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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. Reviewed Comments on Exposed Items

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

1. Agenda Item 2024-10

Bruggeman directed the Working Group to agenda item2024-10: 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.

1. 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.

1. 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 item2024-26EP: Fall 2024 Editorial Revisions as of Jan. 1, 2025 (Attachment 2). The motion passed unanimously.

1. 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.

1. Agenda Item 2024-06

Bruggeman directed the Working Group to agenda item 2024-06: Risk Transfer Analysis of CombinationReinsurance 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.

1. Considered the Maintenance Agenda—Pending List
2. Agenda Item 2024-27

Bruggeman directed the Working Group to agenda item2024-27: 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.

1. Agenda Item 2024-28

Bruggeman directed the Working Group to agenda item2024-28: 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.

1. Considered the Active Maintenance Agenda
2. Agenda Item 2024-16

Bruggeman directed the Working Group to agenda item2024-16: 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.

1. 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.

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