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Accounting Updates for Insurers

NAIC Statutory and Key US GAAP Updates for Insurers

September 12, 2023

What we will Cover Today

1
Finalized NAIC SAP Updates (Adopted to the Manual)

2
Pending NAIC SAP Updates (Still being discussed)

3
Key US GAAP updates for insurers

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Your Presenter

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David Roberts is an audit partner at Crowe LLP in the insurance practice within the Financial Services group. David has over 25 years of experience and has spent his entire career serving the audit and accounting needs of insurance entities of all types. He has significant experience with the operations of insurance companies including traditional insurance companies and alternative risk vehicles of all types. David has significant expertise with insurance entity financial reporting matters related to U.S GAAP, NAIC Statutory and IFRS reporting. David is a frequent speaker at regional and national insurance conferences and is an author and presenter of multiple internally developed insurance training programs delivered both internally at Crowe and externally. David also serves on the board of the IASA Sunshine Chapter and practices out of Crowe's Tampa, FL office.

Finalized NAIC SAP Updates (Adopted to the Manual)

SSAP 25 Revisions

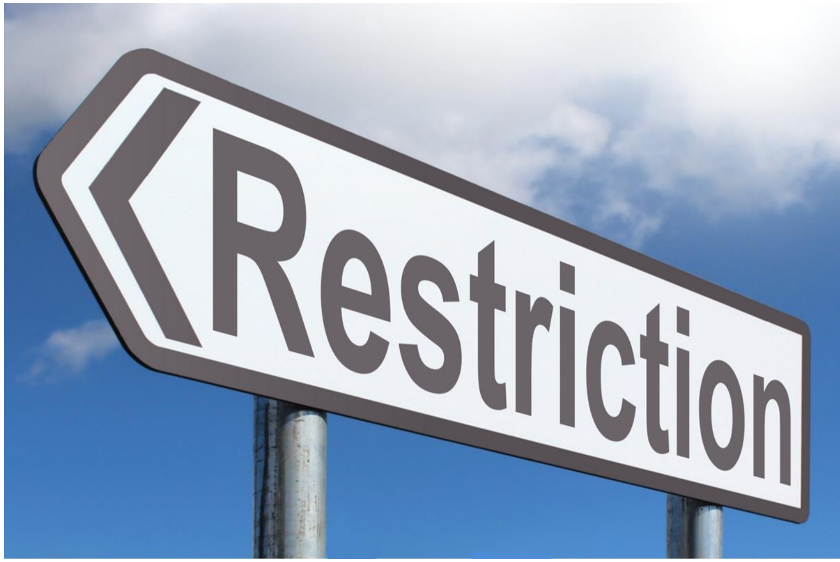
- Fall 2022 NAIC National meeting Statutory Accounting Principles Working Group (SAPWG) adopted changes to SSAP 25 – “Affiliates and Other Related Parties” and exposed additional changes.
- Adopted changes were in effect for December 31, 2022, and related to revising SSAP 25 and 43R related to criteria for identifying an affiliated investment and when direct or indirect control exists.
- SAPWG also exposed revisions to clarify that an any asset issued by an affiliated entity or that includes the obligations of an affiliated entity is considered an affiliated investment.
- SAPWG finalized this these to SSAP 25 in the spring 2023 national meeting, effective immediately.

SSAP 86 Revisions

- Fall 2022 NAIC National meeting SAPWG adopted changes to SSAP 86 – "Derivatives" effective January 1, 2023.
- Adopted changes allowed for the use of interest rate hedges for "partial terms" of instruments.
- Adopted changes also allowed for the use of the "portfolio layer method" to hedge portions of a portfolio of instruments.
- Changes were consistent with FASB ASU 2017-12 revisions to FASB ASC 815.
- Spring 2023 NAIC National Meeting, SAPWG adopted Issue Paper 167 – "Derivatives and Hedging" to provide historical perspective and more guidance related to the changes made.

SSAP 100R Revisions

- Spring 2023 the SAPWG made revisions to SAP 100R – "Fair Value" to incorporate guidance from FASB ASU 2022-03 – "Fair Value measurement of Restricted Securities".
- The disclosure requirements from ASU 2022-03 were not adopted.
- For a sale restriction of an equity security where the restriction is a condition of the entity and not a condition of the security, no impact on fair value, utilize the value from the most advantageous market.
- For a sale restriction that is a condition of the security itself, the restriction on sale should be considered in the valuation, example private placement unregistered shares where sale is restricted.
- Changes were effective immediately.



SSAP 34 Revisions

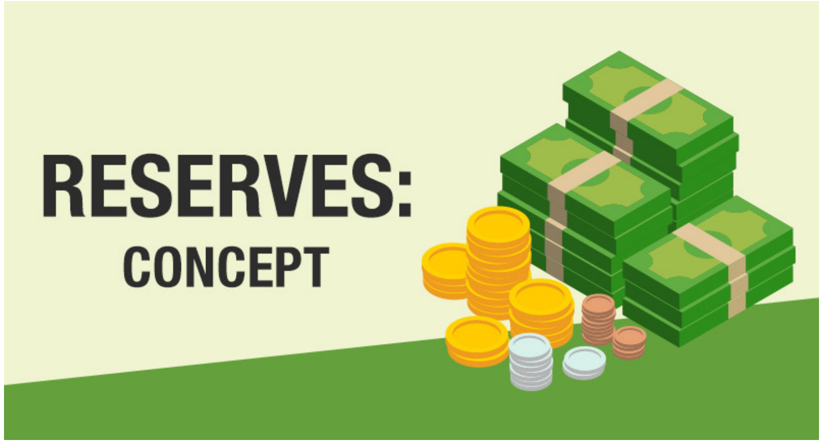
- Spring 2023 NAIC National meeting SAPWG adopted changes to SSAP 34 - "Investment Income Due and Accrued".
- Changes added disclosure requirements related to investment income due and accrued.
- In addition to disclosing the bases by category for investment income non admitted and the total amount of income excluded now need to disclose:
  - The gross amounts of admitted and non-admitted interest income due and accrued; and
  - Amount of deferred interest;
  - Cumulative paid-in-kind interest included in the principal balance.
- Changes are effective December 31, 2023.
- Additionally at the Summer 2023 National meeting, SAPWG added a footnote disclosure requirement for paid-in-kind interest effective with the previous adopted changes.

INT 23-01T – IMR Reserves

- The SAPWG adopted INT 23-01T allowing an optional limited time framework for an admitted asset for “negative interest maintenance reserves” (IMR) for life and accident and health insurers at the Summer 2023 national meeting
- IMR represents a deferral of recognizing realized capital gains and losses resulting from changes in interest rates.
- Net positive IMR represents net interest rate realized gains and is reported as a liability and amortized into investment income over the expected remaining life of investments.
- Currently, net negative IMR which represents net interest rate realized losses is recognized as an other miscellaneous write in asset and fully non admitted.
- Given the current rate environment, the issue was raised and is being discussed to allow an admitted asset for net negative IMR.

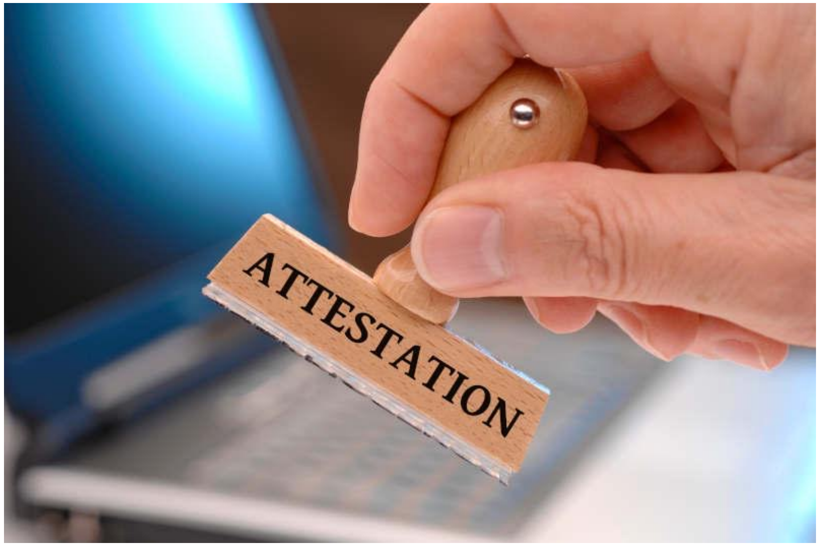
INT 23-01T – IMR Reserves (Continued)

- The adopted INT would allow IMR reserves as follows:
  - Requirement to have RBC over 300% after removing any admitted goodwill, EDP equipment, operating system software, DTAs and the potential admitted negative IMR asset.
  - An allowance to admit an asset up to 10% of adjusted capital and surplus across both general and separate accounts.
  - No exclusion for derivative losses as long as the company can demonstrate a practice of including IMR liabilities for gains.
  - Effective date through December 31, 2025, with a note that it could be nullified earlier or extended by the WG.



INT 23-01T – IMR Reserves (Continued)

- Last, reporting entities are to include a note disclosure attesting to the following:
  - Investments generating IMR losses comply with the entity's documented investment and liability management policies:
  - IMR losses for fixed income derivatives are all in accordance with prudent documented risk management procedures in accordance with the entity's derivative use plans and reflect symmetry with historical treatment in which realized derivative gains were reserved to IMR liability and amortized as opposed to recognized as gains when terminated.
  - Any deviation from documented investment policies was temporary or related to a specific event.
  - Asset sales were not compelled by liquidity pressures.



INT 23-01T – IMR Reserves

- The working group also is working on the formation of an ad hoc subgroup of SAPWG to work on a long-term solution.
- Discussion related to SSAP 7, Asset Valuation Reserve and Interest Maintenance Reserves lead to adding a more in-depth discussion of AVR and IMR noting several disconnects in the guidance as part of the Maintenance Agenda.
- Concepts being considered are:
  - Allocations between IMR and AVR
  - Allocations of perpetual stock
  - Delineation between interest and non-interest charges
  - Derivatives
  - Ceded and assumed reinsurance
  - AVR and IMR crosschecks for filings
  - Overall reporting between general and separate accounts

Proposed Bond Definition

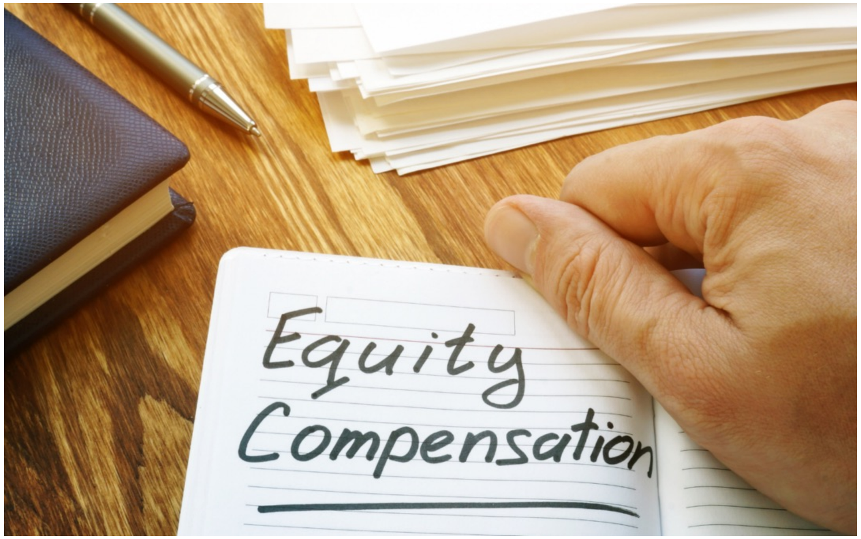
- Summer 2023 NAIC National meeting SAPWG approved the proposed principles-based bond definition and exposed further changes to revised standards SSAP 26R – "Bonds", SSAP 21R – " Other Admitted Assets" and SSAP 43R – "Loan Backed and Structured Securities".
- Scope of what is in SAP 26 R now are:
  - CDs that have fixed payment schedules and maturity over a year
  - Bank loans that are obligations of operating entities, issued directly by a reporting entity or acquired.
  - ETFs that qualify for bond treatment as identified by SVO.
  - Mortgage loans identified as SVO Credit Tennant Loans.
- Changes are effective for January 1, 2025.

Proposed Bond Definition (Continued)

- As a result of the proposed changes to the bond definition, the Blanks (E) Working Group continues to discuss revisions to the annual statement.
- Among changes are Schedule D-1-1 and D-1-2 which are designed to capture required new information specific to issuer credit obligations and asset backed securities.
- Revisions to reporting instructions also continue to be discussed.
- These revisions would mirror the target date to implement the revised SSAP 26R, 43R and 21R standards for January 1, 2025.

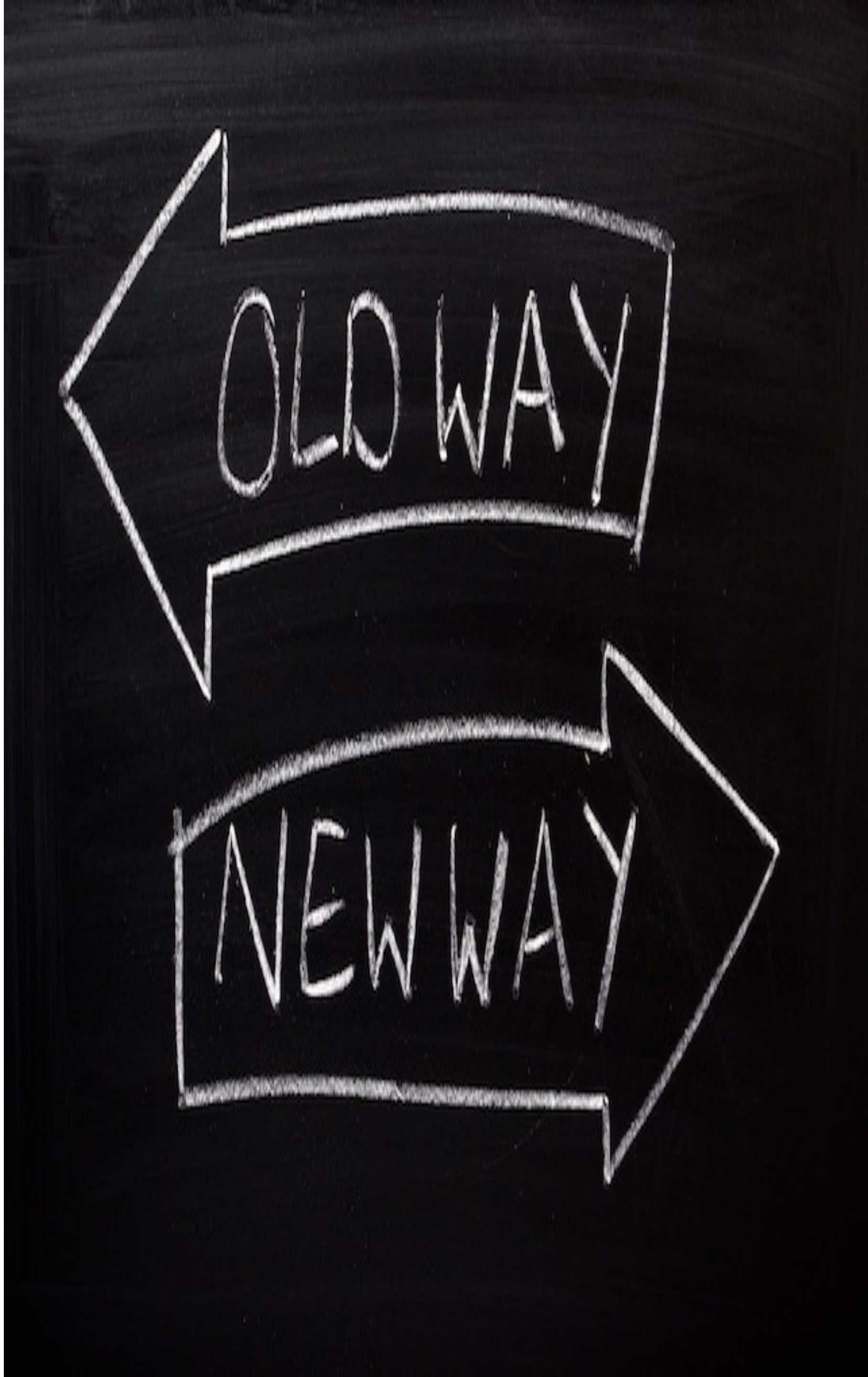
Share Based Payments

- Summer 2023 NAIC National Meeting the SAPWG adopted changes to SSAP 95 – “Non-Monetary Transactions” and SSAP 104R – “Share Based Payments.”
- Changes are to adopt changes made in FASB ASU 2019-08 which modified Topic 718 and 606 related to Stock Compensation and Revenue Recognition under US GAAP.
- Updates modified the SSAPs to include the concept of nonmonetary consideration.
- Updates also indicate that any nonmonetary consideration deemed to be payable by the reporting entity should be accrued at fair value.
- These changes were effective immediately.



Other Minor Items

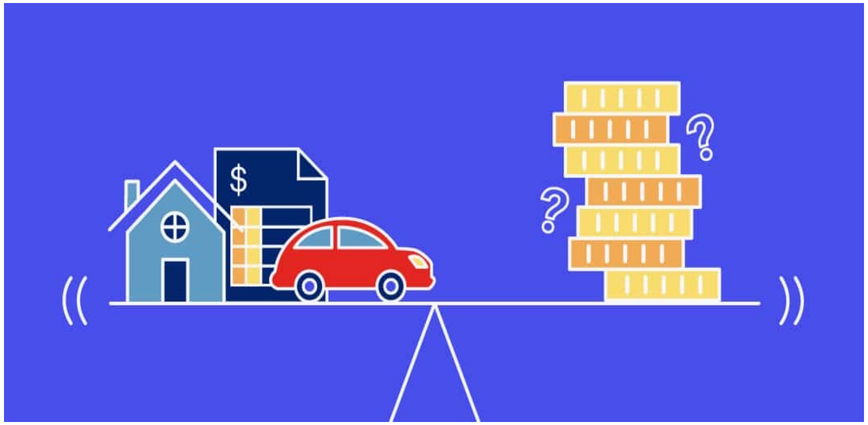
- Summer 2023 national meeting minor updates were as follows:
  - SSAP 5R, Liabilities, Contingencies and Impairments of Assets was revised to incorporate clarified guidance on the fixed nature of a co-obligor liability.
  - SSAP 24, Discontinued Operations and Unusual or Infrequent Items was modified to incorporate disclosures about government assistance however rejected FASB ASU 2021-10, Government Assistance.
  - SSAP 43R, Asset Backed Securities was clarified to include CLOs in the guidance related to securities that need to be modeled.
  - INT 20-01, Reference Rate Reform was modified to revise the expiration date to be December 31, 2024.



Pending NAIC SAP Updates
(Still being discussed)

Collateral for Loans

- Summer 2023 NAIC National Meeting SAPWG re-exposed proposed changes to SSAP 20 – “Non-Admitted Assets” and SSAP 21R “Other Admitted Assets”.
- Proposed changes clarify that an asset pledged as collateral for admitted collateral loans must classify as an admitted asset.
- Additionally, if an investment is a joint venture under SSAP 48 or a subsidiary controlled investment under SSAP 97, held directly by the reporting entity, that the proportionate <u>audited</u> equity valuation is what would be used to determine collateral adequacy.
- If the loan value exceeds the audited equity valuation, then the excess amount should be non-admitted.
- Discussion is ongoing.



New Market Tax Credits

- Summer 2023 NAIC National meeting SAPWG exposed proposed changes related to SSAP 93 – "Low Income Housing Tax Credits" and SSAP 94R "Transferable and Non-Transferable State Tax Credits".
- SAPWG reshared the exposed changes and some of the comments that have been received to date related to the proposal.
- The revisions to SSAP 93 propose to adopt with modification FASB ASU 2023-02 and expand the scope of the pronouncement to include all tax credit programs and tax investment structures.
- The revisions to SSAP 94R expand the scope to include all state and federal tax credits weather purchased or allocated.
- This item continues to be discussed.

Cash and Short-Term Investments

- During the Summer 2023 NAIC National Meeting the SAPWG exposed changes to SSAP 2R, Cash, Cash Equivalents, Drafts and Short-Term Investments.
- Changes aim to clarify and further limit what constitutes a cash equivalent or short-term investment.
- Main concern with current guidance was uncertainty with certain investments meeting the definition of cash equivalent or short-term investment, leading to reporting that would reduce their RBC charge.
- Limitations would only allow investments that qualify under SSAP 26R, Bonds, as issuer credit obligations within 3 months or a year of purchase to be treated as cash equivalent or short-term investments.

Other Admitted Assets

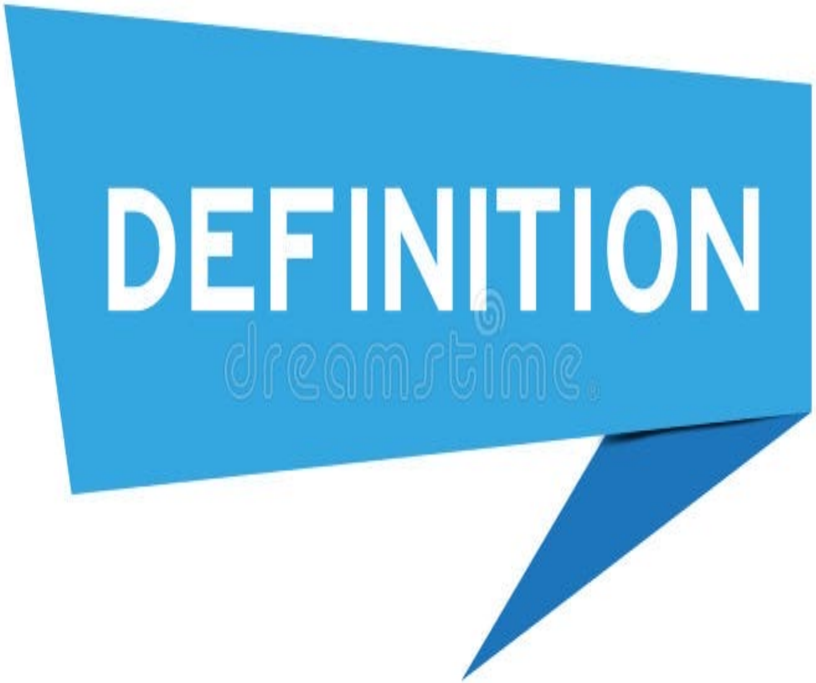
- Summer 2023 NAIC National Meeting the SAPWG exposed changes to SSAP 21R, Other Admitted Assets to provide guidance on measuring securities that do not qualify as bonds as well as guidance on measurement of residuals.
- Revisions clarify what would constitute an admitted asset in either an instrument that does not qualify as a bond under SSAP 26 or meets the definition of a residual.
- Non-bond, non residual instruments where the primary source or repayment is collateral only qualify as admitted assets to the extent collateral is available and an admitted asset.
- Residuals only qualify as admitted assets if debt securities from the same securitization qualify as admitted assets.
- Specific guidance is provided related to valuation of a residual.

Residuals

- Summer 2023 NAIC National Meeting SAPWG exposed proposed changes to SSAP 43R – Asset Backed Securities.
- Proposed changes clarify what constitutes a residual interest or security tranche, collectively referred to as residuals.
- Clarifications come on the heels of changes in the RBC calculation effective for December 31, 2023, increasing the RBC charge for residuals from 30% to 45% in 2024, and add a 15% sensitivity charge to the 30% RBC charge for 2023.
- Concern was the current guidance was not clear enough to define which instruments qualify for the higher RBC charge.

Residuals (Continued)

- The revisions to SSAP 43 indicate that the following are characteristics of a residual under the guidance:
  - Often do not have contractual principal o interest
  - May have stated principal or interest, but with terms that result in receiving residua cash flows of underlying collateral. Term can allow for significant variation in cash flows without triggering default.
  - Do not have credit ratings or NAIC designations. Rather, they provide subordination to support the credit quality of the rated tranches.
  - May provide payment throughout duration, but payments reflect residual amount permitted after other tranches receive contractually due amounts.
  - Frequently there are provisions that dive cash from residual tranches to other tranches if the structure becomes stressed.

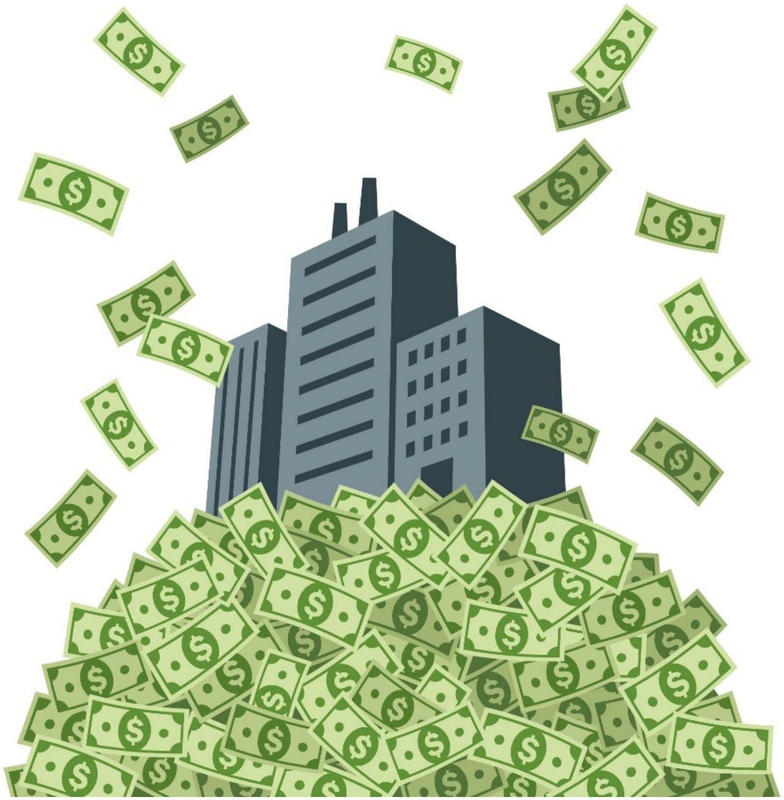


Residuals

- Concurrently, SAPWG exposed requests for responses from industry and regulators on a proposal to further define and provide examples of what constitutes investments in:
  - Nonregistered private funds
  - Joint ventures
  - Partnerships or limited liability companies
  - Residual interests
- Additionally, SAPWG exposed guidance related to changes in reporting for these types of investments for comments.

Corporate Alternative Minimum Tax

- Summer 2023 National Meeting SAPWG exposed INT 23-02 and 23-03 related to the Corporate Alternative Minimum Tax.
- In general, CAMT applies to entities with an average adjusted financial statement income above $1b for the last 3 years. The tax is 15% of adjusted financial statement income.
- INT 23-02 is asking companies to disclose whatever information they have related to their status with CAMT.
- CAMT presents several challenges including:
  - Financial projections for companies outside the group or partnerships
  - Treatment of the infinite CAMT DTA
  - Impact of tax sharing agreements
  - Statutory valuation of the DTA for payments.
- INT 23-03 provides guidance related to these issues.



Other Items of Note

- Summer 2023 NAIC National Meeting SAPWG exposed the following items:
  - Notice of intent to nullify INT 03-02 effective December 31, 2023. INT guidance directed certain reinsurance pooling transactions where assets were transferred between related parties to be accounting for at statutory book value as opposed to fair value which is inconsistent with other guidance.
  - Technical corrections to SSAP 92, Postretirement Benefits Other than Pensions, SSAP 102, Pensions and SSAP 103R, Transfers and Servicing of financial Assets and Extinguishment of Liabilities.
  - Revisions to SSAP 92 and 102 to remove transition guidance.
  - Revisions to SSAP 54R, Individual and Group Accident and Health Contracts which clarify and provide illustrations related to guidance on gross premium valuation and cash flow testing.
  - Review of annual statement instructions to address certain instances related to the changes in IMR guidance adopted.

NOTABLE

Key US GAAP Updates

FASB ASC Topic 326

- Topic 326 represents a modified approach related to the recognition and recording of credit losses on certain financial assets.
- The standard has been in effect for public companies but for nonpublic companies' adoption is required for fiscal year ends beginning on or after December 15, 2022.
- In general, the standard requires companies to record credit losses taking into consideration historical information, current losses and supportable forecasted information to project future credit losses.
- Where the current “impairment” approach recognizes losses when they are probably this approach accelerates that recognition to whenever you acquire the financial asset.

FASB ASC Topic 326 (Continued)

The table below gives examples for insurers of what is in the standard and what is out:

In Scope of Topic 326	Excluded from Scope of Topic 326
Reinsurance and insurance recoverable billed and unbilled	Prepaid reinsurance (ceded unearned premiums)
Premiums and other receivables due (commissions, deductibles, certain contract receivables under topic 606, Etc.)	Policy loans
Funds withheld assets	Reinsurance recoverable from parties under common control
Financial guarantees purchased	Prepaid insurance expense
Structured settlements purchased	Available for sale investments*
Held to maturity investments	
Loans and promissory notes receivable	

*AFS investments are not reserved for under the CECL model, but the approach has been modified to now be an allowance approach to mirror CECL.

FASB ASC Topic 326 (Continued)

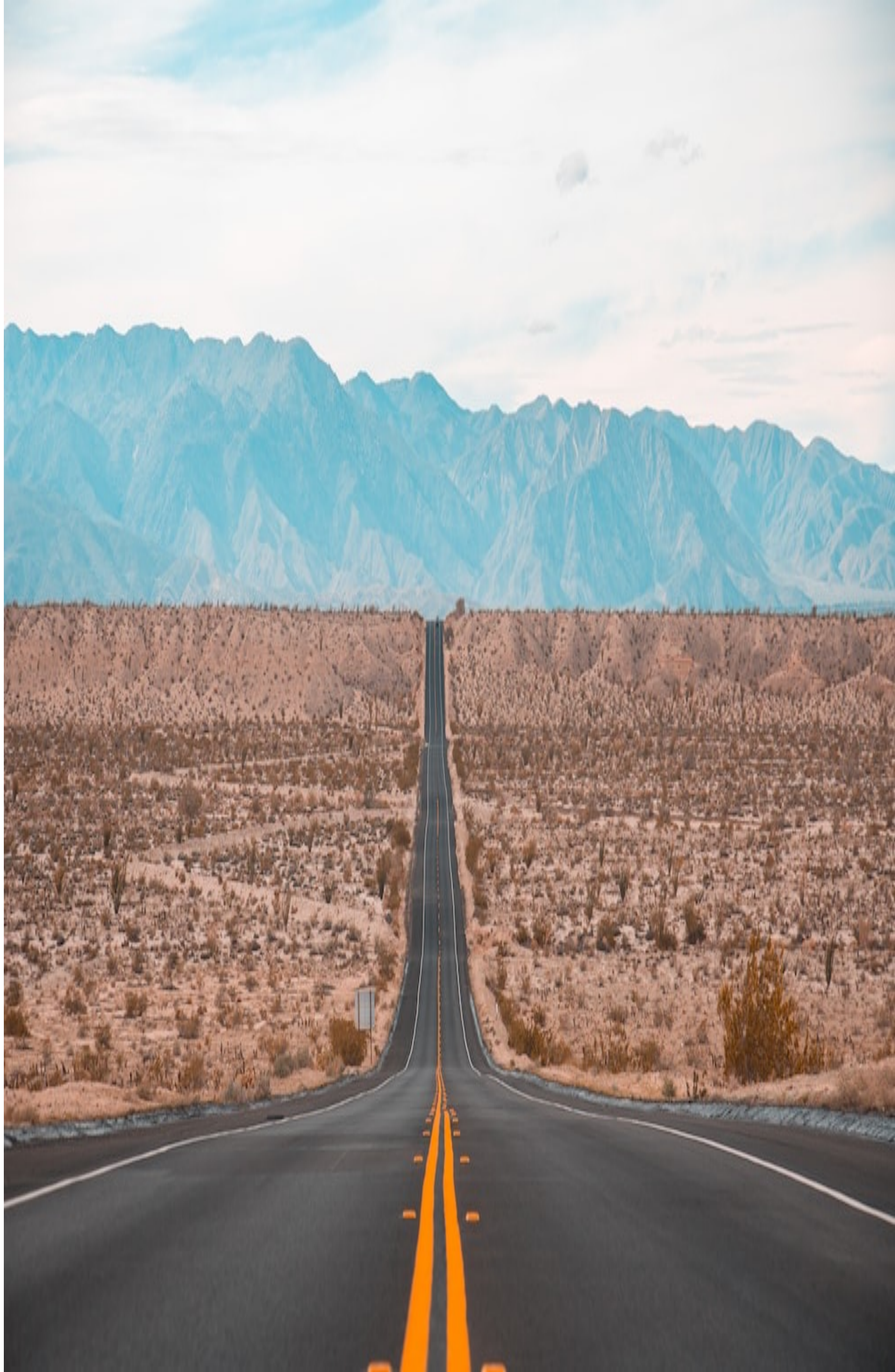
- Companies are required to pool financial assets with similar risk characteristics to be reviewed collectively and assess credit loss allowance.
- Risk characteristics you may consider would be:
  - Credit quality or rating
  - Current or past due status
  - Asset type or term
  - Age of asset
  - Industry of borrower
  - Geography
  - Interest rate

FASB ASC Topic 326 (Continued)

- Companies will need to analyze each category of financial asset for credit losses. To the extent an allowance is required it would be recorded with an offset to income.
- Credit losses would be estimated using historical data, characteristics of the asset, current economic conditions and the use of forecasts. The guidance does NOT prescribe a particular method.
- Methods previously used to estimate credit losses in the past may also be deployed. (Look backs to prior losses, using agings, discounted cash flow methods etc.).
- Methods need to consider impacts of collateral on credit losses as well as credit enhancements.
- Disclosures related to credit losses were also added.
- AICPA noted that the NAIC may not have formally rejected Topic 326 for SAP which could bring disclosures into play.

Long Duration Contracts

- FASB ASC 2018-12 and subsequent revisions relate to targeted improvements of accounting for long duration insurance contracts.
- This guidance is effective for public business entities for fiscal years beginning after December 15, 2022, and for all other entities for fiscal years beginning after December 15, 2024.
- The requirements for adoption are to apply the standard as of the beginning of the earliest period presented.
- In December 2022 the FASB issued ASU 2022-05 to address user concerns related to contracts derecognized by sale prior to the company’s adoption date and how those would be treated for adoption of LDTI.
- The ASU indicates if contracts are derecognized by sale meeting criteria in the standard those contracts would not need to be included in the prior period restatement to adopt the standard retrospectively.



Long Duration Contracts (Continued)

- In summary the long duration targeted improvements require the following changes:
  - Updated cash flow and discount rate assumptions for the liability for future policy benefits.
  - Change to discount rates used to an upper medium grade loss credit risk yield that matches the characteristics of the liability not the underlying investments.
  - Measurement of market risk benefits using the fair value model with changes in the company's credit risk flowing through other comprehensive income.
  - DAC will consistently be amortized on a straight-line basis over the term of the contract and written off if there is a contract termination.
  - Several new disclosures.
  - AICPA Insurance Expert Panel has provided insight related to several implementation issues.

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Thank You for your Participation!

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