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CRE READING PROGRAM INSTRUCTIONS

The Society of Financial Examiners has a Reading Program for Earning Continuing Regulatory Education Credit by Reading the Articles in The Examiner.

You can earn **2 CRE credits** for each of the 4 quarterly issues by taking a simple, online test after reading each issue. There will be a total of 15-30 questions depending on the number of articles in the issue. The passing grade is 66%. To take the test, read all of the articles in the issue. Go to the Members section of the SOFE website to locate the online test. This is a password-protected area of the website, and you will need your username and password to access it. If you experience any difficulty logging into the Members section, please contact **sofe@sofe.org**.

NOTE: Each new test will be available online as soon as possible within a week of the publication release. The Reading Program online tests are free. Scoring is immediate upon submission of the online test. Retain a copy of your online test score in the event you are audited or you need the documentation for any other organization's CE requirements. Each test will remain active for one year or until there is a fifth test ready to be made available. In other words, there will only be tests available for credit for four quarters at any given time.

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The questions are on the following page. Good luck!

Earn Continuing Regulatory Education Credits by Reading *The Examiner!*

CRE Reading Program Questions

All quizzes MUST be taken online.

Questions will be ***available online December 21, 2020.***

A Strong Audit Function Drives a Smoother Regulatory Examination Process

Multiple Choice and True and False Questions — Submit Answers Online

1. The internal audit function is independent and reports directly to the CFO or CEO (or other appropriate level of management) and functionally to the audit committee.
   a. True
   b. False

2. Which of the following activities does not help maintain and improve the effectiveness of risk management process?
   a. Depending on the role of the internal audit function in your organization, there is clear documentation for consideration of enterprise risks and impact on internal audit activities.
   b. Risk assessments are conducted at least annually and include processes for ongoing risk consideration and adaption, and include consideration of inherent and residual risk.
   c. Internal audit testing and associated documentation is appropriate for the nature, timing and extent of procedures performed; well-documented and retention of supporting work papers will vastly improve the efficiency of the examination and reduce the extent of requests on your company's business owners.
   d. Internal audit reports include issues noted for management to follow up on and management can provide verbal updates on any issues noted.

3. Exhibit E requires the examiners to obtain and review documentation supporting the audit approach and performance of both internal and external audit.
   a. True
   b. False

4. Which of the following is not a suggested examination request in the article?
   a. Copies of internal audit resumes
   b. Copies of risk assessments and supporting methodology during the examination period
   c. Listing of internal audit reports
   d. Relevant report of findings, recommendations and remediation plans

5. Which of the following is not suggested by Baker Tilly to include in the template memo prepared for Key Activity Documenting?
   a. A summary of the audit work available related to that key functional activity (whether Model Audit Rule, Sarbanes-Oxley, external audit or internal audit)
   b. The inherent risks and financial statement assertions identified for each material account
   c. All accounts associated with the activity
   d. A table mapping the examiners consideration of the significance of the financial reporting inherent risk identified and the testing considered to address the risk

Employee Retirement Benefits and Captive Insurance

Multiple Choice and True and False Questions — Submit Answers Online

6. ERISA original tax laws have undergone numerous technical corrections. These technical corrections have resulted in Defined Contribution plans disappearing at an alarming rate in favor of Defined Benefit plans.
   a. True
   b. False

7. Which of the following skew benefits against high income wage earners?
   a. Shift to Defined Contribution plan
   b. Secondary system of Social Security
   c. None of the above
   d. Both a & b

8. Significant factors to consider in forming a Captive Insurance Company may include:
   a. Captive Insurance Companies must undergo an annual certified audit
   b. Captive Insurance Companies can create customized insurance coverage
   c. Captive Insurance Companies must issue properly priced insurance policies
   d. All of the above

9. A corporation entering into a captive arrangement must recognize this as a long-term commitment requiring the best in class team consisting of:
   a. Actuaries, Accountants, Lawyers and Regulators
   b. Actuaries and Broker
   c. Actuaries, Accountants and Lawyers
   d. None of the above

10. Building a retirement pyramid using a Defined Contribution plan alongside a risk management vehicle creates:
    a. Maximum flexibility
    b. Asset protection
    c. Strengthens a business while creating a more flexible retirement scenario
    d. All of the above

Aftermath of Civil Unrest Points to the Importance of Captive Insurance

Multiple Choice and True or False Questions — Submit Answers Online

11. The majority of business interruption commercial insurance policies are tied to a property policy and only triggered if property is actually damaged.
    a. True
    b. False

12. A captive insurance company
    a. is a closely-held insurance company that insures primarily though not exclusively your business.
    b. is a C corporation and is licensed and domiciled like any large insurance company.
    c. have their own reserves, policies, policyholders, and claims.
    d. is a sophisticated way to self-insure, and captives are generally formed to insure the risks of a business, group of businesses and related or affiliated third parties.
    e. All of the above

13. A captive insurance company
    a. can issue insurance policies that address gaps not covered by commercial insurers.
    b. can insure deductibles, enabling the parent company to raise its deductible and lower its commercial insurance costs.
    c. can provide broad business interruption coverage when an adverse event occurs, particularly events where commercial insurance doesn't cover all damages or peripheral damages.
    d. can write customizable coverage for the businesses they insure
    e. All of the above

14. Captives can provide broad coverage without the exclusions that riddle typical commercial insurance policies. Insurance coverage is worthless if an exclusion prevents the insured from receiving a claims payment when it needs it most.
    a. True
    b. False

15. Assets accumulated in a captive almost always out-pace retained earnings or a business' "rainy day fund" due to premiums paid to the captive receiving favorable tax treatment and the captive is able to invest and grow larger pool of assets.
    a. True
    b. False

PwC NAIC Fall 2020 Newsletter

Multiple Choice and True or False Questions — Submit Answers Online

16. The Accelerated Underwriting Working Group has completed Phases 1 & 2 of its consideration of the use of external data and data analytics in accelerated life underwriting.
    a. True
    b. False

17. The International Monetary Fund, in its 2020 Financial Sector Assessment Program's review of the U.S. financial regulatory system, recommended all but the following regarding the U.S. state-based regulatory system:
    a. Further development of risk-based supervision
    b. Consistency of asset-backed investment valuation methods
    c. Further regulatory requirements in corporate governance
    d. Enhanced regulatory responses to the increasing risk and severity of natural catastrophes

18. Which was not one of the SAP Working Group's adopted revisions to SSAP No.2?
    a. 13-month rule for classification of repurchase agreement collateral as short-term investments
    b. Restricted classification of "rolling" related party or affiliated investments as cash equivalents or short-term investments
    c. Allow certain cash pools which meet defined criteria to be reported as cash equivalents
    d. Identification of investments that remain on the short-term schedules for more than one consecutive year

19. Which of the following is not one of the three subgroups adopted by Long-Term Care Insurance (EX) Task Force?
    a. Multistate Rate Review Subgroup
    b. Asset-Liability Matching Subgroup
    c. Financial Solvency Subgroup
    d. Reduced Benefit Options Subgroup

20. The Artificial Intelligence Principles based on the Organization for Economic Co-operation and Development's (OECD) AI principles, have been adopted by 42 countries, including the United States.
    a. True
    b. False

A Strong Audit Function Drives a Smoother Regulatory Examination Process

By John Romano, CFE, CPA, CSM, CITP
Philip Talerico, CFE, CPA, MCM
Rachel Schmoyer, CPA, CISA
Baker Tilly Virchow Krause, LLP

An efficient risk-focused financial examination has typically been achieved through the effective leveraging of the work performed by both internal and external auditors, herein referred to as the "audit function." In past iterations of the risk-focused exam process, the leveraging of the audit function work would include re-performance of the control and/or substantive testing available related to each risk identified by the examination team. Currently, the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (FCEH) includes guidance for examiners to apply additional judgement to not only leverage audit function work, but also to reduce the number of financial reporting risks reviewed by the examination team as a result of the audit function work performed.

The purpose of this article is to provide the company with an understanding of an effective audit function and how the examiner's reliance leads to a smoother and more efficient examination of your insurance company. The article also aims to provide the examiners with a high-level understanding of the reliance process and practices utilized during the examination.

Insurance organizations: Leverage your audit function for examination success

Internal audit is known as the third line of defense and, based on the Institute of Internal Auditors, it can be defined as "an independent, objective assurance and consulting activity designed to add value and improve an organization's operations." Its primary purpose is to enhance and protect organizational value by providing risk-based and objective assurance, advice and insight.

Internal audit achieves this goal through the identification and verification that the company has strong risk mitigation strategies (controls) in place that are operating consistently to mitigate risks. This value provided to your company extends to the examination team as well. How does this occur? As part of the NAIC risk-focused examination, specifically Phase 3 (control identification and risk mitigation strategies), the examiners may place reliance on internal audit for the controls identified during previous engagements, and how those controls can be utilized to mitigate the risks identified by the examiners.

In most cases, companies that have strong internal audit functions will have smoother examination (and potential cost savings) than companies that have not invested in a strong internal audit function. This concept is especially true if your company is required to comply with the Internal Control over Financial Reporting requirement of the Model Audit Rule, or your related state regulation. Please refer to our articles for more information:

The Model Audit Rule: Best practices and recommendations to improve your organization's program

The Model Audit Rule: Diagnosing your program's reliability, resources and reengineering processes

There are critical attributes that we have identified through our experience working with examiners that will ensure internal audit is providing value to your company while undergoing an examination:

- Appropriate structure and methodology
  - The internal audit function is independent and reports functionally to the CFO or CEO (or other appropriate level of management) and directly to the audit committee
  - Methodology is supported by policies and procedures and follows appropriate standards
  - Internal audit staff (internal, co-sourced or outsourced) should be qualified and progression shown towards relevant experience and designations
    - Be prepared for examination requests:
      - Internal audit charter
      - Internal audit policies and procedures
      - Interview with chief auditor or equivalent
      - Audit committee reports and supporting materials

- Activities help maintain and improve the effectiveness of risk management processes
  - Risk assessments are conducted at least annually and include processes for ongoing risk consideration and adaption, and include consideration of inherent and residual risk
  - Depending on the role of the internal audit function in your organization, there is clear documentation for consideration of enterprise risks and impact on internal audit activities
  - Internal audit reports include actionable recommendations and associated management responses with clear identification of responsibility and timeline for remediation for observations
  - Internal audit testing and associated documentation is appropriate for the nature, timing and extent of procedures performed; well-documented and retention of supporting work papers will vastly improve the efficiency of the examination and reduce the extent of requests on your company's business owners

- ❖ Be prepared for examination requests:
  - Copies of risk assessments and supporting methodology during the examination period
  - Interview requests to discuss risk assessment results
  - Listing of internal audit reports
  - Specific selection of internal audit reports and supporting work papers for higher risk areas and areas of interest
  - Internal audit assessment of enterprise risk-management activities (if applicable)

- ❍ Activities provide reasonable assurance about the accuracy and timeliness of recorded transactions and the accuracy and completeness of financial reports
  - ♦ Internal audit (or a separate division such as internal control, Model Audit Rule or Sarbanes-Oxley compliance if applicable) is expected to provide assurance but not necessarily duplicate activities of the external auditor; if you are not Model Audit Rule or Sarbanes-Oxley compliant, the examination team will be looking to primarily leverage the external auditors work papers as discussed below
  - ♦ For Model Audit Rule or Sarbanes-Oxley compliant entities, your methodology, assumptions, timeline and supporting documentation should be retained and readily available
  - ♦ As mentioned above, well-documented work papers and retention of supporting work papers will vastly improve the efficiency of the examination and reduce the extent of requests on your company's business owners
  - ♦ Materiality and supporting assumptions are very important; if your materiality is too high, the examination team may not be able to rely on your work papers. If you consider and align with your external auditor's materiality expectations, more often than not, you should be within the ballpark of examiner expectations
    - ❖ Be prepared for examination requests:
      - Model Audit Rule and/or Sarbanes-Oxley methodology documentation for the examination scope period, usually focused on the latest year
      - Risk matrices and risk assessment support where applicable
      - Control testing documentation and support
      - Relevant report of findings, recommendations and remediation plans
      - Evidence of remediation readily available

By ensuring your internal audit department is well-aligned to these critical attributes, you are more than likely to achieve efficiency during the examination as a result of the examiners being able to clearly and concisely

identify controls, and/or identify controls that are not operating consistently. If you have any further questions regarding what we have seen to be a strong internal audit function, please find further information at https://www.bakertilly.com/specialties/internal-audit.

In addition, it is important to ensure that your external audit function is a reputable firm in the insurance industry. The examination team, in addition to placing reliance on internal audit, will first look to place reliance on the external audit work completed including any control testing performed, and any substantive procedures completed. There are some common issues that may limit an examiners reliance on external audit work. The issues can include, but are not limited to: external auditor's failure to retain control narratives and control documentation, a substantive approach that does not include appropriate sample sizes, or an unwillingness to provide all access to their work completed in appropriate and usable formats. It is important that when you know your examination is upcoming, that you have a conversation with the external audit team and make them aware that your examination will be as of year-end 20XX, and therefore they should be prepared to provide all work papers for that last year under review. The quicker they provide the work papers to the examiners, the earlier the examination may be completed.

Regulators: Utilize audit function work papers for examination efficiency

The ability to leverage the audit work requires an effective audit function. The examination team will assess the adequacy of the audit function through the completion of the NAIC FCEH, Exhibit E.

Exhibit E requires the examiners to obtain and review documentation supporting the audit approach and performance of both internal and external audit. The examiners will conduct a meeting or interview with the external audit partner and/or manager, as well as the chief audit executive of the company to understand their roles and performance of the audits. The supporting documentation obtained supports what is described and provides the examiners with a basis for assessing the audit function against industry best practices.

Assessing the audit function provides the examiner with an understanding of the risks identified by the audit function, how those risks are addressed and the overall audit conclusion reached. An overall audit function assessment will be determined as "effective" or "ineffective." An effective audit function not only allows the examiner's to leverage the testing in addressing significant risks, it also allows the examination team to apply judgement in reducing less significant financial reporting risks from the scope of the review. This increased efficiency provides the examiners the ability to focus efforts on non-financial reporting risks and complete examination activities more quickly.

Audit Function Assesment

Internal Audit and/or External Audit Function assesed as effective?

Yes

What type of risk will the examiner be leveraging work for?

Low/Moderate Financial Reporting Risks

Risk can be left off the matrix, no explanation or linking required

Significant Risk/Risk selected to address a Critical Risk

Does the Audit function workpapers address the risk?

Yes

Leverage work as appropriate and provide links to testing

Conclude on the result of working that is leverage, retest as appropriate, and evaluate the results of the procedures performed.
(e.g. perform Phase 6 and 7 procedures)

No/ Partial

No

Leverage of CPA work is limited, perform independent testing.

Note: Depending on the circumstances, examiner may still be able to leverage process memo documentation, workflow and certain workpapers by the CPA or internal audit.

Once it has been determined that the audit function is effective, the examiners now need to determine which less-significant financial reporting risks are appropriately addressed by the audit function and thus can be removed from the Key Functional Activity Matrix.

To do so, the examiners should be following the left-hand side of the "Decision tree for usage of CPA work," included to the right. First, the examiners need to identify the significance of the financial reporting inherent risks. Next, the examiners need to understand and evaluate the work performed by the audit function in addressing the risks. Finally, depending on the level of significance and the work available, the examiners will apply judgement to determine the appropriate leveraging of this work – whether removing the inherent financial reporting risk(s) from the Key Functional Activity Matrix, or reviewing and re-performing to address risks on the matrix through Phase 3 or Phase 5.

While the guidance for evaluating the audit work is documented and available to the examination team, what is left up to examiner judgement is the evaluation of risks and the manner in which the judgement is documented.

Baker Tilly has implemented a process to follow the above decision tree efficiently and effectively, demonstrating our understanding of the financial reporting inherent risks and the audit function work prepared. This process results in a Baker Tilly developed templated memo (template available upon request) prepared for Key Functional Activity documenting:

1. The material accounts associated with the activity
2. The inherent risks and financial statement assertions identified for each material account
3. A summary of the audit work available related to that key functional activity (whether Model Audit Rule, Sarbanes-Oxley, external audit or internal audit)
4. A table mapping the examiners consideration of the significance of the financial reporting inherent risk identified and the testing considered to address the risk

We consider significant risks being those addressing a Critical Risk Category of the Exhibit DD of the NAIC FCEH, risks communicated by the State insurance department financial analyst as significant and requiring detailed review by the examination team, and risks identified by examiners and/or communicated by the company as potentially having a significant impact on solvency during Phase 1 (understanding the company procedures).

Once you have established that the audit function is effective it is equally important to understand the financial reporting risks relevant to the organization and the audit work performed to address these risks, whether control testing, substantive testing or a combination of the two.

Key takeaways:

- Examiners and insurance organizations both want to have an efficient examination that does not require unnecessary work or time.
- An insurance organization's audit function (combination of internal and external) provides comfort to the examiners that financial reporting risks are addressed.
- The ability of the examiners to adequately assess the overall audit function, the inherent financial reporting risks of each activity, and the specific work completed in relation to these financial reporting risks is critical to an efficient exam.
- The insurance organization’s understanding of the examiners ability to leverage audit work and the criteria utilized improves the likelihood of an efficient exam.
- For more general insurance information, please go to https://www.bakertilly.com/industries/financial-services/insurance.

SOFE Editor's Note: *This article was originally published by Baker Tilly Virchow Krause, LLP on its website on July 23, 2020. For the original versions of the article, please visit https://www.bakertilly.com/insights/strong-audit-function-drives-regulatory-examination. Reprinted with permission.*

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John Romano, **CFE, CPA, CITP, CSM**, leads the insurance regulatory and advisory practice at Baker Tilly. In his role, he and his team help regulators and insurance industry clients successfully address a variety of ongoing challenges and requirements, assessing and improving processes, and finding better ways to approach procedures and methodologies leading to a higher realization of value and assurance. He provides regulatory examination services, internal audit and agile auditing, Enterprise Risk Management, Own Risk Solvency Assessment (ORSA), Sarbanes-Oxley (SOX) 404/MAR compliance, and corporate governance and risk management solutions to the financial services industry. Before joining Baker Tilly in 2008, John held financial advisory, hedge fund accounting and internal audit positions in publicly traded companies in financial services and healthcare industries.

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Employee Retirement Benefits and Captive Insurance

By Joseph Tucciarone
National Network of Accounts

Many accounting firms encourage their profitable business clients to develop retirement plans. A well-designed retirement plan will be able to provide future security for both employees and employers. This is a critical component in today's business world, especially as life expectancy is expanding and both employers and employees are seeking peace of mind for the future.

Retirement planning has always served as an important employee benefit program.
The original ERISA tax laws enacted in 1974 have undergone numerous technical corrections over the last forty-six (46) years. This has resulted in inequities, today, that seriously hamper the accumulation of retirement assets for a wide group of people. These technical corrections have resulted in Defined Benefit plans disappearing at an alarming rate in favor of Defined Contribution plans.

Defined Benefit plans are retirement plans designed to create guaranteed retirement income. The contributions and growth are reviewed annually by certified actuaries to ensure a future monthly retirement income amount. Adjustments are made utilizing certain IRS/actuarial guidelines in order to meet these future commitments.

Defined Contribution plans, unlike Defined Benefit plans, are retirement plans where there are no future guaranteed benefits. The future retirement benefits vary with the contributions made and the investment returns achieved. Defined Contribution plans are easier to administer, less costly and simpler for the participants to understand. However, they lack the certainty, at retirement, provided by a Defined Benefit plan.

In addition to this major shift from a benefit formula to a contribution formula, the last forty-six years have seen other changes. Combined, these changes have resulted in inequality and discrimination of benefits between employees and employers.

1. Discrimination against the high wage earners and the leaders of many mid-market businesses in America is a direct result of the adjustments made to equalize contributions between highly compensated employees and lower compensated employees. Nondiscrimination testing is required for qualified retirement plans to ensure that benefits under the plan do not discriminate in favor of officers, owners, shareholders, or any other employee classified as highly compensated. Moreover, the contribution limits on the Defined Contribution plans have not increased along with life expectancy. Most highly compensated individuals, if they were able to contribute, would want the ability to make a larger contribution.

2. The shift away from Defined Benefit plans has caused discrimination against the high wage earners and the leaders of most mid-market business in America. Most employees and middle management are no longer receiving Defined Benefit contributions. These employees are being encouraged to fund their own retirement benefits through salary reduction plans. Due to the rising future retirement needs, the accumulation in most retirement plans has not kept up with the assets necessary to fund future retirement goals. It appears that the same employees who were to benefit from the original law are now ill prepared for retirement. In fact, the average 401(k) balance at Fidelity, which holds 16.2 million 401(k) accounts and is consistently ranked as the largest defined contribution record-keeper, was $103,700 as of March 2019. The average account balance by age was as follows:

    Age 20-29, Average 401(k) balance - $11,800
    Age 30-39, Average 401(k) balance - $42,400
    Age 40-49, Average 401(k) balance - $102,700
    Age 50-59, Average 401(k) balance - $174,100
    Age 60-69, Average 401(k) balance - $195,500

401(k) balances begin to fall as more people start tapping their 401(k) accounts. The average balance for those 70 years and older is $187,100 – an inadequate amount to secure surety for the future! This is going to be more acute as a result of the Coronavirus. Future contributions and benefits are in jeopardy. Actuaries will struggle to design retirement plans that adequately compensate both the leaders in business as well as the people who are instrumental in assisting the management teams in developing profitable businesses. Neither the highly compensated nor the rank and file have the security which ERISA was created to provide.

This situation is a direct result of more than 18 modifications (that we can count) made in the laws governing retirement planning which date back to the Employee Retirement Income Security Act (ERISA) of 1974, plus a worldwide pandemic which will alter future incomes and benefits.

ERISA Sets the Guidelines for all Private Retirement Plans
ERISA was enacted to create uniform standards and to provide equality to all retirement plan participants. Since ERISA's inception there have been many changes made. In addition to the regulatory changes, our society has evolved. There has been a shifting of accountability from corporate retirement planning to individual employee responsibility. Over the years the growth of 401(k) plans have taken center stage. In addition to private retirement planning, our country also utilizes the "Social Security" system as a support program for retirees over and above the personal/business retirement programs.

The shift to **Defined Contribution** retirement planning and the secondary system of Social Security skews the benefits against high income wage owners. The maximum 401(k) annual contribution is $19,000 for 2019 and Social Security contributions stop being deducted at $132,000 of salary. The increased income of the higher paid employees results in a lower percentage of income at retirement. Fewer and fewer Defined Benefit Retirement Plans are being created each year. In addition, due to increased longevity, the Social Security system has become strained. A solution must be implemented to remedy these inequities without resorting to more legislation.

Today, because of the sophistication of the financial marketplace, the authors believe there are alternative programs that currently exist which can improve these overall results. Retirement planning for mid-market businesses can be more effective by utilizing multiple unrelated strategies. By broadening our way of thinking, we believe it is possible to change this outcome by combining unrelated strategies. Moreover, we believe that it is possible to also provide pandemic protection going forward.

The utilization of a **Captive Insurance Company** is a method of leveraging the insurance premiums paid by a business for their company's P&C insurance and at the same time accumulating capital which can be used to supplement retirement benefits. It is a technique wherein businesses form their own stand-alone insurance subsidiary to finance reserves by setting aside assets to cover losses in a formal structure. This is all done under the guidance of an appropriate State Insurance Department. In addition to enhancing, supplementing and managing commercial insurance risk, Captives result in a substantial method of accumulating assets. These accumulated assets make a business stronger and more resilient. A Captive is a legally formed alternative and can do anything a commercial insurance company can do. They can be custom designed and are lifelines during a pandemic.

A Captive Insurance Company is not a commercial insurance company. It is a private insurance company licensed and regulated under the Department of Insurance (DOI) to insure the risk of a specific company or group of companies. Significant factors in forming a Captive Insurance Company include:

- Captive Insurance Companies must be established as "C" corporations.
- Captive Insurance Companies must maintain adequate collateral as well as reserves to pay claims.
- Captive Insurance Companies must issue properly priced insurance policies
- Captive Insurance Companies must undergo an annual certified audit

- Captive Insurance Companies can be grouped into three major insurance types. (1) Group Captive Insurance Companies (2) Large Captive Insurance companies, also known as 831(a) Captives and (3) Small Captive Insurance companies, also known as 831(b) Captives.
- Captive Insurance Companies provide Asset Protection
- Captive Insurance Companies can create customized insurance coverage

Simply put, Captive Insurance Companies give a business the opportunity to capture their unused insurance premiums as profit while providing business protection.

Ordinary businesses cannot take a deduction for reserves that they have set aside for future uninsured claims unless paid to a legitimate insurance company. Many business owners unknowingly self-insure a tremendous amount of business risk, such as malpractice deductibles, professional liability, accounts receivable, administrative actions, loss of professional license and business interruption, etc.

With a properly structured Captive, insurance can create substantial tax deductions resulting in significant tax savings and the accumulation of assets to fund employee benefits that are similar to a retirement plan but have greater flexibility. Because the business owner has control of his insurance company, policies can be custom designed. This flexibility allows the Captive to meet the specific needs in terms of the scope of coverage, level of risks, deductibles, premiums and dealing with unique programs such as the Coronavirus.

Control of a Captive Insurance Company also allows for the control of the claims process. Too frequently, with third party insurance companies, the insurance claims process can be irritating at best and can disintegrate into litigation. With a Captive Insurance Company, the "parent" or related businesses will benefit from good claims experiences while the surplus of the insurance company will be controlled by its shareholders. Without a Captive Insurance Company, premiums paid to a commercial insurance company are always lost.

It is a fact that the overhead of commercial insurance companies account for 35 to 40 percent of insurance premiums charged to each policyholder. Writing insurance directly through a Captive Insurance Company can significantly reduce these costs. In addition, a Captive can offer direct access to the third-party reinsurance market and related wholesale pricing, which is often considerably less than would otherwise be available to most employers utilizing commercial coverage.

Most business people do understand the need for business insurance to protect what they have created. However, most business people dislike paying insurance premiums.

We believe it's time to utilize a Captive Insurance program along with an unrelated strategy; a Defined Contribution Retirement Plan – to improve and maximize retirement benefits for all people building a business. This plan assists stockholders and rank and file employees to enhance retirement benefits. By doing this we can also create a successful strategy to address insurance issues that plague today's businesses and at the same time assist employees and employers in the area of retirement.

It seems obvious that if 90% of Fortune 500 businesses are using Captive Insurance Companies then the majority of mid-market companies should also be reviewing the use of Captive Insurance Companies. It is time to recognize that paying P&C insurance premiums into a Captive Insurance Company is a tax-deductible event just like making a contribution to a Retirement Plan. It is also time to realize the cash reserves of Captive Insurance Companies are a reliable source of future retirement income.

What Else Does This Strategy Offer?

Additional benefits derived from a Captive/401(k) strategy are less subtle. Captives are not subject to the 59-1/2 or 70-1/2 age limitations or excess accumulation penalties that are inherent with ERISA retirement plans. In addition, Captives allow adjustable contributions each year. With respect to oversight and control, retirement plans are overseen by the federal government and the Captive Insurance Companies are overseen by state insurance departments.

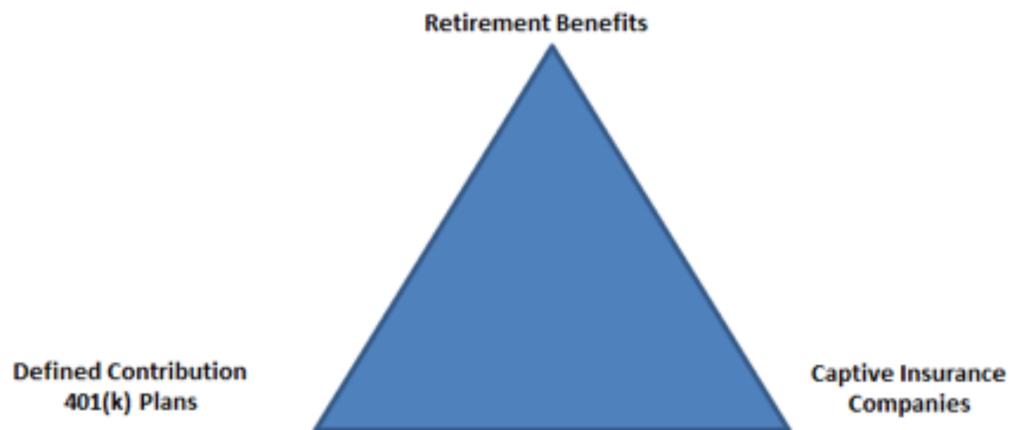
When a business uses a Captive, it is also possible to operate a Defined Contribution retirement plan simultaneously. This creates a new paradigm. In fact, after combining a traditional 401(k) plan with a Captive Insurance program, we can provide a retirement program that is more effective for both the employees and the employer.

When the business owners of a Captive Insurance Company take distributions prior to 59-1/2 for needed business reasons without a penalty, they pay tax at capital gains rates as opposed to having to withdraw assets from their pension accounts, pay ordinary income tax rates and a possible 10% tax penalty. In addition, there would be no mandatory distribution penalty when assets remain in the Captive past the ERISA RMD point.

The companion 401(k) distributions for the employees would still be subject to a 10 percent tax penalty on loan prior to age 59 ½. (A loan may be made from the 401(k) plan on behalf of any employee of up to $50,000 or 50 percent of the vested accrued benefit whichever is less). In addition, ERISA exceptions exist today. These exceptions include, among other scenarios, first time home ownership and chronic illness. There is no mandatory distribution at age 70-1/2 if employees remain working for the employer. However, the employees would still maintain the ability to roll over their accounts to an

IRA. The intent of Congress to allow employees to accumulate assets on a tax-deductible basis and grow on a tax-free basis would be achieved through the 401(k) plan. The strength of this two-prong plan is that it can be used by businesses that have a large employee work force and total payroll which exceeds the total income of the principles. Under these circumstances the principles/shareholders would be limited in making their own contributions into the 401(k) plan.

Building a retirement pyramid using a Defined Contribution plan [401(k)] alongside a risk management vehicle creates maximum flexibility, asset protection and strengthens a business while creating a more flexible retirement scenario.



The ability to develop future security, add additional risk management protection to a business, and provide assets to both workers and owners, without one group becoming disenfranchised, is a goal that is achievable by employing this strategy.

EXAMPLE

A mid-market manufacturing firm was paying $5 million in P&C insurance premiums each year and allocating $600,000 toward their company retirement plan. Under this scenario, the owner had calculated that at retirement (10 years), he would accumulate approximately 3 million dollars in his retirement account. Each year, $250,000 was set aside for the owner from the $600,000 being put in the retirement plan. Under the retirement plan design, $350,000 each year was being awarded to the remaining employees. No benefit accrued to either the employees or employer from the P&C premiums being paid to the commercial insurance company. Over the next 10 years the business would spend $50 million in P&C insurance premiums. All the P&C insurance premiums paid less the claims refunded ($6 million) were lost.

$44 million was profit to the commercial insurance company. Using the same budget funds could be re-allocated between the current commercial insurance company, a newly created Captive Insurance Company, and the company Retirement plan. This new design allocated $1.1 million dollars of expenses to the Captive Insurance Company, $3.9 million dollars would be spent with the Commercial Insurance Company and the same $600,000 would continue to be contributed to the retirement plan. **The result of this redesign is significantly different than utilizing only a 401(k) plan.**

$13 million dollars will accumulate in assets within the captive and another 2.1 million dollars will accumulate in the retirement plan over the 10-year period for the owner. Due to the reallocation of the insurance premiums, the owner also increased the total benefits in the retirement plan for the employees as an offset. By increasing the allocation to the employees 401(k) accounts, the future retirement benefits of the employees were more secure. For the owner, this planning added a $13 million increase in assets for their retirement plus enhanced P&C coverage, plus building greater benefits for the employees. A superior outcome for both employees and employers.

Today building adequate retirement income is mandatory to retain better employees and stronger businesses. If this can be accomplished by re-allocating assets currently being spent and not adding any new dollars into the planning, greater efficiency is achieved.

During the last year, Captive Insurance Companies have taken on even more significance as a result of the recent Coronavirus outbreak. "Employees are finding that Captive Insurance Companies are becoming a life-line." (Source: New York Times 3/20/2020

This option needs to be reviewed in our ever-changing new environment. The base of our economic growth as a country is dependent on a strong work force and this option addresses that problem. We are in a New Normal.

About the Author

Joseph W. Tucciarone is a true visionary and "Rocket Scientist", a graduate mechanical engineer with a minor in nuclear engineering, Joe started his professional career as the Assistant Spacecraft Test Manager at Kennedy Space Center. After leaving the space industry and for the past 35 years, Joe has applied his mathematical and analytical skills developing one of the premier ERISA Qualified Retirement Planning firms in the United States. Joe complemented this extensive pension experience by serving on the Board of Directors of GAMA International and building one of the largest insurance agencies in America. Joe's commitment to and belief that accountants

are indeed the "most trusted" advisors in America, led him to create the National Network of Accountants (NNA) in 1992 and subsequently develop Independent Captive Associates (ICA). He believes both companies are tools for accountants and business owners to provide professional solutions to the business issues. Under Joe's leadership, the NNA has recently been selected by the State of Connecticut to develop a state wide program to design, enhance, protect and provide growth opportunities for both the accounting and business community within the state. He believes that research, analytical thought and professional cooperation create efficient business solutions. His current book on Amazon. "Captive Insurance Companies....a Game Changer", (First and Second Editions) provides insight and education to many business owners and professionals across America today. He continues to innovate and differentiate himself today as a national speaker, writer and industry expert, featured in several renowned financial publications such as The Wall Street Journal, CBS Marketwatch, The CPA Journal, Practical Accountant, CPA Wealth Provider and Accounting Today.

Aftermath of Civil Unrest Points to the Importance of Captive Insurance

By Randy Sadler, CIC Services

2020 has been a brutal year for many businesses. First COVID-19 struck leaving many business leaders blindsided and their companies crippled. Some businesses have thrived, some have survived, some have eked by and others have folded. Paycheck Protection Program (PPP) loans have helped some business, but for many the help was too little too late. Also, the nature of the pandemic has insulated most commercial insurance companies from paying business interruption (revenue replacement) claims to businesses. The majority of business interruption commercial insurance policies are tied to a property policy and only triggered if property is actually damaged.

And recently, a new threat has arrived: civil unrest. And, unlike many prior periods of civil unrest characterized by peaceful protests, strikes and "sit-ins," this civil unrest has been characterized by violence, wonton property damage and looting.

A "one – two punch" from both COVID-19 and civil unrest will be even more difficult for many businesses to survive. According to the Insurance Information Institute, losses from the 1992 Rodney King driven civil disturbance in Los Angeles totaled $1.42 billion in today's dollars—and the current rioting could rival that figure.

Unlike COVID, civil unrest brings a whole new set of problems for businesses. Many businesses have had their properties damaged by rioters, and their commercial insurance policies can be expected to cover their property losses. However, some insurers are pushing back on paying business interruption (revenue replacement) losses for businesses impacted by civil unrest because business interruption could theoretically be caused by COVID and not by rioters. Also, businesses may have weathered COVID-19 and not experienced property damage by rioters, but civil unrest has still caused business interruption. And, because their property wasn't actually damaged, their business interruption coverage isn't triggered. The neighborhood near or around their business may be in shambles, but help won't be on the way. Finally, the rarely discussed impact of civil unrest on businesses is the pressing need to relocate and not rebuild. Many business owners will need enough money to move and start over, and the payment they receive from their commercial insurance may not be enough. Businesses that decide to stay may find it difficult or even impossible to obtain insurance. As the saying goes, "fool me once, shame on you, fool me twice, shame on me." Commercial insurers don't like "shame on me" moments, and communities where people will destroy their own neighborhood aren't a good bet for providing coverage.

COVID? Civil unrest? 2020 is only half over. What is a business owner to do?
So, for some business owners commercial insurance may be enough to ride out the impact of civil unrest, but for others, insurance may come up short. What's a business owner to do?

Similar to 2001 and 2008, 2020 has demonstrated the need for middle-market companies to be prepared for the unexpected. And, the most straightforward to be prepared for the unexpected is to have more robust insurance coverage and more cash. For example, a business with more robust insurance coverage might have purchased business interruption policies that included triggers like:

1. Pandemic disease
2. Natural perils
3. Loss of access to their location
4. Supply chain interruption
5. Government & regulatory actions
6. Loss of key account

And, a business with more cash or access to more cash could more easily ride out a business slowdown or pay to move its operations in the face of civil unrest.

What is a middle-market business solution that provides both more robust insurance coverage and more cash?
For mid-market companies facing the rest of 2020 and unknown crises in the future, a solution that provides more robust insurance coverage and greater cash or liquidity is to own a captive insurance company. By combining commercial insurance with a captive insurance company, a business owner can establish a far more comprehensive and thorough risk management approach. This is also a better forward looking approach, because the captive insurance company will accumulate additional reserves in years with low claims. These reserves can provide more robust insurance coverage in the future and, when necessary, can be accessed by the business to address contingencies or unanticipated risks – extra cash.

What Is A Captive Insurance Company?
Simply put, a captive insurance company is a closely-held insurance company that insures primarily thought not exclusively your business. It is a C corporation and is licensed and domiciled like any large insurance company. Captives also have their own reserves, policies, policyholders, and claims. Insurance policies are issued by the captive to its parent or related companies and are actuarially priced. Owning a captive insurance company is a sophisticated way to self-insure, and captives are generally formed to insure the risks of a business, group of businesses and related or affiliated third parties.

Captive insurance companies can:

Fill Commercial Insurance Party Gaps
A captive insurance company can issue insurance policies that address gaps not covered by commercial insurers. Captives can also insure deductibles,

enabling the parent company to raise its deductible and lower its commercial insurance costs. Also, a business can enjoy more broad business interruption coverage with a captive when an adverse event occurs, particularly events where commercial insurance doesn't cover all damages or peripheral damages.

Utilize Customizable Coverage
Captive insurance companies can write customizable coverage for the businesses they insure. Many businesses face unique risks that may not be addressed by commercial insurers. Unique coverages can also be very expensive when covered by commercial insurers. This feature enables business owners and CFOs to say, "this has gone wrong in the past, let's insure against it in the future," or "other companies have experienced this adverse event, we can insure this via our captive." The flexibility afforded by a captive is extremely beneficial in a complex world.

Benefit From Few Or No Policy Exclusions
Captives can provide broad coverage without the exclusions that riddle typical commercial insurance policies. Insurance coverage is worthless if an exclusion prevents the insured from receiving a claims payment when it needs it most.

Avoid Sunk Cost Of Third Party Insurance
Premiums paid to a captive insurance company remain the property of the captive owners (usually the business or business owners). One of the reasons that most businesses are under-insured (EG only have business interruption insurance if property is damaged) is that purchasing insurance is a bit like purchasing a lottery ticket. If you don't win (or in the case of insurance, experience an adverse event resulting in a claim), your money is gone with nothing to show for it. With a captive, this simply isn't the case. Profits in the captive, defined as premiums collected less claims paid, belong to the captive owners.

Gain Access To Cash
Over time, businesses can build up substantial cash with a captive insurance company. This cash is available to pay insurance claims the business may have. And, it can also be accessed should the owner or the business require funds. Assets accumulated in a captive almost always out-pace retained earnings or a business' "rainy day fund." Because the captive is a formal form of self-insurance, it benefits from insurance law and favorable tax treatment. Hence, it is able to accelerate asset accumulation for two main reasons. First, premiums paid to the captive receive favorable tax treatment. Premiums paid to the captive are an expense to the parent company. This lowers the parent company's taxable income. As, the captive takes in premiums, it is taxed as an insurance company on its underwriting profits (typically defined as premiums less reserves to pay future claims). For large insurance

companies, underwriting profit is actuarially determined. However, small insurance companies can make an 831 (b) tax election, resulting in a tax rate of 0% (that's zero percent) on their underwriting profit. A small insurance company is defined as receiving premiums of $2.3 million or less per year.

Second, the captive is able to invest and grow larger pool of assets. Large commercial insurers have entire staffs whose sole purpose is to invest reserves (that have not been taxed).

For these reasons, a well-run captive insurance company will typically double retained earnings. And, the same claims that would be paid by the captive would have to be covered out of retained earnings anyway if the captive weren't in place.

Reap Long Term Insurance Profits
When business owners are ready to sell their business or retire, they keep the cash. A successful captive amasses wealth for its owners that can be accessed and enjoyed in the future. This unique ability to improve risk management and simultaneously stockpile cash makes owning a captive insurance company the clear choice in a post-COVID, post – riot world.

2020 has been a roller coaster year. We don't know if we are heading into the Roaring '20s, the Boring '20s, The Goring '20s or the Waring '20s. We hope it's either roaring or boring. Nevertheless, before another crisis strikes, now is the time for businesses to review their insurance policies and determine whether their insurance is truly enough to cover them when another storm comes. If the '20s are goring or waring, businesses will want more robust insurance and more cash to meet the challenges ahead

SOFE Editor's Note: *This article was originally published by CIC Services on its website on August 24, 2020. For the original versions of the article, please visit https://www.captivatingthinking.com/civil-unrest-points-to-the-importance-of-captive-insurance/. Reprinted with permission.*

About the Author

Randy Sadler started his career in risk management as an officer in the U.S. Army, where he was responsible for the training and safety of hundreds of soldiers and over 150 wheeled and tracked vehicles. He graduated from the U.S. Military Academy at West Point with a Bachelor of Science degree in International and Strategic History with a focus on U.S. – Chinese Relations in the 20th century. He has been a Principal with CIC Services, LLC for 7 years and consults directly with business owners, CEOs and CFOs in the formation of captive insurance programs for their respective businesses. CIC Services, LLC manages over 100 captives.

PwC NAIC Newsletter

Fall 2020

The National Association of Insurance Commissioners has been especially active in 2020 to address the many regulatory issues arising from the COVID-19 pandemic. This newsletter contains information on activities that occurred in meetings since January 2020, with a focus on the virtual Summer National Meeting and subsequent conference calls through September 30. For questions or comments on this Newsletter, please feel free to contact us at the address given on the last page.

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Executive Summary

- The NAIC established a Special Committee on Race and Insurance to address "racial inequality and promote diversity in the insurance industry."
- The Insolvency and Technology Task Force gave final approval to its Artificial Intelligence Guiding Principles document.
- The Statutory Accounting Principles Working Group adopted seven new Interpretations to assist on COVID-19-related accounting issues. The working group exposed the first draft of an issue paper that is expected to comprehensively revise SSAP 43R on loan-backed securities and exposed guidance on accounting for credit tenant loans.
- The Capital Adequacy Task Force adopted changes to the three RBC formulas to implement 20 NAIC bond rating classes for year-end 2020 (but without any factors assigned to the 20 designations). The Life RBC Working Group adopted its longevity risk proposal for certain annuity products for 2020 RBC; use of a zero-risk factor for 2020 will allow the NAIC to perform impact analysis. The Health RBC Working Group decided to defer implementation of its revised "health test" for determining which entities should file the health annual statement and instead will explore other options.
- The VOS Task Force adopted a revised definition of principal protected notes and removed the filing exempt status for these investments and also adopted revised instructions for financially modeled RMBS and CMBS to map the price breakpoints to the 20 bond rating classes for RBC purposes.
- The Group Capital Calculation Working Group made significant progress in 2020 on completing its work on the calculation template, instructions and confidentiality provisions.
- The Life Actuarial Task Force adopted AG 49-A, *Application of the Life Illustrations Model Regulation to Policies with Index-based Interest* on indexed universal life illustrations to increase consistency and transparency. The guidance is effective for policies issued on or after November 25, 2020. The task force also discussed the results of its YRT reinsurance reserve credit field test; the guidance may not in place for the 2021 Valuation Manual as originally hoped.
- The International Insurance Committee discussed the results of the IMF's FSAP review published in August, which concludes that the U.S. insurance regulatory system is in alignment with the Insurance Core Principles.
- The Casualty Actuarial and Statistical Task Force adopted its white paper on best practices for the regulatory review of predictive models.

PwC NAIC Newsletter

Falls 2020

Special Committee on Race and Insurance

In July, the NAIC formed this new Special Committee and held a two-and-a-half-hour session at the Summer National Meeting promoted as a "candid dialogue on the role of the insurance sector in addressing racial inequality and promoting diversity in the insurance industry." The meeting was a panel discussion of regulators and industry on the following topics:

- Historical context of racial discrimination within the insurance sector
- Current racially-based challenges within the insurance sector, including "current practices that potentially disadvantage minorities, including use of big-data and algorithmic-based underwriting models (i.e., proxy discrimination), access to quality and affordable healthcare, and low levels of financial literacy and access to insurance/financial products."
- How to increase diversity and inclusion within the insurance sector

Based on feedback received, the special committee has organized into five workstreams. Each work-stream has a charge to develop recommendations on action steps.

Workstream One – Research and analyze the level of diversity and inclusion within and access to the insurance industry and insurance products

Workstream Two - Research and analyze the level of diversity and inclusion within the NAIC and state insurance regulator community

Workstream Three, **Four and Five -** Examine and determine which practices or barriers exist in the insurance sector that potentially disadvantage people of color and/or historically underrepresented groups in the property and casualty, life insurance and annuities and health insurance lines of business.

Innovation and technology initiatives

Artificial Intelligence Principles

The AI Principles document, developed over numerous meetings in 2020, was adopted unanimously during the Summer National Meeting by Executive Committee and Plenary. The AI principles are based on the Organisation for Economic Co-operation and Development's (OECD) AI principles, which have been adopted by 42 countries, including the United States.

The guiding principles applies to including insurance companies, rating and advisory organizations and data providers. The adopted principles are as follows:

- Fair and Ethical
- Accountable
- Compliant
- Transparent, and
- Secure, Safe and Robust

Several of the meetings had extensive discussion related to proxy discrimination and whether it should be included in the AI Principles document. The adopted guidance includes the following: "AI actors should proactively engage in responsible stewardship of trustworthy AI in pursuit of beneficial outcomes for consumers and to avoid proxy discrimination against protected classes."

Anti-rebating

The Innovation and Technology Task Force continues to discuss anti-rebating, which relates to rebates of premium or other consideration associated with the use of smart home devices and telematics to mitigate risk.

A drafting group was formed in January to develop amendments to the NAIC's model Unfair Trade Practices Act (#880) to address anti-rebating and the inconsistent application of various states' unfair trade practices laws. Draft revisions to Section 4H of the model law to clarify what are permitted rebates was exposed for comment, and 23 comment letters were received and incorporated into a revised model that was presented at the Summer National meeting. The revised model was then re-exposed with comments due at the end of August. A timeline for adoption of the model law revisions has not been discussed.

Statutory Accounting Principles Working Group

Significant actions taken by the SAP Working Group since January 2020 are summarized below. (Appendix A to this Newsletter summarizes all actions taken by the working group since January.)

Newly adopted guidance

All of the Interpretations adopted in 2020 are posted to the SAP Working Group's webpage (under the Related Documents tab).

Guidance related to the effects of COVID-19 – The SAP Working Group met frequently this spring and summer to develop guidance to assist insurers in accounting for COVID-related issues. Most of the guidance adopted (detailed in Appendix B) is invested asset-related and will expire at the end of the third quarter or year-end 2020. Two of the most significant Interpretations adopted are INT 20-07, Troubled Debt Restructuring of Certain Debt Instruments Due to COVID-19, and INT 20-08, COVID-19, Premium Refunds.

INT 20-07 provides practical expedients in applying the loan concession guidance in SSAP 36: a 10% or less threshold for a "shortfall in the contractual amount due" (paragraph 10.a.) and up to a 3 year extension of the maturity date of the debt (paragraph 10.b.) are to be considered insignificant and not a concession. This allows insurance company creditors more leeway in not recognizing a TDR when a loan concession is given; a TDR requires the insurer to recognize a realized loss on the loan as the difference between the fair value of the collateral and the current carrying value of the loan. The Interpretation applies for the duration of the modification for concessions granted through December 31, 2020.

INT 20-08 provides guidance for the discretionary payments given to auto and health insurance policyholders to reflect the decreased activity/risk of insured losses due to the pandemic and related "stay at home orders." All health insurance and most auto insurance payments are to be reported as "immediate adjustments to written premium or unearned premium" (depending on the applicable period). However mutual insurers may record such amounts as policyholder dividends. After extensive discussion over multiple conference calls, a limited-time exception was granted to property and casualty lines of business when the reporting entity filed policy endorsements or manual rate filings prior to June 15, 2020; these payments are recorded as underwriting expense. The new guidance also includes significant new disclosures.

Transition from LIBOR – The working group adopted two important Interpretations related to the transition from the use of LIBOR as a reference rate in many types of contracts. INT 20-01, ASU 2020-04–Reference Rate Reform, adopts the related U.S. GAAP guidance as "broadly accepted for statutory accounting." The working group also adopted the "optional, expedient and exception guidance" from ASU 2020-04 for debt and other service agreements, leases and derivatives.

INT 20-09 provides guidance that mandatory basis swaps issued by Central Clearing Parties in response to reference rate reform are to be classified as derivatives used for hedging. This "used for hedging" classification, instead of an "other derivative" designation, will allow the basis swaps to be admitted assets under SSAP 86. However, these instruments shall not be considered "effective" hedging derivatives unless the swaps qualify as highly effective hedges under SSAP 86.

Preferred stock (#2019-04) – The SAP Working Group adopted the significantly revised SSAP 32R and related Issue Paper 164 effective January 1, 2021. Key revisions include adding preferred stock definitions and adopting U.S. GAAP guidance for classifying preferred stock as redeemable or perpetual and revising the measurement guidance to provide consistent measurement based on the type of preferred stock held and the terms of the preferred stock.

All perpetual preferred stocks shall be reported at fair value, not to exceed any currently effective call price. Under the previous guidance, perpetual preferreds rated NAIC 1- 3 held by life, fraternal and A&H companies were valued at amortized cost. The revised SSAP also provides clarified impairment guidance and new guidance for dividend recognition and redemption of preferred stock with the issuer. In August, the working group exposed for comment proposed guidance that would permit early adoption of SSAP 32R in 2020.

SSAP 51R – VM-21 Grading (#2019-47) – As PBR for variable annuities is retroactive for all policies in force and can be phased in over three years beginning January 1, 2020 (and up to seven years with domiciliary regulator approval), transition guidance is needed for SSAP 51R. In May, the working group adopted guidance, revised to reflect comments from interested parties. The final guidance no longer requires an allocation from

unassigned funds to segregated surplus for the amount not yet recognized in VA reserves. Instead, the working group agreed that disclosure would be adequate since the transition period is relatively short. Insurers subject to VM-21 will disclose the phase-in period being applied, the remaining time period, amount of valuation basis phased-in, and the remaining amount to be phased-in.

Significant exposures

SSAP 43R revisions – The SAP Working Group has been discussing for more than a year a project to revise SSAP 43R. This is due to regulatory concerns that the "current application of SSAP 43R by some entities has extended beyond SEC and Code of Federal Regulation (CFR) asset-backed securities, with investments captured in scope that are designed to meet explicit structural scope requirements of the SSAP." The working group believes this has resulted in securities being held by insurers that do not fully reflect the resulting investments held in SPV/trust which support repayment of the securities. They are especially concerned with securitizations done with equity-like investments that become "transformed" into debt securities.

As a result of these concerns, the project evolved from targeted changes to SSAP 43R to a full re-write. In March of 2020 the working group exposed for comment a 32-page issue paper on loan-backed and structured securities. The proposed guidance provides new definitions of asset-backed securities, which industry has commented would "have the potential for wide-ranging consequences affecting fixed income securities more generally."

The accounting and reporting of three new categories of securities are proposed as follows:

- "CFR Asset-Backed Securities" - Each ABS-rated debt tranche would be separately reported for accounting and RBC, which would require bifurcation of combination notes or other structures where ABS tranches have been combined to form a new security.

- "Non-CFR ABS (Traditional Securitizations)" proposes four principle concepts to identify securities that are principally similar to CFR ABS securities. If the four principles are met, this guidance proposes to have the securities treated in SSAP 43R as if they were CFR ABS. Like CFR ABS, each rated debt tranche shall be separately reported for accounting and RBC purposes.

- "Non-CFR ABS and Non-traditional Securitizations" – Accounting would vary based on whether there is only one underlying obligor, how the security is impacted by equity collateral, whether the security is a principal-protected note and other variables. If the underlying investment would not qualify as a bond if held directly, the issue paper proposes to require the underlying investment to be reported under the applicable SSAP.

The 67-page industry comment letter expresses several significant concerns including that the guidance has the "potential to drastically change the type of securities within the scope of both SSAP 26R and SSAP 43R that are currently afforded bond accounting treatment and reporting on Schedule D." They request that "if the end product of this project results in significant changes to bond accounting and Schedule D reporting, interested parties strongly believe any new scope requirements should be applied prospectively, so as to not penalize insurance companies who have complied with the rules prior to any such scope change."

A two-hour conference call has been scheduled for October 13 to review comments received and discuss next steps. The earliest possible effective date of a revised SSAP 43R appears to be year-end 2021, but year-end 2022 may be more likely.

SSAP 43R - Accounting for credit tenant loans (#2020-24) – The SAP Working Group exposed two options to provide explicit guidance on credit tenant loans, which are currently not separately addressed in the APP Manual. The options are to 1) continue treatment of conforming CTLs as SSAP 43R bonds, with nonconforming CTLs classified as either mortgage loans or SSAP 21 other admitted assets, or 2) classify all CTLs as SSAP 21 assets to be reported on Schedule BA. The industry comment letter noted that interested parties were "surprised and alarmed" to see that the exposure questioned whether conforming CTLs are, or should be treated, as bonds, since bond treatment has been used for the last 25 years for CTLs and these investment possess bond characteristics.

SSAP 71 – Commission Financing (#2019-24)
In 2019, the working group exposed for comment a proposal intended to prevent insurers from deferring the recognition of commission expense using financing transactions including those in which a third party (referred to as a super-agent) pays agents non-levelized commissions and an insurer pays the super-agent levelized amounts.

Despite strong objections from several insurers, the regulators have reiterated their belief that the original intent of SSAP 71 was that for levelized commission arrangements that represent repayment of an advance should be accrued as a liability. The following footnote has been added to SSAP 71: "the guidance … notes that that levelized commissions which use a third party to pay agents that are linked to traditional elements require establishment of a liability for the amounts that have been paid to the agents and any interest accumulated to date."

At the Summer National Meeting, the working group again had extensive discussions with the opponents of the revised guidance. The working group then re-exposed the proposed changes, adding transition guidance that the effect of adoption should be recorded as a correction of an error in accordance with SSAP 3 as of December 31, 2020. The proposed transition guidance is inconsistent with how clarifications of guidance have been accounted for in the past, which has been as a change in accounting principle.

The working group has scheduled an October 15th conference call to finalize revisions to SSAP 71.

Risk-based capital

The regulators made the following significant progress on RBC projects. (Appendix B summarizes other actions taken by the various RBC Working Groups since January 2020.)

Investment RBC
The Capital Adequacy Task Force adopted its proposal for Life, P/C and Health RBC to implement the 20 NAIC rating classes for year-end 2020 (2019-16-CA). The adopted bond pages do not include any proposed risk charges; they are meant to summarize bond carrying values by the 20 classes so that the NAIC can perform impact analysis to determine the effect of various factors on RBC results.

The Blanks Working Group had previously adopted related changes to Schedules D, DL, and BA to add an electronic only column to capture the NAIC Designation Categories (2019-18BWG) and to expand the AVR for the 20 categories (2020-17BWG).

During its September 25th conference call, the Life RBC Working Group discussed that the ACLI is working to engage a consultant (with input from the working group) to review the AAA-proposed bond factors, which the ACLI and other interested parties believe are too high. The chair stated that he hopes to implement the new bond and real estate factors for 2021 RBC.

Life RBC
Longevity risk – After significant discussion by both the Longevity Risk Subgroup and the Life RBC Working Group, the NAIC adopted guidance (2019-13-L) to implement longevity risk in the Life RBC formula. The regulators made a last-minute change to adopt a zero charge for 2020 so that the NAIC can stress test the effect of different factors with and without covariance between longevity and mortality risk. The products scoped in for 2020 are as follows: single premium immediate annuities (SPIA) and other payout annuities in pay status, deferred payout annuities that will enter annuity pay status in the future upon annuitization, structured settlements for annuitants with any life contingent benefits, and group annuities, such as those associated with pension liabilities with both immediate and deferred benefits. Instructional changes (2020-06-L) have also been adopted.

Mortality Risk – The AAA's C-2 Mortality Work Group is reviewing the assumptions and methodology for life insurance (individual, industrial, group and credit life) to update the original 1993 factors. (Per the Academy, preliminary modeling indicates an estimated decline in factors versus current.)

In September, the Life RBC Working Group heard an update from the Academy on its progress. Most of the meeting was spent discussing Academy proposals to 1) add a factor to address "unknown risk catastrophes" and 2) differentiate factors by individual life products. Regarding the latter, for example, products with less in-force pricing flexibility (e.g., longer level term and ULSG products) would be modeled with a 10-year projection period and products with more in force pricing flexibility such as permanent whole life and annually renewable term) would be modeled with a 5-year projection period. Feedback from the regulators was that they did not want to incorporate an "unknown risk" component and thought it is premature at this point to differentiate among life products but would want to reconsider that later.

The next steps for the work group are to finalize the model and assumptions in the next few months, review the group life premium stabilization reserve credit, review mortality capital requirements in other solvency regimes, review aggregate model output, complete documentation, peer review, and finally, recommend updated factors to the work group.

VA Framework and C-3 smoothing – In 2019, the Life RBC Working Group exposed for comment proposal 2020-03-L, which addresses an issue related to voluntary reserves held under the "old" VA Framework in which the impact of changes to these voluntary reserves was not properly considered. In 2020, final guidance was adopted, which provides phase-in and smoothing guidance, and which also includes deletion of instructions specific to 2019 which are not applicable for 2020 and beyond.

2020 NOI calculation – Industry has requested temporary changes to the commercial mortgage RBC net operating income calculation as a result of the effects of COVID-19 on mortgage loan income. The current proposal, which would be first effective for the 2021 calculation, is the following:

> Where RBC reporting instructions specify 2020 NOI as an input into the calculation of Rolling Average NOI for 2021, 2022, and 2023 RBC reporting, use the greater of 1) 2020 NOI or 2) 85% of 2019 NOI.

The intent of the changes is to reduce the impact of the pandemic on mortgage loan income for mortgages that were performing prior to the pandemic and will return to being performing mortgage in 2021. The ACLI representative noted that based on their modeling a reduction in NOI of 15% would result in an 8% increase in required RBC. The working group exposed the industry proposal for a short comment period and will discuss comments during a subsequent meeting.

P/C RBC

Review of underwriting risk component – The AAA continues to work on its Line 1 underwriting risk reserves and premiums methodology, which they will present at the P/C RBC Working Group's next meeting on October 27.

Catastrophe risk – The Catastrophe Risk Subgroup will discuss the possibility of adding wildfire peril to the catastrophe risk charge (Rcat) during its upcoming October 19 meeting.

Health RBC

Health Annual Statement Test – The Health RBC Working Group exposed for comment in 2019 a proposal to revise the annual statement "health test," which would move filers who write predominantly health business (premium ratio of 90% or more for the current year and prior year) and file on the life or property/ casualty blank to begin filing on the health blank. This proposal is an effort to capture the one-third of "missing" health premiums filed on other blanks.

In August the working group decided to put this proposal on "pause" to pursue other options, such as new schedules for the Life and P/C blanks, due to the significant work involved in switching annual statements. For example, life companies may not have been capturing data necessary for the Five-Year Historical Data page for the Health blank.

Health care receivable factors – The Health RBC Working Group has been studying the need to revise the RBC charges for all heath care receivables. The regulators have concluded that data quality needs to be improved before revised factors should be considered. In August, the working group exposed for comment "Guidance on reporting Exhibit 3A collection and offset amounts." After the guidance is finalized, the working group will ask the Blanks Working Group to post the information on its webpage as unofficial guidance for 2020 reporting. The information gathered 2020 through 2022 will be used to develop factors.

Health RBC bond factors – The Health RBC Working Group continued its discussion of the AAA-proposed bond factors for health RBC. Based on comments received from industry, the working group agreed to ask the AAA to incorporate investment income in the modeling of Underwriting Risk factors. (As part of that discussion, the Academy noted that they did not believe it would be appropriate to ascribe all investment income to offset default risk.)

The regulators asked the Academy to model factors using a five-year time horizon, in addition to the modeling using a 2-year time horizon. The results of that modeling showed an increase in the factor for the ten rating classes modeled using five years, some of which are significant. For example, the factor for a BBB bond increased from 1.2% using 2 years to 2.5% for 5 years.

Valuation of Securities Task Force

The task force had significant activity on the following projects.

P&P Manual amendment adoptions

Principal Protected Notes (PPNs) – SVO staff and industry worked together in 2020 to refine and narrow the definition of PPNs. The task force then adopted a significant amendment to revise the definition of PPNs and remove this class of security

from eligibility for filing exemption. The adopted definition includes the following:

> PPN (sometime called "Principal Protected Securities," "Principal Protected Loans," or "Combo Notes") ...are a type of security that repackages one or more underlying investments and for which contractually promised payments according to a fixed schedule are satisfied by proceeds from an underlying bond(s) but for which the repackaged security generates potential additional returns...

The regulatory concern is that these instruments may have other than non-payment risk and the debt rating of the PPNs "obscures the overall risk of performance asset," and should not be classified as filing exempt. Some of these instruments may be eligible for Schedule D reporting, if designated as such by the SVO after its review. The amendment also includes examples of structures that meet the definition of a PPN. Excluded from the definition are broadly syndicated securitizations like collateralized loan obligations and asset-backed securities (except as described in the examples).

This amendment is effective January 1, 2021 and PPNs acquired prior to January 1, 2021 must be filed with the SVO by July 1, 2021.

Financially modeled RMBS/CMBS securities – The task force amended the P&P manual to add instructions to map the financially modeled RMBS and CMBS NAIC designations based on current price breakpoints to the 20 new NAIC designation categories. For year-end 2020 this will be done through an electronic-only column. The mapping is a temporary measure for reporting NAIC designation categories until new RBC factors are adopted. For RBC data gathering purposes, modeled RMBS and CMBS that result in an NAIC 1 designation will be mapped to category 1.D (the fourth highest rating). Securities modeled 2-5 are mapped to 2.B, 3.B, 4.B and 5.B respectively. In addition, tranches that have no expected loss under any modelling scenarios will be mapped to the highest NAIC designation category of 1.A.

The continued use of financial modeling and book adjusted carrying value price breakpoints to determine designations for RMBS and CMBS securities was retained by the task force although moving to a single NAIC designation was previously recommended by SVO staff given the complexity of using breakpoints with the 20 new granular designations. However, industry was concerned about the adverse impact to RBC.

New SEC rule on ETFs – The task force adopted proposed amendments to the P&P Manual to remove references to SEC exemptive orders from the descriptions of ETFs. The intent of the SEC rule change is to modernize the regulatory framework for ETFs.

Short-term credit rating provider ratings - The task force adopted an amendment to update the table in the P&P Manual that maps CRP ratings for short-term instruments to also map them to NAIC designation categories. As there is no one-to-one mapping between short-term and long-term ratings, the mid-point of the range of the long-term ratings covered will be used to map the short-term ratings to the NAIC designations.

Sovereign rating limitation for filing exempt securities – The task force adopted an amendment to clarify that the sovereign rating limitations apply to filing exempt securities and that all NAIC designations for foreign securities including those filing exempt and those rated by the SVO are capped by the Sovereign NAIC Foreign Designation Equivalent List when reporting on the Supplemental Investment Risk Interrogatories. (The individual security rating can be no higher than the related sovereign rating.) The task force also adopted an amendment to include supranational entities (e.g. European Union) filed with the SVO to the list.

Exchange traded funds – The task force added instructions to the P&P manual to allow ETFs that hold a portfolio that is a combination of bonds and preferred stock (i.e., not just predominately bonds or predominately preferred stock) to be included on the SVO-Identified Preferred Stock ETF list and reported on Schedule D, Part 2, Section 1.

Extension of the 2020 filing deadline for newly acquired or in-transition securities - The task force agreed to temporarily extend the 2020 initial filing deadline from 120 days to 165 days for newly acquired securities or in-transit securities due to delays caused by COVID-19.

<u>P&P Manual amendment exposures</u>

Use and regulation of derivatives in ETFs - The task force exposed an SVO report that discusses the use and regulation of derivatives in exchange traded funds and the SEC's proposed Rule 18f-4 which includes a derivative risk management program requirement and a value-at-risk (VaR) based limit on

leverage. The SVO does not believe the rule will change how it analyzes derivatives in ETFs as the focus of that analysis is whether the cash flows are fixed income-like, but the rule may provide more information on ETFs' use of derivatives.

Bespoke securities – In May, the task force received and exposed an SVO issue paper on concerns about bespoke securities (securities that are not broadly syndicated and are usually privately rated by only one credit rating provider) and reliance on CRP ratings. There are several recommendations in the issue paper including:

- Establish a process to monitor and evaluate rating agency activities,
- Require legal documents of "red flag" bespoke securities to be filed with the SVO for analysis,
- Modify the filing exempt rule, and
- Expand the use of the SVO and increase regulator reliance on the SVO for these securities.

After the comment period, the task force directed the staff to begin drafting incremental recommendations to address the identified risks.

Nonconforming credit tenant loans – The task force exposed an amendment to update the instructions in the SVO P&P Manual for nonconforming CTL transactions (leased-backed securities that do not meet the definition of a CTL or ground finance lease) that relied upon credit ratings but were determined not to be eligible for filing exempt. The instructions clarified there should be no presumption of approval of the use of the CRP ratings for NAIC designations and that all nonconforming CTLs acquired prior to January 1, 2020 are to be filed with the SVO for assessment. The exposure period ended in June. The task force also referred this issue to the SAP Working Group to affirm that SAPWG would consider these loans to have characteristics of a bond, if assigned an NAIC designation by the SVO.

Requirements for material credit events - The task force heard a report from the NAIC staff reminding insurers to timely file material change statements with the SVO and reiterating that it is not just the responsibility of the lead lender. The discussion also included SVO's approach to assessing credit quality and the importance of considering liquidity and business and financial positions of the companies.

Group capital calculation

The Group Capital Calculation Working Group has met numerous times in 2020 to discuss 1) the results of the field test of 32 companies and proposed revisions to the GCC template and instructions to reflect feedback from the field test, 2) confidentiality provisions for filing the calculation, and 3) applicability and use of GCC by the regulators.

Comments have been by organized by NAIC staff into core issues which include: use of GCC by regulators, definitions included in the instructions including financial entities and materiality, the scope of entities included in the calculation, use of scalars, and the treatment of debt. Much of the discussion in 2020 has focused on two issues:

Calibration Level: The current GCC is calibrated to a 300% Authorized Control Level. Many insurers have taken issue with this given that current insurance entity NAIC RBC is calibrated at 200% ACL. There is concern that including a different level of calibration would create confusion for comparison purposes, and that the higher standard at a group level is more onerous than the stand-alone requirements. During the discussions, there was no indication that the working group would change the 300% ACL calibration level.

Financial Entities: These issues include both the definition of Financial Entities as well as the capital charges being suggested. Industry representatives have commented that the definition of Financial Entities is too broad and "one size fits all." In addition, there is no diversification credit given to Financial Entities.

During the working group's September 29 call, the regulators discussed proposed changes to the template and instructions, including revisions to the definition of Financial Entity and exposed the revisions for comment until October 15. At the close of the meeting, the chair stated that in his view the calculation and instructions are "close to being finished" and after the current exposure period, they will be ready for a fatal flaw review.

The earliest effective date for filing the GCC appears to be 2022, based on year-end 2021 data.

Reinsurance Task Force

At the Summer National Meeting, the task force heard an update on the progress of states' adoption of the 2019 revisions to the Credit for Reinsurance Model Law (#785) and Regulation (#786) to comply with the EU and UK Covered Agreements by September 1, 2022. Eleven U.S. states have adopted the revisions to the model law, and 17 jurisdictions have action under consideration. Progress has been slowed by COVID-19 because some states had to stop all legislative activity this spring or curtail sessions.

Financial Regulation and Accreditation Committee

During the Summer National Meeting, the committee adopted a clarification to the 2019 and 2011 revisions to Credit for Reinsurance Model Law (#785) and Regulation (#786) to make them applicable as accreditation standards for risk retention groups organized as captives with an effective date of September 1, 2022.

During its Summer National Meeting, the committee also adopted technical corrections to the Term and Universal Life Insurance Reserve Financing Model Regulation (#787) accreditation standard to incorporate changes made to Model #785 during the 2019 Fall National Meeting.

Principles-based reserving

Valuation Manual amendments
During LATF calls from January through the Summer National Meeting, many APFs were discussed, exposed or adopted, the most notable being the following.

Adopted guidance

APF 2019-58 provides that updates to templates prescribed by the Valuation Manual are considered substantive, and therefore subject to VM governance requirements for substantive changes.

APF 2019-60 removes the requirement for companies to apply the same credibility method to all business subject to VM-20 (e.g. a company using the Buhlmann method for fully UW business may use Limited Fluctuation method for business issued on 2008 VBT).

APF 2019-61 clarifies that universal life policies with secondary guarantees are not eligible for the Life PBR Exemption, regardless of whether the secondary guarantee is embedded in the base policy or is a separate rider.

APF 2019-62 emphasizes the requirement to reserve for additional risk arising from the conversion of term life insurance and provides guidance on Life PBR Actuarial Report content relative to conversions.

APF 2020-03 clarifies that the direct calculation of mean and mid-terminal net premium reserves to reflect non-annual premium modes is acceptable, consistent with language in SSAP 51R.

APF 2020-05 clarifies that the NPR assumes deaths occur continuously and there is an immediate payment of claims; this applies to death claims and not cash values paid upon surrender.

APF 2020-06 provides that when the NAIC determines LIBOR is no longer effective for the calculation of interest rate swap spreads, the NAIC shall recommend a replacement to LATF which shall be effective upon adoption by LATF. The APF also changes the methodology for calculating the 3-month and 6-month swap spreads to use market observable data rather than the average of values from third parties.

APF 2020-07 replaces VM references to the 4% interest rate floor on the life standard nonforfeiture rate with language that sets the floor to the rate determined in IRC Section 7702, consistent with changes to IRC Section 7702 resulting from the Heroes Act.

Significant exposures

APF 2019-33 proposes changes to clarify that group life contracts with individual life certificates meeting certain requirements are included in the requirements of VM-20. LATF discussion and subsequent updates to the APF originally exposed in Fall 2019 clarify the requirements that must be met for individual life certificates under group contracts to be included for purposes of VM-20. (re-exposed until October 25).

APF 2019-34 proposed changes introduce a new section in VM-30 to provide guidance for treatment of mod-co reinsurance, specifically that such business remains subject to the applicable valuation laws after reinsurance, and to clarify responsibilities

of the appointed actuaries for both the ceding and assuming companies.

APF 2020-02 proposed changes clarify VM-20 Section 2.H and introduce Section 2.I to ensure that companies do not skip mandated steps on grounds of materiality or reliance on approximations. A guidance note provides examples of steps that cannot be omitted (e.g. computation of NPR, inclusion of prescribed margins) (comment period closed; under discussion).

Other VM project updates

YRT Reserve Credit Field Test
Work has progressed on the Academy's YRT Field Test to study the impacts of proposed alternative methodologies for reflecting YRT reinsurance reserve credit in life deterministic and stochastic reserves. The NAIC has engaged Oliver Wyman to facilitate the study, including analysis of results under three APFs and a survey of the methods and assumptions companies expect to use in modeling reserves under these APFs (the "range of interpretation survey"). The APFs incorporate revisions which address alternative mortality improvement scenarios (2019-40), prudent estimates (2019-41) and prescribed reinsurance premium margins (2019-42).

LATF members discussed the initial analysis performed to establish base cases to be used to analyze and evaluate the various amendment proposals. The analysis demonstrates the potential variation in reinsurance reserve credit depending upon adjustments assumed in the YRT reinsurance premiums and differences between PBR mortality and best estimate mortality. At the Summer National Meeting LATF members discussed the results of the field test and the range of interpretation survey; reports for these activities were published by the Academy and are available on the LATF website.

- *YRT Range of Interpretations Survey*
- *YRT Field Test Report*

Of 187 companies requested to participate, ultimately only 10 companies participated in the field test (but which represented a good cross section of the industry): 7 reporting on term business and 8 reporting on universal life with secondary guarantees. These participating companies were all direct writers and reflect a wide range of annual sales and mortality credibility. The participating company results under the base scenario (½ cx) and the provisions of each APF were evaluated relative to corresponding results from the representative PBR model, which was refined based on field test submissions to reflect more granularity in the most significant drivers of variation. The biggest driver of the variation in results was the relationship between the current scale of rates and anticipated mortality. The representative PBR model was then used to confirm the integrity of the submissions and provide insights to the variability in results.

The interpretation survey asked participants to detail how they would implement each of the proposed solutions. Responses were received from 36 companies, both direct writers and reinsurers, representing 55% of the industry measured by total face amount on new business. For each YRT treaty with a separate modeling approach, participants were asked to provide standardized responses on how YRT premium rates would be adjusted based on language presented in each amendment proposal. Several options were provided including no change to YRT premiums, reactive (with variation in frequency, triggers and basis for increase), and break-even. Responses varied notably for each proposal, pointing to several considerations for the ultimate solution including level of prescription, modeling complexity, potential for variability in results, potential for asymmetry between assumed and ceded company interpretation and defined level of risk sharing.

LATF members took no action on this matter at the Summer National Meeting; discussion will continue on a future call. The original project timeline targeted LATF to adopt a recommendation to affect the 2021 Valuation Manual. Although timing of adoption was not discussed at this meeting, it appears any change will now be targeted for the 2022 Valuation Manual.

Experience reporting
The NAIC became the life mortality experience reporting agent on January 1, 2020, concurrent with the effective date of VM-20. The NAIC had notified 176 companies selected to submit mortality experience data in 2020 and was set to begin the data call in Q2 2020. However, in April the ACLI requested a one-year delay in the data call because of disruption experienced by life insurance companies due to the COVID-19 pandemic. The NAIC supported the proposal and drafted a memorandum which recommends the collection of data for the 2018 and 2019 observation years in 2021. LATF members unanimously endorsed the recommendation, which was ultimately approved by

the Executive Committee and Plenary at the Summer National Meeting.

VM-22 Fixed Annuity PBR
LATF heard updates from the VM-22 Subgroup and the Academy Annuity Reserves Work Group (ARWG) on activities related to fixed annuity PBR. The ARWG continues work on development of a fixed annuity PBR framework and has discussed the following aspects of the developing framework.

- Scope: The framework is expected to include accumulation annuities as well as income annuities.
- In force application: The ARWG sees merits to retrospective application, but no decisions have been made.
- Approach: ARWG envisions a CTE 70 stochastic reserve calculation, consistent with VM-21 and incorporating elements of VM-20 as appropriate.
- Exclusion test: The group recommends an exclusion test similar to that in VM-20; products which pass the exclusion test would be subject to valuation under AG 33.
- Reinvestment assumptions: ARWG anticipates proposing guardrails reflecting elements of VM-21 and VM-22.
- Standard Projection Amount (SPA): Regulators have mixed views on the need for a SPA and whether it should be a reserve floor or a disclosure item; discussions on this matter are ongoing. The ARWG proposes only a modeled reserve.
- Aggregation: The subgroup discussed aggregation across product types but a decision on this matter has been tabled until the framework is fully developed.

The ARWG preliminary timeline reflected completion of the non-variable annuity PBR framework in 2020 and adoption in time to be effective January 1, 2023, however, the Subgroup chair indicated January 1, 2024 may be more realistic considering current progress.

Considering the progress toward a PBR methodology for non-variable annuities, including the use of exclusion tests, the subgroup voted to pause work by the Academy SVL Interest Rate Modernization Work Group to develop a new methodology to establish non-SPIA non-variable annuity valuation rates. This work will resume once the exclusion tests and other aspects of non-variable annuity valuation are further developed.

Life Actuarial Task Force

IUL Illustration Subgroup
In June LATF members adopted *Actuarial Guideline XLIX-A - The Application of the Life Illustrations Model Regulation to Policies with Index-Based Interest* (AG 49-A). AG 49-A was subsequently adopted by the NAIC at the Summer National Meeting and is effective for new business and in-force illustrations on policies issued on or after November 25, 2020. The adoption of AG49-A is the culmination of work that began in late 2018 to increase transparency and consistency between illustrations of products with multipliers, cap buy-ups, and other enhancements that are linked to an index or indices as compared to illustrations of products without such features. The Indexed Universal Life Illustration Subgroup and LATF members debated changes to AG 49-A in calls and meetings over the past 18 months, and ultimately reached consensus on regulator and industry concerns relative to timing, applicability and various technical matters. The revised guidance incorporates provisions which allow for innovation but prevent loopholes, recognizing that product complexity will continue as companies search for yield opportunities, and the guidance may need more consideration in the future.

Standard Nonforfeiture Law for Individual Deferred Annuities (#805)
In May LATF members exposed proposed revisions to the *Standard Nonforfeiture Law for Individual Deferred Annuities (#805)* to lower the minimum nonforfeiture rate from 1% to 0%. The change was proposed by the ACLI, considering the current economic environment and low interest rates, to allow companies to support the nonforfeiture guarantees in their deferred annuity contracts. The Executive Committee agreed to reopen the model for LATF to consider revisions to the minimum rate; Life Insurance (A) Committee asked the task force to consider a rate between 0% and 0.5%.

2020 Life Mortality Improvement Factors
At the Summer National Meeting LATF heard a presentation from the Life Mortality Improvement Subgroup (LMISG) of the Academy Life Experience Committee and SOA Preferred Mortality Project Oversight Group regarding updates to the Life

Mortality Improvement Factors for use in 2020 valuations.

VM-20 Section 9.C.3.g provides that companies may reflect historical mortality improvement, but not future mortality improvement. Currently the methodology used by the LMISG to develop the mortality improvement factors reflects data for the 10 year experience period ending two years prior to the current valuation year (i.e. 2018 for 2020), and a moving average is used to smooth out the impact of any one year or event. Hence, COVID-19 impacts would not be automatically reflected in the 2020 factors unless there was a change in methodology; COVID-19 effects would, however, be reflected in the 2022 mortality improvement factor scale update.

The subgroup noted experience data is limited and the need to understand more long-term impacts of COVID-19 before reflecting anything in the mortality improvement scale, and therefore recommends no change in methodology for 2020 and no “shock effect” adjustment to the 2020 scale. LATF members discussed alternatives to reflect COVID-19 impacts, but no actions were taken during the meeting, with several regulators noting that companies would likely adjust the assumption as needed to reflect their own experience.

Annuity suitability

Following the adoption of the revised Suitability in Annuity Transactions Model Regulation (#275) in February 2020, some states have started the process of adopting the new regulation. To assist state regulators with informing their legislators about the revisions, the Annuity Suitability Working Group has begun development of an FAQ document, which will promote greater uniformity across NAIC member jurisdictions. The FAQ document was exposed for comment until October 2.

Retirement security initiative

The Life Insurance and Annuities Committee renewed its commitment to the Retirement Security Working Group following the withdrawal of the chair. To date, a draft work plan had been developed and comments were received in January 2020. The committee hopes to finalize the draft work plan shortly so that the working group can continue with its charge.

Long-term care issues

Long-Term Care Insurance (EX) Task Force
During the Summer National Meeting the task force heard an update from its six workstreams; the meetings of the workstreams are not currently open to the public but are expected to be opened at some time in the future. The task force also adopted the consolidation of the six workstreams into three subgroups; LTCI Multistate Rate Review Subgroup, LTCI Reduced Benefit Options Subgroup, and the Financial Solvency Subgroup.

Multi-state rate review practices – The goal of this workstream is to develop a recommendation for a consistent national approach to multi-state LTCI rate reviews. The workstream members are currently reviewing several rate filings as part of a pilot project and determining what the final work product will be. The plan is to have a process in place by the end of the year.

Restructuring techniques – This workstream will focus on alternatives to receivership for LTC insurers. This workstream group has developed a scope of work and list of qualifications for a legal consultant to review restructuring options. The group anticipates issuing an RFP.

Reduced benefits options (RBO) – This group is focused on information gathering on practices for the state regulatory review of reduced benefit options in lieu of premium increases, and consumer notices sent by companies. The group will also evaluate whether reduced benefit options offered to consumers are fair and equitable.

During its July meeting, the task force exposed a draft RBO Principles document intended to provide guidance to state regulators as they evaluate RBO offerings and covers issues including fairness and equity for policyholders, clarity of communications, whether states should encourage or require companies to offer certain RBOs, and product innovation. Industry comments were supportive and provided three broad principles for a review: it should not be required to modify a contract, it should consider the impact on remaining policyholders, and it should ensure no unfair discrimination. The group will also start developing a principles document for consumer notices.

Valuation of LTCI reserves – This workstream is focused on multi-state coordination/communication of the review of the financial condition of LTCI insurers and actuarial reviews of LTCI blocks. Much of this work is being done by the Valuation Analysis

Working Group's review of LTC insurers' AG 51 (Application of Asset Adequacy Testing to LTCI Reserves) reports. In 2019, the VAWG's focus was on morbidity improvement, rate increases and investment return assumptions. In 2020, the focus will be on morbidity, including cost of care projections, effect of underwriting and what happens with older age policies. The group developed and exposed a document (to regulators only) "to help ensure states' LTC rate review and reserve teams are coordinating."

Non-actuarial inputs to state rate approvals – As a result of a 14-state survey on departments' policies, practices and authority to modify rate increases based on non-actuarial factors, the regulators learned that nearly all states responding indicated that they have authority to consider non-actuarial factors in the rate approval process. The top three factors were phase-in periods, limits on the amount of allowed rate increases at any one time and waiting periods between rate increase approvals and subsequent requests. The survey also found that the length of phase-in and waiting periods and the threshold for caps varies from state to state. The workstream used the survey information to adopt its recommendations that address the following for possible best practice: caps, phase-in periods, solvency effect, waiting periods, size of the block, and age of the policyholders.

Data call design and oversight – This workstream is exploring whether additional data is needed to support the work of the task force or workstreams. To that end, the NAIC hired an LTC consulting group to conduct a data call of 19 insurers selected by the regulators from the seven states responsible for this workstream in order to "accumulate, analyze, and describe to the NAIC the current level of rate inequity among states' policyholders." Most of the selected insurers have completed the data call and the consulting firm is analyzing the results. Once complete, a report will be made available.

LTC actuarial topics

The LTC Actuarial Work Group heard a presentation from the joint Society of Actuaries and Academy LTC Valuation Work Group. The charge from the NAIC is to develop proposed mortality and lapse tables for use as prescribed assumptions for statutory minimum reserves. The joint group presented detailed results of draft mortality, mortality improvement and lapse rates; the remaining work of the joint group is considering mortality on an active life basis and drafting its report.

The LTCAWG heard a presentation on the current SOA LTC experience study. Data has been collected from 18 companies and includes the experience of 2012-2016 calendar years. The experience includes 80% of the industry 2016 earned premium. New data not included in prior experience studies include additional underwriting information, expanded benefits information and ICD 9/10 claims information. There is heightened awareness on the part of companies regarding HIPAA privacy. The experience data will be grouped for attained ages 90 and above following HIPAA Safe Harbor Rules. The chair voiced a concern regarding the grouping of data for attained ages 90 and above and asked that SOA consider how the results could be disaggregated.

The LTC Pricing Subgroup has been discussing Cash Value (CV) Buyouts in lieu of rate increases. Regulators are concerned with the impact of CV Buyouts on the remaining pool of insureds. There is proposed legislation in Connecticut to convert stand-alone LTC policies to a hybrid LTC/Life product. The statutory reserve of the stand-alone LTC policy would be used to fund the new hybrid policy.

The chair of the LTC Valuation Subgroup gave observations of the impact of COVID-19 on LTC. Overall, COVID-19 leads to additional uncertainty in LTC experience. It is expected that the increase in disabled life mortality will result in shorted claim durations for the next 1 -2 years; the chair commented that the impact to loss ratios is not material, approximately 1% - 2%. However, any changes to attitudes regarding LTC facilities will have a longer impact. In addition, the decrease to an already low interest rate environment has a significant impact on LTC.

Health Actuarial Task Force

The task force discussed the following significant issues in 2020.

COVID-19 claim costs

The task force heard a presentation from the Society of Actuaries on recent SOA health research. The SOA has developed a 2021 Health Care Cost Model to assist regulators, insurance company actuaries and consulting actuaries in estimating the impact of COVID-19 on claim costs. The model is a VBA Excel model projecting future monthly costs with user inputs for commercial group and individual, Medicare and Medicaid lines of business. The model includes different types of trended costs. The model,

user guide, training and documentation guide are available for download.

ASB update
HATF heard an update on Actuarial Standards Board activities. Proposed revisions to ASOP 28, now titled *Statements of Actuarial Opinion Regarding Health Insurance Assets and Liabilities* has been exposed for comment until November 13. The ASOP provides guidance to actuaries when performing actuarial services with respect to issuing or reviewing a statement of actuarial opinion regarding health insurance assets and liabilities.

The ASB has adopted Actuarial Standards of Practice 56 *Modeling*, which provides guidance to actuaries when performing actuarial services with respect to designing, developing, selecting, modifying, using, reviewing, or evaluating models, and is effective October 1, 2020.

Restructuring Mechanisms

The Restructuring Mechanisms Working Group has not held a public meeting in 2020. Its scheduled in August was cancelled with the following information: "COVID-19 and its many ramifications over the past several months have taken attention away from the important and on-going work of the RMWG. While drafting and preparation of the White Paper is in progress, a draft is not yet ready for circulation and discussion at the 2020 Summer National Meeting. We hope to have a chair's draft out within the next 60 days for public view and comment at an upcoming RMWG meeting."

Financial Stability Task Force

Liquidity stress testing framework
In April via an e-vote, the task force approved pausing its work on the 2019 liquidity stress test in process and added a 2020 charge to assess "how the insurance sector is navigating market conditions due to the economic impact of the pandemic." When work resumes, the stress test will consider a pandemic in conjunction with an economic stress as a testing scenario.

International Insurance Relations Committee

The committee heard update on projects in process.

FSAP review
In August, the IMF published the final results of the 2020 Financial Sector Assessment Program's review of the U.S. financial regulatory system. The IMF concluded that the U.S. insurance regulatory system is in alignment with the Basel Insurance Core Principles and that the observations from the 2015 FSAP report are being appropriately addressed. Strengths of the U.S. state-based system include implementation of PBR and risk-focused surveillance and monitoring invested asset risks. Recommendations include "further development of risk-based supervision, consistency of life insurer liability valuation methods, further regulatory requirements in corporate governance, and enhancing regulatory responses to the increasing risk and severity of natural catastrophes."

The observations from the published report will be reviewed and allocated to the appropriate committees to be addressed; however, in instances where there is disagreement with the observation or recommendation, constructive feedback will be provided to the IMF.

ComFrame gap analysis
Following the adoption of ComFrame by the IAIS, the responsibility of implementation of ComFrame was assigned to the Group Solvency Issues Working Group. To address this charge, the working group has performed a gap analysis, comparing the key elements of ComFrame to existing elements of U.S. regulation, including recent amendments to the holding company models and the establishment of ORSA requirements. In addition to identifying gaps, recommendations were outlined to address the gaps. Some of the recommendations require finalization of projects already in progress with the GCC Working Group, Receivership and Insolvency Task Force, and the Liquidity Assessment Subgroup. For some of the more significant recommendations requiring an update to the Financial Examiners Handbook and ORSA Manual, drafting groups will be formed to address the recommendations.

Interested parties expressed concern that there was not enough information on the gaps and recommendations to draw conclusions on whether the analysis and recommendations are appropriate.

IAIS update
The International Association of Insurance Supervisors launched its annual global monitoring exercises in March as part of the implementation of the Holistic Framework. The exercise has been refocused on COVID-19 related information to assist with forming a view of the impact of the coronavirus on the insurance industry and included specific COVID- 19 data collection. Themes noted were the "potential materialization of credit risk in insurers' investment portfolio," impact of the low interest rate environment, business interruption, operational resilience and increased cyber risk due to so many people working from home. Reporting of the results has been postponed to October 2021 and will inform the global risk dashboard.

The IAIS is also engaged on other COVID-19 issues, including coordination of information sharing on supervisory responses, collaboration with supervisors on risk assessments, replacement of in-person meetings with virtual events, and adjustment to the 2020-2021 roadmap to accommodate challenges with various deadlines.

The IAIS completed and exposed the liquidity risk management application paper and began drafting the macroprudential supervision application paper to provide guidance on the Insurance Core Principles (ICP) 24 – *Macroprudential Surveillance and Insurance Supervision.*

The IAIS also conducted a baseline assessment questionnaire related to the implementation of the holistic framework that will inform the FSBs process in 2022 of deciding to discontinue or re-establish the process of identifying globally systemic important insurers.

Big data

Predictive models
Property/casualty underwriting – After several years of study, the Casualty Actuarial and Statistical Task Force adopted its Regulatory Review of Predictive Models White Paper (dated September 9) during its September 15 conference call. The white paper includes the following guidance:

> Best practices will help the state insurance regulator understand if a predictive model is cost-based, if the predictive model is compliant with state law, and how the model improves a company's rating plan. Best practices can also improve the consistency among the regulatory review processes across the states and improve the efficiency of each regulator's review, thereby helping companies get their products to market faster. With this in mind, the regulator's review of predictive models should:
>
> 1. Ensure that the selected rating factors, based on the model or other analysis, produce rates that are not excessive, inadequate, or unfairly discriminatory.
>
> 2. Obtain a clear understanding of the data used to build and validate the model, and thoroughly review all aspects of the model, including assumptions, adjustments, variables, sub-models used as input, and resulting output.
>
> 3. Evaluate how the model interacts with and improves the rating plan.
>
> 4. Enable competition and innovation to promote the growth, financial stability, and efficiency of the insurance marketplace.

In response to concerns over the scope of the paper and whether it would override the legal structure states follow to review rates and rating plans, the following guidance was added:

> As discussed further in the body of the White Paper, this document is intended as guidance for regulators as they review predictive models. Nothing in this document is intended to, or could, change the applicable legal and regulatory standards for approval of rating plans. This guidance is intended only to assist regulators as they review models to determine whether modeled rates are compliant with existing state laws and regulation.

Life underwriting – The Accelerated Underwriting Working Group was created at the 2019 Summer National Meeting with the charge of considering the use of external data and data analytics in accelerated life underwriting which they plan to achieve in three phases: 1) information gathering, 2) identify issues and potential work products, and 3) develop work products. The working group has completed phase 1 which included presentations from consulting firms, life insurers and industry organizations. Executing phase 2 will focus on synthesizing the information gathered in order to make recommendations on a work product. The working group's updated timeline includes developing a work product for exposure by December 2020 and delivering a final product to the Life Insurance and Annuities Committee by the 2021 Summer National Meeting.

Climate risk

A representative from Ceres gave an overview to the Climate Risk and Resilience Working Group of their recently published report *Addressing Climate as a Systemic Risk, a Call to Action for U.S. Financial Regulators* to the task force. The remarks highlighted why regulators should take action to protect the economy from climate events and recommendations for insurance regulators, including the following:

- Acknowledging and coordinating action to address the material risks of climate change
- Assessing the adequacy of current insurer actions for addressing climate risks
- Requiring insurers to conduct climate-risk stress tests and scenario analyses
- Requiring insurers to integrate climate change into their ERM and ORSA processes
- Mandating the assessment and management of climate-risk exposure through their investments
- Mandating insurer climate-risk disclosure using the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures
- Assessing the sector's vulnerabilities to climate change and reporting findings to the Financial Stability Oversight Council

Mortgage guaranty insurance capital model

The Mortgage Guaranty Insurance Working Group has not held a public meeting in 2020.

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The next National Meeting of the NAIC will be held virtually on the following days: December 3-4 and December 7-9. Registration and agendas are now available at the NAIC's website. We welcome your comments regarding issues raised in this newsletter. Please provide your comments or mail address changes to your PwC LLP engagement team, or directly to the NAIC Meeting Notes editor at jean.connolly@pwc.com.

Disclaimer

Since a variety of viewpoints and issues are discussed at task force and committee meetings taking place at the NAIC meetings, and because not all task forces and committees provide copies of meeting materials to industry observers at the meetings, it can be often difficult to characterize all of the conclusions reached. The items included in this Newsletter may differ from the formal task force or committee meeting minutes.

In addition, the NAIC operates through a hierarchy of subcommittees, task forces and committees. Decisions of a task force may be modified or overturned at a later meeting of the appropriate higher-level committee. Although we make every effort to accurately report the results of meetings we observe and to follow issues through to their conclusion at senior committee level, no assurance can be given that the items reported on in this Newsletter represent the ultimate decisions of the NAIC. Final actions of the NAIC are taken only by the entire membership of the NAIC meeting in Plenary session.

Appendix A

This table summarizes actions taken by the SAP Working Group since January of 2020 on open agenda items. Items exposed for comment were due September 18, and a conference call to review comments on exposed items has been scheduled for November 12. For full proposals exposed and other documents, see the SAP Working Group webpage.

Issue/ Reference #	Status	Action Taken/Discussion	Proposed Effective Date
ASU 2016-13 - Credit Losses (#2016-20)	Discussion deferred	In 2019, the SAP Working Group asked NAIC staff to continue monitoring implementation of the ASU after the FASB extended the effective date of ASU 2016-13 until 2023 for all entities except large SEC filers. The regulators may resume consideration of the statutory other-than-temporary impairment methodology for available-for-sale bonds later in 2020.	TBD
SSAP 86 – ASU 2017-12, Derivatives and Hedging (#2017-33)	Discussion deferred	This project will review the overall accounting and reporting changes required by this ASU as potential substantive revisions to SSAP 86. There has been no discussion of this standard in 2020.	TBD
SSAP 41R – Surplus Notes Linked to Other Structures (#2018-07)	Discussion deferred	The working group sponsored a data call to obtain additional information on surplus notes with "associated assets," such as situations in which the two instruments negate or reduce cash flow exchanges, and/or when amounts payable under the surplus note and amounts receivable under other agreements are contractually linked. Discussion of the data call is expected to be scheduled for a meeting later this year.	TBD
SSAP 97 – SCA Loss Tracking/ Negative equity of SCAs (#2018-26)	Adopted	The working group adopted its proposed revisions which clarify that SSAP 97 no longer requires negative equity value for SCAs when the investee has cumulative losses and the insurer has guaranteed obligations or would provide future commitments. Instead, SSAP 5R has been revised to require liability recognition of the fair value of any guarantees or commitments.	March 18, 2020
SSAP 55 – Prepaid Providers (#2018-38)	Adopted	The regulators adopted revisions to SSAP 55 to strengthen the existing guidance on nonadmitting prepaid assets for payments made to third parties; the newly adopted changes are a result of comments from interest parties to provide specific guidance for life, p/c and health entities.	March 18, 2020
Investment Classification Project – Preferred Stock (#2019-04)	Adopted	The working group adopted Issue Paper 164 and SSAP 32R with significant revisions to the accounting for preferred stock. See the SAP Working Group summary above for additional discussion.	January 1, 2021

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SSAP 52 – Reporting Deposit-Type Contracts (#2019-08)	Adopted	The SAP Working Group has been discussing why some guaranteed investment contracts and other deposit-type contracts are reported in Exhibit 5 –Aggregate Reserves for Life Contracts or Exhibit 6 –Aggregate Reserves for A&H Contracts, as opposed to Exhibit 7–Deposit-Type Contracts. Industry representatives noted it has been a long-standing practice is to classify and report contracts in the appropriate schedule at policy inception and not move reporting schedules for any changes in the policy, e.g. a policyholder electing a payout benefit. The working group adopted a new footnote to Exhibit 5 which will disclose the dollar amount of contracts that no longer have mortality risk. The Blanks Working Group also adopted this proposal (2020-23BWG).	December 31, 2020 Annual Statement
SSAPs 68 & 97 – ASU 2014-17, Pushdown Accounting (#2019-12)	Discussion deferred	The working group is considering one of three options related to goodwill that has been pushed down. Discussion has been delayed until later in 2020 due to all the time spent on COVID-related accounting issues earlier in the year.	TBD
SSAP 2 – Rolling Short-Term Investments (#2019-20) and SSAP 2 – Cash and Liquidity Pools (#2019-42)	Adopted	Revisions to SSAP 2 were adopted 1) to incorporate “principle concepts” that will restrict the classification of “rolling” related party or affiliated investments as cash equivalents or short-term investments only when the criteria are met, and 2) allow that certain cash pools which meet defined criteria to be reported as cash equivalents. The Blanks Working Group also adopted SAPWG’s recommendation to identify investments that remain on the short-term schedules for more than one consecutive year (2020-19BWG).	May 20, 2020
SSAP 43R – Revised Issue Paper (#2019-21)	Exposed	In March, the working group exposed for comment a completely re-written Issue Paper, which would replace SSAP 43R, Loan-backed and Structured Securities. See discussion in the SAPWG summary above.	TBD
SSAP 71 – Commission Financing (#2019-24)	Re-exposed	The working group re-exposed for comment a proposal to prevent insurers from deferring the recognition of commission expense using “financing transactions.” See the SAPWG summary for additional discussion.	December 31, 2020
SSAP 105 – Working Capital Finance Investments (#2019-25)	Adopted	The working group adopted substantive revisions to SSAP 105 to incorporate industry proposed language, which would relax some of the strict requirements to allow additional insurers to make investments in working capital finance notes. Issue Paper 163 was also adopted.	June 30, 2020
SSAP 97 – Look-Through with Multiple Holding Companies (#2019-32)	Adopted	The regulators adopted SCA investment guidance to clarify that look-through of more than one holding company is permitted when each of the holding companies within the structure complies with SSAP 97, e.g. is a par. 8.b.iii entity, does not own other assets that are material and is not subject to material liabilities.	June 30, 2020

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SSAP 25 – Disclosures (#2019-33)	Adopted	The working group adopted a proposal to restructure SSAP 25 footnote disclosures so the information can be data captured and analyzed. Transactions with affiliates disclosed in Schedule Y, Part 2 would not need to be duplicated in the data captured footnotes. The related Blanks Working Group changes (2020-08BWG) were also adopted.	Year-end 2020 financial statements
SSAP 25 – Related Parties, Disclaimers of Affiliation and Variable Interest Entities (#2019-34)	Re-exposed	The regulators updated their proposal to require that non-controlling ownership interests greater than 10% meet the definition of a related party; the new guidance would apply only to related party disclosures and would not change the accounting of such entities. This is being proposed to ensure that any related party identified under U.S. GAAP or SEC requirements is also a related party for SAP. The SEC does not allow disclaimers of affiliation, unlike the Insurance Holding Company Model Act.	TBD
SSAPs 51 & 52 – Update With-drawal Disclosures (#2019-35)	Adopted	The working group adopted minor clarifying edits to the "liquidity" Notes 32 and 33 disclosures made by life insurers.	Year-end 2020 financial statements
Various SSAPs – Expand MGA and TPA Disclosures (#2019-36)	Deferred	The working group had exposed guidance to significantly expand disclosures related to MGAs and TPAs to more "fully understand the level and extent to which core services and binding authority are provided by MGAs or TPAs." Discussion has been deferred to develop a more functional definition of Third-Party Administrator that encompasses more lines of business.	TBD
SSAP 41 – Surplus Notes – Enhanced Disclosures (#2019-37)	Adopted	The working group adopted new disclosures for issued surplus notes when such notes and amounts receivable under other agreements are contractually linked. The related Blanks Working Group proposal (2020-03BWG) has also been adopted, which includes disclosures in tabular format for data capture.	May 20, 2020 for year-end 2020 financial statements
SSAP 86 – Revised Financing Derivatives (#2019-38)	Adopted	The regulators adopted an extensive proposal that includes the guidance that the book adjusted carrying value and fair value of these derivatives "shall reflect the value without inclusion of any impact from financing provisions." It also requires that the premiums payable or premiums receivable be separately reported. The related Blanks Working Group proposal (2020-26BWG) has also been adopted, which includes a new column for Schedule DB, Part D, Section 1: Column 5, Present Value of Financing Premiums.	January 1, 2021
SSAP 86 – Acceptable Collateral for Derivatives (#2019-39)	Disposed	The SAP Working Group disposed of this proposal without any changes to statutory accounting or reporting after discussion with interested parties that "third-party derivative exposure is appropriately captured in existing reporting."	N/A
SSAP 53 – Reporting of Installment Fees and Expenses (#2019-40)	Adopted	The regulators adopted the following new guidance that "the footnote on flat fee service charges on installment premium is intentionally narrow and specific and this guidance should not be applied to other fees or service charges." .	March 18, 2020

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SSAP 43R – Financial Modeling (#2019-41)	Disposed	The working group disposed of this proposal to eliminate financial modeling for RMBS and CMBS without making any revisions to SSAP 43R, because the VOS Task Force decided to no longer pursue this approach.	N/A
SSAP 72 – ASU 2017-11, Earning Per Share, Distinguishing Liabilities from Equity, Derivatives & Hedging (#2019-43)	Adopted	The SAP Working Group rejected ASU 2017-11. As part of that discussion, the regulators adopted guidance for SSAP 5R and SSAP 72 to require issued, free-standing financial instruments with characteristics of both liability and equity to be reported as a liability "to the extent that the instrument embodies an unconditional obligation of the issuer."	March 18, 2020
SSAP 51 – VM-21 Grading (#2019-47)	Adopted	Revisions to SSAP 51 are necessary to reflect that VM-21 allows the required changes to VA reserves to be phased in over three years. See further discussion on page 2 above.	January 1, 2020
SSAP 62R – Reciprocal Jurisdiction Reinsurers – (#2019-48)	Adopted	A reference to reinsurers domiciled in reciprocal jurisdictions was added to paragraph 106 of SSAP 61R on disclosures related to unsecured reinsurance recoverables.	March 18, 2020
SSAP 62R – Retroactive Reinsurance Exception (#2019-49)	Discussion deferred	The regulators have been asked to address inconsistencies in application of the retroactive reinsurance accounting and reporting guidance, especially with respect to the Schedule P reporting. Work on this project has been deferred due to time spent on COVID-related accounting issues but should resume later this year.	TBD
Issue Paper 99 – Proposals to reject recent GAAP guidance	Adopted	The working group adopted guidance to reject the following GAAP guidance as not applicable to statutory accounting: ASU 2013-11, Income Taxes – Presentation of Unrecognized Tax Benefit (#2019-44), and ASU 2016-14, Presentation of Financial Statements for Not-for-Profit Entities (#2019-45).	March 18, 2020
SSAP 26R – Bond Mutual Fund Reference Removal (#2020-01)	Adopted	Revisions eliminate references to the NAIC Bond Fund List (Bond List) in SSAP 26R and add reference to the "NAIC Fixed Income-Like SEC Registered Funds List" in SSAP 30R.	July 30, 2020
SSAP 26R – Accounting for Bond Tender Offers (#2020-02)	Adopted	The SAP Working Group concluded that the accounting and reporting of investment income and capital gain/loss due to the early liquidation should be the same, whether a bond is called or liquidated through a tender offer.	January 1, 2021, with early adoption permitted
SSAP 68R – Enhanced Goodwill Disclosures (#2020-03)	Adopted	Expanded disclosures related to goodwill were adopted, including amount of goodwill recorded for each SCA and total admitted goodwill, along with tabular disclosures of adjusted capital and surplus, amount of the total goodwill limitation and current period admitted goodwill as a percentage of prior period adjusted capital and surplus. The related Blanks Working Group proposal (#2020-22BWG) has also been adopted and will be data captured.	December 31, 2021

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SSAPs 51R, 52 and 54R – Commissioner Discretion in the Valuation Manual (#2020-04)	Adopted	The regulators adopted guidance that specifies that voluntary decisions to choose one allowable reserving methodology over another, which require commissioner approval under the Valuation Manual, are to be reported as a change in valuation basis.	July 31, 2020
SSAP 106 – Repeal of the Affordable Care Act Section 9010 Assessment (#2020-05)	Adopted	Because the U.S. Congress repealed the ACA Section 9010 assessment for calendar years beginning January 1, 2021, the NAIC adopted guidance to sunset SSAP 106 and INT 18-01 as of January 1, 2021. The SAP Working Group will also send referral to the Blanks Working Group to remove Note 22 and refer the ACA adjustment sensitivity test from the Health RB formula for 2021.	January 1, 2021
Appendix A-001, Changes to the Summary Investment Schedule (#2020-07)	Adopted	The Summary Investment Schedule was revised to add a separate line for mortgage loan valuation allowances. This will allow the summary schedule to agree to Schedule B, Part 1.	Year-end 2020 financial statements
SSAP 37, Participating in Mortgage Loans (#2020-19)	Exposed	The working group exposed for comment a proposal to clarify that a participant's financial rights in a mortgage participation agreement may include the right to take legal action against the borrower or participate in the determination of legal action, but they do not require that the participant has the right to solely initiate legal action, foreclosure or require the ability to communicate directly with the borrower.	TBD
SSAP 2R - Cash Equivalent Disclosures (#2020-20)	Exposed	Proposed revisions would require the identification of cash equivalents, or substantially similar investments, that are disclosed on the same reporting schedule for more than one consecutive reporting period. The disclosure can be complied with using a code on the investment schedules.	TBD
SSAP 43R - NAIC designation categories for RMBS/CMBS (#2020-21)	Exposed	Proposed revisions reflect the updated NAIC designation category guidance for RMBS and CMBS recently adopted by the VOS Task Force for the SVO P&P Manual.	TBD
SSAP 26R – Perpetual Bonds (#2020-22)	Exposed	The exposed revisions would require that all perpetual bonds be reported at fair value as opposed to amortized cost, and not to exceed any currently effective call price.	January 1, 2021
SSAP 19 – Amortization of Leasehold Improvements (#2020-23)	Exposed	Suggested revisions update the amortization guidance for leasehold improvements to allow such improvements to have lives that match the associated lease term, which is consistent with U.S. GAAP.	TBD
SSAP 43R - Accounting for credit tenant loans (#2020-24)	Exposed	The regulators exposed for comment two possible options for the accounting of credit tenant loans. See further discussion in the SAP Working Group summary above.	TBD

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SSAPs 53, 54R &66 Policyholder refunds (#2020-30)	Exposed	The regulators have requested input from industry on whether additional guidance is necessary related to discretionary policyholder refunds and other premium adjustments for heath and P/C lines of business. The working group would like assistance from industry in developing principles-based guidance, particularly for the varieties of data-telematics policies.	TBD
Issue Paper 99 – Proposals to reject recent GAAP guidance	Adopted	The SAP Working Group rejected the following GAAP standards as not applicable for statutory accounting: ASU 2016-20, Technical Corrections & Improvements, Revenue from Contracts with Customers (#2020-08), ASU 2018-18, Collaborative Arrangements (#2020-09), ASU 2017-14, Amendments to SEC Paragraphs in Topics 220, 605 and 606 (#2020-10), and ASU 2020-02, Amendments to SEC Paragraphs in Credit Losses and Leases (#2020-11).	May 20, 2020
INT 20-01 – Reference Rate Reform (#2020-12)	Adopted	This Interpretation adopts the GAAP guidance on bank reference rate reform, ASU 2020-04. See the SAPWG summary above for further details.	April 15, 2020
SSAP 26R – Assessment of OTTI (#2020-14)	Adopted	SSAP 26R has been modified to state that if a debt instrument has been modified pursuant to SSAP 36 or SSAP 103 (non-troubled situations), subsequent assessments of OTTI shall be based on the modified contractual terms of the debt instrument (not the original contractual terms as previously required).	May 20, 2020
INT 20-02 – Extension of 90-Day Rule for the Impact of COVID-19	Adopted	The regulators adopted as a temporary extension of the 90-day nonadmit rule for first and second quarter 2020 financial statements for policies in U.S. jurisdictions that have been impacted by COVID-19; in August, the guidance was extended through the third quarter of 2020 at the request of the industry.	April 15, 2020
INT 20-03 – Troubled Debt Restructuring Due to COVID-19	Adopted	This Interpretation provides guidance that insurers shall follow the OCC Interagency Statement on Loan Modifications and the CARES Act for determining whether a loan modification is a troubled debt restructuring. The guidance ends on the earlier of December 31, 2020, or the date that is 60 days after the date on which the national COVID emergency is terminated.	April 15, 2020
INT 20-04 – Mortgage Loan Impairment Assessment Due to COVID-19	Adopted	SAPWG adopted limited time exceptions to defer assessments of impairment for bank loans, mortgage loans and investments which predominantly hold underlying mortgage loans, which are impacted by forbearance or modifications in response to COVID-19. The guidance was extended in August through the third quarter of 2020.	April 15, 2020
INT 20-05 – Investment Income Due and Accrued	Adopted	This Interpretation provides a collectability assessment exception for certain items in response to COVID-19, and an exception for all items that are deemed collectible and over 90-days past due.	August 17, 2020

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INT 20-06 – Participation in the 2020 TALF Program	Adopted	INT 20-06 provides an exception to allow admitted asset reporting for pledged securities to the Term Asset-Backed Securities Lending Facility (TALF) program when an insurer is the borrower directly receiving the TALF loan. However, insurance entity investors are not permitted to admit assets that have been pledged to the TALF program if they are not the direct borrower, e.g. an investment in an LLC that receives the loans.	May 20, 2020
INT 20-07, Troubled Debt Restructuring of Certain Debt Instruments Due to COVID-19	Adopted	The NAIC adopted practical expedients in applying the loan concession guidance in SSAP 36, Troubled Debt. See additional discussion in the SAPWG summary above.	May 20, 2020
INT 20-08, COVID-19 Premium refunds	Adopted	This INT provides guidance to P/C and Health entities on how to account for premium refunds issued in response to COVID-19. See discussion at the SAPWG summary above for additional detail.	July 22, 2020
INT 20-09, Basis Swaps as a Result of the LIBOR Transition	Adopted	The SAP Working Group adopted an interpretation of SSAP 86 on the accounting for basis swaps issued solely in response to the market-wide transition away from the LIBOR to the Secured Overnight Financing Rate (SOFR). See the SAPWG summary above for further discussion.	July 30, 2020

Appendix B

This chart summarizes action on other proposals of the RBC Working Groups since January of 2020, i.e. those not discussed on pages 4-5 of this Newsletter. The detail of all proposals adopted for 2020 RBC are posted to the Capital Adequacy Task Force's webpage (under Related Documents).

RBC Formula	Action taken/discussion	Effective Date/ Proposed Effective Date
All/multiple formulas		
Risk-Based Capital Preamble (2019-07-CA)	The Capital Adequacy Task Force **adopted** the RBC Preamble, which formally documents the background, purpose, history, objectives and critical concepts of risk-based capital. During the discussion of this document, the task force reiterated the guidance that "there are no state permitted practices to modify the RBC formula and all insurers are required to abide by the RBC instructions." The chair commented that he had been told that some states have been allowing permitted practices.	2020 RBC Filings
P/C RBC	Action taken/discussion	Effective Date/ Proposed Effective Date
Vulnerable 6 or Unrated Risk Charge (2018-09-P)	The P/C Working Group **adopted** revisions to the RBC instructions to reflect that the factors for all uncollateralized reinsurance recoverables from unrated reinsurers be the same as for authorized, unauthorized, certified and reciprocal reinsurers. The factor is being updated to be more aligned with risk-indicated factors used by rating agencies. The working group will evaluate the data annually to determine where changes to the factor or structure are warranted.	2020 RBC Filings
Line 1 premium and underwriting factors (2020-01-P)	The P/C RBC Working Group **adopted** its annual update for the underwriting factors for premium and reserves.	2020 RBC Filings
Eliminate separate credit risk charge for unrated authorized reinsurers (2019-19-P)	The P/C RBC Working Group **exposed** for comment a proposal to eliminate the separate 10% RBC charge for unrated authorized reinsurers and use the 14% charge for uncollateralized reinsurance recoverables from all unrated reinsurers (authorized, unauthorized, certified and reciprocal).	2020 RBC Filings

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