extent possible, but there would need to be variations based on the specific intent and application of these derivatives. A key item to note is that SSAP No. 108 does not use IMR for the reporting of deferred derivative gains and losses and this approach will also be considered within the new guidance for consistency purposes.

Existing Authoritative Literature:

- ***SSAP No. 86—Derivatives***
  SSAP No. 86 provides the broad statutory accounting principles for derivative instruments. The guidance is used to determine whether a derivative qualifies as "effective" and therefore permitted to be accounted for under the "hedge accounting" provisions. (Derivatives that qualify for hedge accounting are reported at the measurement method that mirrors the hedged item. For example, a derivative that qualifies for hedge accounting that is hedging a bond would be reported at amortized cost, to mirror the amortized cost measurement of the bond.) Derivatives that do not qualify for "hedge accounting" are required to be reported at fair value.

  The guidance in SSAP No. 86 is explicit that derivative gains or losses from derivatives that qualify for hedge accounting shall be recognized in a manner consistent with the hedged item. Hence, if the gain/loss on a hedged item was to go to IMR, then the gain/loss on the effective, hedging derivative should also go to IMR. This guidance makes sense, as the derivative gain/loss should predominantly offset the hedged item gain/loss, resulting in a zero (or negligible) impact to IMR.

  SSAP No. 86 requires derivatives which do not qualify as effective to be carried at fair value and changes in fair value are reported in unrealized gains and losses until termination.

- ***SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees***
  SSAP No. 108 provides special accounting treatment for limited derivatives hedging variable annuity guarantee benefits subject to fluctuations as a result of interest rate sensitivity. The items in scope of SSAP No. 108 would not qualify for hedge effectiveness under SSAP No. 86. The guidance is specific in that the provisions are only permitted if all of the components of the statement are met and that the guidance shall not be inferred as an acceptable statutory accounting approach for derivative transactions that do not meet the state qualifications or that are not specifically addressed within the guidance.

  The guidance in SSAP No. 108 addresses derivative transactions that reflect a macro-hedge (portfolio of variable annuity contracts) as well as a dynamic hedging approach (rebalancing of derivative instruments). Due to the heightened risk of misrepresentation of successful risk management, specific provisions are detailed to ensure governance of the program as well as to provide sufficient tools for regulators to review.

  Under SSAP No. 108, all derivatives are reported at fair value, and all fair value fluctuations attributed to the hedged risk (unrealized) are compared to the changes in the VM-21 reserve liability. The fair value fluctuations are then 1) recognized to realized gain/loss to offset a current period liability change, 2) recognized as deferred if attributed to the hedged risk but not offsetting a current period liability change or 3) recognized as unrealized if not attributed to the hedged risk. The changes recognized as deferred are amortized over a straight-line method into realized gains/losses via a timeframe that matches the Macaulay duration of the guarantee benefit cash flow, not to exceed 10 years. SSAP No. 108, although specific to interest rate risks, does not take derivative gains or losses to IMR.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):
In 2023, the Working Group adopted *INT 23-01: Net Negative (Disallowed) IMR* as short-term guidance and directed efforts towards a long-term resolution of IMR. The IMR Ad Hoc Group, comprised of accountants and actuaries representing regulators and industry, has met to discuss IMR, including the gains/losses from "economic effective" (ALM) derivatives that some reporting entities have been taking to IMR. With those discussions, and an ACLI presentation on ALM derivatives, regulators from the Ad Hoc Group supported moving discussion of potential statutory accounting guidance to the Working Group.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:
None

Convergence with International Financial Reporting Standards (IFRS): N/A

Staff Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, classified as a new statutory accounting concept, with exposure of this agenda item to obtain comments from Working Group members, as well as interested regulators and interested parties on the potential to develop statutory guidance for macro-derivative programs that hedge interest rate risk for asset-liability matching purposes. Initially, NAIC staff is requesting feedback on the following key concepts:

1) **Do Working Group members support the development of statutory accounting guidance that would defer derivative gains/losses for structures that hedge interest rate risk with amortization over time into income? (These derivative programs would not qualify as accounting effective under SSAP No. 86 and are not captured within the specific variable annuity guarantee guidance in SSAP No. 108.)**

2) **If further development / consideration of guidance is supported, the following items are noted for discussion:**

    a. **Determination of effectiveness that permits the derivative program to qualify for the special accounting treatment.**

    b. **Discussion of whether net deferred losses (reported as assets) would be admissible, and if so, any admittance limitations.**

    c. **Macro-limits on admittable net deferred losses (reported as assets) and other "soft" assets. (For example, capturing IMR and derivative deferred net losses, and then perhaps considering other soft assets, such as DTAs, EDP equipment and software, goodwill, etc.)**

    d. **Timeframes over which deferred items are amortized into income.**

    e. **Extent of application across the industry. (NAIC staff notes that SSAP No. 108 is only applied by 9 entities, and from a review of the derivative disclosures for INT 23-01, only 14 entities captured derivative gains/losses in the IMR balance.)**

NAIC staff requests direction to work with regulators and industry during the interim to continue discussions and in the consideration of guidance.

Staff Review Completed by: Julie Gann, NAIC Staff—May 2024

On August 13, 2024, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, classified as a new SAP concept, and exposed this agenda item with a request for feedback on the items noted within the above staff recommendation. This item was exposed with a longer comment period ending November 8, 2024. This item is not planned for detailed discussion at the 2024 Fall National Meeting but is planned for discussion in the interim after that meeting, or at the 2025 Spring National Meeting.

On December 17, 2024, the Statutory Accounting Principles (E) Working Group received comments from the prior exposure. Due to the extent of comments, and the complexity of the topic, the Working Group deferred directing staff from moving forward. This item is anticipated to be a focus of discussion at the Spring National Meeting, along with a review of the data reported for IMR derivatives as that information will be data-captured for the year-end 2024 financial statements. This item was not formally re-exposed.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2025/03-24-25 Spring National Meeting/Hearing/12 - 24-15 - ALM Derivatives.docx

Statutory Accounting Principles (E) Working Group
Spring National Meeting
Comment Letters Received

TABLE OF CONTENTS

American Property Casualty
Insurance Association
INSURING AMERICA apci.org

December 10, 2024

Mr. Dale Bruggeman
Chair, NAIC Statutory Accounting Principles (E) Working Group

Re: Agenda Item 2024-07, Modified Coinsurance Reporting

Dear Mr. Bruggeman:

The American Property Casualty Insurance Association (APCIA)[1]appreciates the opportunity to comment on Agenda Item 2024-07. We write to urge the Working Group to reject the proposed new Schedule F Part 7 to the property casualty Annual Statement that would require special reporting for funds withheld for reinsurance contracts. We participated in the discussions and endorse the comments of the industry's interested parties group on this item, but would like to raise several issues that are specific to property casualty insurers as there are significant differences in funds held arrangements between property casualty and life insurers.

<u>The use of funds withheld arrangements in property and casualty reinsurance agreements has declined due to the recognition of Certified Reinsurers and Reciprocal Jurisdictions.</u>
There are generally two types of arrangements in the property and casualty insurance industry where cash were "withheld" in past reinsurance transactions. The first is quota share arrangements where the cedent would hold back cash as both a credit risk mitigant and to lessen the operational burden of funds being paid to/from the reinsurer. The second was cash received as collateral in lieu of a letter of credit or trust agreement to allow the ceding insurer to take credit for reinsurance. The cash withheld component of these agreements is generally no longer used due to changes in the reinsurance collateral rules with the introduction of Certified Reinsurers and Reciprocal Jurisdictions. As a result, the reinsurance agreements in which funds were withheld as collateral in the past are in runoff and thus the proposed reporting change would generally only apply to older reinsurance contracts where the cash withheld amounts are generally no longer significant.

<u>No specifically identified assets</u>
The proposed Schedule F-Part 7 requires specific identification and reporting of the assets comprising funds withheld. This is contrary to the manner in which property casualty reinsurance is conducted. Property casualty insurers do not use modified co-insurance (modco) and ceding companies generally hold cash in the funds withheld arrangement and the cash held is comingled with the ceding company's general cash account(s). There was no need to designate specific assets as supporting a funds withheld liability because the necessary amounts due the reinsurer are either paid from the ceding company's general account or are netted with amounts receivable from the reinsurer in satisfaction of amounts owed to the cedent. If the new Schedule F Part 7 requires companies to segregate assets to support funds withheld, this would require companies to attempt to track fungible cash from funds withheld to the investments made from those funds for reinsurance agreements that were generally entered into prior to the reinsurance collateral changes

[1] APCIA is the primary national trade association for home, auto, and business insurers. APCIA promotes and protects the viability of private competition for the benefit of consumers and insurers, with a legacy dating back 150 years. APCIA members include companies of all sizes, structures, and regions—protecting families, communities, and businesses in the U.S. and across the globe.

555 12th Street, NW, Suite 550, Washington, DC 20004 | 202-828-7100
8700 W. Bryn Mawr Avenue, Suite 1200S, Chicago, IL 60631-3512 | 847-297-7800

and are in runoff. In addition, such reporting would not be supported by any legal restriction on such cash (in fact, no such legal restriction exists).

Funds withheld already reported

Schedule F, Part 3 of the property casualty Annual Statement already requires ceding companies to report funds withheld with regard to each reinsurer with which the cedent does business. Funds withheld are further included in the analysis of credit risk in Part 3. Since funds withheld are not attributable to specific assets, there is no additional reporting to be made.

No significant effect on RBC

We understand that in the life insurance industry funds withheld and modco assets may be separately identified, and that such identification has RBC (risk-based capital) and/or IMR (interest maintenance reserve) consequences. The identity of funds withheld assets has no implications for property casualty insurers – the RBC charge for a particular type of asset is not affected by whether the asset relates to funds withheld or not. In other words, any asset will have the appropriate RBC charge whether it is a funds held asset or not.

Finally, we notice that the agenda item contains no rationale for imposing this requirement on property casualty insurers except that "funds withheld also exist for property/casualty insurance". This is not a sufficient reason to impose an unnecessary requirement that will require significant company resources for no solvency-related purposes. APCIA respectfully requests that this agenda item be amended to remove the proposed requirement for a new property casualty Part 7.

Sincerely,

Jay Muska

Jay Muska, CFA, CPA
Vice President of Accounting and Financial Issues
American Property and Casualty Insurance Association

cc: Julie Gann
Jake Stultz
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December 16, 2024

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

RE: Ref #2024-07: Reporting of Funds Withheld and Modco Assets

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the following item that was exposed for comment by the Statutory Accounting Working Group (the Working Group) with comments due December 9th.

Ref #2024-07: Reporting of Funds Withheld and Modco Assets

Interested parties appreciate the opportunity to comment on the above referenced item that was re-exposed for comment by the Statutory Accounting Principles (E) Working Group (SAPWG) during the NAIC Summer National Meeting in Chicago.

The proposal, Ref # 2024-07, Reporting of Funds Withheld and Modco Assets, originated from discussions among the IMR Ad Hoc Group, as they noted issues with identifying assets that are subject to funds withheld (FWH) or modified coinsurance (Modco) arrangements. Our understanding of the intent of the proposal is to have transparency in the Annual Statement into the reduction of Risk Based Capital (RBC) charges for ceded FWH and Modco assets in the life RBC formula.

Interested parties request that SAPWG reject the proposed new Schedule F - Part 7 to the property and casualty Annual Statement that would require special reporting for FWH and Modco assets and consider the proposed alternative to the proposed new Schedule S - Part 8 to the life and health Annual Statement as discussed below.

<u>Property & Casualty</u>

Interested parties request that the SAPWG reject the proposed Schedule F - Part 7 for property and casualty FWH and Modco assets.

Reasons for Rejection:

1. **Limited Applicability:** Property and casualty insurers do not engage in Modco transactions. Moreover, due to the recognition of Certified Reinsurers and Reciprocal Jurisdictions, FWH provisions in reinsurance agreements have significantly decreased. Contracts with FWH provisions are typically in run-off and not substantive.

2. **Lack of Specific Asset Identification and Use Restrictions:** Past reinsurance agreements did not mandate specific identification or restrict the use of assets acquired with the withheld funds. Consequently, the assets are commingled with property and casualty insurers' general account assets and reported in cash and/or the appropriate investment schedule in the ceding insurer's annual statement. Additionally, FWH liabilities are either settled using general account assets or netted against amounts due from reinsurers. Currently, the amounts of FWH are reported in the aggregate on line 13 of the liabilities page of the annual statement balance sheet and in Schedule F - Part 3, column 20, by individual reinsurer.

<u>Life Insurance</u>

Reporting Format

As noted in the interested parties comment letter dated May 31, 2024, we are concerned that the disclosure of CUSIP-by-CUSIP information may create competitive harm or jeopardize the proprietary nature of reinsurance pricing strategies. Additionally, the presentation of this level of information does not seem relevant based on the stated objective of the accounting standard.

Given these concerns, we recommend that this proposed schedule follow the format of the AVR Schedule in the Annual Statement that shows summarized data by each asset class and rating category. This approach ties directly to the 20-category structure used by the RBC calculation which will allow software providers to easily program the asset totals to move through to the RBC calculation. FWH and Modco assets in this schedule would include Book/Adjusted Carrying Value (BACV) of General Account and Guaranteed Separate Account assets.

We have created a revised version of the exposed Schedule S – Part 8 (see attachment) utilizing the AVR Schedule format including ceded and assumed transactions. Given that this revised schedule is based on the AVR Schedules format, any future changes to the AVR schedules should be considered for Schedule S – Part 8.

We believe this solution would address regulators' goals with respect to RBC for FWH and Modco reinsurance transactions while addressing key industry concerns by creating a direct feed to the RBC formula. For cedants, the scope of reinsurance transactions subject to this reporting requirement would be where RBC credit is taken for asset risks transferred to the assuming entity. For assuming companies, the scope would include transactions where RBC asset charges are taken for asset risks assumed from the cedant.

Separate Account Assets

For Separate Account assets where there is no C-1 required capital, interested parties propose including the BACV of such FWH and Modco assets as a single line in the schedule. For example, reinsurance arrangements involving liabilities supported by Non-Guaranteed Separate Account assets are typically reinsured on a Modco basis, as the underlying assets are owned by the policyholders rather than the insurer. Consequently, they do not incur an RBC asset charge and are not recorded in an AVR schedule.

Timing

To facilitate the required reporting, commercial annual statement reporting vendors will need to build the new schedule into their software. Beyond that, many companies note additional work may be required to modify their investment and/or accounting systems to populate the proposed new schedules with the assets associated with FWH and Modco agreements. Others may not have the ability to make changes to their investment and/or accounting systems and would need to create manual processes including appropriate controls to meet the reporting obligations. This will all require significant time, effort, and cost. The ongoing bond definition project will compete for company resources. In spite of these challenges, the preliminary view of life interested parties is that a 2025 year-end implementation of a newly populated schedule S – Part 8 is likely achievable. However, process steps including Blanks Working Group adoption, RBC linkages, and software vendor requirements must be considered as well.

Interested parties acknowledge the importance of transparency in financial reporting for RBC with respect to assets backing FWH and Modco reinsurance transactions. We look forward to working with the SAPWG, as you further refine this proposal.

*   *   *   *

Please feel free to contact either one of us if you have any questions or would like to discuss further.

Sincerely,

D. Keith Bell   Rose Albrizio

cc: Interested parties
NAIC staff

Attachment 13

	B	C	D	E	F	G	H	I	J	K	L	M	N	O
1		Company	Statement											
2														
3														
4		ANNUAL STATEMENT FOR THE YEAR 2023 OF THE ABC Life Insurance Company												
5		Schedule S - Part 8												
6			Ceded General Account Assets		Ceded Guaranteed Separate Account Assets		Total Ceded Assets		Assumed General Account Assets		Assumed Guaranteed Separate Account Assets		Total Assumed Assets	
7			1	2	3	4	5	6	7	8	9	10	11	12
8			FWH Book/Adjusted Carrying Value	Modco Book/Adjusted Carrying Value	FWH Book/Adjusted Carrying Value	Modco Book/Adjusted Carrying Value	FWH Book/Adjusted Carrying Value	Modco Book/Adjusted Carrying Value	FWH Book/Adjusted Carrying Value	Modco Book/Adjusted Carrying Value	FWH Book/Adjusted Carrying Value	Modco Book/Adjusted Carrying Value	FWH Book/Adjusted Carrying Value	Modco Book/Adjusted Carrying Value
9		Cash and Cash Equivalents												
10	L030 - AVRDC													
11	01	Exempt Obligations												
12	02.1	Long-Term Bonds: NAIC Designation Category 1.A												
13	02.2	NAIC Designation Category 1.B												
14	02.3	NAIC Designation Category 1.C												
15	02.4	NAIC Designation Category 1.D												
16	02.5	NAIC Designation Category 1.E												
17	02.6	NAIC Designation Category 1.F												
18	02.7	NAIC Designation Category 1.G												
19	02.8	Subtotal NAIC 1 (2.1+2.2+2.3+2.4+2.5+2.6+2.7)	0		0				0		0			
20	03.1	NAIC Designation Category 2.A												
21	03.2	NAIC Designation Category 2.B												
22	03.3	NAIC Designation Category 2.C												
23	03.4	Subtotal NAIC 2 (3.1+3.2+3.3)	0		0				0		0			
24	04.1	NAIC Designation Category 3.A												
25	04.2	NAIC Designation Category 3.B												
26	04.3	NAIC Designation Category 3.C												
27	04.4	Subtotal NAIC 3 (4.1+4.2+4.3)	0		0				0		0			
28	05.1	NAIC Designation Category 4.A												
29	05.2	NAIC Designation Category 4.B												
30	05.3	NAIC Designation Category 4.C												
31	05.4	Subtotal NAIC 4 (5.1+5.2+5.3)	0		0				0		0			
32	06.1	NAIC Designation Category 5.A												
33	06.2	NAIC Designation Category 5.B												
34	06.3	NAIC Designation Category 5.C												
35	06.4	Subtotal NAIC 5 (6.1+6.2+6.3)	0		0				0		0			
36	07	NAIC 6	0		0				0		0			
37	08	Total Unrated Multi-class Securities Acquired by Conversion												
38	09	Total Long-Term Bonds (1+2.8+3.4+4.4+5.4+6.4+7+8)	0		0				0		0			
39	10	Preferred Stocks: Highest Quality												
40	11	High Quality												
41	12	Medium Quality												
42	13	Low Quality												
43	14	Lower Quality												
44	15	In or Near Default												
45	16	Affiliated Life with AVR												
46	17	Total Preferred Stocks (Sum of Lines 10 thru 16)	0		0				0		0			
47	18	Short-Term Bonds: Exempt Obligations												
48	19.1	Short-Term Bonds: NAIC Designation Category 1.A												
49	19.2	NAIC Designation Category 1.B												
50	19.3	NAIC Designation Category 1.C												
51	19.4	NAIC Designation Category 1.D												
52	19.5	NAIC Designation Category 1.E												
53	19.6	NAIC Designation Category 1.F												
54	19.7	NAIC Designation Category 1.G												
55	19.8	Subtotal NAIC 1 (19.1+19.2+19.3+19.4+19.5+19.6+19.7)	0		0				0		0			
56	20.1	NAIC Designation Category 2.A												
57	20.2	NAIC Designation Category 2.B												
58	20.3	NAIC Designation Category 2.C												
59	20.4	Subtotal NAIC 2 (20.1+20.2+20.3)	0		0				0		0			
60	21.1	NAIC Designation Category 3.A												
61	21.2	NAIC Designation Category 3.B												
62	21.3	NAIC Designation Category 3.C												
63	21.4	Subtotal NAIC 3 (21.1+21.2+21.3)	0		0				0		0			
64	22.1	NAIC Designation Category 4.A												
65	22.2	NAIC Designation Category 4.B												
66	22.3	NAIC Designation Category 4.C												
67	22.4	Subtotal NAIC 4 (22.1+22.2+22.3)	0		0				0		0			
68	23.1	NAIC Designation Category 5.A												
69	23.2	NAIC Designation Category 5.B												
70	23.3	NAIC Designation Category 5.C												

	B	C	D	E	F	G	H	I	J	K	L	M	N	O
71	23.4	Subtotal NAIC 5 (23.1+23.2+23.3)	0		0				0		0			
72	24	NAIC 6												
73	25	Total Short-Term Bonds (18+19.8+20.4+21.4+22.4+23.4+24)	0		0				0		0			
74	26	Derivative Instruments: Exchange Traded												
75	27	Highest Quality												
76	28	High Quality												
77	29	Medium Quality												
78	30	Low Quality												
79	31	Lower Quality												
80	32	In or Near Default												
81	33	Total Derivative Instruments	0		0				0		0			
82	34	Total (Lines 9 + 17 + 25 + 33)	0		0				0		0			
83	35	Mortgage Loans: In Good Standing: Farm Mortgages - CM1 - highest quality												
84	36	Farm Mortgages - CM2 - high quality												
85	37	Farm Mortgages - CM3 - medium quality												
86	38	Farm Mortgages - CM4 - low medium quality												
87	39	Farm Mortgages - CM5 - low quality												
88	40	Residential Mortgages - Insured or Guaranteed												
89	41	Residential Mortgages - All Other												
90	42	Commercial Mortgages - Insured or Guaranteed												
91	43	Commercial Mortgages - All Other - CM1 - highest quality												
92	44	Commercial Mortgages - All Other - CM2 - high quality												
93	45	Commercial Mortgages - All Other - CM3 - medium quality												
94	46	Commercial Mortgages - All Other - CM4 - low medium quality												
95	47	Commercial Mortgages - All Other - CM5 - low quality												
96	48	Overdue, Not in Process: Farm Mortgages												
97	49	Residential Mortgages - Insured or Guaranteed												
98	50	Residential Mortgages - All Other												
99	51	Commercial Mortgages - Insured or Guaranteed												
100	52	Commercial Mortgages - All Other												
101	53	In Process of Foreclosure: Farm Mortgages												
102	54	Residential Mortgages - Insured or Guaranteed												
103	55	Residential Mortgages - All Other												
104	56	Commercial Mortgages - Insured or Guaranteed												
105	57	Commercial Mortgages - All Other												
106	58	Total Schedule B Mortgages (Sum of Lines 35 thru 57)	0		0				0		0			
107	59	Schedule DA Mortgages												
108	60	Total Mortgage Loans on Real Estate (Lines 58 + 59)	0		0				0		0			
109														
110	L033 - AVREC													
111	01	Unaffiliated Public												
112	02	Unaffiliated Private												
113	03	Federal Home Loan Bank												
114	04	Affiliated Life with AVR												
115	05	Affiliated Investment Subsidiary: Fixed Income - Exempt Obligations												
116	06	Fixed Income - Highest Quality												
117	07	Fixed Income - High Quality												
118	08	Fixed Income - Medium Quality												
119	09	Fixed Income - Low Quality												
120	10	Fixed Income - Lower Quality												
121	11	Fixed Income - In/Near Default												
122	12	Unaffiliated Common Stock - Public												
123	13	Unaffiliated Common Stock - Private												
124	14	Real Estate												
125	15	Affiliated - Certain Other (See SVO Purposes and Procedures Manual)												
126	16	Affiliated - All Other												
127	17	Total Common Stock (Sum of Lines 1 through 16)	0	0	0	0			0	0	0	0		
128	18	Real Estate: Home Office Property (General Account only)												
129	19	Investment Properties												
130	20	Properties Acquired in Satisfaction of Debt												
131	21	Total Real Estate (Sum of Lines 18 through 20)	0	0	0	0			0	0	0	0		
132	22	Other Invested Assets: Exempt Obligations												
133	23	Highest Quality												
134	24	High Quality												
135	25	Medium Quality												
136	26	Low Quality												
137	27	Lower Quality												

	B	C	D	E	F	G	H	I	J	K	L	M	N	O
138	28	In or Near Default												
139	29	Total with Bond Characteristics (Sum of Lines 22 thru 28)	0	0	0	0			0	0	0	0		
140	30	Investments with Underlying...Preferred Stocks: Highest Quality												
141	31	High Quality												
142	32	Medium Quality												
143	33	Low Quality												
144	34	Lower Quality												
145	35	In or Near Default												
146	36	Affiliated Life with AVR												
147	37	Total with Preferred Stock Characteristics (Sum of Lines 30 thru 36)	0	0	0	0			0	0	0	0		
148	38	Investments with Underlying...Mortgage Loans: In Good Standing Affiliated: Mortgages - CM1 - highest quality												
149	39	Mortgages - CM2 - high quality												
150	40	Mortgages - CM3 - medium quality												
151	41	Mortgages - CM4 - low medium quality												
152	42	Mortgages - CM5 - low quality												
153	43	Residential Mortgages - Insured or Guaranteed												
154	44	Residential Mortgages - All Other												
155	45	Commercial Mortgages - Insured or Guaranteed												
156	46	Overdue, Not in Process Affiliated: Farm Mortgages												
157	47	Residential Mortgages - Insured or Guaranteed												
158	48	Residential Mortgages - All Other												
159	49	Commercial Mortgages - Insured or Guaranteed												
160	50	Commercial Mortgages - All Other												
161	51	In Process of Foreclosure Affiliated: Farm Mortgages												
162	52	Residential Mortgages - Insured or Guaranteed												
163	53	Residential Mortgages - All Other												
164	54	Commercial Mortgages - Insured or Guaranteed												
165	55	Commercial Mortgages - All Other												
166	56	Total Affiliated (Sum of Lines 38 through 55)	0	0	0	0			0	0	0	0		
167	57	Unaffiliated - In Good Standing With Covenants												
168	58	Unaffiliated - In Good Standing Defeased With Government Securities												
169	59	Unaffiliated - In Good Standing Primarily Senior												
170	60	Unaffiliated - In Good Standing All Other												
171	61	Unaffiliated - Overdue, Not in Process												
172	62	Unaffiliated - In Process of Foreclosure												
173	63	Total Unaffiliated (Sum of Lines 57 through 62)	0	0	0	0			0	0	0	0		
174	64	Total with Mortgage Loan Characteristics (Lines 56 + 63)	0	0	0	0			0	0	0	0		
175	65	Investments with Underlying...Common Stock: Unaffiliated Public												
176	66	Unaffiliated Private												
177	67	Affiliated Life with AVR												
178	68	Affiliated Certain Other (See SVO Purposes & Procedures Manual)												
179	69	Affiliated Other - All Other												
180	70	Total with Common Stock Characteristics (Sum of Lines 65 thru 69)	0	0	0	0			0	0	0	0		
181	71	Investments with Underlying...Real Estate: Home Office Property (General Account Only)												
182	72	Investment Properties												
183	73	Properties Acquired in Satisfaction of Debt												
184	74	Total with Real Estate Characteristics (Lines 71 through 73)	0	0	0	0			0	0	0	0		
185	75	Low Income Housing Tax Credit Investments: Guaranteed Federal Low Income Housing Tax Credit												
186	76	Non-guaranteed Federal Low Income Housing Tax Credit												
187	77	Guaranteed State Low Income Housing Tax Credit												
188	78	Non-guaranteed State Low Income Housing Tax Credit												
189	79	All Other Low Income Housing Tax Credit												
190	80	Total LIHTC (Sum of Lines 75 through 79)	0	0	0	0			0	0	0	0		
191	81	Residual Tranches or Interests: Fixed Income Instruments - Unaffiliated												
192	82	Fixed Income Instruments - Affiliated												
193	83	Common Stock - Unaffiliated												
194	84	Common Stock - Affiliated												
195	85	Preferred Stock - Unaffiliated												
196	86	Preferred Stock - Affiliated												
197	87	Real Estate - Unaffiliated												

	B	C	D	E	F	G	H	I	J	K	L	M	N	O
198	88	Real Estate - Affiliated												
199	89	Mortgage Loans - Unaffiliated												
200	90	Mortgage Loans - Affiliated												
201	91	Other - Unaffiliated												
202	92	Other - Affiliated												
203	93	Total Residual Tranches or Interests (Sum of Lines 81 through 92)	0	0	0	0			0	0	0	0		
204	94	All Other Investments: NAIC 1 Working Capital Finance Investments												
205	95	NAIC 2 Working Capital Finance Investments												
206	96	Other Invested Assets - Schedule BA												
207	97	Other Short-term Invested Assets - Schedule DA												
208	98	Total All Other (Sum of Lines 94, 95, 96 and 97)	0	0	0	0			0	0	0	0		
209	99	Total Other Invested Assets - Schedules BA & DA (Sum of Lines 29, 37, 64, 70, 74, 80, 93 and 98)	0	0	0	0			0	0	0	0		
210														
211		Total Non-guaranteed Separate Account Assets	XXXXXXXXXXXX	XXXXXXXXXXXX	XXXXXXXXXXXX	XXXXXXXXXXXX			XXXXXXXXXXXX	XXXXXXXXXXXX	XXXXXXXXXXXX	XXXXXXXXXXXX		
212														
213		Total Assets including Non-guaranteed Separate Account Assets	XXXXXXXXXXXX	XXXXXXXXXXXX	XXXXXXXXXXXX	XXXXXXXXXXXX			XXXXXXXXXXXX	XXXXXXXXXXXX	XXXXXXXXXXXX	XXXXXXXXXXXX		
214														
215		**Notes:**												
216		Column 5 = Column 1 + Column 3												
217		Column 6 = Column 2 + Column 4												
218		Column 11 = Column 7 + Column 9												
219		Column 12 = Column 8 + Column 10												
220														

UnitedHealthcare

December 16, 2024

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

RE: 2024-07 Reporting of Funds Withheld and Modco Assets

Dear Mr. Bruggeman:

Thank you for the opportunity to comment on the above-referenced item that was re-exposed by the Statutory Accounting Principles (E) Working Group (SAPWG). The intent of this item was to make it easier to identify assets that are subject to a funds withheld or modified co-insurance arrangements through updated reporting in the financials.

Interested parties previously submitted comments in response to the initial exposure indicating that, under certain reinsurance arrangements, it would not be possible to identify or report specific assets for funds withheld as proposed in this exposure. To further clarify the point in the original comment letter, we would like to provide the following example, which is similar to several of our reinsurance arrangements:

An insurer may have a reinsurance arrangement transferring insurance risk whereby the terms of the agreement require funds to be withheld equal to the amount of ceded statutory reserves. The funds are withheld to permit statutory credit for nonadmitted reinsurance. The insurer's financial statements would reflect a ceded funds withheld liability. In this case, there is no investment risk being passed to the reinsurer and no specific assets separately identified. As such, the information proposed to be disclosed in the newly developed Schedule S page would not be applicable to this type of arrangement with these characteristics. This type of reinsurance arrangement is often seen for health insurance.

In the re-exposed item, SAPWG staff noted that the Life RBC formula reflects a reduction in RBC charges for modco and funds withheld assets. This reduction is by asset type and often by asset designation. SAPWG staff also indicated the fair value of the assets withheld is also reported in the reinsurance Schedule S and F as collateral. As such, SAPWG staff feels there may be a disconnect.

In response to these points, it is important to note that assets are only required to be identified for Life RBC calculation purposes if the insurer is passing investment risk to the reinsurer. For the types of arrangements with the characteristics described in our example above, this RBC reporting requirement does not apply. In addition, upon review of the instructions for Schedule S, we were unable to locate a place in Schedule S where we are required to report fair value of the assets withheld as collateral. The fair value reporting requirement applies to assets that are held in a trust or are otherwise placed on deposit by the reinsurer; however, in the example given above, the assets are simply investments within the ceding company's general account and are not segregated or separately identified.

We respectfully request the Working Group limits the application of this guidance and Schedule S reporting requirement to reinsurance arrangements under which investment risk is being passed to the reinsurer or where the terms of the reinsurance arrangement require a segregation or specific identification of assets used to collateralize the ceded reserves. Arrangements without such characteristics should be excluded from the reporting requirements as they are not applicable.

Please feel free to contact me if you have any questions or would like to discuss the above recommendation.

Sincerely,

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December 16, 2024

Updated January 30, 2025: See Ref #2022-14 and Repurchase Agreements beginning on page 9 (both indicated by ***)

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

RE: Interested Parties Comments on the Items Exposed for Comment by the Statutory Accounting Principles Working Group with Comments due December 16th

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the following items that were exposed for comment by the Statutory Accounting Working Group (the Working Group) with comments due December 16 th.

Ref #2022-14: ***New Market Tax Credits*****

On May 16, 2023, the Working Group exposed revisions to SSAP No. 93 – *Investments in Tax Credit Structures,* and 94R – *State and Federal Tax Credit*. The revisions to SSAP No. 93 propose adoption with modification of ASU 2023-02 and expansion of the SSAP scope to include all tax credit programs and tax investment structures. The revisions to SSAP No. 94R expand the scope of the SSAP to include all state and federal tax credits whether purchased or allocated, and that tax received should be recorded at face value with losses realized immediately and gains deferred.

Interested parties have no comments on this item.

Ref #2023-24: Current Expected Credit Losses (CECL)

The Working Group exposed for comment an Issue Paper to document for the historical record the Generally Accepted Accounting Principles impairment guidance which existed prior to the implementation of *Accounting Standards Update (ASU) 2016-13, Financial Instruments—Credit Losses* (CECL). In January 2024, the Working Group rejected CECL for statutory accounting purposes and directed NAIC staff to prepare this issue paper. Since many SSAPs adopted pre-CECL impairment guidance, the Working Group wanted to ensure that any guidance which was superseded by CECL was readily available for future use.

Interested parties agree with the concepts noted in the draft Issue Paper but would like additional time to address some of the descriptions of current GAAP practice versus statutory accounting to ensure that the descriptions are technically correct.

Ref #2024-04: Conforming Repurchase Agreements Assets

On August 13, 2024, the Working Group exposed this agenda item along with a memo detailing accounting and reporting guidance for repurchase agreements and securities lending transactions.

Interested parties have repeated the memo below and provided comments in italics following each section.

Overview: Fundamentally, securities lending and repurchase/reverse repurchase (Repo) transactions perform similar functions and are entered into for short-term collateralized funding/lending. Although some articles identify that the type of collateral exchanged (security or cash) is a key difference, from discussions with industry cash or securities can be used as collateral under either a security lending or repo agreement. Industry has identified that the counterparty is a key difference between the transactions.

Although similar in function, the accounting and reporting for securities lending and repurchase transactions are different under statutory accounting even when both are accounted for under the "secured borrowing" approach. (All scenarios below focus on secured borrowing accounting, and not as a "sale," as that is the more prevalent accounting approach.)

This memo intends to document the current accounting guidance and identify how NAIC staff believe accounting and reporting should be reflected. The Working Group is requesting comments on this memo, particularly within the established notes. Subsequently, NAIC staff plan to propose statutory accounting and reporting changes to reflect a consistent approach between securities lending and repurchase transactions.

The guidance for securities lending / borrowings and repo agreements are *in SAP No. 103—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. Although other aspects of the SSAP are applicable, focused guidance for these transactions are in the following paragraphs:

- Securities Lending: Paragraphs 85-92.
- Securities Borrowing: Paragraphs 93-95

- Repurchase Agreements: Paragraphs 102-104 & 113
- Reverse Repurchase Agreements: Paragraphs 111-113

Broad concepts for secured borrowing are in paragraph 19. The concepts for securities lending differ from this guidance with the requirement to recognize items on balance sheet with the ability to sell/repledge collateral. Disclosure guidelines for these transactions are in paragraph 28.
The "conforming" securities lending guidelines are captured in the RBC instructions. The full detail of the requirements is included as an appendix to this memo, but collateral requirements include:

- Cash and cash equivalents
- Direct obligations of, or securities that are fully guaranteed as to principal and interest by, the government of the United States, or any agency of the United States, or by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation.
- NAIC 1 Designated Securities
- Affiliated-issued collateral is not deemed acceptable.
- In all cases, collateral held must be permitted investments in the state of domicile for the respective insurer.

Securities Lending – Reporting Entity Lends a Security and Receives Collateral in Exchange:
A security lending transaction involves the temporary transfer of securities from one party (security lender) to another party (security borrower) and with the lender receiving collateral from the borrower to protect against the risk of loss. The lender receives a fee for the use of the security. Under statutory accounting guidance, the accounting for security lending depends on whether the reporting entity has the ability to pledge or sell the collateral received.

1. Lending Entity Cannot Sell / Repledge Security Collateral Received:

a) Reporting entity lends a security under a secured borrowing agreement. The reporting entity retains the lent security on books and codes it as a restricted asset.

b) Reporting entity lender does not recognize security collateral received as an asset and does not recognize an obligation to return the collateral.

c) If the fair value of the collateral received drops below 100% of the fair value of the loaned security, then the reporting entity (lender) is to nonadmit a portion of loaned security (which is still reported on the books). The amount nonadmitted should be the difference between the collateral and the security reported on the books. (This calculation is done at any point in time – so for a lent $100 bond, if the fair value of the bond declines to $90, then the collateral comparison would be done to the current FV of the bond, and not the FV at the time the security was lent. So, if collateral was received at $102, and declined to $90 (matching the bond), nonadmittance would not be required.) The comparison is also completed in aggregate by counterparty, so if the collateral for one security was to appreciate in value, and the collateral for another was to decline, as long as the combined collateral value continued to represent 100% of the fair value of the loaned securities, additional collateral would not be required.

The Restricted Asset / RBC Impact is as follows:

d) The retained asset lent to the counterparty should be identified as a restricted asset. This loaned asset shall be captured on general interrogatory (GI) line 25.04 or GI line 25.05 based on whether the security lending arrangement is considered to be a 'conforming' security lending program. Amounts reported on these lines flow to LR017 (Off-Balance Sheet and Other Items), lines 1 and 2. Items captured in GI line 25.04 (conforming) receive a 0.0020 RBC charge. Items captured in GI line 25.05 (nonconforming) receive a 0.0126 RBC charge. There is no current disclosure on the type of collateral received for these off-balance sheet programs. As such, regulators cannot verify from the financial statements whether the program complies with the "conforming" program requirements. However, as the collateral cannot be sold/repledged, if the collateral complies with the conforming requirements, there would be no change to that assessment over the duration of the transaction. ***(Note 1)***

e) As the collateral asset is not recognized on book of the lender, there is no RBC asset (C-1) charge. As the collateral asset is not recognized, there is no restricted asset reporting or RBC restricted asset charge. The restricted asset charge is placed on the asset that is lent but still retained on the books as discussed above in paragraph 1d. ***(Note 2)***

Note 1: Should the type of collateral received in these programs be captured in a financial statement disclosure to allow for regulator verification of the "conforming" program guidelines? Additionally, it has been noted that the admittance calculation focuses solely on the fair value comparison of the collateral received to the security lent. However, there is no current guidance that assesses admittance based on the quality/type of collateral received. Under the current guidance, residuals or low-quality assets could be received and there is no documentation of this type of collateral for certain sec lending and repo programs. Even if these programs would not qualify as conforming, there is a question on whether admittance restrictions should exist based on the collateral received from the counterparty.

Interested parties' response: Given the deferral of the conforming repo proposal, only conforming sec lending programs will be subject to the conforming guidelines. In these programs, the insurer attests to the conforming criteria. One possible additional disclosure could be footnote like footnote 5.E.8 for repo, whereby the collateral received is specified by asset type.

In typical security lending programs, the insurer receives cash in these transactions, but the master agreement between the counterparties also allows the insurer to receive high-quality collateral – restrictively defined as "acceptable collateral" - which must be marked to market regularly for ongoing margining purposes. Regardless of whether the program is conforming or not, the combination of daily margining and the restrictive definition of "acceptable collateral" should provide NAIC with sufficient comfort that additional admittance restrictions on collateral received would be duplicative.

Note 2: NAIC staff believes there is inconsistent application of the current guidance as there is a disconnect in language between RBC and the Blanks on whether the collateral received or the lent asset is identified as a restricted asset. The blanks instructions in GI 25.04 and GI 25.05 identify the

"Amount of Collateral." The lines in RBC identify "Loaned to Others." This inconsistency in terminology likely causes confusion on whether the amount reported should be the lent security or the collateral received in exchange. NAIC staff suggest clarifying terminology for consistency purposes, clarifying that the loaned asset retained on book should be the amount reported as restricted that flows through all schedules.

Interested parties' response: *We agree that consistent terminology should be established between Blanks and RBC to clarify that the loaned security is identified as a restricted asset. We suggest that Blanks references to "Amount of Collateral" in GI 25.04 and GI 25.05 should be changed to "Loaned to Others," consistent with RBC.*

2. Lending Entity Can Sell / Repledge Collateral Received – (Also Applies to Cash Collateral)

a) Reporting entity lends a security under a secured borrowing agreement. The reporting entity retains the lent security on books and codes it as a restricted asset.

b) Reporting entity lender recognizes collateral received from the counterparty on its book and recognizes a liability to return the collateral. (This collateral is reported on Schedule DL.) If security collateral is captured directly on the investment schedules, the collateral is **not** coded as a restricted asset. *(See paragraph 2f.)*

c) If the fair value of the collateral received drops below 100% of the fair value of the loaned security, then the reporting entity is to nonadmit a portion of loaned security (which is still reported on the books). The amount nonadmitted should be the difference between the collateral and the security reported on the books. (This calculation is done at any point in time – so for a lent \$100 bond, if the fair value of the bond declines to \$90, then the collateral comparison would be done to the current FV of the bond, and not the FV at the time the security was lent. So, if collateral was received at \$102, and declined to \$90 (matching the bond), nonadmittance would not be required.) The comparison is also completed in aggregate by counterparty, so if the collateral for one security was to appreciate in value, and the collateral for another was to decline, as long as the combined collateral value continued to represent 100% of the fair value of the loaned securities, additional collateral would not be required. ***(Note 3 & Note 4)***

The Restricted Asset / RBC Impact is as follows:

d) The retained asset lent to the counterparty should be identified as a restricted asset. This loaned asset shall be captured on GI line 25.04 or GI line 25.05 based on whether the security lending agreement is considered to be a 'conforming' security lending program. Amounts reported on these lines flow to LR017 (Off-Balance Sheet and Other Items), lines 1 and 2. Items captured in GI line 25.04 (conforming) receive a 0.0020 RBC charge. Items captured in GI line 25.05 (nonconforming) receive a 0.0126 RBC charge. ***(Note 5)***

e) The current collateral recognized on the balance sheet is subject to the corresponding asset (C-1) RBC charge. (This occurs directly from the investment schedule, or indirectly from

Schedule DL if the program is administered by a third-party administrator.) The RBC charge depends on the form of the collateral. (This recognition occurs regardless of whether the original collateral is reinvested.)

f) The collateral reported on book as it can be sold/repledged, is not coded as a restricted asset as there is an offsetting liability recognized for the obligation to return the collateral. Identifying both the lent security and the on-book collateral as restricted assets, particularly with the offsetting liability to return the collateral would result in a double-counting of restricted asset charges for the same transaction.

g) On day 1, both the collateral asset received and liability to return are recognized at fair value. Subsequently, the asset is measured pursuant to the applicable SSAP and the liability to return shall be adjusted as needed to reflect the current fair value of the collateral originally received. If the collateral received is reinvested, the resulting asset shall be accounted for pursuant to the applicable SSAP. As the measurement method for the collateral asset on book may not reflect fair value, this may result in a disconnect between the collateral asset and liability to return reported, but the reporting entity's liability to return the collateral shall always reflect the full obligation (fair value) to return collateral originally received.

Note 3: As the collateral can be sold/repledged, there is a question on the application of the admittance provisions in paragraphs 91-92 of SSAP No. 103. That guidance is focused on the fair value of the original collateral received in comparison to the fair value of the security lent. Once the collateral has been reinvested, the reporting entity is responsible for the reinvestment risk and the counterparty is not responsible for fair value changes of the reinvested security. Although a position could be taken that the fair value of the collateral originally received should continue to be compared to the fair value of the lent security to determine if more collateral needs to be provided, with the current financial statement reporting, this information is not captured to allow assessments once the collateral has been reinvested allowing regulators to verify the admittance provisions.

Interested parties' response: *We do not believe that there is any ongoing need to compare the fair value of the original collateral received in comparison to the fair value of the security lent. One salient feature of securities lending and repurchase agreement transactions is that exchange of variation margin covers the differences that emerge over time between the original market value of the security lent and the original market value of the collateral received. The margining process maintains equality between the market value of the collateral received – plus or minus any variation margin – and the market value of the security lent. This market structure obviates the need for regulators to generate an admittance test on whether the fair value of original collateral received compares with the fair value of the security lent.*

Existing disclosures also provide regulators with sufficient visibility:

1. *Footnote 5.E.5 b: The reinvestment portfolio acquired with cash received consisted principally of high quality, liquid, publicly traded long term bonds, short term investments, cash equivalents, or held in cash. If the securities sold or the reinvestment portfolio become*

less liquid, the Company has the liquidity resources of most of its general account available to meet any potential cash demands when securities are returned to the Company.

2. *Footnote 5.E.5 provides a maturity schedule for the collateral received.*
3. *Schedule DL provides full transparency and look-through to the assets in the reinvestment portfolio.*

In summary, existing financial statements disclose the risk and maturity summary in the footnotes and provide a full schedule for reinvested assets. The fair value security lent and collateral received continue to be matched via the margining process.

Note 4: With regards to the admittance calculation, there is also a question on application when the original collateral still covers 100% of the BACV of the loaned security but does not meet the requirement for 100% of the loaned security's fair value. As an example, if the loaned security at amortized cost has a BACV of $90, but had a fair value of $100 when loaned, the guidance in paragraph 91 requires collateral of $102 at the onset of the transaction. If the original collateral was to decrease in fair value to $98, it would no longer comply with the guidance in paragraph 91 and nonadmittance of the loaned security for $2 is expected under the guidance ($100 - $98). However, as the loaned security is reported at BACV of $90, the collateral still covers the full reported value of the loaned security. If the counterparty was to default, the reporting entity would eliminate the loaned security ($90) and the liability to return the collateral ($98) from the books and retain the collateral asset as their own. This transaction would result in an $8 gain for the reporting entity. If the loaned security had been nonadmitted by $2 prior to the default due to the FV decline of the collateral, there would have been a surplus hit of $2 for the nonadmittance. Upon the counterparty default, in addition to the $8 gain, there would have then been a surplus bump of $2 with the elimination of the nonadmitted asset. *(It is noted that if the fair value for the collateral asset had been retained, the reporting entity would have had a greater gain, but they are still fully covered based on how the loaned asset is reported.)* NAIC staff requests confirmation of the admittance guidance and its application from regulators, particularly when the fair value of the collateral continues to cover the BACV of the loaned security.

Interested parties' response: *We agree with NAIC staff's recommendation that admittance calculations should be based on the fair value of the original collateral and loaned security, as opposed to book value. As discussed above, the margining provisions of these contracts ensures that market values, rather than book values, remain aligned over the term of each transaction.*

Note 5: As the collateral received can be sold/repledged, there is a question on the application of the "conforming security lending" collateral requirements. From a broad review of financial statements, collateral reported on Schedule DL was identified as outside of the conforming parameters, but the security lending program was identified as "conforming" with the lower RBC charge. NAIC staff recommend clarification on the application of the "conforming" requirements. Particularly, if the intent is to permit a lower RBC charge due to the liquidity / stability of certain types of collateral, then it may be appropriate to require the collateral to always comply with the "conforming" provisions regardless of if it has been reinvested by the reporting entity.

Interested parties' response: *We believe that the narrow definition of "acceptable collateral," which is intended to be applied* ***only*** *to the original collateral received against the lent security, has been misapplied to the reinvestment portfolio. Acceptable asset classes in the reinvestment portfolio are defined in the portfolio's Investment Guidelines, not by the "acceptable collateral" criteria. Applying the narrow definition of "acceptable collateral" to the reinvestment portfolio could disrupt the economic viability of these programs.*

3. <u>Securities Borrowing – Entity Borrows a Security and Provides Collateral in Exchange</u>

a) Reporting entity borrower retains security collateral provided to counterparty on book and codes it as a restricted asset. (If providing cash in exchange for the borrowed security, then the cash is derecognized with a receivable for the return.) ***(Note 6)***

b) Reporting entity borrower does not recognize the borrowed security on their books, unless the reporting entity sells the borrowed security or the counterparty defaults. If the reporting entity sells the borrowed security, the cash received or reinvested asset is recognized with an obligation (liability) to return the borrowed security. Pursuant to paragraph 94 of SSAP No. 103, assets equivalent to the fair value of the borrowed security shall be coded as a restricted asset. Specific guidance exists in SSAP No. 103 for when borrowed securities are used to settle a short-sale. (A counterparty default would always result with an unwinding of the transaction with each party reporting the asset they have in their possession as their resulting asset.) ***(Note 7 & 8)***

The Restricted Asset / RBC Impact is as follows:

c) The retained asset (provided as collateral to a counterparty) is still on the reporting entity's investment schedules and should continue to receive the RBC asset C-1 charge. It should also be coded as a restricted asset. Due to the reporting lines available, it could be coded as "collateral held under securities lending agreements" or as an "other" restricted asset and captured in GI 26.32. If captured as a collateral within a security lending agreement, would be captured on GI line 25.04 or GI line 25.05 based on whether it is from a 'conforming' security lending program. Amounts reported on these lines flow to LR017 (Off-Balance Sheet and Other Items), lines 1 and 2. Items captured in GI line 25.04 (conforming) receive a 0.0020 RBC charge. Items captured in GI line 25.05 (nonconforming) receive a 0.0126 RBC charge. If reported as an "other" restricted asset, it would be captured on GI 26.32 with a 0.0126 RBC charge.

d) There would be no RBC impact for the borrowed security unless it is sold. At that time, the reinvested asset would be recognized and subject to an RBC asset C-1 charge. This asset (or an equivalent of other assets) would be identified as restricted. This is likely "collateral held under security lending agreement" and reported based on conforming /nonconforming in GI line 25.04 (0.0020 factor) or 25.05 (0.0126 factor).

<u>Note 6</u>: A security borrowing transaction is the flipside of the security lending transaction, with the reporting entity operating on the opposite side as borrower instead of lender. With this dynamic, it is presumed that the same restricted asset categories, and whether it is a conforming program, would be determinants in reporting the restricted asset and in the resulting RBC charge. NAIC staff requests confirmation of this assessment. (A security borrowing is the transaction, and it is accounted for as a "secured borrowing" – this terminology can be confusing when discussing the design.)

Interested parties' comments on Notes 6-8: *From the insurer's perspective, securities borrowing transactions have a very different structure than securities lending transactions. Insurers have not, and do not anticipate, requesting the establishment of "conforming securities borrowing" programs with changes to RBC.*

Note 7: The guidance for a security borrowing could result with restricted asset reporting for both the collateral provided (if not cash collateral) as well as for the reinvested borrowed securities that the reporting entity has sold. NAIC staff notes that this could be a double hit of restricted asset charges and recommends comments on paragraph 94 of SSAP No. 103 on the elimination of the restricted asset requirement for the assets received from the sale of the borrowed security. It is noted that the reporting entity would already have a liability recognized to return the borrowed security to the counterparty.

See interested parties' comments above.

Note 8: For security borrowing transactions, it is identified that both a receivable and payable from the counterparty could be recognized. A receivable - if cash was originally provided as collateral for the return of the cash - and a payable - if the reporting entity sold the borrowed security for the obligation to return the security. This dynamic could result in a netting of the transactions under SSAP No. 64. If netted, then the regulators would not be able to identify these aspects within the financial statements, but the provisions that permit netting under SSAP No. 64 (legal right to offset) may be present.

See interested parties' comments above.

Repurchase Agreements***

Repurchase agreements, by definition, are agreements in which a reporting entity sells a security and simultaneously agrees to repurchase the security or a substantially similar security at a stated date and price. Repurchase agreements are functionally similar to securities lending. These transactions are generally captured as "secured borrowings" due to the requirement to repurchase the security transferred but could qualify as "sale" transactions. As very few (if any) are captured as sales under statutory accounting, this assessment will only focus on those captured as "secured borrowings."

Reporting entities can operate on both sides of repurchase agreements. If the reporting entity is selling a security and receiving cash (cash taker), it is considered a repurchase agreement. If the reporting entity is buying a security and providing cash (cash provider) it is considered a reverse repurchase agreement. SSAP No. 103 is explicit that only short-term repo agreements (with a stated short-term maturity date of 365 days or less) are allowed as admitted assets. Long-term repo agreements (with maturity dates in excess of 365 days) are nonadmitted.

There is no current concept for a "conforming repurchase agreement" and incorporating this concept, allowing for a lower RBC charge, was the request of the ACLI to the Life RBC Working Group.

4. **<u>Repurchase Agreement – Reporting Entity Sells Security and Receives Cash / Collateral</u>**

a) Reporting entity (cash taker) retains sold security on book and codes it as a restricted asset. This would remain an asset of the reporting entity unless the reporting entity defaults under the terms of the secured borrowing agreement. If that occurs, the reporting entity would derecognize the asset and eliminate the obligation to return the cash collateral per subparagraph (b).

b) Reporting entity recognizes cash received and obligation to return cash. (If security collateral is received, it is off-balance sheet unless that collateral is sold by the reporting entity. If sold, the reporting entity recognizes the proceeds from the sale and the obligation to return the collateral to the repo counterparty.) This process for security collateral received under a repurchase agreement is different from securities lending. Under security lending, if collateral received can be sold or repledged, even if it is not sold or repledged, the collateral is reported on balance sheet with an obligation to return. The disclosure guidance for repurchase agreements varies significantly from securities lending transactions as Schedule DL does not apply to repurchase agreements. As such, for repurchase agreements, there is no detail that identifies collateral held when the collateral can be sold/repledged. ***(Note 9)***

c) For repurchase agreements the reporting entity should receive proceeds (collateral) with a fair value of at least 95% of the fair value of the sold security. So, if the security has a FV of $100, proceeds (collateral) of $95 is required. If the FV of the proceeds (collateral) is not sufficient, then nonadmittance of the "sold" security for the amount of the shortfall is required. So, if only 93% collateral was received, the security "sold" but still reporting on-book would only be admitted for $98 with nonadmittance of $2. ***(Note 10)***

The Restricted Asset / RBC Impact is as follows:

a) The retained asset (sold to the counterparty) is still on the investment schedule and should continue to receive the RBC asset (C-1) charge. It should also be coded as a restricted asset as "subject to repurchase agreements" and captured in GI 26.21. This would then be captured in LR017 on line 3, "subject to repurchase agreements" and would receive a 0.0126 RBC charge. Under SSAP No. 103, repo agreements must be short-term to be admitted. If the repo agreement extends beyond 365 days, then the asset sold (retained on the book) would be identified as a nonadmitted asset.

b) The cash proceeds (collateral) would be recorded as cash and flow through on Schedule E - Part 1 - Cash to LR012 with a .0039 RBC charge. If the cash is used to acquire another security, then the acquired security would be reported on the investment schedules and flow through to RBC accordingly based on the investment.

Note 9: Due to the similarities in overall function between securities lending and repurchase agreements, NAIC staff supports consistent accounting, reporting and disclosures. NAIC staff recommends expanding Schedule DL to capture repurchase agreements, and a reassessment of the repurchase agreement disclosures to determine whether the level of detail should be retained.

Interested parties' response: Extending Schedule DL to repurchase agreements makes sense only for any future "conforming repo" programs that have segregated assets in the reinvestment portfolio. In certain cases, repo can be used for secured borrowing whereby the cash is used for alternative purposes and not explicitly reinvested. Since industry is no longer requesting the establishment of conforming repo programs, we believe that Schedule DL should not be extended to repo programs at this time.

Note 10: The same concept issues exist for the nonadmittance of reported securities under repo transactions than what exist under the securities lending transactions. Under current guidance, if the fair value of the sold security was to increase, more proceeds (collateral) is required or the sold security is subject to nonadmittance. If collateral was reinvested, the comparison would have to be based on the original collateral received and not the reinvested collateral. Also, there is the question on nonadmittance when the collateral received still covers the BACV of the sold security.

Interested parties' response (similar to Note 3): One salient feature of securities lending and repurchase agreement transactions is that exchange of variation margin covers the differences that emerge over time between the original market value of the security lent and the original market value of the collateral received. The margining process therefore aligns the ***market value*** of the collateral received – plus or minus any variation margin – with the ***market value*** of the security lent. This market structure obviates the need for regulators separately to test the market value of original collateral received in comparison with the fair value of the security lent. Additionally, repo funding proceeds may be used for purposes outside of a reinvestment portfolio which results in a lack of asset base to test against for nonadmittance.

Reverse Repurchase Agreement – Reporting Entity Buys Security and Provides Cash / Collateral

a) Reporting entity (cash provider) acquires security from counterparty but does not report the security on their investment schedule. (The reporting entity would recognize the asset if the counterparty defaulted on the agreement.) ***(Note 11)***

    i. If the reporting entity sells the acquired security, the reporting entity would recognize the cash proceeds from the sale and an obligation to return the security to the counterparty. If the cash proceeds are reinvested, then the acquired investment would be on the applicable investment schedule.

b) Reporting entity derecognizes the cash provided to acquire the security and recognizes a receivable for the cash return. This is captured as a short-term investment on Schedule E-2. If the reverse repo agreement was long-term, it shall be nonadmitted.

   i. If the reporting entity provides security in exchange for the security (instead of cash), the security would remain on the reporting entity's investment schedules, coded as a restricted asset.

c) For reverse repurchase agreements the reporting entity should receive securities with a fair value of at least 102% of the purchase price (cash or securities transferred). So, if the cost of the transaction is $100, the reporting entity should receive securities worth $102. ***(Note 12)***

The Restricted Asset / RBC Impact is as follows:

d) The acquired asset is not reported unless the counterparty defaults or unless the reporting entity sells the acquired assets. Unless one of these things occurs, there is no RBC impact for the acquired asset under a reverse repo. (If those transactions occur, then the RBC is determined by the resulting security reported on the investment schedule.)

e) The receivable for the return of the cash collateral would be recorded as a short-term investment on Schedule E – Part 2 and flow through to LR012 with a .0039 RBC charge. This receivable would also be coded as restricted as an "asset subject to a reverse repurchase agreement" on GI 26.23. This would flow to LR017 line 6 and would receive a 0.0126 RBC charge. ***Note 13***

Note 11: The SSAP No. 103 guidance for reverse repo transactions does not have an explicit nonadmittance component if the % threshold is not met. Clarification on what should occur if the adequate collateral is not received / retained is recommended. Additionally, it has been noted that there is no current guidance that assesses admittance based on the quality/type of collateral received. Under the current guidance, residuals or low-quality assets could be received and there is no documentation of this type of collateral for certain sec lending and repo programs. Even if these programs would not qualify as conforming, there is a question on whether admittance restrictions should exist based on the collateral received from the counterparty.

Interested parties' comments on Notes 11-13: In terms of general quality of collateral received in reverse repo transactions, we do not believe there should be regulatory restrictions on the type of collateral that is eligible to be received, other than it being a permitted investment for the reporting entity. The yield earned on the transaction and haircut charged reflects the quality of the collateral.

Maintenance of the collateralization threshold is governed by the legal document (MRA or MSLA) between the counterparts. While collateralization threshold is one of the criteria for a conforming securities lending program, there is no intention to establish conforming reverse repo programs. We believe that regulators should derive comfort on collateralization thresholds from the existing legal agreements between counterparts.

Note 12: SAP does not currently capture details on securities acquired upon the sale of the asset acquired under a reverse repo. The note disclosures only detail aggregate amounts.

See interested parties' comments on Notes 11-13 above.

Note 13: The guidance does not explicitly indicate that the short-term receivable recorded for reverse repurchase transactions should be coded as a restricted asset and taken to GI 26.23. However, as the restricted asset note detailed in SSAP No. 1 and GI 26.23 both capture "assets subject to reverse repurchase agreements," this reference can only refer to the short-term receivable as there is no other asset reported on the books from the transaction. Assessment may be warranted on identification of restricted assets on reverse repurchase transactions.

Interested parties' comments: Interested parties do not believe that there is a cogent rationale for restricting the short term lending receivable. Other short-term lending receivables - CDs, CP and Short Term ABS – are not considered "restricted". Nothing in these short term loans implies lack of exclusive control or encumbrances or third party interests prohibiting the insurer from using these short term loans (or the collateral obtained therefrom at 102% FMV or greater) to satisfy policyholder obligations.

Appendix A – "Conforming" Securities Lending Guidance from RBC Instructions

Line (1) Securities lending programs that have all of the following elements are eligible for a lower off-balance sheet charge:

1. A written plan adopted by the Board of Directors that outlines the extent to which the insurer can engage in securities lending activities and how cash collateral received will be invested.

2. Written operational procedures to monitor and control the risks associated with securities lending. Safeguards to be addressed should, at a minimum, provide assurance of the following:

    a. Documented investment guidelines, including, where applicable, those between lender and investment manager with established procedure for review of compliance.

    b. Investment guidelines for cash collateral that clearly delineate liquidity, diversification, credit quality, and average life/duration requirements.

    c. Approved borrower lists and loan limits to allow for adequate diversification.

    d. Holding excess collateral with margin percentages in line with industry standards, which are currently 102% (or 105% for cross currency loans).

    e. Daily mark-to-market of lent securities and obtaining additional collateral needed to ensure that collateral at all times exceeds the value of the loans to maintain margin of 102% of market.

    f. Not subject to any automatic stay in bankruptcy and may be closed out and terminated immediately upon the bankruptcy of any party.

3. A binding securities lending agreement (standard "Master Lending Agreement" from Securities Industry and Financial Markets Association) is in writing between the insurer, or its agent on behalf of the insurer, and the borrowers.

4. Acceptable collateral is defined as cash, cash equivalents, direct obligations of, or securities that are fully guaranteed as to principal and interest by, the government of the United States or any agency of the United States, or by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation and NAIC 1-designated securities. Affiliate-issued collateral would not be deemed acceptable. In all cases the collateral held must be permitted investments in the state of domicile for the respective insurer.

Collateral included in General Interrogatories, Part 1, Line 25.04 of the annual statement should be included on Line (1).

* * * *

Thank you for the opportunity to comment on the above items. Please feel free to contact either one of us if you have any questions or would like to discuss further.

Sincerely,

D. Keith Bell

Rose Albrizio

cc: Interested parties
NAIC staff

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January 31, 2025

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
hut Street, Suite 1500
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RE: Interested Parties Comments on the Items Exposed for Comment by the Statutory Accounting Principles Working Group with Comments due January 31st

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the following items that were exposed for comment by the Statutory Accounting Working Group (the Working Group) with comments due January 31st.

Ref #2023-28: Collateral Loan Reporting

The Working Group re-exposed this agenda item detailing the proposed reporting lines for Schedule BA and AVR. This item was re-exposed to allow for concurrent exposure with blanks proposal 2024-19BWG. Comments received by the Blanks (E) Working Group and the SAPWG will be reviewed collectively.

Interested parties have responded (responses are in *italics*) to the following elements for which feedback was requested during the exposure:

1) Should collateral loans backed by mortgage loans be included in the new collateral loan category, or should those continue to flow through the "Investments with the Underlying Characteristics of Mortgage Loans" permitted during the interim as the long-term resolution?

Interested parties believe the ‘Collateral Loans – Backed by Mortgage Loans’ Schedule BA subcategory should continue to flow through the “Investments with the Underlying Characteristics of Mortgage Loans” AVR category until a permanent solution is identified.

If captured in the new collateral loan AVR category, to what extent should the underlying characteristic lines detailing quality / past due / foreclosure status (AVR lines 38-64) be duplicated?

Interested parties believe there should be just 1 category in AVR for ‘Collateral Loans – Backed by Mortgage Loans’ and not bifurcate between quality / past due / foreclosure status. The accounting for Collateral Loans will be able to appropriately report the fair value of the underlying collateral.

2) What additional reporting lines (breakouts) of the proposed AVR categories are necessary to ensure appropriate look-through for RBC assessment purposes?

   Interested parties believe no changes in the following breakouts are warranted at this time. We will actively engage in the RBC discussions with the appropriate NAIC Working Group on this issue.

As it relates to the corresponding Blanks Working Group exposure 2024-19BWG, we have requested a re-exposure / deferral to address this item which was exposed for the first time. Our question to the Working Group is: should Ref #2023-28 also be re-exposed / deferred to align these 2 items?

Ref #2024-10: SSAP No. 56 – Book Value Separate Accounts

During the NAIC Summer National Meeting, the Working Group exposed revisions to *SSAP No. 56—Separate Accounts*, as shown below as “2024 Summer National Meeting Exposed Revisions,” to allow for initial review and consideration of potential changes to update measurement method guidance and specify the process to transfer assets for cash between the general and book-value separate accounts. The Working Group also requested comments from regulators and industry on the noted questions, which are highlighted in grey in the exposure draft. This item was originally exposed with a longer comment period ending November 8, 2024, with the comment period extended to January 31, 2025. This item was not discussed in detail during the 2024 Fall National Meeting but is planned for discussion in the interim after that meeting, or during the 2025 Spring National Meeting.

Interested parties continue to support clarification of statutory accounting guidance for Book Value Guaranteed Separate Accounts. ACLI is very appreciative of the on-going dialogue with SAPWG and the IMR Ad Hoc Working Group and stands ready to continue working with the NAIC on this initiative.

ACLI would like to provide specific comments regarding existing SSAP 56 guidance and proposed changes to SSAP 56

The ACLI is in support of much of the exposed guidance updates. Particularly, we continue support for the proposed guidance for transfers between General Account and Separate Account (paragraphs 19 – 22). The ACLI previously provided a detailed presentation entitled "ACLI Derivative IMR Solution Proposal" ("ACLI Solution," included as Appendix I) to the IMR Ad Hoc Working Group. Discussions of the ACLI solution at the NAIC Ad Hoc IMR WG were the impetus for this exposure. The exposed guidance updates to SSAP 56 largely reflect the findings from the ACLI Solution presentation and, should it be beneficial to regulators, the ACLI would appreciate the opportunity to present to the full SAPWG membership and any additional interested regulators.

While in support of much of the exposed guidance updates, the ACLI would like to further discuss some of the proposed guidance for Book Value Guaranteed Separate Accounts:

Paragraph 22 requires that all other transfers of assets between Separate Account and General Account, excluding those assets sales for cash transfers already described in Paragraphs 19 through 21, be recorded at fair value. In order to avoid any potential for diversity in practice, we believe guidance should be added clarify that IMR should be utilized for these transactions in a similar way to how IMR is utilized in the transfer for cash transactions. The ACLI recommends at minimum the addition of the following phrase (change highlighted in red): "Asset transfers that do not reflect sales for cash between the general account and separate account are subject to domiciliary state approval and shall be recorded at fair value with gains and losses offset to IMR similar to asset sales for cash guidelines as detailed in Paragraphs 20 & 21…". Should it be decided that more detailed instruction be required, the ACLI would like to request some additional time to build out a more detailed proposal.

Paragraph 24 identifies the in-scope Separate Account population as "*…separate accounts that would qualify for separate account classification under U.S. GAAP…".* We do not believe the direct reference to US GAAP regulation within the SSAP to be appropriate, especially as not all insurers perform U.S. GAAP filings and would not be sufficiently expert in U.S. GAAP Separate Account guidance. Language surrounding guaranteed separate accounts is already included in Paragraph 18. Rather than creating separate language to identify non-guaranteed separate accounts which do not require AVR, direct reference to a "population excluding that population identified in Paragraph 18 would both provide clarity without reference to U.S. GAAP guidance and provides inclusive language ensuring the entire population of separate accounts to fall in either bucket rather than risk any population that may not fall in either the U.S. GAAP standard or the Paragraph 18 standard.

Paragraphs 34.C.iii. and 39.F. appear to be seeking additional disclosure (within General Account and Separate Account filings, respectively) of the assets supporting book value separate accounts, as specific reference is made to product types identified as book value in Paragraph 18 (PRT and RILA), We believe this additional disclosure to be redundant to the Book Value column reporting in the Separate Account Asset Page, providing no additional detail or value to what has already been reported. While the ACLI recognizes that there is no prohibition of domicile approval of non-guaranteed book value separate account with Statutory guidance surrounding Plan/Memorandum of Operations process, we feel that proposed guidance within SSAP 56 Paragraph 25 eliminates that probability: "*Assets supporting separate account contracts where the insurer bears the risk of* *investment performance, which shall include all book value separate accounts…”*. Due to the Paragraph 25 requirement that all book value separate accounts shall be in support of guaranteed separate accounts where the insurer bears the risk of investment performance, it is not probable that the Book Value column breakout within the Separate Account Assets page filing will include any population other than the Guaranteed population and thus cannot not diverge from the disclosures proposed in Paragraphs 34.C.iii. and 39.F. The ACLI requests that these disclosure requirements be removed from SSAP 56.

Once again, the ACLI appreciates the opportunity to provide comment and looks forward to continued dialogue and collaboration on Book Value Separate Account guidance. If you have any questions regarding this letter, please do not hesitate to contact us.

Ref #2024-16: Repacks and Derivative Investments

On December 17, 2024, the Working Group exposed proposed annual statement instructions, as shown in the exposure draft under “December 2024 Proposed Revisions to Annual Statement Instructions” to clarify that held debt securities that are sold to an SPV and then reacquired reflecting the addition of derivative or other components shall be reported as a disposal and reacquisition in the investment schedules. With this exposure, the Blanks (E) Working Group was requested to expose a blanks proposal sponsored by the Statutory Accounting Principles (E) Working Group at the 2024 Fall National Meeting.

Interested parties have no comments on this item.

Ref #2024-20: Restricted Asset Clarification

On November 17, 2024, the Working Group moved this item to the active listing categorized as a SAP clarification and exposed revisions illustrated in the recommended changes to SSAP No. 1 as well as corresponding proposed revisions to the Annual Statement instructions/template for the restricted asset disclosure in Note 5L to specify how Modco and FWH assets reported within a ceding company’s financial statements shall be reported. The exposed revisions also include a new disclosure to identify whether Modco/FHW assets are pledged by the ceding entity as well as expanded disclosures to detail differences between what is reported in the restricted asset note and what is in the general interrogatories.

Interested parties appreciate the opportunity to comment on this item after it was re-exposed for comment by the Working Group during the NAIC Fall National Meeting in Denver.

We have split our comments below based on the section of instructions they refer to, following feedback comments related to the overall exposure.

<u>General Feedback</u>

Interested parties note that the instructions for SSAP No. 1, Note 5L, General Interrogatories (GI), and Risk Based Capital (RBC) do not indicate which values should be used for each of the disclosures (i.e., Book Adjusted Carrying Value (BACV), collateral amount, Fair Value). As such, we recommend that BACV be used for all disclosures to ensure consistency.

For example, in Note 5L, columns 8 & 9, Total Admitted/Nonadmitted Assets are reported using BACV, as the assets would appear in the Assets page under the Admitted and Nonadmitted Assets columns. In lines b and c, *Collateral held under security lending agreements* and *Subject to repurchase agreements*, may be reported as collateral amounts to match the General Interrogatory (GI). Combining BACV and collateral amounts could be misleading to the reader.

Interested parties recommend that changes to the *NAIC Accounting Practices and Procedures Manual* (AP&P manual) be made concurrent with any Blanks and RBC instruction updates to ensure that all reporting is consistent.

<u>SSAP No. 1</u>

We have no comment on the changes in SSAP No. 1 – *Accounting Policies, Risks & Uncertainties and Other Disclosures* other than the clarification of expected reporting values.

<u>Notes to the Financial Statements - 5L</u>

5L(1)

- Interested parties note that instructions are not included for the new columns and rows or the newly required reconciliation. Therefore, we recommend instructions be added to the Restricted Assets section.
- We note that this section still has line o titled: *Total restricted assets*, but the new chart shows that the total is now line r. We recommend instructions be updated with the new line titles.
- We note that changes to SSAP No. 1's requirements would also require Note 5L be updated for Health and Property & Casualty companies, which have slightly different formats than Life.

<u>Illustrations to the Financial Statements - 5L</u>

5L(1)

- The exposure should clarify what happens if assets are pledged and may show up as restricted assets in another row.
- Interested parties recommend the removal of the reference to SSAP No. 1 Paragraph 23.c from the Restricted Assets Category in lines o-q.
- We would like to confirm that line o should exclude collateral received from security lending and repurchase agreements as these items are already included in lines b-f. We recommend clarification language to call out the exclusions.

5L(2)

- Question: Is the amount of total assets pledged under derivative contracts supposed to be on the new line (*Amount of Total pledged under derivative contracts*) and not included above the current line "Total (c)"? If so, why would we need to remove that line from the new total line?

- We recommend that the new Total Excluding Derivatives include a formula showing it is Total (c) less Amt of total pledged under derivative contracts.
- We recommend Staff Note be included as a subnote to the table or included in the Note 5L instructions.
  - ✓ **Note: The amount of pledged under derivative contracts should agree to Schedule DB and agree to what is subtracted from the life RBC formula.**

5L(4)

- Interested parties would like clarification if the new Collateral/Modco/FWH Columns are independent of each other or are Modco/FWH subsets of the collateral amount.
- We note that the subnotes for Columns 3 and 4 were not updated and still state the formula is column 1 / Asset page. Column 1 refers to all data for BACV. The columns will need to be renumbered (i.e., 1.1 Collateral; 1.2 Modco; 1.3 FWH) and/or the subnotes for j and t would be updated.
- We note that row j currently should be column total lines, but the headers for the Separate Account (SA) section were added to the total line instead of a new row. We recommend a new line be added for the SA section headers. Line t should be numerical values rather than column headers.
- We would like to confirm that the "Recognized Obligation for Modco/FWH Assets" required in 5L(4)u and v are equal to the Modco/FWH reserve liabilities. If so, the language should be updated to read as such.

5L(4) – The second one should be renumbered to 5L(5)

- The exposure should clarify that this table applies only when the economic benefits received from pledging the asset stay with the cedant. Stated differently, if the benefit or cost associated with the restriction inures to the reinsurer, that would not be considered "purpose specific to the ceding insurance reporting entity." We recommend a principle be developed to apply the intended rules to a wide array of transactions.

Life RBC (E) Working Group Referral

Interested parties propose the following changes be made to the referral to the Life RBC (E) Working Group.

> *Basis of Factors*
> When the default risk in modified coinsurance (MODCO) and other reinsurance transactions with funds withheld is transferred, this transfer should be recognized by reducing the RBC for the ceding company and increasing it for the assuming company. **In the event that the entire asset credit or variability in statement value risk associated with the assets supporting the business reinsured is not transferred to the assuming company for the entire duration of the reinsurance treaty, the RBC for the ceding company should not be reduced. For clarity, if the Modco/Funds Withheld reinsurance agreement asset held as of the year-end date has been used as a pledged asset concurrently with the**

pledged asset being included as a Modco/Funds Withheld reinsurance agreement asset for any purpose specific to the ceding insurance reporting entity at any time during the year, the RBC for the ceding company shall not be reduced. For example, if the Modco/Funds Withheld reinsurance agreement asset held as of the year-end date was the collateral in a securities lending, repurchase, or FHLB transaction executed for the benefit of ~~by~~ the ceding entity at any time over the year concurrently with the pledged asset being included as a Modco/Funds Withheld reinsurance agreement asset, then ~~the reporting entity cannot assert that they have transferred the asset risk or variability and~~ RBC shall not be reduced. In situations where the economic benefit received from pledging the assets inure to the reinsurer throughout the duration of the reinsurance treaty, the cedant is allowed to reduce its RBC for those assets.

Ref #2024-21: Investment Subsidiaries

On November 17, 2024, the Working Group moved this item to the active listing and exposed this concept agenda item requesting comments on options to clarify accounting guidelines and resulting reporting impacts for investment subsidiaries.

As background, investment subsidiaries are often used by insurers as operationally efficient investment vehicles and also may be used for various legal reasons (e.g., reinsurance transactions). Using a separate legal entity to own certain types of investments may be a lot more efficient than having the insurer own the assets outright. For example, insurers may use an investment subsidiary to own residential mortgage loans. This asset type usually requires the issuance of a high volume of loans to achieve the appropriate economies of scale so that the investment is cost-effective. Insurers may create a separate legal entity to allow for licensing to purchase loans in every state and that will engage a mortgage loan servicer to administer and service all the loans. Additionally, when insurers establish an investment subsidiary in the form of a trust with a national bank as trustee, the national bank trustee is either explicitly exempted from state lending licensing requirements or entitled to federal preemption from state lending license requirements. Using an investment subsidiary in this case would allow the insurance company to invest in large volumes of residential mortgages without significant burden on internal resources and internal operations while holding a capital charge on the underlying mortgages that is commensurate with the risk of each underlying mortgage loan.

With the background above, following are our comments to the potential actions included in the exposure draft.

1. **Proposal No. 1: Revisions to SSAP No. 97 to incorporate statutory accounting guidance for SCAs that hold assets on behalf of the reporting entity and affiliate (investment subsidiaries)**

   Interested parties agree with including guidance in SSAP No. 97 to address the following items:

   a. The definition of an investment subsidiary from Schedule D should be brought over into SSAP No. 97.

b. Interested parties agree that clarification should be added on the accounting for these investments. We understand that these investments are to be reported using an equity method of accounting with U.S. GAAP audited financial statements required for admissibility. There is a current lack of clarity on how to apply the "imputed value" requirement in the investment subsidiary definition. There is inconsistency in practice as to whether the underlying investments are adjusted from a U.S. GAAP value to a U.S. SAP value in instances where U.S. GAAP and U.S. SAP differ from an investment valuation perspective. If the intent is for the investment subsidiary's assets to be recorded with a carrying value equal to what would be recorded if the assets were held directly by the insurer, more clear guidance should be included in SSAP No. 97 as to how this rule is intended to be applied.

c. There should be clarification that in no instance the RBC charges applied to the underlying assets can be more beneficial than if the assets were held directly by the insurer. This should address the Working Group's concern regarding investment subsidiaries that own bonds that do not meet the new principles-based definition and would require an SVO designation for reporting. Interested parties also request clarification in the RBC instructions that the applicable charges be applied to the accounting basis used to determine the carrying value of the investment subsidiary.

2. **Proposal No. 2: Sponsor Blanks proposals to capture new investment Schedules or perhaps expansions to existing investment schedules, to detail the underlying assets held within an investment subsidiary**

   Interested parties believe that having to include a listing of each underlying asset of the investment subsidiary will take away some of the operational efficiency that is gained by having the investment subsidiary own the underlying assets. If this is a "must have" for the Working Group, perhaps we can work together on the most efficient way to provide the data. See additional suggestions under item 3 below.

3. **Proposal No. 3: Referrals to Capital the Capital Adequacy (E) Task Force and related RBC Working Groups to incorporate details that allow regulators to verify the RBC calculation for the underlying assets in investment subsidiaries**

   Interested parties agree with providing transparency for RBC purposes. Since listing each asset individually may take away some of the benefits of creating an investment subsidiary, perhaps the assets can be provided by groupings that match AVR/RBC schedules similar to the industry's recent response on the funds withheld assets exposure. Another option may be to include detail in a note to the financial statement that would be less onerous than including it in the actual Investment schedules.

In addition to providing responses above to the specific actions detailed in the Exposure Draft, interested parties would like to provide additional comments as follows:

1. We understand from the exposure draft that the concept of an investment subsidiary is intended to be limited to Schedule D common stock and preferred stock investments. However, it is not clear to us why the concept cannot be extended to investments in subsidiaries that are legally structured as limited partnerships (LPs) or limited liability companies (LLC). The legal form of the entity should not impact whether a subsidiary meets the criteria for investment subsidiary reporting as the accounting and reporting would follow substance over form. In fact, we understand that insurance law in some states already allows the concept of an investment subsidiary to be applied to any legal entity. For example, state statutes modeled on the NAIC Holding Company System Regulatory Act refer to investment subsidiaries as "entities organized as corporations, partnerships, associations, joint stock companies, trusts, unincorporated organizations that are engaged or organized to engage exclusively in the ownership and management of assets authorized as investments for the insurer." We understand that this would require some changes to Schedule BA to add a specific line item for investment subsidiaries, which will require additional work and new AVR/RBC mapping. Another option could be to require all investment subsidiaries, regardless of legal form, to be reported on Schedule D.

2. There are entities that are not legally structured as either a corporation or LP/LLC. However, the equity they issue is more akin to a common stock investment in a corporation than it is to an equity interest in an LP/LLC. This is the case for Delaware statutory trusts (DSTs). From a legal perspective, equity investments in these types of entities are treated similarly to common stock as investors in both DSTs and corporations have limited liability. Unlike LPs/LLCs, DSTs do not maintain separate capital accounts for each investor since the ownership interest is usually represented by shares/beneficial interests similar to ownership of equity in a corporation. Any new guidance added to SSAP No. 97 should allow for the reporting entity's assessment of whether the equity investment in the investment subsidiary is more akin to common stock (Schedule D reporting) or more akin to LP/LLC interests (Schedule BA reporting). Each reporting entity needs to assess individual facts and circumstances for each investment vehicle to determine guidance applicability and the appropriate schedule in which to report the investment subsidiary.

3. Some trusts are established to hold assets such as mortgage loans that allow for direct reporting on Schedule B. We understand that this is done by including legal language in the trust certificates that specifically state that ownership in the trust represents a participation in each mortgage loan owned by the Trust. In these instances, the insurer has an undivided interest in each mortgage loan and it has the same rights as the lender of record with all proceeds from the loans as well as foreclosure rights being pari-passu with the lender of record. We believe that since ownership in the trust in this instance represents a participation in each loan as defined in SSAP No. 37, these loans are Schedule B eligible assets and are outside of the scope of the investment subsidiary guidance.

Ref #2024-22: ASU 2024-01, Scope Application of Profits Interest and Similar Awards

On November 17, 2024, the Working Group moved this item to the active listing and exposed revisions, as shown in the exposure draft, to adopt with modification *ASU 2024-01 Compensation—Stock Compensation (Topic 718), Scope Application of Profits Interest and Similar Awards* within *SSAP No. 104—Share-Based Payments*.

Interested parties have no comments on this item.

Ref #2024-23: Derivative Premium Clarifications

On November 17, 2024, the Group moved this item to the active listing, categorized as a SAP clarification, and exposed this agenda item proposing revisions to *SSAP No. 86—Derivatives* and the annual statement instructions to ensure consistent terminology for derivative financing premiums and to further clarify that derivative premium costs shall not be recognized as a realized gain/loss.

After discussion with NAIC staff, interested parties suggest that the Ref #2024-23: Derivative Premium clarification be captured in the discussion of Ref #2024-15: ALM Derivatives.

Ref #2024-24: Medicare Part D - Medicare Prescription Payment Programs

On November 17, 2024, the Working Group moved this item to the active listing, categorized as a SAP clarification, and exposed tentative *Interpretation (INT) 24-02: Medicare Part D Prescription Payment Plans* as well as minor edits to *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage*, as described above. The Working Group directed notice of the exposures to the Health Insurance (B) Committee and Health Risk-Based Capital (E) Working Group. In addition, NAIC staff were directed to coordinate on the annual statement blanks proposals and to develop disclosures for future discussion.

Interested parties support the comment letter submitted by AHIP and BCBSA.

Ref #2024-25: SSAP No. 16 Clarifications

On November 17, 2024, the Working Group moved this item to the active listing, categorized as a SAP clarification, and exposed revisions to *SSAP No. 16—Electronic Data Processing Equipment and Software* to clarify the references to the U.S. GAAP Accounting Standards Codification (ASC).

Interested parties agree with the updated references in this item.

Ref #2024-27: Issue Papers in the Statutory Hierarchy

On December 17, 2024, the Working Group moved this item to the active listing as a SAP clarification and exposed revisions, as shown in the exposure draft, to classify issue papers in Level 5 of the statutory hierarchy.

Interested parties raised the issue of the placement of Issue Papers in the statutory hierarchy in our previous comment letter of September 27, 2024, where we suggested that Issue Papers be recognized as authoritative guidance and included in either Level 2, or alternatively Level 4, in the statutory hierarchy of authoritative guidance. Because Issues Papers frequently have more accounting guidance rather than reporting guidance, we suggested first Level 2 as this would place issue papers higher in the hierarchy than the annual statement instructions (Level 3) which is arguably more appropriate.

Level 4 specifically includes the preamble as authoritative guidance and paragraph 45 of the preamble states, “While it is not intended that there be any significant differences between an underlying issue paper and the resultant SSAP, if differences exist, the SSAP prevails and shall be considered definitive.” This part of the preamble puts the guidance in an SSAP above the guidance in an Issue Paper if a difference exists between the two, which we agree is appropriate. However, there are instances where there is no guidance in an SSAP and the underlying Issue Paper has either a detailed discussion or specific guidance that is on point for an accounting issue that a preparer or auditor is researching. As mentioned in our prior comment letter, examples include feeder funds related to the new principles-based bond definition (PBBD) and superseded US GAAP OTTI impairment guidance that is still applicable for statutory accounting but is not codified within the SSAPs).

The current exposure draft recommends that Issue Papers be included in Level 5 of the statutory hierarchy as “nonauthoritative guidance” which includes “Accounting textbooks, handbooks and articles.” We believe this is inappropriate as the guidance in Issue Papers is the result of the deliberative process used by the Working Group and the Accounting Practices and Procedures Task Force to identify appropriate statutory accounting guidance and practices, expose draft guidance for comment, receive public comment, and deliberate a final Issue Paper that is and should be maintained as part of the process for developing authoritative statutory accounting practices and procedures. In short, the Issue Papers are the product of an iterative, open process that become part of the documented discussion of statutory accounting guidance by the Working Group, industry, and others. We believe this should result in Issue Papers being placed in Level 4.

Ref #2024-28: Holders of Capital Notes

This agenda item has been prepared in response to the direction of the Working Group during the 2024 Fall National Meeting with the adoption of INT 24-01: Principles-Based Bond Definition Implementation Questions and Answers. With the adoption of the INT, and the guidance for reporting certain debt securities as capital notes in scope of SSAP No. 41—Surplus Notes, industry identified that slight revisions may be necessary to reflect the capital note distinctions. The Working Group directed NAIC staff to work with industry in this review and identifying necessary changes.

From the initial review and working with industry, revisions have been proposed to address the following specifically for capital notes:

1. Incorporate a definition/reference to the INT for capital notes.

2. Clarify the admittance restrictions.

3. Clarify the guidance for NAIC designations.

4. Update the impairment guidance to refer to capital notes.

In addition to these items, it was identified that an existing disclosure for surplus notes, which requires disclosure of any holder of 10% or more of an SEC-registered surplus note, is likely an extensive administrative burden, may be difficult to complete, and as a narrative disclosure only (not data-captured), is likely not often utilized. From a review of the disclosure, it predates the issuance of SSAP No. 41—Surplus Notes, and there are questions as to how a disclosure of certain holders of SEC-registered notes would be purposeful or used. NAIC staff has proposed to eliminate this aspect of the disclosure but retain the disclosure focusing on surplus notes with affiliates. NAIC staff requests feedback on whether this disclosure should be retained. Interested parties reviewed this exposure and have the following comments.

Interested parties appreciate the attempted clarification in the exposure regarding paragraph 9a as this paragraph was a point of confusion during interested parties' pre-exposure review of SSAP No. 41. Even with the proposed changes, there is still confusion surrounding this paragraph. More specifically, do the state law admission limits discussed pertain to ownership related to an individual company, affiliates, an aggregate equity limit or something else? As noted in the NAIC Staff Note, it is not generally characteristic of the SSAPs to detail provisions used in state limitations. As a result, absent further clarification and/or a compelling rationale from regulators as to the purpose of having such guidance in SSAP No. 41, interested parties would support the deletion of this paragraph if determined appropriate by regulators in response to the question asked of them in the NAIC Staff Note.

Interested parties are also supportive of the proposed changes to paragraph 21 as not only is this language likely not purposeful or used but it also not readily obtainable for issuers if at all. Relatedly, the disclosure in paragraph 18c includes the following to be disclosed for as long as the surplus notes are outstanding:

> *Holder of the note, or if public, the names of the underwriter and trustee, with the identification on whether the holder of the surplus note is a related party per SSAP No. 25 – Affiliates and Other related Parties.*

Interested parties believe this disclosure can also be deleted as: 1) the holder of the note, is duplicative of the proposed deletion in paragraph 21, is likely not purposeful or used and not readily obtainable 2) the names of the underwriter and trustee are likely not purposeful or used, and 3) any surplus note for which the holder is a related party would appear to be captured in paragraph 21 which is not being deleted. If a distinction is being made between related party and affiliate, maybe that could be clarified within paragraph 21 and thus allow the deletion of paragraph 18c.

Interested parties do not believe it is appropriate for capital notes to be nonadmitted in the event the regulatory authority halts principal or interest payments as suggested in paragraph 9b. Mechanisms already exist to appropriately reduce capital such as the carrying value of NAIC designations of 3 through 6 capital notes are reported as the lesser of amortized cost or fair value in paragraph 11 and proposed impairment guidance in paragraph 16 recording an impairment down to fair value.

A wide range of scenarios may exist in regard to regulator authority cancelling coupons and/or writing off par value. Typically, a cancellation of a coupon would cause a down grade and likely an impairment decision. Carrying the capital note at fair value (which is generally readily available in the market) is more suitable than non-admitting the remaining fair value of a capital note. During 2009, several bank issuers agreed with their EU regulators on cancelling coupons for 24 months. If held, many of these hybrid securities recovered and ultimately were called by the issuer at par value. Further, nonadmitting an asset that may have a significant fair value would work to incentivize companies to sell at depressed prices, ultimately hurting policyholders, rather than holding the capital note for a potential recovery.

* * * *

Thank you for the opportunity to comment on the above items. Please feel free to contact either one of us if you have any questions or would like to discuss further.
Sincerely,

D. Keith Bell Rose Albrizio

cc: Interested parties
NAIC staff

Interpretation of the
Statutory Accounting Principles (E) Working Group

INT 24-02T: Medicare Part D Prescription Payment Plan

Drafting Note: Tracked changes reflect BCBSA/ AHIP recommended revisions to February 25, 2025, exposure which are exposed until March 5, 2025, to allow for 2025 Spring National Meeting discussion.

INT 24-02T Dates Discussed

November 17, 2024; February 25, 2025

INT 24-02T References

Current:
- *SSAP No. 47—Uninsured Plans*
- *SSAP No. 54—Individual and Group Accident and Health Contracts*
- *SSAP No. 66—Retrospectively Rated Contracts*
- *SSAP No. 84—Health Care and Government Insured Plan Receivables*
- *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage*

INT 24-024T Issue

1. The Inflation Reduction Act of 2022 introduced changes to Medicare Part D, which is the voluntary outpatient prescription drug program (Part D), including a new program to offer Part D enrollees the option to pay ~~-~~their out-of-pocket Part D prescription drug costs through monthly payments over the course of the plan year instead of paying the full amount upfront at the pharmacy counter. This program, known as the Medicare Prescription Payment Plan (MPPP), is effective on January 1, 2025.

2. The purpose of this interpretation is to provide statutory accounting and reporting guidance for aspects of the MPPP. This interpretation specifically addresses the MPPP components of Medicare Part D and does not intend to alter the guidance in *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage*, which offers high-level accounting guidance on the current Medicare Part D program.

MPPP Program Overview

3. The MPPP requires all Medicare prescription drug plans (Part D plan sponsors), including both standalone Medicare prescription drug plans and Medicare Advantage plans with prescription drug coverage, to offer ~~its~~ enrollees the option to pay their out-of-pocket prescription drug costs through monthly payments to the Part D plan sponsor over the remainder of the plan year, as opposed to paying the full amount upfront to the pharmacy.

4. Part D plan enrollees who elect to participate in the MPPP (MPPP participants) will pay $0 to the pharmacy for covered Part D drugs. Instead, the Part D plan sponsor is required to fully pay the pharmacy the total of an MPPP participant's applicable out-of-pocket amount and the Part D plan sponsor's portion of the payment in accordance with Part D prompt payment requirements. Subsequently, the Part D plan sponsor will bill the MPPP participant monthly for any cost-sharing incurred while enrolled in the MPPP.

5. -MPPP ~~participants~~ will not reduce total out-of-pocket costs for participants' prescription drug purchases for a plan year.-. The MPPP simply spreads MPPP participants' out-of-pocket Part D costs into monthly payments over the remaining term of the plan year which may help some to better manage their monthly cash flow.

6. Unlike other existing aspects of Medicare Part D, which involve funds due from the federal government for which payment is effectively assured, MPPP installment balance recoverables are due from individual MPPP participants. Consequently, Part D plans may pay pharmacies for MPPP participants' out-of-pocket pharmacy claim costs, but some amounts billed to the MPPP participants might be uncollectible. That could occur when an MPPP participant does not pay the full outstanding balance after the required grace period. This raises statutory accounting concerns regarding potential nonadmittance of overdue amounts and impairment of unpaid outstanding recoverables from MPPP participants.

7. To help cover potential uncollectible balances, the Centers for Medicare and Medicaid Services (CMS) allows Part D plan sponsors to include an estimate for MPPP related losses in their plan bids. However, for the initial years, Part D plan sponsors lack directly relevant prior experience in estimating the MPPP program's potential for uncollectible amounts.

8. The government is responsible for the estimated MPPP losses to the extent they are included in plan bids by Part D plan sponsors. Part D plan sponsors thus receive additional premium revenue from the government, which helps to cover uncollectible balances from MPPP participants. Part D plan sponsors face pricing/underwriting risk relating to the prescription needs of enrollees and may inaccurately estimate the amounts of uncollectible balances to include in plan bids. In addition, there are risks that the costs of uncollectible amounts and other aspects of implementing the MPPP will vary from amounts that had been factored into plan bids.

MPPP Program Requirements for Unpaid Balances

9. Under the MPPP, Part D plan sponsors take on the risk for uncollectible balances not covered by the plan bid. The program rules prohibit or limit many of the common methods used to mitigate loss from uncollectible MPPP balances. Examples of such prohibitions or limitations include the following:

a. **Late Fees, Etc. –** Under the MPPP, late fees, interest payments, or other fees, such as for different payment mechanisms, are not allowed.

b. **Billing and Payment Procedures –** Part D plan sponsors can design their own billing and payment procedures for the MPPP. However, they must prioritize payments towards Part D plan premiums to avoid an enrollee losing their Part D coverage. This rule applies when it is unclear if an enrollee intended a submitted payment to cover their outstanding Part D plan premium or their MPPP balance.

c. **Pharmacies Not Responsible for Balances –** Participation in the MPPP is considered an arrangement between the Part D plan sponsor and the MPPP participant. Pharmacies are not responsible for losses attributed to the uncollectibility of MPPP participants' balances or for collecting unpaid balances from the MPPP participant on the Part D plan sponsor's behalf.

d. **Termination of Participation –** A Part D plan sponsor must terminate an enrollee's participation in the MPPP if the enrollee fails to pay their monthly billed amount. An MPPP participant will be considered to have failed to pay their monthly billed amount only after a required grace period of at least two months. The Part D plan sponsor cannot terminate an enrollee from the Part D plan for nonpayment of any of their MPPP billed amounts. Part D plan sponsors must continue billing amounts owed under the program in monthly amounts up to the maximum monthly cap based on the statutory formula for the remaining duration of the plan year after an enrollee has been terminated.

e. **Reinstatement of Enrollees -** Part D plan sponsors must reinstate terminated MPPP participants if the individual demonstrates good cause for failure to pay the program billed amount within the grace period and pays all overdue amounts billed.

f. **Preclusion from Subsequent Enrollment -** A Part D plan sponsor may prevent an individual from opting into the MPPP program in a subsequent year if the individual owes an overdue balance to that Part D plan sponsor or to another Part D plan sponsor with the same parent organization. In other words, an individual who owes an overdue MPPP balance to a Part D plan sponsor cannot be barred from enrolling in the MPPP in a subsequent year through a different Part D plan sponsor that does not have the same parent organization.

g. **Compliance with Federal and State Laws -** Part D plan sponsors (and any third parties with whom~~that~~ Part D plan sponsors contract) collecting unpaid balances related to the program must follow other applicable federal and state laws and requirements, including those related to other types of payment plans, credit reporting, and debt collection.

Medical Loss Ratio

10. The current Public Health Act outlines how to calculate medical loss ratio (MLR) rebates, which are generally based on a comparison of incurred health claims and quality improvement activities to premium revenue, considering various factors and adjustments, all as prescribed by CMS. *SSAP No. 66—Retrospectively Rated Contracts* provides disclosures related to the MLR. The CMS MLR requirements are separate from the statutory accounting reporting requirements for the MPPP~~. However, statutory accounting~~ which ~~differences from CMS requirements~~ create the need to ~~for~~ report differences~~ing adjustments~~ between them in the annual statement *Supplemental Health Care Exhibit*.

11. According to the CMS guidance, the losses related to uncollectible MPPP participants' balances are considered for MLR purposes as part of the Part D plan sponsor's administrative expenses. CMS guidance thus excludes losses attributed to uncollectible MPPP participants' balances from the numerator of the MLR calculation, which ~~this~~ is consistent with CMS' treatment in the MLR of other administrative expenses incurred by Part D sponsors. The CMS guidance states that the additional premium revenue attributable to the estimates of MPPP uncollectible amounts included in the Part D plan sponsor plan bids are included in the MLR calculation denominator.

Drafting Note: The MPPP program considers uncollectible recoverables from MPPP participants as incurred plan administrative costs and does not include these amounts in the MLR numerator, so reporting guidance for other adjustments to the Supplemental Health Care Exhibit will be needed. Such reporting revisions are not addressed in this interpretation but would be anticipated to be in the annual statement reporting revisions submitted to the Blanks (E) Working Group.

INT 24-02T Discussion

Statutory Accounting and Reporting Considerations for MPPP

12. The Working Group reached the following tentative consensus for MPPP statutory accounting and reporting guidance. In addition, Appendix 1 illustrates some basic journal entries which help to show the intended financial statement results.

Recoverables from MPPP Participants

13. Recoverables from MPPP participants shall be accrued and reported as an asset on the asset page in the line for *Health care and other amounts receivable*, when the related payment is made by the Part D plan sponsor to the pharmacy for the out-of-pocket costs incurred on behalf of the MPPP participant.

14. Current recoverables from MPPP participants, meaning those that are less than and up to 90 days overdue, are admitted assets to the extent that they comply with the guidance in this interpretation. Recoverables from MPPP participants are also subject to impairment analysis.

15. Uncollected MPPP recoverables more than 90 days overdue are nonadmitted. The due date for aging of the MPPP recoverables shall follow the program billing guidelines.

16. If a recoverable from an MPPP participant is fully collected, ~~it will~~the amount received by the Part D plan sponsor will equal the corresponding out-of-pocket payment it made for a pharmaceutical claim ~~payment~~. In those cases, there will not be an income statement impact regarding claims (or claims adjusting expenses).

Impairments

17. Uncollected recoverables from MPPP participants are subject to an impairment analysis which shall be assessed using the evaluation guidelines in *SSAP No. 5—Liabilities, Contingencies, and Impairment of Assets*. However, when uncollectible recoverables from MPPP participants are written off, the expense shall be reflected as an incurred Medicare Part D prescription drug claims in the statutory income statement.

Out-of-Pocket MPPP Pharmacy Payments

18. When the Part D plan sponsor pays out-of-pocket drug claims to the pharmacy, a claims expense, a contra claims expense, and a contra claims expense account recoverable are recorded. The contra claims expense, or similar mechanism, is recorded to prevent initial claims expense recognition in the income statement so there is zero initial impact to the income statement. This is because there is an amount recoverable from the MPPP participant, and to the extent that the MPPP participant pays in full, there should not be any claims recognition. This is analogous to the handling of anticipated pharmaceutical rebates or anticipated subrogation recoveries.

19. If the MPPP participant pays the amount due in full, there will be no income statement impact in claims expenses resulting from the Part D plan sponsor's payment of the MPPP participants out-of-pocket costs to the pharmacy. This is because the MPPP participant's subsequent monthly payments to the Part D plan sponsor have fully offset the initial pharmacy payments. In such cases, the MPPP recoverable will be reduced as payments are collected and there would be no income statement impact.

20. If the MPPP participant's balance ~~-~~is not repaid in whole or in part, there will be an income statement impact to reflect ~~paid~~ claims expense for the uncollectible MPPP balance~~s~~ which has~~ve~~ been evaluated ~~for~~ as impaired~~ment~~ and written off. Since there is a recoverable from the MPPP participant there should be no income statement amount for an incurred claim until the related MPPP recoverable is written off as uncollectible based on ~~-~~impairment analysis.

21. When the recoverable from the MPPP participant is evaluated as ~~for~~ impaired~~ment~~, the contra claims expense is decreased by the amount of the MPPP recoverable that is written off. This results in the incurred Medicare prescription claim reported reflecting the uncollectible recoverable from MPPP participants for statutory reporting. The premium to offset these claims is included in Medicare premium bids, so reporting the uncollectible MPPP amounts as losses allows the statutory accounting loss ratio to reflect incurred Medicare Part D prescription costs, including the MPPP uncollectible amounts which have been impaired and written off.

Administrative Costs

22. Other costs, e.g., those incurred by Part D plan sponsors in implementing and administering the MPPP program and related collections, are included in the administrative expenses of the Part D plan sponsor and are not included in the claim expenses or claim adjustment expenses.

MLR Reporting Difference

~~23.~~ Note that the statutory reporting of the written off (impaired) recoverable from MPPP participants in Medicare prescription claims is different from CMS treatment of such amounts in the MLR. The CMS requires Part D plan sponsors to report losses from impairment write-offs ~~-~~of uncollectible recoverables from MPPP participants as administrative amounts and, thus, such losses are excluded from the numerator in the CMS MLR. For loss ratios determined under statutory accounting, and pursuant to the guidance in this INT 24-02, such amounts are reported as claims expense and included in the numerator of the loss ratio. ~~s. These administrative amounts are included in the denominator of the MLR by CMS.~~

~~24.~~23.

INT 24-02T Status

~~25.~~24. This interpretation is tentatively effective March 30, 2025~~.~~

~~26.~~25. Further discussion is planned.

Appendix 1 - Illustrative Journal Entries

Medicare Prescription Payment Plan Scenarios			
	Claims	**Receivable**	**Cash**
Initial entries for all scenarios *Assumed to have been recorded by the Part D plan sponsor prior to Scenarios 1 – 3.*			
DR Claims Expense *To represent claims expenses incurred on behalf of the MPPP participant.*	$ 2,000		
CR Cash *To represent the $2,000 paid by the Part D plan sponsor to the pharmacy on behalf of the MPPP participant.*			$ (2,000)
DR Healthcare Receivable *To represent the amount due to the Part D plan sponsor from the MPPP participant, which the MPPP participant must pay over the policy term.*		$ 2,000	
CR Claims A/R (contra-claims expense) *To be reported within the claims expense line, essentially a contra-claims expense, and represents the amount due to the Part D plan sponsor from the MPPP participant which the MPPP participant must pay over the policy term. This offsets the claims expense amount, so results in a current net $0 impact on the income statement, but both the DR and CR on the income statement are in claims expense.*	$ (2,000)		
Scenario 1 - The MPPP participant pays their full amount of $2,000 to the Part D plan sponsor.			
DR Cash *To record receipt of the MPPP participant's payment in full.*			$ 2,000
CR Healthcare Receivable *The net income statement impact remains at $0, because the original claims expense was offset by the contra-claims expense (Claims A/R), and since the full $2,000 was received from the MPPP participant, there are no further income statement journal entry impacts.*		$ (2,000)	
Scenario 1 Net result on Financial Statements	**$ -**	**$ -**	**$ -**
Scenario 2 - The MPPP participant pays $1,500 out of the $2,000 to the Part D plan sponsor and does not pay the remaining $500.			
DR Cash			$ 1,500

Appendix 1- Illustrative Journal Entries

T*o record receipt of MPPP participant partial payment of outstanding balance.*			
CR Healthcare receivable *To reduce MPPP participant receivable for amounts paid.*		$ (1,500)	
DR Claims A/R (contra-claims expense) *To represent the write-off of the receivable. This results in the Part D plan sponsor having a total income statement impact debit to claims expense of $500, represented as the initial $2,000 claims expense for the out-of-pocket paid to the pharmacy by the Part D plan sponsor, offset by the $1,500 received from the MPPP participant.*	$ (500)		
CR Healthcare receivable *To write-off the remaining uncollectible amount as impaired*		$ (500)	
Scenario 2 Net result on Financial Statements	**$ 500**	**$**	**$ (500)**
Scenario 3 - The MPPP participant does not pay any of the $2,000 owed to the Part D plan sponsor.			
DR Claims A/R (contra-claims expense) *To represent the write-off of the amount anticipated to be paid by the MPPP participant. This results in the income statement impact to the Part D plan sponsor being a debit of $2,000, for the amount paid to the pharmacy by the Part D plan sponsor and not reimbursed by the MPPP participant.*	$ 2,000		
CR Healthcare receivable *To represent the write-off of the $2000 receivable.*		$ (2,000)	
Scenario 3 Net result on Financial Statements	**$ 2,000**	**$ -**	**$ (2,000)**

Statutory Accounting Principles (E) Working Group
Spring National Meeting
Comment Letters Received -ALM only

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Financial Security for Life

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November 4, 2024

Mr. Dale Bruggeman
Chair, Statutory Accounting Principles (E) Working Group
National Association of Insurance Commissioners (NAIC)
110 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Re: 2024-15 – ALM Derivatives

Dear Mr. Bruggeman:

The ACLI appreciates the opportunity to comment on the exposure referred to above that was released for comment by SAPWG on August 13, 2024.

We support the development of new statutory accounting guidance for interest-rate hedging derivatives that do not qualify for hedge accounting under SSAP No. 86—Derivatives, but that are used for asset-liability management (ALM), also referred to as "ALM Hedges". ACLI is very appreciative of the on-going dialogue with SAPWG and the IMR Ad Hoc Working Group and stands ready to continue working with the NAIC on this initiative.

Companies manage ALM programs to mitigate reinvestment, guarantee, and disintermediation risks, and to manage asset portfolios within limited ranges around a liability target duration. The new statutory accounting guidance is intended for derivative transactions that alter the interest rate characteristics of assets/liabilities under these types of risk mitigation programs. More specifically, "macro-hedging" ALM programs hedge risks that are often off-balance sheet risks given the "amortized cost" nature of statutory accounting, and therefore hedge accounting frameworks do not address this type of hedging construct. As discussed in our white paper "Derivatives and Hedging with Life Insurance" (included as Appendix I), this is because the duration and convexity of assets and liabilities may differ. When interest rates change, asset and liability durations may change by different amounts, making it nearly impossible to maintain the tight effectiveness assessment corridor requirements as the measurement criteria do not include metrics commonly used in these programs (e.g., duration). As a result, economically effective "macro-hedges" are generally considered hedges and carried at fair value, which misstates insurer solvency by causing surplus volatility or worse, can disincentivize prudent risk management. As further discussed in Appendix I, there is a critical need for developing appropriate accounting guidance.

Within the exposure, NAIC staff has identified several items for further discussion:

2) If further development / consideration of guidance is supported, the following items are noted for discussion:

a. Determination of effectiveness that permits the derivative program to qualify for the special accounting treatment.
b. Discussion of whether net deferred losses (reported as assets) would be admissible, and if so, any admittance limitations.
c. Macro-limits on admittable net deferred losses (reported as assets) and other “soft” assets. (For example, capturing IMR and derivative deferred net losses, and then perhaps considering other soft assets, such as DTAs, EDP equipment and software, goodwill, etc.)
d. Timeframes over which deferred items are amortized into income.
e. Extent of application across the industry. (NAIC staff notes that SSAP No. 108 is only applied by 9 entities, and from a review of the derivative disclosures for INT 23-01, only 14 entities captured derivative gains/losses in the IMR balance.)

The ACLI previously provided a detailed presentation entitled “ACLI Derivative IMR Solution Proposal” (“ACLI Solution,” included as Appendix II) to the IMR Ad Hoc Working Group. Discussions of the ACLI solution at the NAIC Ad Hoc IMR WG were the impetus for this exposure. The solution addresses many of the exposure’s components and ACLI would appreciate the opportunity to present to the full SAPWG membership and any additional interested regulators.

Additionally, the ACLI would like to provide specific comments regarding the admittance limitations identified in discussion points 2b and 2c. Although one of the methods within the ACLI Solution includes accounting which does not utilize the IMR, discussion of accounting treatment revisions for ALM Hedging arose within the context of derivatives and IMR. Therefore, our comments start with the “Definition of IMR” developed by the IMR Ad Hoc Working Group:

> *IMR is a valuation adjustment to maintain consistency between insurance liabilities (the assumptions for which are often unchanged from origin) and the assets needed to support them (where the assumptions can essentially be revisited any time there are fixed income realizations).*
>
> *IMR defers and amortizes the recognition of non-economic gains or losses where investment activity, whether through fixed income investment sales or fixed income derivative hedging transactions, essentially unlock unrealized gains/losses for either assets or liabilities. IMR is not intended to defer economic gains and losses related to asset sales compelled by liquidity pressures that fund significant cash outflows (e.g., such as excess withdrawals and collateral calls).*
>
> *Specifically, the IMR valuation adjustment more appropriately reflects the impact to statutory surplus from fluctuations in interest rates and therefore provides a more accurate representation of solvency under the NAIC’s statutory framework which often includes amortized cost valuation of fixed income investments and liability valuations with fixed assumptions in accordance with the Accounting Practices and Procedures and Valuation Manual.*

This definition is part of a broader document (see attached Appendix III) that provides foundational principles for the NAIC's statutory accounting framework.

As the document and definition of IMR states: fixed income investment assumptions can be more easily revised, that is "unlocked," when the investments are sold/purchased. Statutory reserve liability assumptions typically are not revised. Therefore, to avoid situations in which transitory interest rate related realized gains/losses caused inaccurate solvency reflections (which could disguise an insurer's true ability to pay claims), the IMR valuation adjustment was developed. Appendix III provides detailed examples in which this could occur. The IMR also remains a vital element of the statutory accounting framework and was incorporated in the methodology within other evolutions such as Principle-Based Reserving (PBR) and Asset Adequacy Testing (AAT).

The IMR is not an intangible asset, it is a valuation adjustment to reflect the company's true solvency position under statutory accounting. Therefore, equating negative IMR to an asset (tangible or intangible) with claims paying ability, is not logical or appropriate. Following this, imposing any limit on admittance would misconstrue an insurer's true solvency and would equate to a limit on unrealized losses on fixed income instruments more broadly, such as bonds where the unrealized losses are embedded within their amortized cost valuation; contrary to the purpose of the IMR and consistent valuation of assets and liabilities.

ACLI understands regulators may wish to separate ALM derivatives from IMR (both for recording unrealized during their lives and for recording any applicable realized gains/losses). However, ACLI emphasizes, in light of the previous, that:

1. Fixed income ALM hedges can be used to alter the interest rate characteristics of assets and/or liabilities, and therefore are another method of "unlocking" the fixed assumptions. Whether ALM hedge realized gains/losses are included in the IMR or a separate valuation adjustment, they will be theoretically aligned and maintain the intent of the IMR (see the definition of IMR discussed above); and
2. Any fixed income hedge unrealized gains/losses are not intangible assets. They represent the offset to the valuation of the derivative itself (the contract asset/liability) and equate to the value needed to close (settle) the derivative contract with the counterparty.

Any limits (or potential subsequent non-admittance) on these components would in fact equate to a limit on ALM hedging programs themselves, disincentivizing insurers from engaging in vital, prudent, fixed income hedging strategies. As discussed in Appendix I and II, ALM hedges are used to mitigate reinvestment, guarantee, and disintermediation risks, as well as managing asset portfolios within limited ranges around a liability target duration, all of which are shared goals between regulators and insurers.

Further limiting hedging programs through statutory accounting guidance creates significant regulatory redundancies given other existing, effective regulatory protections:

1. From a state perspective, insurer hedging programs are limited under individual state laws and insurer DUPs, such as the type(s) of derivative programs and/or derivative contract(s). Insurers are also prohibited from speculative derivatives.

2. From a federal perspective, most standard US agreements with derivative counterparties also require derivative trades to be collateralized through margin requirements.[1] Collateral agreements ensure each counterparty (both the insurer and the institution on the other side of the derivative) are able to financially fulfill the derivative contract (ie., pay the amount owed for the derivative's fair value) and/or reduce default risks incorporated in the contract for either party. In this case, any limit on the "valuation offset" is overly punitive when the insurer is legally required to post collateral to the counterparty.

Therefore, an aggregate cap for IMR and/or ALM derivatives is not appropriate, and it is not logical to call them intangible assets that cannot be used to pay claims. Rather, "negative" or "asset" valuation adjustments are simply explicitly shown on the balance sheet, whereas other unrealized losses are embedded in their amortized cost carrying values (i.e., bonds), both of which are required for consistent valuation of assets and liabilities so surplus properly reflects an insurers claims paying ability.

Turning to the macro cap on "soft assets," it is difficult to group these items as one category given their unique characteristics and purpose within the statutory accounting framework. Prudent business and risk decisions should not be disincentivized by the presence of completely unrelated economically viable assets or valuation adjustments on a company's balance sheet. To view these "soft assets" or intangibles in isolation from their broader purpose is also not appropriate. The NAIC's framework is an "amortized cost framework" with appropriate embedded conservatism, not a liquidation basis of accounting, for both assets and liabilities.

Deferred Tax Assets (DTAs) have appropriate conservatism by limiting reversals to 3-years as well as limiting carryback and carryforward potential. Further, DTAs represent real economic value to an insurer, and in fact does help pay claims by way of realizing tax benefits (i.e., reduction in tax payments).

Goodwill generally represents the difference between the cost of acquiring an entity and the reporting entity's share of the book value of the acquired entity. Within the acquisition, components of Goodwill could represent things of value such as costs acquiring a fully amortized building or an asset manager. Asset managers generally have limited balance sheet assets where its value is attributable to asset manager fees and directly proportional to assets under management (i.e., a not balance sheet metric).

Unlike US GAAP or IFRS, where Goodwill is not amortized because it is considered to have an indefinite useful life, until it is determined to be impaired, under statutory accounting Goodwill is conservatively amortized over a period not to exceed 10-years, as well as being subject to impairment testing.

DTAs and Goodwill also have percentage of surplus limitations, which serves as another layer of conservativism.

The common theme among all of these valuation adjustments and/or assets is that they either adjust values for consistent valuation of assets and liabilities to provide an accurate picture of

[1] Mandated by the Dodd Frank Act and related SEC and CFTC regulatory requirements.

claims paying ability or represent real economic value that help insurers pay claims. They are also all unique, with distinct purpose in the statutory accounting framework, so an aggregate limiting cap across other completely unrelated economically viable assets or valuation adjustments on a company's balance sheet is inappropriate.

Lastly, ACLI proposes a few brief comments on exposure item 2e regarding the extent of application in industry. From conversations with our members, use of SSAP 108 is limited due to its narrow scope (variable annuity guarantees only) and the relative rigor of guardrails that must be satisfied to implement (resource intensive, so the benefit must be substantial to justify the effort). However, we understand that the population of insurers who engage in macro-hedging programs is significantly larger and using the Negative IMR disclosures to gauge the population is not truly representative for several reasons, such as:

1. The interim solution did not allow insurers to engage in new hedging programs or to include any hedging programs that did not previously include realized gains within the IMR. There could be insurers who have had to adjust or start programs as the interest rate environment evolved, which may have disqualified them from using this guidance and therefore including their programs in the disclosure.
2. There is diversity in practice in insurer's interpretation of SSAP 86; not all insurers included gains/losses from interest rate related macro-hedging programs in the IMR, which also would have precluded them from using the interim guidance and included balances in the disclosure. Ensuring clear ALM hedging guidance would reduce diversity in practice and would likely lead to more insurers clearly identifying these programs in any future required disclosures.

Once again, the ACLI appreciates the opportunity to provide comments and looks forward to continued dialogue and collaboration on new statutory guidance for ALM Hedges. If you have any questions regarding this letter, please do not hesitate to contact us.

Sincerely,

MMonahan

Mike Monahan
ACLI

Cc: Julie Gann, Assistant Director - Solvency Policy, Robin Marcotte, Senior Manager II, Accounting Policy, Jake Stultz, Manager II – Accounting Policy, Jason Farr Senior SCA Valuation and Accounting Policy Advisor, and Wil Oden, Senior Technical Accounting Policy Advisor

Appendix I

Derivatives and Hedging Under Life Insurance and the NAIC's Statutory Framework

The intent of this document is to offer insights into why life insurance companies have derivative overlays on their investment portfolios to achieve appropriate results under prudent risk or asset liability management (ALM) practices. Strictly adhering to covering the liability with cash bonds through either buy and hold strategies or more dynamic portfolio rebalancing strategies are often insufficient to achieve these same results. It also offers insights into why existing derivative accounting and hedge accounting rules under US GAAP and US statutory accounting (which has incorporated many US GAAP concepts) fall short in appropriately addressing insurer and regulator needs in the broader US statutory framework for the life insurance sector. It further highlights how this framework gap can inadvertently incentivize increased risk-taking in the life insurance sector. This document further discusses the special and prudent ALM & hedging needs of life insurance companies, the marking to market of derivatives under the US statutory framework, and the appropriate lens for assessing effectiveness of derivative hedging programs under the life insurance sector's prudent risk and ALM practices.

To fully understand the proper context of this document, it should be read in conjunction with the "Definition and Purpose of the Interest Maintenance Reserve (IMR)" document which provides grounding in core concepts of the US statutory framework, which includes the IMR. That context provides a basis for understanding Appendix 3 of that document (IMR in the context of Derivatives Hedging Transactions), while this document substantially expands upon those concepts. For convenience, that example is included here as Appendix I.

A Glossary of terms commonly used when discussing these strategies and/or used throughout this document is included in Appendix II. Glossary terms used throughout the document are in italics.

Background

As detailed in the aforementioned "Definition and Purpose of the Interest Maintenance Reserve (IMR)" document, the US statutory framework is generally an "amortized cost framework," where most fixed income investments and insurance liabilities are valued at amortized cost or with assumptions locked at their inception, respectively. The US GAAP framework, on the other hand, largely defaults to a market value or market consistent framework. The US statutory accounting framework is built on a modified US GAAP foundation. However, in the case of the derivative accounting guidance, the default market value carrying value was not modified, creating a mismatch in the accounting recognition of derivatives compared to the assets and liabilities they hedge.

Most life insurance and annuity products have complex ALM profiles that do not lend themselves to simple cash-flow-matching format of ALM using traditional fixed income instruments. Our liabilities are often very long dated (often for 40+ years), and frequently have embedded optionality for policyholders to withdraw their cash values at book or minimum crediting rate guarantees. These long-dated cash flows and embedded options create complex *duration* and *convexity* profiles. At the same time, the universe of fixed income assets is concentrated in maturities of 10 years or less, with very limited availability beyond the 30-year horizon or beyond.

A subset of the overall derivative accounting guidance, hedge accounting allows the derivatives to be accounted for in the same manner as the hedged item(s), however, there are additional concerns with the US GAAP based hedge accounting regime for certain unique life insurance sector derivative hedging programs as well. Current guidance makes it extremely difficult to achieve hedge accounting for *duration* portfolio hedging. This creates significant problems for those responsibly trying to limit *duration* and *convexity* risks:

1. While replication rules can be used to correct some of the *duration* issues, there is significant burden and cost associated with each replication derivative transaction. This makes the activity inefficient and, in some cases, cost prohibitive and/or limited under state law.
2. There is no capacity under these rules to include options or dynamic replication strategies necessary to manage the net *convexity* profile of the portfolios.
3. There are some allowances for “portfolio” or cash flow hedges or certain instances of anticipatory bond hedging. But there is often burden and difficulty in achieving this treatment in many cases, differing audit firm opinions on qualifying strategies, and these strategies are not always available for liability hedging.

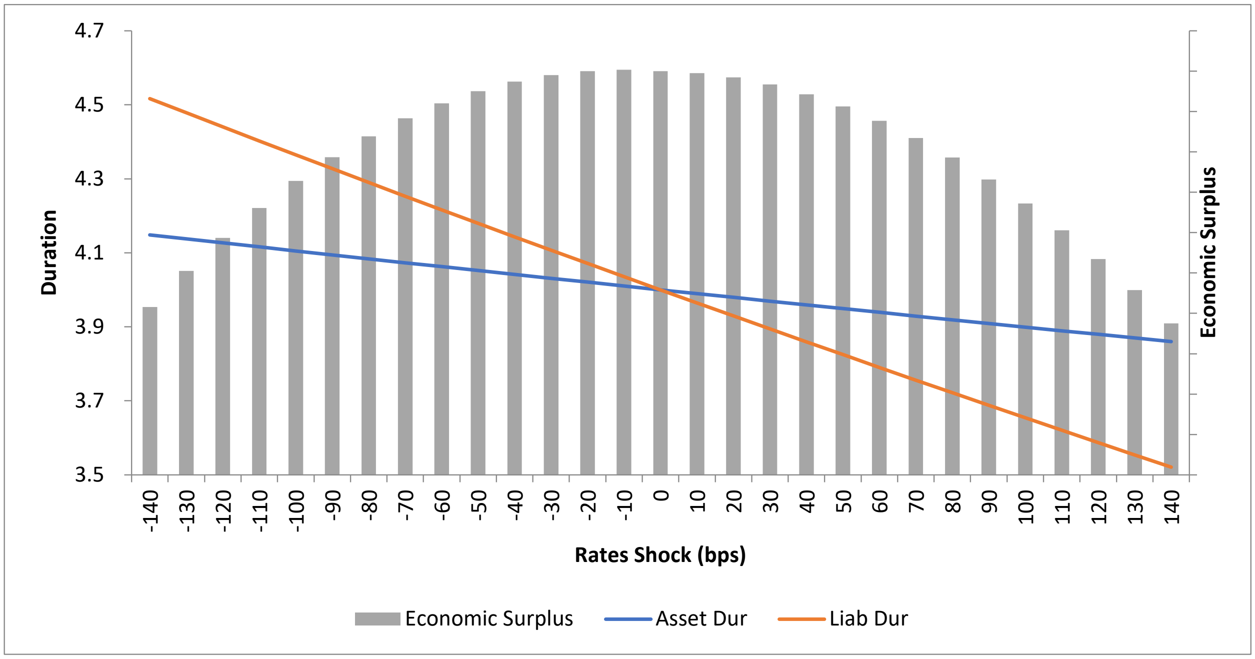
If alignment of the interest rate derivatives used for ALM with the investments and liabilities they support is not upheld, the framework creates disincentives for insurers to engage in prudent and comprehensive ALM and risk management. Consistent accounting through the balance sheet and income statements would create a much more appropriate view of insurers’ surplus and solvency.

The US GAAP hedge accounting framework (and as a result the US Statutory hedge accounting framework) is largely focused on hedges of identified current or future balance sheet and income statement items (i.e., bonds, cash flows, raw materials, etc.), however, the life insurance industry has additional considerations that must be addressed. The long *duration* nature of our products leads to additional risks, such as those from interest rates, which must be addressed and do not align with the existing hedge accounting frameworks. However, the ability to hedge these risks and amortize resultant realized gains and losses through the IMR will allow insurers to manage the risk in a manner consistent with the statutory framework.

Further, if hedge accounting rules are aligned to appropriately allow for the hedged item to be not limited to hedges of an asset or portfolio of assets, but rather the economic profile of the cash assets net of liabilities (*duration*), this would allow for effectiveness testing used in any economic framework where one can illustrate that the hedges move in a way that is offsetting the movement of the economic value of the rest of the hedged item.

Duration **Risk Management of Life Insurance Companies**

Let's first look at the following hypothetical example that life insurers face with regards to asset *duration* risk and how they manage that risk through asset liability management.



This chart shows where the asset *duration* (blue line) equals the liability *duration* (orange line) of approximately 4 at today's interest rate (0 on the horizontal axis). The sensitivity of *duration* to interest rates is referred to as *convexity* and the different slopes of the asset *duration* and liability *duration* lines show that the asset and liability convexities differ. Liability *convexity* is greater than asset *convexity*, which is often the case with life insurance and annuity products. In this example, if interest rates go up by 100 bps, liability *duration* is approximately 3.7 while asset *duration* is approximately 4.0. Likewise, if interest rates go down by 100 bps, liability *duration* is approximately 4.4, while asset *duration* is approximately 4.1. It is virtually impossible, and therefore impractical, for insurers to attempt to be perfectly cash flow matched in any particular interest rate scenario. Managing *convexity* is thus necessary to address this potential change in exposure as interest rates move.

As noted in the 2002 report to E-Committee, there are instances where the statutory framework (for which IMR was developed) gave rise to inappropriate results. The following is pertinent here:

> *Changes in values due to interest rate swings were recognized inconsistently on the asset and liability sides of the balance sheet. Liabilities are valued using interest rates fixed at issue while some assets may be valued using current interest rates through trading activity.*
>
> *When the assets are poorly matched to the liabilities, a significant adverse swing in the interest rates will reduce financial strength and could lead to insolvency even though the balance sheet value of the assets exceeds the balance sheet value of the liabilities. Using long term assets to back demand liabilities is dangerous if there is a significant upswing in interest rates. In addition, individual insurance premiums are received and invested for many years after the*

> *issue date on which the reserve interest rate is determined, creating a potential for inadequate yields that is not reflected in standard accounting procedures.*

What the above example shows is an increase or decrease in interest rates can turn *duration* matched investments and liabilities into a scenario with other concerns that do not show up timely or appropriately under statutory accounting.

An insurance company, in these instances, could certainly address the 100 bp increases (decreases) by selling (buying) long *duration* securities and buying (selling) short *duration* securities, to match the *duration* of liabilities. In such a situation, the investment gains and losses would appropriately be IMR eligible, as liabilities are valued using interest rates fixed at issue while some assets are now valued using current interest rates through trading activity. However, it is not always practical to buy and sell securities to achieve this impact (e.g., availability, tax costs, bid/ask spread, etc.). More practically, the *duration* of the portfolio can be changed via more liquid derivatives instruments to protect against these same risks, in a more efficient way. This is why we believe the following was noted in the 2002 Report to E-Committee.

> *Realized gains and losses on derivatives investments, which alter the interest rate characteristics of assets/liabilities, also are allocated to the IMR and are to be amortized into income over the life of the associated assets/liabilities.*

The E-Committee report only specifies hedging (derivatives which alter the interest rate characteristics of assets/liabilities) but does not distinguish that IMR eligibility is appropriate solely for derivatives that are hedge effective under accounting standards. This is also why we believe the 2002 Report to E-Committee called for symmetrical treatment for losses as well as gains.

Let's explore the implications of interest rate shocks upward and downward, respectively.

Due to the differences in *convexity* of assets and liabilities, the example shows how an interest rate spike can change a perfectly *duration* matched investment portfolio into one that is longer than the liabilities. As the E-Committee report's authors noted, it can be dangerous to back demand liabilities with long assets during an upswing in interest rates, as liabilities can become shorter in *duration* and more prone to disintermediation risk.

Similarly, the example shows how a downward interest rate move can also change a *duration* matched investment portfolio into one that is shorter than the liabilities. Individual insurance premiums can be received and invested for many years after the issue date on which the reserve interest rate is determined, creating a potential for investing in inadequate yields – a risk which is not reflected in standard accounting procedures. This same phenomenon also occurs when the insurance liabilities extend beyond 30 years, typically beyond US investable asset maturities.

Therefore, this example and subsequent discussion is intended to highlight several things:

1) The *duration* mismatch created by an interest rate shock creates increased risk, whether through reinvestment risk or disintermediation risk.
2) Why life insurance companies have developed sophisticated ALM practices to manage *duration* risk to ensure policyowner contractual obligations can be fulfilled.

3) Why it is important for the balance sheet to properly reflect these risk mitigation strategies and why not reflecting realizations from these risk management strategies in IMR, including for bond and derivative losses, can work to disincentivize prudent risk management practices, and increase life insurer risk, by requiring their immediate recognition.

Hedging *Duration* Risk and Hedge Accounting

The US statutory framework is fundamentally different than the US GAAP framework. US GAAP tends to focus more on earnings and market valuations, while US Statutory focuses on long-term solvency and utilizes amortized cost. US statutory accounting adopted much of US GAAP's derivative accounting framework, which is not aligned with and does not fully reflect the inherent nature of the life insurance industry and its policyholder liabilities. Therefore, the gap of what is needed from a regulatory accounting context is still significant considering the sophisticated ALM practices life insurance companies employ to manage *duration* risk so that they can fulfil policy contract liabilities.

To illustrate the difference between a company utilizing US GAAP to hedge risk, let's first walk through an example.

In some instances, the hedge accounting rules work well under US GAAP. Let's look at an example of ABC Company which makes widgets for the automotive industry. The widgets are each molded from 8 grams of 100% copper. ABC company's warehouse can only hold one month's supply of copper.

ABC Company recently signed a contract with XYZ Automotive to provide 100 widgets at $10 each for each of the next 12 months. ABC Company will therefore need to purchase 80 grams of copper on the 1st of each month for the next 12 months at the prevailing spot rate (price). At today's price of $1 per gram, ABC's expected profit margin is 20% or $200 per month. However, if the price of copper goes up, the company's resulting profit would be different than expected (the target profit). If the price went up high enough the company might not even be able to fulfil their obligation to XYZ Automotive.

ABC Company's management is aware that the market for copper can be highly volatile, and their risk management committee decided to lock in the price of copper over the next 12 months to hedge against the risk that the price of copper increases and they will be making widgets at a loss. As such, ABC Company entered into forward/future derivative contracts for the 1st of each month for the next 12 months that lock in today's price of copper at $1 per gram over the next 12 months for their anticipated copper needs.

With these derivative hedging transactions, ABC has guaranteed a 20% profit margin on the contract with XYZ Automotive over the next 12 months. If copper prices double or fall by half, ABC Company's profit margin is not impacted. Any gain (loss) on the derivative contracts is offset by an equal economic loss (gain) on the copper purchase price.

Additionally, because ABC Company does not want to have non-economic and volatile earnings over the course of the next 12 months (i.e., by marking the derivatives to market through income each month), it follows the documentation requirements of US GAAP to prove hedge effectiveness (i.e., the terms match 100%). Any increase or decrease of the price of copper is offset by their derivative hedges.

While the derivatives are still required to be marked to market under US GAAP, any gain (loss) is recognized in other comprehensive income (OCI), not earnings, until the 1st of each month, which then offsets any economic loss (gain) on the copper purchases since the initial spot rate when the contract with XYZ Automotive was affected.

While the copper widget example is one example of hedge accounting under US GAAP, and by partial extrapolation to US Statutory Accounting, US GAAP only touches on the fringes of dynamic and portfolio hedging strategies. Let's explore some of the differences in the *duration* management insurance companies employ when compared to the copper widget example.

1) In life insurance, a change in interest rates can change the *duration* target being hedged. In the copper widget example, a change in copper prices does not change the target (i.e., the copper requirement is determined independently from the price) whereas in life insurance, any change in interest rates can change the risk that needs to be hedged due to the difference in *convexity* of the assets and liabilities. There can be less *duration* to hedge if interest rates rise and more reinvestment risk to hedge if interest rates decline.
2) In the copper widget example, it is easy to match the critical terms for each linear transaction, even if 100% of the transactions are not hedged, and prove 100% hedge effectiveness. Hedging programs which manage *duration* risk may relate to significantly large portfolio(s) of assets supporting large portfolio(s) of insurance contract liabilities, and often the same one-to-one relation of the hedging derivative and the hedged item does not exist. Often, the components of each portfolio are not static, occasionally beyond the control of the insurer, and many times they require ongoing balancing and adjustments. Therefore, these hedging programs must be dynamic.
3) In the copper widget example, under US GAAP, it may be appropriate to meet the required of 80-125% fair value change assessment requirement to keep the derivative fair value changes from impacting earnings. US GAAP is primarily an earnings-based accounting regime, and there is less focus on solvency. The statutory framework, on the other hand, focuses on solvency and the proper reflection of the balance sheet includes the utilization of IMR. As derivatives can be efficient substitutes for the selling and buying of bonds (which are themselves IMR eligible), dynamic interest rate hedging strategies that mitigate ALM risks in the service of meeting policyholder obligations needs to be a component of the framework.

That focus that assesses effectiveness in the context of life insurance makes more sense in the following examples, which illustrate simplified common life insurer hedging programs and further detail why these programs are vital.

<u>Example: *Duration* gap risk reduction</u>

Consider a product such as long-term care insurance or life insurance, where a company expects fixed premium payments each year of a given contract, and in return agrees to pay benefits in the future, contingent on realization of underwritten risk, upon which premium payments cease. Most investable assets in the US mature well within 30 years of issuance, while insurance liability benefits can extend significantly beyond that time horizon, which can create reinvestment risk for both coupons and principal payments. The premium dollars and bond coupons in future years will be reinvested at then prevailing yields. This can result in more interest rate (or *duration*) risk in the portfolio backing such a liability than what the insurer can cover with a portfolio of cash bonds alone. This is typically referred to as a *duration* gap between the assets and liabilities. The use of interest rate derivatives can help to hedge or reduce this risk.

For simplicity, in the below example, the book value of assets is set equal to the reserve for a block of liabilities. Assume the company invests in a long *duration* bond portfolio with a *duration* of 12.0 to back liabilities with a *duration* of 20.0. *DV01* is a measure of the mark-to-market sensitivity for a 1 basis point (0.01% or 1 bp) change in interest rates. Using this bond only investment example, there remains an unhedged *DV01* risk of -$80,000 for every 1 bp move in rates. Ignoring *convexity* impacts, a 1% decline in interest rates could result in losing surplus equal to nearly 8% of the reserves.

However, the insurance company can hedge or reduce its *duration* gap using derivatives. For instance, it could use Treasury bond futures, interest rate swaps, or Treasury bond forwards to synthetically add *duration* to the bond portfolio. In this example, let's assume the company hedges some of the risk and adds $60,000 of *DV01* sensitivity to the portfolio. If interest rates rise or fall, the total value of the assets will move much more closely to the liabilities, and surplus volatility is significantly reduced. The below chart illustrates the various outcomes of these scenarios.

Unhedged initial position (t=0):

	(A) Assets SV (Stat BS)	(B) Asset MV	(C) Asset Duration	(D) Asset DV01	(E) Liability SV (Reserves, Stat BS)	(F) Liability MV (Reserves)	(G) Liability Duration	(H) Liability DV01	(I=D-H) Surplus DV01
Bonds	$100mm	$100mm	12.0	$120,000	$100mm	$100mm	20.0	$200,000	-$80,000

Hedged initial position (t=0):

	(A) Assets SV (Stat BS)	(B) Asset MV	(C) Asset Duration	(D) Asset DV01	(E) Liability SV (Reserves, Stat BS)	(F) Liability MV (Reserves)	(G) Liability Duration	(H) Liability DV01	(I=D-H) Surplus DV01
Bonds	$100mm	$100mm	12.0	$120,000	$100mm	$100mm	20.0	$200,000	
Hedges	$0mm	$0mm	6.0*	$60,000					
Total	$100mm	$100mm	18.0	$180,000	$100mm	$100mm	20.0	$200,000	-$20,000

Note: Example ignores convexity for simplicity. Bond duration is consistent with that of the Bloomberg Agg Long Corporate index as of 10/31/2023. Even if considering only 25 year and longer maturities in this index, the duration would only get to about 14.5 units.

* Hedge duration included based on a $100mm notional for ease of understanding.

Potential scenarios (t=1) at MV (Economic view):

	Rates -1%	Rates unch.	Rates +1%
Bonds	$112mm	$100mm	$88mm
Hedges	$6mm	$0mm	-$6mm
Total Assets**	$118mm	$100mm	$82mm
Reserves	$120mm	$100mm	$80mm
Surplus Change (No Hedge)	-$8mm	$0mm	$8mm
Surplus Change (With Hedge)	-$2mm	$0mm	$2mm

Potential scenarios (t=1) at SV (Statutory view):

	Rates -1%	Rates unch.	Rates +1%
Bonds	$100mm	$100mm	$100mm
Hedges	$6mm	$0mm	-$6mm
Total Assets**	$106mm	$100mm	$94mm
Reserves	$100mm	$100mm	$100mm
URCGL (Surplus)	$6mm	$0mm	-$6mm

** For simplicity, hedges are considered part of Assets regardless of gain or loss position.

In this approach, the company is reducing the mismatches between identified assets and liabilities. There is not a requirement to offset all mismatch risk, just that some of the risk is offset on a net basis. Derivatives for a given strategy would be considered on a net basis in terms of the *duration* metric that is offset.

Example: Pension Risk Transfer (PRT) Repositioning

Consider a PRT transaction where an up-front asset portfolio is received from the client on 1/1 consisting of $1B of cash and short-term bonds (portfolio asset *duration* = 1, average interest rate = 5%). The liabilities have a *duration* of 10 (average effective interest rate = 4%), so the asset portfolio must be repositioned. The liability *duration* calculation has been simplified for the purposes of this example. It will take ~12 months to reposition the asset portfolio for various reasons (e.g., availability of desired bond issuers, maturities, credit qualities, etc.). For simplicity, the example assumes the initial asset portfolio is sold on day-365 (12/31).

On 1/1 (and throughout the following 12 months), significant bond reinvestment risk exists. For example, if (on 12/31) market interest rates for planned bond purchases drop to 1%, then eventually there will be insufficient assets to pay all policyholder liabilities. However, this risk can be hedged with 12-month forwards; so, when interest rates drop, the derivative increases in value thereby eliminating the yield and *duration* deficit of the assets vs. liabilities (which essentially locks in the positive yield difference of assets vs. liabilities on 1/1). Alternatively, if interest rates rise, the derivatives would generate a loss, but that loss would be offset by the ability to invest in higher yielding assets.

In combination, the bonds and derivatives are intended to earn the yield needed to support the liabilities. Without these transactions, the total yield on assets would not be aligned with the presumed yield required to meet product obligations over the entire life of the product. See examples below:

Duration View (1% Change)

Unhedged initial position (t=0):

	(A) Assets SV (Stat BS)	(B) Asset MV	(C) Asset Duration	(D) Asset DV01	(E) Liability SV (Reserves, Stat BS)	(F) Liability MV (Reserves)	(G) Liability Duration	(H) Liability DV01	(I=D-H) Surplus DV01
Bonds	$1B	$1B	1.0	$100K	$1B	$1B	10.0	$1M	-$900K

Hedged initial position (t=0):

	(A) Assets SV (Stat BS)	(B) Asset MV	(C) Asset Duration	(D) Asset DV01	(E) Liability SV (Reserves, Stat BS)	(F) Liability MV (Reserves)	(G) Liability Duration	(H) Liability DV01	(I=D-H) Surplus DV01
Bonds	$1B	$1B	1.0	$100K	$1B	$1B	10.0	$1M	
Hedges	$0	$0	9.0*	$900K					
Total	$1B	$1B	10.0	$1M	$1B	$1B	10.0	$1M	$0

* Hedge duration included based on a $1B notional for ease of understanding.

Potential scenarios (t=1) at MV (Economic view):

	Rates -1%	Rates unch.	Rates +1%
Bonds	$1,010M	$1B	$990M
Hedges	$90M	$0	-$90M
Total Assets**	$1,100M	$1B	$900M
Reserves	$1,100M	$1B	$900M
Surplus Change (No Hedge)	-$90M	$0	+$90M
Surplus Change (With Hedge)	$0	$0	$0

Potential scenarios (t=1) at SV (Statutory view):

	Rates -1%	Rates unch.	Rates +1%
Bonds	$1B	$1B	$1B
Hedges	$90M	$0M	-$90M
Total Assets**	$1,190M	$1,100M	$1,010M
Reserves	$1B	$1B	$1B
URCGL (Surplus)	$90M	$0M	-$90M

** For simplicity, hedges are considered part of Assets regardless of gain or loss position.

Statutory & Yield View (1% Change)

Company will receive $1B premium in short-term bonds
After year 1, Company invests $1B in longer term bonds to support the liabilities
Short-term bond yields and to be purchased longer term bonds' current interest rates are 5% (i.e., flat yield curve)
Liability effective rate (crediting) is 4%
Company wants to hedge reinvestment risk on future bond purchases to economically lock in 5% yield
Company enters into 1 year bond forwards
Company will realize gain/loss at end of t=1 if rates change
Calculation of derivative G/L has been simplified to make example intuitive

Rates Unchanged		End of Year	1	2	3	4	5	6	7	8	9	10
Bond Yield at t=1 (EOP)	5%	Interest Income		50	50	50	50	50	50	50	50	50
Deriv G/L at t=1 (EOP)	0	IMR Amort (start BOY2)		-	-	-	-	-	-	-	-	-
		Total Income		50	50	50	50	50	50	50	50	50
		Asset Yield		5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
		Crediting		40	40	40	40	40	40	40	40	40
		Liability Yield		4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
		Net Income		10	10	10	10	10	10	10	10	10
		Net Yield		1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Balance Sheet												
IMR				-	-	-	-	-	-	-	-	-
Surplus (Retained earnings)				10	20	30	40	50	60	70	80	90

Rates -1%		End of Year	1	2	3	4	5	6	7	8	9	10
Bond Yield at t=1 (EOP)	4%	Interest Income		40	40	40	40	40	40	40	40	40
Deriv G/L at t=1 (EOP)	90	IMR Amort (start BOY2)		10	10	10	10	10	10	10	10	10
		Total Income		50	50	50	50	50	50	50	50	50
		Asset Yield		5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
		Crediting		40	40	40	40	40	40	40	40	40
		Liability Yield		4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
		Net Income		10	10	10	10	10	10	10	10	10
		Net Yield		1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Balance Sheet												
IMR				80	70	60	50	40	30	20	10	-
Surplus (Retained earnings)				10	20	30	40	50	60	70	80	90

Rates +1%		End of Year	1	2	3	4	5	6	7	8	9	10
Bond Yield at t=1 (EOP)	6%	Interest Income		60	60	60	60	60	60	60	60	60
Deriv G/L at t=1 (EOP)	(90)	IMR Amort (start BOY2)		(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)
		Total Income		50	50	50	50	50	50	50	50	50
		Asset Yield		5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
		Crediting		40	40	40	40	40	40	40	40	40
		Liability Yield		4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
		Net Income		10	10	10	10	10	10	10	10	10
		Net Yield		1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Balance Sheet												
IMR				(80)	(70)	(60)	(50)	(40)	(30)	(20)	(10)	-
Surplus (Retained earnings)				10	20	30	40	50	60	70	80	90

Assume the same situation as above, and Company hedged their reinvestment risk, but was not able to defer any resulting hedge realized gains or losses to the IMR. The resulting statutory statements would appear as follows, giving a distorted view of the Company's financial position and solvency:

Rates Unchanged		End of Year	1	2	3	4	5	6	7	8	9	10
Bond Yield at t=1 (EOP)	5%	Interest Income		50	50	50	50	50	50	50	50	50
Deriv G/L at t=1 (EOP)	0	Realized G/L		-	-	-	-	-	-	-	-	-
		Total Income		50	50	50	50	50	50	50	50	50
		Asset Yield		5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
		Crediting		40	40	40	40	40	40	40	40	40
		Liability Yield		4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
		Net Income		10	10	10	10	10	10	10	10	10
		Net Yield		1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Balance Sheet												
IMR				-	-	-	-	-	-	-	-	-
Surplus (Retained earnings)				10	20	30	40	50	60	70	80	90

Rates -1%		End of Year	1	2	3	4	5	6	7	8	9	10
Bond Yield at t=1 (EOP)	4%	Interest Income		40	40	40	40	40	40	40	40	40
Deriv G/L at t=1 (EOP)	90	Realized G/L		90	-	-	-	-	-	-	-	-
		Total Income		130	40	40	40	40	40	40	40	40
		Asset Yield		13.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
		Crediting		40	40	40	40	40	40	40	40	40
		Liability Yield		4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
		Net Income		90	-	-	-	-	-	-	-	-
		Net Yield		9.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Balance Sheet												
IMR				-	-	-	-	-	-	-	-	-
Surplus (Retained earnings)				90	90	90	90	90	90	90	90	90

Rates +1%		End of Year	1	2	3	4	5	6	7	8	9	10
Bond Yield at t=1 (EOP)	6%	Interest Income		60	60	60	60	60	60	60	60	60
Deriv G/L at t=1 (EOP)	(90)	Realized G/L		(90)	-	-	-	-	-	-	-	-
		Total Income		(30)	60	60	60	60	60	60	60	60
		Asset Yield		-3.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%
		Crediting		40	40	40	40	40	40	40	40	40
		Liability Yield		4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
		Net Income		(70)	20	20	20	20	20	20	20	20
		Net Yield		-7.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
Balance Sheet												
IMR				-	-	-	-	-	-	-	-	-
Surplus (Retained earnings)				(70)	(50)	(30)	(10)	10	30	50	70	90

Now let's assume the same situation, but the Company did not exercise prudent risk management and did not hedge their reinvestment risk. If rates decreased 2%, the resulting statutory statements would appear as follows, and the Company may not be able to meet their policyholder obligations:

Rates -2%		End of Year	1	2	3	4	5	6	7	8	9	10
Bond Yield at t=1 (EOP)	3%	Interest Income		30	30	30	30	30	30	30	30	30
Deriv G/L at t=1 (EOP)	0	Realized G/L		-	-	-	-	-	-	-	-	-
		Total Income		30	30	30	30	30	30	30	30	30
		Asset Yield		3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
		Crediting		40	40	40	40	40	40	40	40	40
		Liability Yield		4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
		Net Income		(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)
		Net Yield		-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%
Balance Sheet												
IMR				-	-	-	-	-	-	-	-	-
Surplus (Retained earnings)				(10)	(20)	(30)	(40)	(50)	(60)	(70)	(80)	(90)

Example: Single Premium Fixed Deferred Annuity (FDA)

Options and swaps are frequently used to hedge potential dis-intermediation and extension risk in insurance products. These examples are focused on the disintermediation risk in Fixed Deferred Annuities (FDA), which have an uncertain timing of potential realization of both derivative side and liability side gains or losses.

We start with a single 7-year single premium FDA product with $1,000 of initial premium and a surrender charge of 7% in the first 4-years, then grading down to 3% from years 5-7. We issue policy when the 7-year treasury rate is 4.5%, and assume a credit spread of 1%. The fixed crediting rate for the guarantee period is 4.5%.

We invest our cash in a 7-year zero coupon bond to match to maturity of the contract. To manage the embedded option inside the product, we need an out-of-the-money, American exercise, 7-year put option on a 7-year bond (with declining maturity). Because these are not readily available instruments, we instead purchase two payer swaptions: one with a 2-year maturity on 5-year swap, and one with a 5-year options on a 2-year swap to cover majority of the exposure to potential losses due to early surrenders if rates were to spike up. Because of surrender charges, we need protection that is 100-200 basis points out of the money, so we purchase options with a 6% Strike. These options cost $~14, the remaining $986 is invested in bonds.

In all the cases below, where we illustrate amortization of the IMR, we conservatively amortize it from the time of realization to contract maturity (year 8 of the projection). Also, for simplicity purposes we did not amortize the upfront cost of the option and excluded taxes and expenses.

We start by looking at what happens in the scenario where interest rates don't move – Table 1. Here the options are expected to mature worthless, and we expect to realize the loss of premium in years 2 and 5.

The point of these simplified examples is to show that timing of realization of derivatives gains and losses (even when utilizing a buy-and-hold investment strategy) varies significantly from bonds and can introduce unintentional accounting volatility if the derivatives are not IMR eligible. This example is abstracted from real life practice, as it focuses on a single issuance cohort to illustrate how the hedges, assets and liabilities could interact and therefore overstates the ease with which one may identify excess vs expected surrenders and what assets and derivatives are related to particular liabilities (i.e. the examples assume that the surrenders do not meet the excess withdrawal rules as they focus on just a single cohort that is part of a much broader mix of cohorts). We also use a static hedge portfolio for clarity of illustration. However, in reality, an evolving going concern book of business, with a mix of issuance cohorts is managed dynamically using a variety of instruments and strategies, where the realization of the derivatives gains and losses can be even more time-mismatched then this illustration. The purpose of these examples is to illustrate the appropriateness of IMR eligibility for derivatives consistently with bonds. Separately, excess withdrawals can be addressed in the future (e.g., consistently for derivatives and bonds).

The following examples will demonstrate that it is imperative (1) to use derivatives to hedge interest rate risk (which should be a shared goal of regulators and insurers); (2) to treat derivative gains/losses in a manner consistent with gains/losses on bonds; (3) to have accounting policies that do not disincentivize hedging or risk reduction practices by introducing non-economic income and surplus volatility.

Scenario 1. Interest rates stay the same as they were at issue, no excess surrenders.

	Projection Year	T=0	1	2	3	4	5	6	7	8
	Treasury Rate	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
	Asset Yield	5.50%	5.50%	5.50%	5.50%	5.50%	5.50%	5.50%	5.50%	5.50%
	Surrender Value	930	972	1,016	1,061	1,121	1,184	1,250	1,320	1,422
	Bond at Fair Value	986	1,041	1,098	1,158	1,222	1,289	1,360	1,435	92
	Assets									
1	Bond Book Value	986	1,041	1,098	1,158	1,222	1,289	1,360	1,435	92
2	Market Value of derivative	14	8	4	3	1	-	-	-	-
3	Total Asset Book Value	1,000	1,049	1,102	1,161	1,223	1,289	1,360	1,435	92
	Liabilities									
4	Account Value/Reserve	1,000	1,045	1,092	1,141	1,193	1,246	1,302	1,361	0
5	IMR Liability	-	-	(6)	(5)	(4)	(8)	(5)	(3)	-
	Surplus	-	4	16	25	35	51	63	77	92
	Net Income									
6	Interest Income	-	54	57	60	64	67	71	75	79
7	IMR Amortization (Derivatives)	-	-	(1)	(1)	(1)	(3)	(3)	(3)	(3)
8	IMR Amortization (Bond)	-	-	-	-	-	-	-	-	-
9	Premium (Claim)	1,000	-	-	-	-	-	-	-	(1,422)
10	Change in Liability Reserve	(1,000)	(45)	(47)	(49)	(51)	(54)	(56)	(59)	1,361
11	G/L on Liquidated Bonds		-	-	-	-	-	-	-	-
12	Derivative Loss		0	(7)	0	0	(6)	0	0	0
13	Net Income (held FV no IMR)		9	3	11	12	7	15	16	18
14	Net Income (held FV transfer to IMR)		9	9	10	11	11	12	14	15
15	Net Income (held amt cost transfer to IMR)		9	9	10	11	11	12	14	15
16	Chg in Surplus (held FV no IMR)		4	6	10	11	12	15	16	18
17	Chg in Surplus (held FV transfer to IMR)		4	12	9	10	16	12	14	15
18	Chg in Surplus (held amt cost transfer to IMR)		9	9	10	11	11	12	14	15
19	Surplus (held FV no IMR)		4	10	20	31	43	58	74	92
20	Surplus (held FV transfer to IMR)	-	4	16	25	35	51	63	77	92
21	Surplus (held amt cost transfer to IMR)		9	18	29	40	51	63	77	92

We can see in line 13, option losses introduce income volatility in years 2 and 5 and the change in surplus on lines 16-17 show non-economic surplus volatility due to expiry (early years lower surplus) If everything else happens as expected the cost of managing the "unrealized" risk should have been amortized over the life of the product, showing a smoother emergence of surplus in line 18 and consistent with Net Income in line 15. Sections highlighted in yellow illustrate inconsistency of accounting through the balance sheet and income statement from inconsistent treatment of derivatives from the rest of the block of business, which creates confusing views of either income or surplus/solvency. Meanwhile, when derivatives are treated on a consistent basis, as highlighted in green, surplus and income emerge in the same way that is more aligned to the block's decay of risk, and emergence of profits. We see that divergence go away after year 5, in all the measures once the derivatives are off the books.

Scenario 2. Interest Rates stay as they were at issue, but we have an unexpected $500 surrender in year 4.

		T=0	1	2	3	4	5	6	7	8
	Projection Year									
	Treasury Rate	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
	Asset Yield	5.50%	5.50%	5.50%	5.50%	5.50%	5.50%	5.50%	5.50%	5.50%
	Surrender Value	930	972	1,016	1,061	1,121	656	693	731	788
	Bond at Fair Value	986	1,041	1,098	1,158	722	762	804	848	107
	Assets									
1	Bond Book Value	986	1,041	1,098	1,158	722	762	804	848	107
2	Market Value of derivative	14	8	4	3	1	-	-	-	-
3	Total Asset Book Value	1,000	1,049	1,102	1,161	723	762	804	848	107
	Liabilities									
4	Account Value/Reserve	1,000	1,045	1,092	1,141	661	690	721	754	0
5	IMR Liability	-	-	(6)	(5)	(4)	(8)	(5)	(3)	-
	Surplus	-	4	16	25	67	79	87	97	107
	Net Income									
6	Interest Income	-	54	57	60	64	40	42	44	47
7	IMR Amortization (Derivatives)	-	-	(1)	(1)	(1)	(3)	(3)	(3)	(3)
8	IMR Amortization (Bond)	-	-	-	-	-	-	-	-	-
9	Premium (Claim)	1,000	-	-	-	(500)	-	-	-	(788)
10	Change in Liability Reserve	(1,000)	(45)	(47)	(49)	481	(30)	(31)	(32)	754
11	G/L on Liquidated Bonds		-	-	-	-	-	-	-	-
12	Derivative Loss		0	(7)	0	0	(6)	0	0	0
13	Net Income (held FV no IMR)		9	3	11	44	3	11	12	13
14	Net Income (held FV transfer to IMR)		9	9	10	43	7	8	9	10
15	Net Income (held amt cost transfer to IMR)		9	9	10	43	7	8	9	10
16	Chg in Surplus (held FV no IMR)		4	6	10	43	9	11	12	13
17	Chg in Surplus (held FV transfer to IMR)		4	12	9	42	12	8	9	10
18	Chg in Surplus (held amt cost transfer to IMR)		9	9	10	43	7	8	9	10
19	Surplus (held FV no IMR)		4	10	20	63	71	82	94	107
20	Surplus (held FV transfer to IMR)	-	4	16	25	67	79	87	97	107
21	Surplus (held amt cost transfer to IMR)		9	18	29	72	79	87	97	107

In this scenario there is no gain or loss on the bonds, and the surrender charges create a windfall in year 4. But derivatives, cause unexpected income volatility in years 2 & 5, if not amortized through IMR, as illustrated in net income lines 13 (without IMR). Years 1-5, highlighted in yellow, show uneconomic volatility and divergence between net income (lines 13 &14) and change in surplus (on lines 16 & 17) due to the inconsistent treatment of the derivatives.

Scenario 3 interest rates jump 300 bps to 7.5% in year 2, but no excess surrenders are seen

	Projection Year	T=0	1	2	3	4	5	6	7	8
	Treasury Rate	4.50%	4.50%	7.50%	7.50%	7.50%	7.50%	7.50%	7.50%	7.50%
	Asset Yield	5.50%	5.50%	8.50%	8.50%	8.50%	8.50%	8.50%	8.50%	8.50%
	Surrender Value	930	972	1,016	1,061	1,121	1,184	1,250	1,320	1,463
	Bond at Fair Value	986	1,041	1,006	1,092	1,185	1,310	1,421	1,542	210
	Assets									
1	Bond Book Value	986	1,041	1,150	1,215	1,283	1,380	1,459	1,542	210
2	Market Value of derivative	14	8	24	24	24	-	-	-	-
3	Total Asset Book Value	1,000	1,049	1,174	1,239	1,308	1,380	1,459	1,542	210
	Liabilities									
4	Account Value/Reserve	1,000	1,045	1,092	1,141	1,193	1,246	1,302	1,361	0
5	IMR Liability	-	-	38	32	26	33	22	11	-
	Surplus	-	4	43	66	89	101	135	170	210
	Net Income									
6	Interest Income	-	54	57	65	68	72	79	83	131
7	IMR Amortization (Derivatives)	-	-	6	6	6	11	11	11	11
8	IMR Amortization (Bond)	-	-	-	-	-	-	-	-	-
9	Premium (Claim)	1,000	-	-	-	-	-	-	-	(1,463)
10	Change in Liability Reserve	(1,000)	(45)	(47)	(49)	(51)	(54)	(56)	(59)	1,361
11	G/L on Liquidated Bonds		-	-	-	-	-	-	-	-
12	Derivative Gain		0	45	0	0	18	0	0	0
13	Net Income (held FV no IMR)		9	55	16	17	37	23	25	29
14	Net Income (held FV transfer to IMR)		9	17	22	24	30	33	36	40
15	Net Income (held amt cost transfer to IMR)		9	17	22	24	30	33	36	40
16	Chg in Surplus (held FV no IMR)		4	78	16	17	19	23	25	29
17	Chg in Surplus (held FV transfer to IMR)		4	40	22	24	12	33	36	40
18	Chg in Surplus (held amt cost transfer to IMR)		9	17	22	24	30	33	36	40
19	Surplus (held FV no IMR)		4	82	98	115	134	157	181	210
20	Surplus (held FV transfer to IMR)	-	4	43	66	89	101	135	170	210
21	Surplus (held amt cost transfer to IMR)		9	26	48	71	101	135	170	210

This scenario creates a windfall from derivatives in year 2 & 5 of $45 and $18. If there are no surrenders in year 2, this will create an unrealistic surplus bump in year 2, which may be consumed by a surrender in any of the following years, and hence should not be released into income or surplus at that time, similar holds for the value of the option that matures in year 5.

However, Lines 15 and 18 (highlighted in green) above show significantly smoother NII and Surplus when derivative gains are treated consistently with other fixed income and transferred to the IMR. Also, when derivatives are treated consistently with the rest of the assets and liabilities, there is no disconnect between income and surplus.

Scenario 4 – interest rates go up 300 bps and we see a 500 M surrender in year 4.

	Projection Year	T=0	1	2	3	4	5	6	7	8
	Treasury Rate	4.50%	4.50%	7.50%	7.50%	7.50%	7.50%	7.50%	7.50%	7.50%
	Asset Yield	5.50%	5.50%	8.50%	8.50%	8.50%	8.50%	8.50%	8.50%	8.50%
	Surrender Value	930	972	1,016	1,061	1,121	656	693	731	810
	Bond at Fair Value	986	1,041	1,006	1,092	685	767	833	903	170
	Assets									
1	Bond Book Value	986	1,041	1,150	1,215	739	806	853	903	170
2	Market Value of derivative	14	8	24	24	24		-	-	-
3	Total Asset Book Value	1,000	1,049	1,174	1,239	764	806	853	903	170
	Liabilities									
4	Account Value/Reserve	1,000	1,045	1,092	1,141	661	690	721	754	0
5	IMR Liability	-		38	32	(10)	6	4	2	-
	Surplus	-	4	43	66	113	110	128	147	170
	Net Income									
6	Interest Income	-	54	57	65	68	42	47	50	77
7	IMR Amortization (Derivative)	-	-	6	6	6	11	11	11	11
8	IMR Amortization (Bond)	-	-	-	-	(9)	(9)	(9)	(9)	(9)
9	Premium (Claim)	1,000	-	-	-	(500)	-	-	-	(810)
10	Change in Liability Reserve	(1,000)	(45)	(47)	(49)	481	(30)	(31)	(32)	754
11	G/L on Liquidated Bonds	-	-	-	-	(43.88)	-	-	-	-
12	Derivative Gain	-	0	45	0	0	18	0	0	0
13	Net Income (held FV no IMR)	-	9	55	16	40	22	7	9	11
14	Net Income (held FV transfer to IMR)	-	9	17	22	47	15	18	20	22
15	Net Income (held amt cost transfer to IMR)	-	9	17	22	47	15	18	20	22
16	Chg in Surplus (held FV no IMR)	-	4	78	16	40	4	7	9	11
17	Chg in Surplus (held FV transfer to IMR)	-	4	40	22	47	(3)	18	20	22
18	Chg in Surplus (held amt cost transfer to IMR	-	9	17	22	47	15	18	20	22
19	Surplus (held FV no IMR)	-	4	82	98	138	142	150	158	170
20	Surplus (held FV transfer to IMR)	-	4	43	66	113	110	128	147	170
21	Surplus (held amt cost transfer to IMR)	-	9	26	48	95	110	128	147	170

In this case, in year 1, we see the same surplus drag from the decay of market value as in the prior scenarios. We see the payout of the first option in year 2, before the surrender in year 4, creating outsized income and surplus in year 2 in lines 13, 16 & 17. If options are not included in IMR (line 16) there is a windfall in surplus in year 2 and there is a big drop in surplus in year 5. Treating derivatives consistently with assets and liabilities creates a much more reasonable profile of surplus and income, consistent with timing of the realization of the risk.

Scenario 5 - In Scenario 5 rate environment same as Scenario 4 but surrenders happen gradually starting in years 2 through 6.

	Projection Year	T=0	1	2	3	4	5	6	7	8
	Treasury Rate	4.50%	4.50%	7.50%	7.50%	7.50%	7.50%	7.50%	7.50%	7.50%
	Asset Yield	5.50%	5.50%	8.50%	8.50%	8.50%	8.50%	8.50%	8.50%	8.50%
	Surrender Value	930	972	1,016	852	689	516	334	247	274
	Bond at Fair Value	986	1,041	806	675	532	402	336	365	122
	Assets									
1	Bond Book Value	986	1,041	920	748	573	420	343	365	122
2	Market Value of derivative	14	8	24	24	24		-	-	-
3	Total Asset Book Value	1,000	1,049	944	772	598	420	343	365	122
	Liabilities									
4	Account Value/Reserve	1,000	1,045	877	701	520	333	244	255	0
5	IMR Liability		-	13	(9)	(21)	(11)	(9)	(5)	-
	Surplus	-	4	54	80	99	98	108	114	122
	Net Income									
6	Interest Income		54	57	52	43	33	26	22	31
7	IMR Amortization (Derivative)		-	6	6	6	11	11	11	11
8	IMR Amortization (Bond)		-	(4)	(8)	(12)	(15)	(16)	(16)	(16)
9	Premium (Claim)	1,000	-	(200)	(200)	(200)	(200)	(100)	-	(274)
10	Change in Liability Reserve	(1,000)	(45)	168	176	181	187	89	(11)	255
11	G/L on Liquidated Bonds		-	(30.10)	(23.74)	(17.55)	(11.54)	(2.84)	-	-
12	Derivative Gain		0	45	0	0	18	0	0	0
13	Net Income (held FV no IMR)		9	66	19	12	24	(1)	(5)	(4)
14	Net Income (held FV transfer to IMR)		9	27	26	19	17	10	6	7
15	Net Income (held amt cost transfer to IMR)		9	27	26	19	17	10	6	7
16	Chg in Surplus (held FV no IMR)		4	89	20	12	6	(1)	(5)	(4)
17	Chg in Surplus (held FV transfer to IMR)		4	51	26	19	(1)	10	6	7
18	Chg in Surplus (held amt cost transfer to IMR)		9	27	26	19	17	10	6	7
19	Surplus (held FV no IMR)		4	93	112	125	131	130	125	122
20	Surplus (held FV transfer to IMR)	-	4	54	80	99	98	108	114	122
21	Surplus (held amt cost transfer to IMR)		9	37	62	81	98	108	114	122

Here, with different emergence of losses on bonds and gains on the derivatives the surplus and income are much more volatile without the symmetrical reflection of derivatives gains and losses in IMR. Even though surrenders start to happen in year 2, when we see the first gain on the derivatives, there is still an overwhelming windfall from the derivatives because of how it is sized compared to the surrender. Lines 15 & 18, show a much more reasonable profile of net income and surplus emergence than holding at fair value without IMR treatment as shown on lines 13 &16.

Conclusion

In summary, the needs of US life insurers within the context of the US statutory accounting framework are broader than contemplated in the existing derivative and hedge accounting framework. The risks faced are often not fully visible within the financial statements, and therefore require additional risk management practices. The US GAAP hedge accounting framework does not adequately address these specific needs (i.e., *duration*, as it is not a true “balance sheet item”).

Insurers use derivatives to achieve the same results as buying and selling fixed income investments. Very often however, buying and selling fixed income investments would be inefficient, or the necessary investments do not exist. As fixed income investments are IMR eligible, and interest rate derivatives can be a substitute for them, removing IMR eligibility for their realized gains and losses would misalign the necessary economic picture insurers need to prudently enact their risk or ALM practices.

In order to avoid unintended disincentives against prudent behavior, all economically effective interest rate hedging derivatives should remain IMR eligible. Further, the hedge accounting effectiveness assessment requirements, at a minimum, should be revisited in relation to these hedging strategies so that impacts to surplus are appropriately recognized both during the derivatives’ life and at termination.

Appendix I – IMR in the context of Derivative Hedging Transactions

The applicability of the IMR construct to gains or losses from derivative hedging transactions flows from the concepts outlined in the earlier text. To illustrate its importance within plausible ALM strategies, the example outlined here assumes a more complex and realistic set of insurance liabilities.

Example 3

Assume Company XYZ issues life insurance contracts where the premiums come in each year until death and there is a payment upon death estimated to occur at the end of 5 years. Assume Company XYZ is again starting out with $10 of surplus invested in equity securities (again, assume no change in value over the period of valuation). The current interest rate environment is such that the fixed income bond yield and the insurance liability valuation rate are again both 4%, and Company XYZ:

- Sells 100 insurance contracts that pay $1 upon death for yearly premiums of 18.47 cents at the end of each year 1 through 5.
- Purchases bonds with a coupon rate of 4%, with all premiums and coupons received, maturing at the anticipated time of death in 5 years.
- Assume the market yield of 4% is constant throughout the 5-year period.

Company XYZ's balance sheet for each year, using a simplified net premium calculation for reserves, would look like Figure H.

Figure H						
	Assets			Liabilities and Surplus		
Year	Bonds	Equities	Total	Insurance Liability	Surplus	Total
1	18.47	10.00	28.47	18.47	10.00	28.47
2	37.67	10.00	47.67	37.67	10.00	47.67
3	57.64	10.00	67.64	57.64	10.00	67.64
4	78.40	10.00	88.40	78.40	10.00	88.40
5	100.00	10.00	110.00	100.00	10.00	110.00

Company XYZ can pay all claims on the policy and the balance sheet surplus appropriately reflects surplus at the end of each reporting period. In the real world with this more dynamic pool of liabilities, other changes could occur, such as one or multiple of:

- Interest rates could decline, and coupon and premium payments would not be able to be invested at 4%.
- Death benefits could be paid at a point in time greater than the invested bond maturity and if interest rates decline, the bond would not be able to be re-invested at 4%.
- Policy surrenders could occur, including due to changes in market interest rates, causing the claims patterns to change from expectations.

Amidst this real-world uncertainty, Company XYZ could consider any of the following risk mitigating activities, which inherently depend upon its mix of insurance liabilities:

- Accept the risk of future asset and liability cash flow fluctuations, which could result in an inability pay claims in certain situations. For instance, if interest rates declined, the coupon payments, premium payments, and/or maturities would not be able to be re-invested in fixed income investments that have sufficient yield to pay claims as expected.
- Charge higher premiums at inception to account for the reinvestment risk and *duration* risk associated with the insurance liabilities.

- Manage the investment portfolio to a prudent liability *duration* or any number of appropriate and prudent asset liability management (ALM) strategies.
- Prudently hedge with derivatives within the ALM strategy. Such derivative usage strategies are used where purchases are not viable or where it is more efficient to utilize derivatives.

If the derivative strategy is applied, the reinvestment risk could be hedged to lock in a 4% yield. When interest rates fluctuate, any gain or loss on the derivative offsets the lower or higher actual yield that is received on the reinvestments.

In Example 3, if interest rates plunged to 0% on day 2, Company XYZ would not be able to support the liabilities because future premiums and coupons would not be able to be reinvested at 4%. If Company XYZ had hedged reinvestment risk, they would have a gain on derivatives equal to the economic loss of not being able to invest at 4%. Similarly, if interest rates doubled to 8%, Company XYZ would have a loss on derivatives equal to the economic gain of now being able to invest at the much higher interest rate of 8%. In both cases, Company XYZ has hedged reinvestment risk and has not changed the solvency picture in Example 3.

In summary, IMR is appropriate for all types of fixed income investments, including derivatives which alter the interest rate characteristics of assets/liabilities, for all realized capital gains and losses which result from changes in the overall level of interest rates as they occur.

Appendix II – Glossary

These terms are commonly used in these strategies and/or included in the document, therefore are defined here for common understanding.

- "Duration" is a measure of interest rate sensitivity related to the sensitivity of the market value of an instrument for a given change in interest rates, when the entire curve is shifted. This may be based on MacAuley, modified, or effective duration metrics. Shocks may be based on par curve, spot curve, or other similar methods.
  $$Duration = \frac{PV_{CF}(Starting\ Yield\ Curve - 1bp) - PV_{CF}(Starting\ Yield\ Curve)}{PV_{CF}(Starting\ Yield\ Curve) * 0.0001} = \frac{\text{DV01}}{PV_{CF}(Starting\ Yield\ Curve) * 0.0001}$$
- "Convexity" is measure of the curvature of how price changes with respect to interest rates. Alternatively, it is the change in duration for changes in interest rates.
  $$Convexity = DV01(Starting\ Yield\ Curve - 1bp) - DV01\ (Starting\ Yield\ Curve)$$
- "Duration dollars" is a measure of interest rate sensitivity when the entire curve is shifted, and is the duration times the market value of an instrument.
- "DV01" is a measure of interest rate sensitivity of how much the market value of an instrument changes, in dollars or other currency, for a 1 bps move in rates when the entire curve is shifted. It may be calculated off of a larger shock and scaled to a 1 bp size.

  Dollar

  $$DV\underbrace{01}_{\textbf{1}\text{ Basis Point}} = PV_{CF}(Starting\ Yield\ Curve - 1bp) - PV_{CF}(Starting\ Yield\ Curve)$$

  Value

- "Key rate duration (KRD)" is similar to duration but represents the impact when a shock is applied to a specific bucket or set of maturities along the curve. The buckets to be used are not prescribed and can be determined by a given firm. The sum of all key rate exposures is very close to the overall duration
- "Key rate duration dollars" is similar to duration dollar but represents the impact when a shock is applied to a specific bucket or set of maturities along the curve. The buckets to be used are not prescribed and can be determined by a given firm.
- "Key rate DV01" is similar to DV01 but represents the impact when a shock is applied to a specific bucket or set of maturities along the curve. The buckets to be used are not prescribed and can be determined by a given firm.

Appendix II

Special Accounting Provision Proposal for Asset Liability Management (ALM) Derivatives

The "Derivatives and Hedging Under Life Insurance and the NAIC's Statutory Framework" memo concluded:

- In summary, the needs of US life insurers within the context of the US statutory accounting (US Stat) framework are broader than contemplated in the existing derivative and hedge accounting framework. The risks faced are often not fully visible within the financial statements, and therefore require additional risk management practices. The US GAAP hedge accounting framework does not adequately address these specific needs (i.e., ALM exposures, like duration, as they are not true "balance sheet items," but instead contribute to the volatility of other balance sheet items as financial markets move).

- Insurers use derivatives to achieve the same results as buying and selling fixed income investments. Very often however, buying and selling fixed income investments is inefficient or the necessary investments do not exist or are illiquid. As fixed income investments are IMR eligible, and interest rate derivatives can be a substitute for them, removing IMR eligibility for their realized gains and losses would misalign the appropriate economic portrayal of insurer solvency and be contrary to the goal of prudently enacting their risk management and ALM practices.

- To avoid unintended disincentives against prudent behavior, all derivative instruments that are economically effective in hedging interest rate risks should remain IMR eligible. Further, the accounting should be revisited in relation to these hedging strategies so that impacts to surplus are appropriately recognized both during the derivatives' life and at termination.

This document expands on the above conclusion that derivatives used in interest rate hedging should remain IMR eligible and proposes updates to accounting for derivative IMR that reflect the economics of hedging activities while still presenting financial statements that appropriately reflect financial condition.

Current State

In 2023, the NAIC adopted interim guidance that allows for the admission of negative IMR up to 10% of surplus (excluding DTA, goodwill, etc.), which may include negative IMR generated by interest related realized gains and losses on fair value derivatives (as long as positive IMR generated by derivatives was previously admitted by the insurance company).

Current guidance highlights (including the interim IMR guidance):

- Per IMR instructions (2023 NAIC Annual Statement Instructions for LAH companies, pages 343-357), it is appropriate to include hedges in IMR:
    - For derivative instruments used in hedging transactions, the determination of whether the capital gains/(losses) are allocable to the IMR or the AVR is based on how the underlying asset is treated

- Realized gains/(losses), on derivative transactions entered into solely for the purpose of altering the interest rate characteristics of the company's assets and/or liabilities (hedging transactions) should be allocated to the IMR and amortized over the life of the hedged assets

- Note: "hedging transactions" are defined as derivative transactions which reduce the risk of a change in fair value or cash flow of assets and liabilities (SSAP 86, paragraph 8) and not whether the derivative is deemed "qualified" under US STAT for hedge accounting treatment

- While industry practice varies, many companies amortize gains and losses generated by certain derivatives hedging interest rates through IMR over the average maturity of the invested assets in the hedged portfolio

- Derivatives that qualify for hedge accounting treatment are reported using the same valuation method as the hedged asset (i.e., a derivative hedging bonds will be held at amortized cost)

- Statutory accounting guidance does not allow for a hedge accounting model specific to or sufficient for ALM hedges
  - Therefore, to achieve hedge accounting, interest rate derivatives must be linked to specific assets or liabilities and prove to be highly effective at offsetting their changes in cash flows or fair value from interest rate movements.

  - As noted in previously referenced memos, many of these hedging programs are calibrated on a portfolio basis and the existing hedge accounting frameworks do not address this type of hedging construct (i.e., focused on more of a fixed "1x1" relationship construct, as opposed to a dynamic portfolio of assets and liabilities).

  - As a result, many insurance companies with ALM and portfolio duration hedging programs mark their derivatives to market through surplus (unrealized gains/losses) and reclass realized gains/losses to IMR at termination/maturity.
    - This causes surplus volatility that does not reflect the economics of the hedging transactions (which ironically are intended to mitigate surplus volatility; see examples in the previously referenced memo)

More specifically, three items have been proposed for review given perceived shortfalls in current statutory accounting related to derivative accounting and IMR:

1) Effectiveness assessment methods for ALM hedging,
2) Accounting for hedges entered into and maintained in a manner consistent with the definition of IMR without causing inappropriate surplus volatility, and
3) Guidelines for the amortization of derivatives gains or losses that have been deferred to IMR.

<u>Background</u>

Current derivative accounting under SSAP No. 86 includes four categories of derivatives, none of which include speculative derivatives (which are disallowed under state insurance laws):

1) Income Generation Transactions

Income generation transactions are defined as derivatives written or sold to generate additional income or return to the reporting entity. They include covered options, caps, and floors (e.g., a reporting entity writes an equity call option on stock that it already owns).

Noting derivatives cannot be speculative, per SSAP 86, paragraphs 47 and 48, as well as state derivatives laws, income generation transactions are limited to “covered” transactions.

Derivative gains and losses are based on how the underlying interest (for a put) or covering asset (for a call, cap or floor) is treated. Therefore, if the underlying/covering asset is IMR eligible (e.g., a bond), the derivative gains and losses go to IMR. If it is not IMR eligible (e.g., equity), the derivative gains or losses do not go to IMR.

2) Replication (Synthetic Asset) Transactions (RSATs)

RSATs are entered into in conjunction with other investments to reproduce the investment characteristics of otherwise permissible investments. Hedging or income generation transactions shall not be considered an RSAT. Derivative gains and losses follow those of the replicated investment. If it is IMR eligible, the derivative gains and losses go to IMR. If it is not IMR eligible, the derivative gains or losses do not go to IMR.

3) Other Derivatives (Derivatives that are not used in hedging, income generation, or replication transactions)

Other derivatives are non-admitted under statutory accounting, examples include structured notes or private warrants. Given that state insurance law does not allow companies to engage in speculation using derivative instruments, any derivatives included in this category must still comply with state insurance law, which defines them as derivatives not used for hedging, income generation, or replication. Therefore, by default, they must be one of the aforementioned examples or a similar such instrument.

4) Hedging Transactions

Hedging transactions are defined as derivatives which reduce the risk of a change in fair value or cash flow of assets and liabilities. As mentioned previously, all hedges must be legally effective to comply with state insurance laws, and companies are not allowed to speculate using derivatives. There is no additional or prescriptive effectiveness assessment requirement within SSAP No. 86, unless companies elect hedge accounting under SSAP No. 86 or 108 (see additional detail below).

The US Stat framework for hedging transactions is largely aligned with US GAAP accounting, with a few variations due to the broader valuation standards within the accounting frameworks (ie., amortized cost versus fair value). Hedging transactions that do not attain hedge accounting are carried at market value with unrealized gains and losses in surplus (under US Stat). This is aligned with US GAAP, except that US GAAP allows reporting of unrealized gains/losses within the P&L. US Stat does not use these concepts. Hereafter the “default” hedging transactions that are not designated as Hedge Accounting under SSAP No. 86 or 108 will be referred to as “Other Economic Hedges”.

The concept of “Hedge Accounting” (hereafter referred to as “HA Hedges”), a specific subset of hedging derivatives meeting prescriptive requirements, exists in both US Stat (SSAP No. 86 and 108) and US GAAP frameworks (and is also consistent with other accounting frameworks). Under US Stat, hedges for which the entity both elects the treatment and which “meet the criteria of a highly effective hedge shall be considered an effective hedge and are permitted to be valued and reported in a manner that is consistent with the hedged asset or liability.” Under US GAAP accounting, the derivative is carried at fair value regardless of its characterization as a HA Hedge. However, US GAAP HA Hedges receive a geography match, by which the derivative accounting appears in the same financial statement line as the hedged item. Additionally, under US GAAP, the balance sheet is largely carried at fair value for certain investments, so prudent hedging strategies can more easily achieve their purpose of both financial statement and economic risk and volatility mitigation even without hedge accounting treatment.

Under US Stat, any derivative in a HA Hedge relationship is permitted to be valued and reported in a manner that is consistent with the hedged asset or liability (there is nuance between SSAP No 86 and 108, but these are both effectively amortized cost when considering the direct accounting impact of the derivative(s) within surplus). As discussed in previous papers, this typically leads to amortized cost accounting (or a form of amortized cost accounting) for interest rate related hedges of assets and liabilities. However, if the derivative cannot achieve, or if the entity does not elect, hedge accounting there is an accounting mismatch between the hedging instrument (derivative at fair value) and the hedged item (asset or liability, often at amortized cost). This means the same prudent transaction would generally reduce volatility under US GAAP (as both are generally mark-to-market, albeit not within the same financial statement line), may actually introduce volatility under US Stat (as the hedged item is typically amortized cost and the derivative is mark-to-market).

While there is some nuance between SSAP 86 and SSAP 108, specifically within the hedge documentation requirements and actual accounting methodology, both could be considered a form of an amortized cost methodology. As a very high-level summary, one method could be thought of as “off Balance Sheet” amortized cost (SSAP No 86) and one method could be thought of as “grossed up Balance Sheet” amortized cost (SSAP No 108). However, both methods ensure that the matched derivative mark-to-market volatility (which is unrealized) is not reflected in surplus.

Many companies treat interest related gains and losses from both Other Economic Hedges and HA Hedges as IMR eligible due to the historical documentation of IMR which noted that:

> *Realized gains and losses on derivatives investments, which alter the interest rate characteristics of assets/liabilities, also are allocated to the IMR and are to be amortized into income over the life of the associated assets/liabilities.*

Additionally, for HA Hedges of bonds under SSAP No 86, if the derivative is terminated when the bond is sold, gains and losses on the derivative follow and are aligned with the treatment of the bond’s gains and losses. If only the derivative is terminated, the derivative gain/loss can either adjust the basis of the bond or be deferred to the IMR. This is consistent with the interpretation from the IMR instructions, which state:

> *For derivative instruments used in hedging transactions, the determination of whether the capital gains (losses) are allocable to the IMR or the AVR is based on how the underlying asset is treated. Realized gains (losses) on portfolio or general hedging instruments should be included with the hedged asset. Gains (losses) on hedges used, as specific hedges should be included only if the specific hedged asset is sold or disposed of.*

As stated, insurance companies are often subject to Derivatives Use Plans (many with annual Agreed Upon Procedures by audit firms) filed with regulators. Any Income Generation, RSAT, and Hedging derivatives should not be considered Other Derivatives (and therefore non-admitted) as this would misstate solvency and disincentivize prudent risk management of insurers.

Given the wide variety of prudent hedging strategies required and employed by life insurers, the framework for assessing their effectiveness must be sufficiently flexible, while providing meaningful information to regulators as to their effectiveness. Therefore, it may be best to use the economic hedging framework within SSAP No. 108 for variable annuities where the embedded derivatives on VAs are not marked-to-market, while derivatives hedging the VA risk are. A proposal for requirements to qualify for a special accounting provision for ALM derivatives which effectively hedge interest rate risk is included below.

This proposal should be a company election on an individual program basis. Any Hedging derivatives utilized by the company which either do not meet the provision's criteria or those for which the company does not elect the provision (akin to the election and qualification process for Hedge Accounting under SSAP No. 86 and the special accounting provision under SSAP No. 108), would be considered as Other Economic Hedges under SSAP No. 86 (carried at fair value and gains/losses would not be IMR eligible).

ALM Hedging Derivatives Proposal

Due to uneconomic volatility caused by economical and precise hedges, as well as to prevent concerns related to the transformation of negative surplus to assets, we propose the following solution. This special accounting provision is intended for derivative transactions that alter the interest rate characteristics of assets/liabilities under risk mitigation programs. More specifically, "macro-hedging" ALM programs (which hedge risks that are often not true balance sheet items) and therefore hedge accounting frameworks do not address this type of hedging construct. This is because the duration and convexity of asset and liability may differ and when interest rates change, asset and liability duration may change by different amounts. Companies manage ALM programs to mitigate reinvestment, guarantee, and disintermediation risks, and to manage asset portfolios within limited ranges around a liability target duration. For these derivative transactions to be IMR eligible, they need to hedge assets/liabilities within the context of the definition and purpose of IMR; that is, to provide consistency between asset and liability measurement so solvency is accurately reflected.

If this proposal becomes effective, any existing programs with active derivatives could be redesignated (at the proposal implementation/effective date) to the solution proposed herein so as not to cause unintended consequences or disqualify existing programs. ACLI would work with NAIC Staff to determine appropriate accounting for the transition date.

Definition and Purpose of IMR

IMR is a valuation adjustment to maintain consistency between insurance liabilities (the assumptions for which are often unchanged from origin) and the assets needed to support them (where the assumptions can essentially be revisited any time there are fixed income realizations).

IMR defers and amortizes the recognition of non-economic gains or losses where investment activity, whether through fixed income investment sales or fixed income derivative hedging transactions, essentially unlock unrealized gains/losses for either assets or liabilities. IMR is not intended to defer economic gains and losses related to asset sales compelled by liquidity pressures that fund significant cash outflows (e.g., such as excess withdrawals and collateral calls).

Specifically, the IMR valuation adjustment more appropriately reflects the impact to statutory surplus from fluctuations in interest rates and therefore provides a more accurate representation of solvency under the NAIC's statutory framework which often includes amortized cost valuation of fixed income investments and liability valuations with fixed assumptions in accordance with the Accounting Practices and Procedures and Valuation Manual.

Program Parameters and Documentation

The entity must document and follow a Clearly Defined Hedging Strategy (CDHS) for each ALM hedging program, which, at a minimum, must identify:

A. Specific risks being hedged,
B. Hedge objectives,
C. Risks not being hedged,
D. Financial instruments that will be used to hedge the risks (incorporating all potential instruments),
E. Hedge trading rules, including permitted tolerance from hedging objectives,
F. Metric(s) used for measuring hedge effectiveness,
G. Criteria that will be used to measure effectiveness,
H. Frequency of measuring hedging effectiveness,
I. Conditions under which hedging will not take place, and
J. The individuals responsible for implementing the hedging strategy.

The ALM hedging program may be based at a legal entity, product, segment, portfolio, investment strategy, or similar level. Any assessment should be completed at the overall ALM hedging program level and must include all hedged items (assets and/or liabilities) and hedging instruments (derivatives) within each program (aligned with the specifications within the program's CDHS). Specifically, the company should specify in advance the criteria that are being used to test for effectiveness. For example, companies could focus on duration, duration dollars, DV01, key rate durations, key rate duration dollars, and key rate DV01s, among other measures, for this approach (the latter referred to as "Allowed Metric"). At a minimum, one metric needs to be identified. Alternatively, a company may focus on a modeled downside risk measure over a range of interest rate scenarios to show a reduction in risk, such as n-th percentile or conditional tail expectation on the present value of ending surplus (PVES) or similar metric (referred to as "Allowed Modeled Metric.")

The portfolio of derivative positions meeting the quantitative assessment requirements would be eligible for the proposed special accounting provision.

Documentation required at inception

The Company must document the calculation and measured values for their records in support of initial qualification of the hedging activity/program. There should be a clear determination, in advance of the inception of the program or the trade (if one-off), that the intent of that program/position is to manage the risks noted below. This could include, but is not limited to, identifying a portfolio or other tagging approach to which all derivatives assigned to it would be included. Trades must be designated as included within the ALM hedging program at their inception (except any noted at the time of the transition, which will be identified at transition). Such documentation should be available for review by the firm's external auditor or domiciliary regulator.

Documentation required at each reporting period

Quantitative effectiveness assessment must occur and be documented at the beginning and end of each reporting period (at a minimum, at least every three months). All derivatives within the designated ALM program must be effective at both measurements to qualify for this special accounting provision. The selected effectiveness assessment and allowed metrics must be specified in the inception documentation (CDHS), see additional details in the "Effectiveness Assessment" section.

<u>Effectiveness Assessment</u>

The designated portfolio of assets, liabilities, and derivatives comprising a CDHS within this special accounting provision require a quantitative assessment at the beginning and end of each reporting period (at a minimum, at least every three months). Metric and assessment level (legal entity, etc.) should be consistent with prior periods and how the hedges are calibrated. Changes should be supported by changes in business conditions and hedging strategies and should be infrequent (e.g., not every quarter), with any changes documented in the CDHS (including the effective date of the change and the rationale details for the change). Given that exposure amounts can change day-over-day due to new sales, surrenders, interest rate moves, etc., it is acceptable for a quantitative assessment to reference metrics that are within three months of the assessment.

ALM Hedging Programs under this proposal will follow the guidance in SSAP No. 86, paragraph 23 and 40, as well as Exhibit A, regarding the effectiveness of the derivatives and any excluded components. The inception documentation (CDHS) and any assessment will clearly indicate which component(s) are excluded (e.g., foreign currency rates).

Definitions:

- L – the portfolio of liabilities hedged
- A – the portfolio of assets backing liabilities L (excluding derivatives)
- D – the portfolio of derivatives that is hedging the residual ALM exposure of assets and liabilities.
- M(x) – the Allowed Metric for L, A, D, or any linear combination of the three

Example Assessment Metrics:

1. *"ALM Risk Reduction Approach"*
   - In this approach, the company is reducing the mismatches between identified assets and liabilities. The requirement is that the trades that are part of the designated program reduce the risk that would exist without the program. There is not a requirement to offset the entire mismatch. Derivatives for a given strategy or program would be considered on an aggregate basis in terms of the duration metric that is being hedged. The interest rate risk exposure for the chosen metrics for derivatives are measured consistently with the same metrics for the Hedged Item.
   - The requirement would be that trades in D are such that Portfolio D under the designated program would reduce the risk in the portfolio of A & L that would exist without the program such that under above definitions: $|M(A)-M(L)| \geq |M(A+D)-M(L)|$, where $|X|$ = Absolute Value of X.
   - Alternatively, a company may rely on actuarial modeling over a range of interest rate scenarios to show a reduction in an Allowed Modeled Metric. The requirement would be that the Allowed Modeled Metric is improved when performing the modeling on A+D (assets including the hedging derivatives), compared to only modeling with A (assets excluding the hedging derivatives).

2. *"ALM Limit Management Approach"*
   - In this approach, the company is using derivatives to help keep an asset portfolio aligned with a duration or key rate duration target or threshold, backing a liability need. Using interest rate derivatives can be akin to buying/selling bonds, can be a more efficient way to keep the portfolio aligned with target durations, while also providing for investment flexibility.
   - The liability target or threshold should be determined to align with the interest rate-related objectives for that given liability and/or the Specified Portfolio backing some or all of the assets of that liability. This target or threshold should be communicated based on an Allowed Metric. It is acceptable for the target or threshold to be represented in a number of ways, such as: a specific point metric, a calculation, a formula, a market-based investment index (like the Bloomberg US Aggregate bond index), or a customized version of a market-based investment index.
   - Portfolio D under the designated program must comply with the following definition of staying within a limit P: $|M(A+D)-M(L)| < P$.
   - The limit P can be specified as a certain percentage of either M(A) or M(L), or just as an absolute number defined and governed by the company's Risk or Asset Liability Management Committee (or similar oversight Committee function).

<u>Accounting</u>

ACLI proposes three different possible accounting methods for derivatives which qualify under effective ALM hedging programs. Two approaches are modeled from existing derivative accounting guidance, and one approach is new. The following table illustrates the methodologies, with example journal entries to further illustrate and compare the potential accounting methods.

Note Method 3 is intended to incorporate the “total” derivative (both changes in FV and interest accruals) to treat all derivative instruments equally. Methods 1 and 2 do not incorporate changes in interest accruals within the unrealized gains/losses discussed below.

	Amortized Cost (Method 1)	**Defer Unrealized (Method 2)**	**Mark and Spread (Method 3)**
Precedent Guidance	Yes – same as SSAP No. 86 (qualified accounting hedges)	Yes – similar to SSAP No. 108	No – New method
Description	Derivatives carried at amortized cost (following the accounting treatment of the hedged items).	Derivatives carried at fair value, but any unrealized gains/losses are deferred to a different Balance Sheet account as opposed to recognized in surplus.	Derivatives carried at fair value, but any unrealized gains/losses are deferred to a different Balance Sheet account, as opposed to recognized in surplus, with amortization beginning immediately.
Derivative Basis (Carry Value)	Amortized Cost	Fair Value	Fair Value
Unrealized Gain/Loss Treatment	Not recognized until termination	Deferral Account until termination	Deferral Account with amortization through income beginning immediately
Realized Gain/Loss Treatment	Deferred to and amortized through the IMR	Deferred to and amortized through the IMR	Deferred to and amortized through the Deferral Account (same treatment as IMR)

The following table highlights differences between the methodologies:

	Amortized Cost (Method 1)	**Defer Unrealized (Method 2)**	**Mark and Spread (Method 3)**
Better Economic and Accounting Alignment?	Yes	Yes	Yes
Discretionary surplus changes (realized losses reclass from surplus to asset)	Virtually all eliminated (potential discretion on timing of realization, but no surplus impact)	Virtually all eliminated (potential discretion on timing of realization, but no surplus impact)	All eliminated (all derivatives treated as terminated each reporting period end)
Derivative Fair Value on Balance Sheet?	No	Yes	Yes
Derivative Unrealized (MTM) in Surplus?	No	No	No (current period amortization only)
Do Derivative and Hedged Portfolio accounting align?	Yes	Somewhat (Unrealized not reflected in surplus, net carry value approximates amortized cost)	Somewhat (Amortization is aligned)

The following simplified journal entries highlight each of the above methods:

Method 1	
Amortized Cost (URGL/RGL recognized only at termination, then amortized)	
Change in Value Example Entries:	
Change in Value	
N/A	
Amortization (subsequent quarter)	
N/A	
Termination Example Entries:	
Termination	
DR-CR: Cash	*surplus neutral*
DR-CR: IMR	*(simplified RCGL to IMR)*
Amortization (subsequent quarter)	
DR-CR: IMR	*surplus impact*
DR-CR: Net Investment Income	*over amort period*
Note-surplus impacts in year of termination limited (e.g., assuming 10-year life and mid-year termination, only 5% of g/l impacts surplus; so discretionary surplus changes materially eliminated)	

Method 2	
Fair Value Deferred (amortized upon termination)	
Change in Value Example Entries:	
Change in Value	
DR-CR: Derivative Asset/Liab	*surplus neutral*
DR-CR: Deferred Asset/Liab	
Amortization (subsequent quarter)	
N/A	
Termination Example Entries:	
Termination	
DR-CR: Cash	*surplus neutral*
DR-CR: Derivative Asset/Liab	
DR-CR: Deferred Asset/Liab	*surplus neutral*
DR-CR: IMR	*(simplified RCGL to IMR)*
Amortization (subsequent quarter)	
DR-CR: IMR	*surplus impact*
DR-CR: Net Investment Income	*over amort period*
Note-surplus impacts in year of termination limited (e.g., assuming 10-year life and mid-year termination, only 5% of g/l impacts surplus; so discretionary surplus changes materially eliminated)	

Method 3	
Mark & Spread (MTM and defer each quarter, begin amortization the following quarter regardless of termination)	
Change in Value Example Entries:	
Change in Value	
DR-CR: Derivative Asset/Liab	*surplus neutral*
DR-CR: Deferred Asset/Liab	
Change in value includes entire fair value of derivative instrument (clean value plus accrued income)	
Amortization (subsequent quarter)	
DR-CR: Deferred Asset/Liab	*surplus impact*
DR-CR: Net Investment Income	*over amort period*
derivative is remeasured each reporting period, with any chg in value amortized starting in the subsequent qtr (regardless of termination)	
Termination Example Entries:	
Termination	
DR-CR: Cash	*surplus neutral*
DR-CR: Derivative Asset/Liab	
Amortization (subsequent quarter)	
N/A (already occurring)	
Notes-amortization is independent of termination, so discretionary surplus changes eliminated	
At termination, any change in value (realized gain/loss) would continue to be recognized in the Deferred Asset/Liab account and amortized, which is the same treatment as deferring to IMR and amortizing.	
Propose a separate deferral account (similar to SSAP No. 108, however could utilize IMR)	

Method 1	
Amortized Cost (URGL/RGL recognized only at termination, then amortized)	
Using SSAP No. 86 as a guide:	
De-Designation Example Entries:	
De-designation	
DR-CR: Derivative Asset/Liab	*current value*
DR-CR: IMR	*(surplus neutral)*
Start amortizing	
Subsequent Accounting (MTM)	
DR-CR: Derivative Asset/Liab	*(prospective MTM in URGL*
DR-CR: URGL (Surplus)	*no addl IMR when RGL)*

Method 2	
Fair Value Deferred (amortized upon termination)	
De-Designation Example Entries:	
De-designation	
DR-CR: Deferred Asset/Liab	*reclass deferral to IMR*
DR-CR: IMR	*(surplus neutral)*
Start amortizing	
Subsequent Accounting (MTM)	
DR-CR: Derivative Asset/Liab	*(prospective MTM in URGL*
DR-CR: URGL (Surplus)	*no addl IMR when RGL)*

Method 3	
Mark & Spread (MTM and defer each quarter, begin amortization the following quarter regardless of termination)	
De-Designation Example Entries:	
De-designation	
No entry or surplus impact (Deferral already booked)	
Amortizion already occurring	
Subsequent Accounting (MTM)	
DR-CR: Derivative Asset/Liab	*(prospective MTM in URGL*
DR-CR: URGL (Surplus)	*no addl IMR when RGL)*

Regardless of the selected individual accounting method for ALM hedging program, any realized gain or loss at termination or de-designation is not permitted to adjust the basis of the hedged item (per SSAP No. 86 paragraph 24). Basis adjustments are limited to derivatives in Hedge Accounting relationships as specified in existing SSAP No. 86 guidance.

Along with each proposal above, ACLI would work with NAIC staff to create additional footnote disclosures and/or updates to Schedule DB. For example, for methods 2 and 3, additional disclosures could be added to separately report the balance carried in the IMR. New Schedule DB categories could be considered for any of the methods (e.g., new reporting categories similar to those added for SSAP No. 108).

IMR Amortization

ACLI acknowledges the diversity in practice for the amortization period used for any hedging derivatives' realized gain/loss after deferral to the IMR. However, this is due to how insurers view the risks hedged and their specific ALM hedging programs. To create industry uniformity, ACLI has highlighted two common amortization periods for discussion, with the intent to include both or one method in the final special accounting provision guidance.

The applicable amortization method would apply to realized gains/losses from the selected accounting methodology (applicable to Methods 1, 2, and 3), as well as for any deferred unrealized gains/losses under Method 3 (within the "Deferred Asset/Liability" account as illustrated within the sample journal entries above).

Possible amortization periods for this special accounting provision are summarized below:

- Proposed Amortization Period 1: Life of the underlying/referenced item: Utilize the underlying or referenced item, which may differ from the life of the derivative contract itself (ie., gains/losses from a 3-month futures contract on a 5-Year T-Note would be amortized over a 5-year period)

  This method would tie to the underlying risk being managed by the derivative and creates a similar outcome as if a company had used cash bond transactions to achieve the same interest rate exposure. This method is preferrable to using a single maturity assumption or the average duration of the hedged portfolio, as it more closely ties to the specific intent of a given derivative. Given that bonds (and derivatives) in the portfolio can each cover specific cash flow and key rate duration objectives for the liability(ies), tying the amortization period for derivatives to the underlying/referenced item most accurately aligns with the interest rate exposures being managed.

  For instance, if an insurer trades ultra-bond futures to manage interest rate exposure at the 30-year point of the curve, this method would align with the deliverable basket of the bond future (25+ years). It would be similar to an insurer instead buying 30-year bonds. If the insurer uses bond forwards or forward starting interest rate swaps to manage reinvestment risk into long duration assets, the underlying bond or swap tenor aligns with the liability need being hedged and with the assets that would eventually be purchased on the other side of the hedge creating a smooth income pattern. When using a swaption to manage interest rate risks, the underlying swap that the trade is exercisable into is the exposure period being managed and aligns with managing price risk on a similar-tenor bond in the portfolio.

- Proposed Amortization Period 2: Average duration of the hedged portfolio (assets or liabilities): Utilize the duration of the assets or liabilities identified in the Program (must specify which population will be referenced and how often it will be calculated)

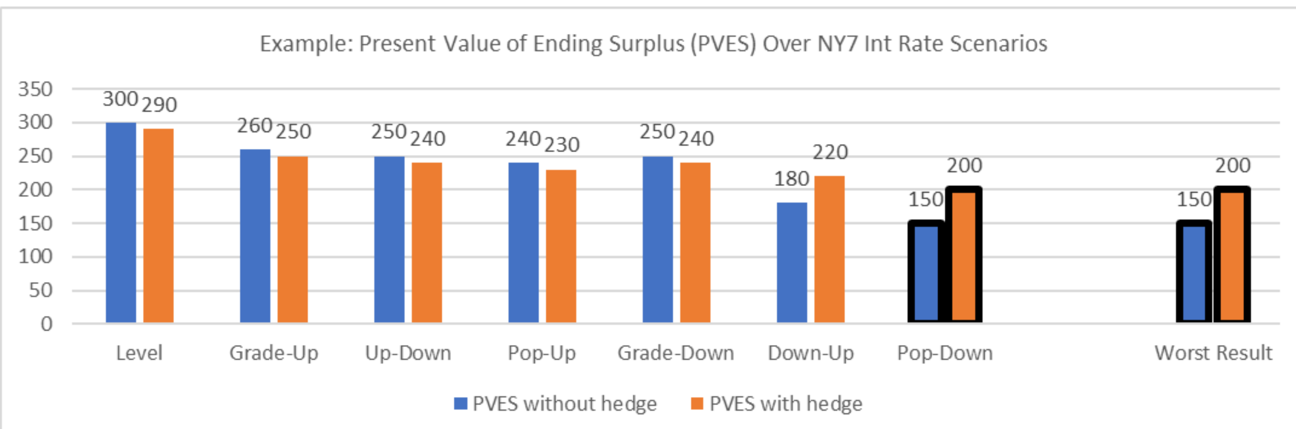
These types of ALM hedging programs are most often focused on a combination of static and dynamic activities to reduce the key rate DV01/duration mismatches between assets and liabilities. Therefore, the optimal amortization method would allow us to reflect these mismatches properly. However, to amortize over the mismatch (or DV01/duration gap between assets and liabilities), would likely be too complicated, as the mismatches can change more frequently, and can migrate over time. Therefore, the next best thing is the weighted average life (WAL) or duration of the liabilities, as that represents the set of cashflows that the portfolio of cash bonds and derivatives is intended to defease. A company could also choose to utilize the duration of the assets supporting the liabilities. This method also eliminates having different amortization periods based on the use of different derivative instruments.

Appendix: Example of an Allowed Modeled Metric to Show Effectiveness

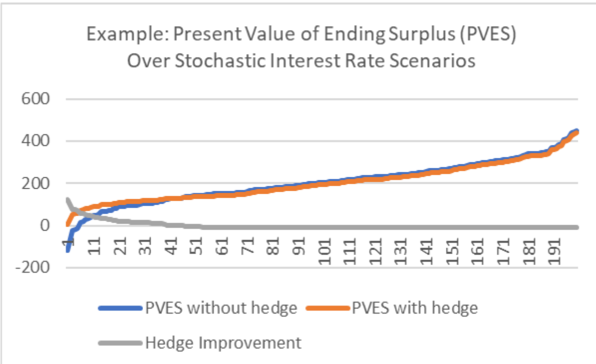
The use of an Allowed Modeled Metric can be a useful way to show hedge effectiveness. The example below shows hypothetical results under deterministic and stochastic interest rate scenarios, with and without a hedge. Metrics like the worst Present Value of Ending Surplus (PVES) outcome over a set of NY7 interest rate scenarios, or the 90th percentile outcome over a range of stochastic interest rate scenarios can be a good way to illustrate the benefit of these types of hedging instruments. While these aren't the only metrics that a company could focus on, these are used in the illustrations below.

Consider a company that has issued an annuity product with an embedded minimum interest rate guarantee. They will be subject to downside risk in the event interest rates decline. They could purchase interest rate floors or receiver swaptions as a hedge against this risk. They would pay an upfront premium (reducing the PVES in most "good" scenarios) and would see a benefit of a hedge payout (increasing the PVES in the worst scenarios). This type of hedge can help to support guarantees, protect against the risk of reserve deficiencies, and reduce income volatility - which are desirable outcomes for all stakeholders.

The first chart shows hypothetical modeled results over a set of deterministic interest rate scenarios like the NY7, and an improvement in "Worst Result" from the unhedged product (blue) compared to with the hedge (orange).



The second chart shows hypothetical modeled results over a set of stochastic scenarios, including the reduced downside risk (PVES improvement in the left side of the distribution). Additionally, the table below shows improvement in some potential Allowed Modeled Metrics that a company may consider using based on the distribution of modeled results.



	PVES Without Hedge	PVES With Hedge	Hedge Improvement
90th %ile	81	106	24
95th %ile	37	84	46
99th %ile	-61	34	96
80 CTE	65	98	32
90 CTE	27	78	52
95 CTE	-10	60	70
99 CTE	-89	21	109

Appendix III

Definition and Purpose of the Interest Maintenance Reserve (IMR)

The intent of this document is to offer a theoretical definition and purpose of IMR within the context of the U.S. Statutory Framework so that specific IMR-related issues can be addressed in future sessions of the Ad Hoc Technical Working Group from a mutually agreed upon foundation. In summary, the conceptual development of IMR recognized the need for a valuation adjustment to ensure consistent treatment of assets and liabilities and an accurate presentation of solvency amid fluctuations in interest rates. Illustrative examples further illuminate the necessity of an IMR for both positive and negative balances within the context of such a framework. After such a conceptual grounding, IMR is then considered in tandem with the more recent development of Principles-based Reserves (PBR) in Appendix 1 with Asset Adequacy Testing (AAT) in Appendix 2 and with Derivatives in Appendix 3 ensuring no inconsistencies need to be separately addressed.

The Objective of the Statutory Framework and the Necessity of IMR

The most important and fundamental purpose of the Statutory Statements is to provide basic financial information focusing on solvency. It must provide regulators (and management) the tools to monitor and ensure policy and contract holder obligations can be met when they come due. To that end, "the valuation of assets and liabilities proceeds on the assumption that the insurer is a going concern" and "valuation is not done on a liquidation basis."[2]

<u>Liability Valuation</u>

In keeping with the focus on solvency and conservatism, the prudent valuation of long duration insurance liabilities needs to be determined. Because insurance liabilities generally do not have a deep and wide market, their valuation is dependent on assumptions, calculations, and/or models. A market-consistent approach to liability valuation can be challenging to develop, is highly sensitive to the assumptions used, and can over rely upon or misapply current market conditions. These challenges can distort financial solvency and inhibit companies from issuing long duration insurance products. A market-consistent approach has not been adopted in the U.S. Statutory framework.

The Statutory framework's amortized cost valuation approach utilizes conservative methodologies and assumptions. In many cases, these conservative methodologies and assumptions are determined at origin and may not be changed over the entire course of the liability. As the U.S. Statutory framework has evolved, additional/new valuation approaches have been introduced (e.g., PBR). Regardless of the specific approach, the U.S. Statutory framework has remained focused on ensuring the company's long-term solvency in a stable, durable, and conservative manner.

<u>Asset Valuation</u>

To support their insurance liabilities and ensure solvency, companies need to invest their assets such that they have a very high probability of paying contractual liabilities when they become due. For long-duration liabilities, these investments are predominantly in conservative fixed income assets. To accurately assess whether a company can fulfill its obligations, its liabilities and assets must be presented on a financially integrated and consistent basis.

In the Statutory framework, asset valuations for fixed income securities are primarily based on amortized cost accounting principles. Here the valuations reflect the market available yields (interest rates) and outlook at the time of purchase. They

[2] "Asset Valuation Reserves and Interest Maintenance Reserves, Blue Book, December 2002". Report to the NAIC Financial Condition Committee.

are generally not revisited for changes in interest rates (only for impairment). The amortized cost asset valuation approach maintains consistency with the valuation of liabilities. It also limits the use of market values, which are not always observable or reliable across the spectrum of assets insurance companies hold in support of their liabilities.

However, if an asset is sold and a new asset is purchased, the company effectively "unlocks" the yield and reflects the current market available yield in the asset valuation. The liability assumptions, as explained earlier, cannot be readily adjusted in the same manner. Because of this potential for inconsistent asset and liability valuations, the company's financial statements could provide false indicators of financial strength or of financial weakness. Concerns related to this dynamic led to the development of a prudent and innovative valuation adjustment concept within the Statutory framework: the Interest Maintenance Reserve.

<u>Interest Maintenance Reserve</u>

The original E Committee report lays out many considerations reviewed during its development of IMR, and it summarizes the IMR as:

> *The Interest Maintenance Reserve (IMR) - captures for all types of fixed income investments, all of the realized capital gains and losses which result from changes in the overall level of interest rates as they occur. Once captured, these capital gains or losses are amortized into income over the remaining life (period to maturity) of the investments sold. Realized gains and losses on derivative investments, which alter the interest rate characteristics of assets/liabilities, also are allocated to the IMR and are to be amortized into income over the life of the associated assets/liabilities.* [3]

Ultimately, the IMR facilitates better alignment of the timing of interest rate related gain/loss realizations on certain fixed income investments with the interest rate assumptions embedded in the policyholder liabilities they support. The IMR was developed to complement existing valuation practices, rather than replace them, and subsequent updates to valuation methodologies considered IMR in their development.

There are times when IMR treatment of an interest-related gain or loss would not be appropriate; for instance, if assets are sold to fund excess withdrawals or surrenders or to meet other significant expenses, collateral calls, etc. In general, the IMR is only appropriate for fixed income gains and losses from a portfolio of assets that support existing insurance liabilities.

Applicable Illustrative Examples

Illustrative examples are useful for understanding the concepts underpinning IMR. The following examples are simplified (e.g., the role asset adequacy testing plays in the valuation of liabilities is ignored), but they illustrate the implications of the valuation concepts involved in the IMR's development. They can then be appropriately extrapolated to the more complex insurance contracts and reserve methodologies.

[3] "Asset Valuation Reserves and Interest Maintenance Reserves, Blue Book, December 2002". Report to the NAIC Financial Condition Committee.

Example 1

Assume Company XYZ starts out with $10 of surplus invested in equity securities with no change in value over the period of valuation. The prevailing interest rate environment is such that the fixed income bond yield and the insurance liability valuation rate are both 4%, and Company XYZ:

- Sells an insurance contract that pays $100 at the end of ten years as well as pays $4 at the end of years 1 – 10 for $100 dollars of premium received today.
- Purchases a 10-year bond with a coupon rate of 4% to support the liability.

Under statutory accounting, Company XYZ's balance sheet would look like Figure A.

Figure A			
Assets		Liabilities and Surplus	
Bonds	100	Insurance liability	100
Equities	10	Surplus	10
Total Assets	110	Liabilities & Surplus	110

Next, assume that bond yields drop to 2% immediately after Company XYZ purchases the bond. Company XYZ's balance sheet would not change, although the bond is now valued at $118. From a statutory solvency perspective, there is no concern with the balance sheet because the bond can fund the liability and the financial statements are reported on a financially integrated basis and accurately reflect solvency.

Later that day, assume Company XYZ sells the bond and immediately invests the proceeds in a new 10-year bond of the same credit quality with a coupon rate of 2%. Par value would now be $118. Company XYZ's balance sheet, without the Interest Maintenance Reserve concept (or performing asset adequacy analysis), would now look like Figure B.

Figure B			
Assets		Liabilities and Surplus	
Bonds	118	Insurance liability	100
Equities	10	Surplus	28
Total Assets	128	Liabilities & Surplus	128

Without IMR, Company XYZ's balance sheet shows an illusory increase in surplus as the bond has essentially been marked to market at $118 but the insurance liability is unchanged. The bond's coupon payments are now insufficient to meet policyholder obligations, and the company may have to sell a portion of the bond every year to meet its yearly obligation.

To further illustrate the solvency distortion absent the IMR, assume Company XYZ sells $18 of the bond and dividends the $18 to its owners. Its balance sheet in Figure C would show the company still appearing solvent.

Figure C			
Assets		Liabilities and Surplus	
Bonds	100	Insurance liability	100
Equities	10	Surplus	10
Total Assets	110	Liabilities & Surplus	110

However, the total shortfall (without adjusting for minor interest effects) as the liability runs off would be:

Total of yearly (40) and final (100) payments owed policyholder	(140)
Total bond interest payments (20) and maturity (100)	120
Total equity sale	10
Total shortfall including sale of surplus assets	(10)

As discussed earlier, the IMR was developed to address the marking to market of assets upon sale, where the liabilities are unchanged, with a valuation adjustment (IMR) so that the Statutory framework can value both assets and liabilities on a consistent basis. With IMR, the inappropriate portrayal of solvency in Figures B and C would not occur. More importantly, the inappropriate dividend would not have been able to occur, and the balance sheet would instead look like Figure D.

Figure D			
Assets		Liabilities and Surplus	
Bonds	118	Insurance liability	100
Equities	10	IMR	18
Total Assets	128	Surplus	10
		Liabilities & Surplus	128

Example 2

After demonstrating the importance of IMR in a declining interest rate environment in Example 1, Example 2 demonstrates its importance in a rising interest rate environment. For Company XYZ, assume the same starting position as Example 1. Immediately after purchasing the bond, the bond yield increases to 6%. Company XYZ's balance sheet would not change although the bond now has a market value of $85. From a statutory solvency perspective, there is no concern with the balance sheet valuation because the bond can fund the liability and the financial statements are reported on a financially integrated basis and accurately reflect solvency.

Later that day, assume Company XYZ sells the bond and immediately invests the proceeds in a 10-year bond of the same credit quality with a coupon rate of 6%. Par value would now be $85. Company XYZ's balance sheet, without IMR, would look like Figure E.

Figure E			
Assets		Liabilities and Surplus	
Bonds	85	Insurance liability	100
Equities	10	Surplus	(5)
Total Assets	95	Liabilities & Surplus	95

Company XYZ's balance sheet now shows illusory decreased financial strength as the bond has essentially been marked to market at $85 but the insurance liabilities are unchanged. The company could still fund the liability by retaining and investing the increased bond coupons received. The total surplus as the liability runs off would be:

Total of yearly (40) and final (100) payments owed policyholder	(140)
Total bond interest payments (55*) and maturity (85)	140
Total equity sale	10
Total surplus including after sale of surplus assets	10

*10 payments of $5.10 ($85 x 6%) plus approximately $4 of interest earnings from investing the annual excess of the coupon payments the new bond generates ($5.10) from that paid to the policyholder ($4).

Just like in Example 1, the inappropriate portrayal of solvency in this example would not occur after including IMR, and the balance sheet would look like Figure F.

Figure F			
Assets		Liabilities and Surplus	
Bonds	85	Insurance liability	100
IMR*	15	Surplus	10
Equities	10	Liabilities & Surplus	110
Total Assets	110		

* For these examples, it is inconsequential whether negative IMR is reported an asset or contra liability. It is placed here as an asset for illustrative purposes only.

Prior to selling the original bond and re-investing the proceeds, the bond on Company XYZ's balance sheet was in an unrealized loss position. Hypothetically, it could have been shown in the financial statements as in Figure G.

Figure G			
Assets		Liabilities and Surplus	
Bonds at Market	85	Insurance liability	100
Unrealized Loss	15	Surplus	10
Equities	10	Liabilities & Surplus	110
Total Assets	110		

As the original bond and the new bond are transacted at market value, there would be no difference in solvency position pre- and post-trade for Company XYZ. Disallowing negative IMR in Figure F (the IMR value under "Assets") is no more appropriate than disallowing the unrealized loss embedded within the balance sheet in Figure G.

An illustrative example regarding IMR in the context of derivative hedging transactions is provided in Appendix 3.

Definition of IMR

With this background, we now have the proper context to define and state the purpose of IMR:

> IMR is a valuation adjustment to maintain consistency between insurance liabilities (the assumptions for which are often unchanged from origin) and the assets needed to support them (where the assumptions can essentially be revisited any time there are fixed income realizations).
>
> IMR defers and amortizes the recognition of non-economic gains or losses where investment activity, whether through fixed income investment sales or fixed income derivative hedging transactions, essentially unlock unrealized gains/losses for either assets or liabilities. IMR is not intended to defer economic gains and losses related to asset sales compelled by liquidity pressures that fund significant cash outflows (e.g., such as excess withdrawals and collateral calls).
>
> Specifically, the IMR valuation adjustment more appropriately reflects the impact to statutory surplus from fluctuations in interest rates and therefore provides a more accurate representation of solvency under the NAIC's statutory framework which often includes amortized cost valuation of fixed income investments and liability valuations with fixed assumptions in accordance with the Accounting Practices and Procedures and Valuation Manual.

To accurately assess whether a company can fulfill its obligations, it must present its liabilities and assets on a financially integrated and consistent basis. If they are inconsistent, then the annual statement will not reveal the degree to which assets exceed liabilities and neither regulators nor management can appropriately determine the risk of insolvency for the company. Taken further, limiting IMR balances creates an inconsistency within the Statutory framework and would generate false solvency signals for regulators. Limiting IMR balances can also disincentivize prudent interest rate risk management. By appropriately recognizing fixed income gains and losses within the Statutory framework, the IMR prevents the misrepresentation of surplus from changes in interest rates.

Appendix 1 – IMR in the context of Principle-Based Reserving (PBR)

PBR is a relatively recently developed method for calculating U.S. statutory reserves that intends to better quantify product risks. Distinctive to PBR in the Statutory framework, the approach considers a range of future economic scenarios and uses justified company-specific assumptions that can change over time as company experience emerges, subject to regulatory guardrails. PBR is generally applicable for individual life insurance contracts issued 2020 and later (VM-20) and for all variable annuity contracts (VM-21). PBR is expected to apply to fixed annuity contracts issued 2025 and later (VM-22). Minimum reserves under PBR are the maximum of a formula-based reserve and modeled reserves.

For PBR's formula-based reserves, the accounting basis is "frozen" and "locked in" at issue and does not reflect underlying assets or a company's investment strategy (e.g., the net premium reserve). As a result, the existing IMR construct works in tandem with PBR's formula-based reserves to maintain consistency between the liability and asset valuations when the asset valuation is unlocked due to asset sales.

For PBR's modeled reserves, the accounting basis is not "frozen" but is unlocked over time with assumptions that reflect company experience in its cash flow models (e.g., the deterministic reserve and the stochastic reserve). Under PBR's modeled reserves, the reserves reflect the company's underlying assets and investment strategy, and the impact of asset gains or losses is reflected in the modeled reserve calculation. Distinctive to the modeled reserve component(s) of PBR, the modeled reserves then reflect an explicit adjustment for IMR so that there is no surplus impact at time of asset sale.

In summary, the IMR construct is necessary for consistent liability valuation under PBR's formula-based reserves and is already explicitly reflected and accounted for under PBR's modeled reserves.

Appendix 2 – IMR in the context of Asset Adequacy Testing (AAT)

Asset adequacy analysis is an analysis of the adequacy of reserves and other liabilities, considering the assets supporting such reserves and other liabilities under moderately adverse conditions. If additional assets are needed, then the actuary should establish an additional reserve equal to the value of those additional assets.

A common form of asset adequacy analysis is cash flow testing, which is the projection and comparison of the timing and amount of cash flows under one or more scenarios. Conceptually, cash flow testing is similar to the deterministic reserve, or a set of deterministic reserves, under PBR as discussed in Appendix 1.

In 2022 and 2023, the NAIC's Life Actuarial (A) Task Force provided guidance on allocating negative IMR for PBR and AAT. This guidance recommended that any portion of negative IMR that is an admitted asset should be allocated for PBR and AAT in a principle-based, reasonable, and appropriate manner that would be consistent with the handling of negative IMR. Effectively, AAT explicitly accounts for admitted negative IMR by reducing the amount of interest-earning assets. Likewise, AAT can reflect positive IMR by allowing for a larger starting balance of interest-earning assets. In summary, AAT has been designed in tandem with the IMR construct to ensure the consistent valuation of assets and liabilities within the Statutory framework.

Appendix 3 – IMR in the context of Derivative Hedging Transactions

The applicability of the IMR construct to gains or losses from derivative hedging transactions flows from the concepts outlined in the earlier text. To illustrate its importance within plausible ALM strategies, the example outlined here in Appendix 3 assumes a more complex and realistic set of insurance liabilities.

Example 3

Assume Company XYZ issues life insurance contracts where the premiums come in each year until death and there is a payment upon death estimated to occur at the end of 5 years. Assume Company XYZ is again starting out with $10 of surplus invested in equity securities (again, assume no change in value over the period of valuation). The current interest rate environment is such that the fixed income bond yield and the insurance liability valuation rate are again both 4%, and Company XYZ:

- Sells 100 insurance contracts that pay $1 upon death for yearly premiums of 18.47 cents at the end of each year 1 through 5.
- Purchases bonds with a coupon rate of 4%, with all premiums and coupons received, maturing at the anticipated time of death in 5 years.
- Assume the market yield of 4% is constant throughout the 5-year period.

Company XYZ's balance sheet for each year, using a simplified net premium calculation for reserves, would look like Figure H.

Figure H						
		Assets			Liabilities and Surplus	
Year	Bonds	Equities	Total	Insurance Liability	Surplus	Total
1	18.47	10.00	28.47	18.47	10.00	28.47
2	37.67	10.00	47.67	37.67	10.00	47.67
3	57.64	10.00	67.64	57.64	10.00	67.64
4	78.40	10.00	88.40	78.40	10.00	88.40
5	100.00	10.00	110.00	100.00	10.00	110.00

Company XYZ can pay all claims on the policy and the balance sheet surplus appropriately reflects surplus at the end of each reporting period. In the real world with this more dynamic pool of liabilities, other changes could occur, such as one or multiple of:

- Interest rates could decline, and coupon and premium payments would not be able to be invested at 4%.
- Death benefits could be paid at a point in time greater than the invested bond maturity and if interest rates decline, the bond would not be able to be re-invested at 4%.
- Policy surrenders could occur, including due to changes in market interest rates, causing the claims patterns to change from expectations.

Amidst this real-world uncertainty, Company XYZ could consider any of the following risk mitigating activities, which inherently depend upon its mix of insurance liabilities:

- Accept the risk of future asset and liability cash flow fluctuations, which could result in an inability pay claims in certain situations. For instance, if interest rates declined, the coupon payments, premium payments, and/or maturities would not be able to be re-invested in fixed income investments that have sufficient yield to pay claims as expected.

- Charge higher premiums at inception to account for the reinvestment risk and duration risk associated with the insurance liabilities.
- Manage the investment portfolio to a prudent liability duration or any number of appropriate and prudent asset liability management (ALM) strategies.
- Prudently hedge with derivatives within the ALM strategy. Such derivative usage strategies are used where purchases are not viable or where it is more efficient to utilize derivatives.

If the derivative strategy is applied, the reinvestment risk could be hedged to lock in a 4% yield. When interest rates fluctuate, any gain or loss on the derivative offsets the lower or higher actual yield that is received on the reinvestments.

In Example 3, if interest rates plunged to 0% on day 2, Company XYZ would not be able to support the liabilities because future premiums and coupons would not be able to be reinvested at 4%. If Company XYZ had hedged reinvestment risk, they would have a gain on derivatives equal to the economic loss of not being able to invest at 4%. Similarly, if interest rates doubled to 8%, Company XYZ would have a loss on derivatives equal to the economic gain of now being able to invest at the much higher interest rate of 8%. In both cases, Company XYZ has hedged reinvestment risk and has not changed the solvency picture in Example 3.

In summary, IMR is appropriate for all types of fixed income investments, including derivatives which alter the interest rate characteristics of assets/liabilities, for all realized capital gains and losses which result from changes in the overall level of interest rates as they occur.