INVESTMENT MANAGEMENT

PERSPECTIVES, DECEMBER 2018

Statutory Accounting Changes

In this issue of 'Perspectives', we offer a summary of the National Association of Insurance Commissioner's (NAIC) Statutory Investment Accounting and Securities Valuation Office Changes for 2018.

Effective 2018

- SVO-identified bond exchange traded funds (ETFs) may be valued at the systematic value (SV) or fair value. If SV, the election must have been designated at 12/31/17. Any new ETFs must be designated at the next reporting period. The election is at the CUSIP level and is irrevocable until the entire position is sold.
- A new line was added to Schedule D Verification to report prepayment income from callable bonds, with an update to Consideration reported on Schedule D Verification and Schedule D Part 4, effective Q1 2018.
- Insurers are no longer allowed to report private letter rated securities as filing exempt (FE). Proof of the rating is now required by either the credit rating provider or insurer sending a qualified private letter to the SVO, with a grandfather provision for issues acquired before January 1, 2018.
- The Exempt Money Market Fund List in the Purposes and Procedures Manual has been revised to include only funds that invest in *direct* US government obligations.
- Annual reporting updates: two new symbols have been added to identify private letter rated securities:

  PL – assigned by SVO

  PLGI – assigned by insurer if using the grandfather provision, reported in the General Interrogatory
- The * symbol is only valid for NAIC designations of 6: 5*, 5*GI and Z* will be reported as 5, 5GI, and Z.
- New categories and line numbers have been added to Schedule D, DA, E, and DL for Bank Loans.
- Supranational is now defined as 'entities with more than one sovereign government as a member' in the Supplemental Investment Risk Interrogatories instructions and reflected on the schedule as a line with the union or member.
- Fair value Measurement Notes 20A, 20C, and 20D have been updated and a new Note 20E has been added to disclose the use of net asset value (NAV) as a practical expedient to fair value; investments valued at NAV will now be reported in a new category separate from Levels 1-3.
- Wash Sales Note 17C has been updated to exclude cash equivalents, derivative instruments, and short-term investments with NAIC 1 or 2 designations.
- 'NAIC Designation and NAIC Designation/Market Indicator' column headers have been renamed 'NAIC Designation and Administrative Symbol' for Schedules BA, D, and DL.

Effective 2019

- Statement of Statutory Accounting Principles (SSAP) No. 43R has been updated to eliminate the Modified FE process in determining NAIC designation for securities not financially modeled, effective Q1 2019.
- Preferred stock prefixes P & RP have been removed from NAIC designation and new line numbers have been added to report perpetual and redeemable preferred stocks on Schedule D part 2, Section 1, effective YE 2019.

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- Categories and line numbers have been updated in the Summary of Investment Schedule to be more consistent with current investment schedule classifications, effective YE 2019.
- Revisions to SSAP No. 30 to add closed-end funds, unit investment trusts, and both public and non-public stock warrants within the scope of common stocks.

On-going Projects and Discussions (2019 and beyond)

- Revisions to SAP No. 43R to no longer allow the use of weighted average to report NAIC rating at the CUSIP level. Modeled loan-backed or structured securities would be reported at the lot level or aggregated and reported at the lowest rating.
- Risk-based capital factors have been updated from 6 to 20 categories for Life companies. The American Academy of Actuaries is reviewing a similar change for P&C companies.
- Japan Credit Rating Agency is likely to be added as a credit rating provider for FE designation.
- SAPWG is reviewing credit losses to limit GAAP to SAP differences in recognition of impairment when FASB Accounting Standards Update (ASU) 2016-13[1] goes into effect for public business entities on January 1, 2020. Discussion draft exposed to move statutory guidance to an expected credit loss model, similar to GAAP. Key points proposed:
    1. Impaired assets (fair value less than amortized cost) would be assessed for credit loss
    2. Credit loss would be recorded in an allowance account rather than as an other-than-temporary impairment (OTTI)
    3. Recognize reversal of credit loss if credit improves

[1] ASU 2016-13 – Financial Instruments – GAAP Credit Losses (Topic 326): New impairment guidance for financial instruments will replace the current "incurred loss" model with a forward-looking "expected loss" model for estimating credit losses.