NAIC BLANKS (E) WORKING GROUP

Blanks Agenda Item Submission Form

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DATE: **02/28/2018**

CONTACT PERSON: ____________

TELEPHONE: ____________

EMAIL ADDRESS: ____________

ON BEHALF OF: ____________

NAME: **Dale Bruggeman**

TITLE: **Chair SAPWG**

AFFILIATION: **Ohio Department of Insurance**

ADDRESS: **50W. Town St., 3rd Fl., Ste. 300**

Columbus, OH 43215

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Agenda Item # 2018-10BWG
Year 2018
Changes to Existing Reporting [X]
New Reporting Requirement [ ]

REVIEWED FOR ACCOUNTING PRACTICES AND PROCEDURES IMPACT

No Impact [X]
Modifies Required Disclosure [ ]

DISPOSITION

[ ] Rejected For Public Comment
[ ] Referred To Another NAIC Group
[ ] Received For Public Comment
[X] Adopted Date 06/12/2018
[ ] Rejected Date ________
[ ] Deferred Date ________
[ ] Other (Specify) ________

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BLANK(S) TO WHICH PROPOSAL APPLIES

[X] **ANNUAL STATEMENT** [ ] **QUARTERLY STATEMENT**
[X] **INSTRUCTIONS** [ ] **CROSSCHECKS** [ ] **BLANK**

[X] Life and Accident & Health [ ] Property/Casualty [ ] Health
[ ] Separate Accounts [X] Fraternal [ ] Title
[ ] Other Specify

Anticipated Effective Date: Annual 2018

IDENTIFICATION OF ITEM(S) TO CHANGE

Modify the instructions for Line 2 of the IMR and Line 2 of the AVR regarding bifurcation of OTTI investments subject to *SSAP No. 26R—Bonds*.

REASON, JUSTIFICATION FOR AND/OR BENEFIT OF CHANGE**

The purpose of this proposal is to reflect changes to the guidance in *SSAP No. 26R—Bonds* adopted by Statutory Accounting Principles (E) Working Group regarding reporting of OTTI losses entirely in AVR or IMR.

NAIC STAFF COMMENTS

Comment on Effective Reporting Date:____________

Other Comments:

**** This section must be completed on all forms.** **Revised 6/13/2009**

INTEREST MAINTENANCE RESERVE

This exhibit is designed to capture the realized capital gains/(losses) that result from changes in the overall level of interest rates and amortize them into income over the approximate remaining life of the investment sold.

These instructions cover the Interest Maintenance Reserve (IMR) for both the General Account Statement and the Separate Accounts Statement. If an IMR is required for investments in the Separate Accounts Statement, it follows all rules applicable to the general account IMR and it is kept separate from the General Accounts IMR and accounted for in the Separate Accounts Statement. The criteria for determining when an IMR is required for separate accounts are described in the Separate Accounts IMR Worksheet Instructions.

Line 1 – Reserve as of December 31, Prior Year

Enter the amount from Line 6 of the prior year's schedule.

If the prior year's balance entered in Line 1 is negative, refer to the instructions for Line 6 to assure proper recording of the change in any nonadmitted or disallowed portion.

Line 2 – Current Year's Realized Pre-tax Capital Gains/(Losses) of $______ Transferred into the Reserve Net of Taxes of $______

Include interest-rate related realized capital gains/(losses), net of capital gains tax thereon. All realized capital gains/(losses) transferred to the IMR are net of capital gains taxes thereon. Exclude ~~credit~~ non-interest related (default) realized capital gains and losses, realized capital gains/(losses) on equity investments, and unrealized capital gains/(losses).

All realized capital gains/(losses), due to interest rate changes on fixed income investments, net of related capital gains tax, should be captured in the IMR and amortized into income (Column 2, Lines 1 through 31) according to Table 1 or the seriatim method. Realized capital gains/(losses) must be classified as either interest (IMR) or ~~credit~~ non-interest (AVR) related, not a combination except as specified in *SSAP No. 43R—Loan-Backed and Structured Securities*. Purchase lots with the same CUSIP are treated as individual assets for IMR and Asset Valuation Reserve (AVR) purposes.

Exclude those capital gains and losses that, in accordance with contract terms have been used to directly increase or decrease contract benefit payments or reserves during the reporting period. The purpose of this exclusion is to avoid the duplicate utilization of such gains and losses.

Capital gains tax should be determined using the method developed by the company to allocate taxes used for statutory financial reporting purposes. By capturing the realized capital gains/(losses) net of tax, the capital gains tax associated with those capital gains/(losses) due to an interest rate change is charged or credited to the IMR and amortized in proportion to the before-tax amortization.

Include realized capital gains/(losses) on:

Debt securities (excluding loan-backed and structured securities) and preferred stocks whose National Association of Insurance Commissioners (NAIC)/Securities Valuation Office (SVO) designation at the end of the holding period is **NOT** different from its NAIC designation at the beginning of the holding period by more than one NAIC designation. Exclude any such gains/(losses) exempt from the IMR.

Bond Mutual Funds – as Identified by the SVO. Include any capital gains/(losses) realized by the Company, whether from sale of the Fund or capital gains distributions by the Fund. If, during the course of the year, the SVO removes the designation of "NAIC 1" from a Bond Mutual Fund – as Identified by the SVO, the company shall not report capital gains/(losses) in this schedule. Any such removal of the "NAIC 1" designation will cause the Fund to be reported as common stock on the applicable schedules.

SVO Identified Funds designated for systematic value

Called bonds, tendered bonds, and sinking fund payments.

Mortgage loans where:

- Interest is **NOT** more than 90 days past due, or
- The loan is **NOT** in process of foreclosure, or
- The loan is **NOT** in course of voluntary conveyance, or
- The terms of the loan have **NOT** been restructured during the prior two years.

Additional Provisions for Including/Excluding Gains (Losses) from IMR:

Mortgage loan prepayment penalties are not included in IMR. Treat them as regular investment income.

Interest-related gains/(losses) realized on directly held capital and surplus notes reported on Schedule BA should be transferred to the IMR in the same manner as similar gains and losses on fixed income assets held on Schedule D. A capital gain/(loss) on such a note is classified as an interest rate gain if the note is eligible for amortized-value accounting at both the time of acquisition and the time of disposition.

Determination of IMR gain/(loss) on multiple lots of the same securities should follow the underlying accounting treatment in determining the gain/(loss). Thus, the designation, on a purchase lot basis, should be compared to the designation at the end of the holding period to determine IMR or AVR gain or loss.

Realized capital gains/(losses) on any debt security (excluding loan-backed and structured securities) that has had an NAIC/SVO designation of 6 at any time during the holding period should be excluded from the IMR and included as a ~~credit~~ non-interest related gain/(loss) in the ~~Asset Valuation Reserve~~ (AVR).

Realized capital gains/(losses) on any preferred stock that had an NAIC/SVO designation of RP4, RP5 or RP6 or P4, P5 or P6 at any time during the holding period should be reported as ~~credit~~ non-interest related gains/(losses) in the AVR.

The holding period for debt securities (excluding loan-backed and structured securities) and preferred stocks is defined as the period from the date of purchase to the date of sale. For the end of period classification, the most recent available designation should be used. For bonds acquired before January 1, 1991, the holding period is presumed to have begun on December 31, 1990. For preferred stocks acquired before January 1, 1993, the holding period is presumed to have begun on December 31, 1992. For Bond Mutual Fund – as Identified by the SVO, the holding period is defined as one calendar year to expected maturity. For SVO Identified Funds designated for systematic value, the holding period is the weighted-average life of the underlying bonds.

In accordance with *SSAP No. 26R—Bonds*, securities with other-then-temporary impairment losses shall be recorded entirely to either AVR or IMR and not bifurcated between interest and non-interest components.

Where the gain on a convertible bond or preferred stock sold while "in the money" is included in the IMR; the expected maturity date is defined as the next conversion date. "In the money" is defined to mean that the number of shares available currently or at next conversion date, multiplied by their current market price, is greater than the book/adjusted carrying value of the convertible asset. However, for a convertible bond or convertible preferred stock purchased while its conversion value exceeds its par value, any gain or loss realized from its sale before conversion must be excluded from the IMR and included in the AVR. Conversion value is defined to mean the number of shares available currently or at next conversion date, multiplied by the stock's current market price.

In accordance with *SSAP No. 43R—Loan-Backed and Structured Securities*, for loan-backed and structured securities only:

- Other-Than-Temporary Impairment – Non-interest related other-than-temporary impairment losses shall be recorded through the AVR. If the reporting entity wrote the security down to fair value due to the intent to sell or does not have the intent and ability to retain the investment for a period of time sufficient to recover the amortized cost basis, the non-interest related portion of the other-than-temporary impairment losses shall be recorded through the AVR; the interest related other-than-temporary impairment losses shall be recorded through the IMR. The analysis for bifurcating impairment losses between AVR and IMR shall be completed as of the date when the other-than-temporary impairment is determined.

- Security Sold at a Loss Without Prior OTTI – An entity shall bifurcate the loss into AVR and IMR portions depending on interest and non-interest related declines in accordance with the analysis performed as of the date of sale. As such, an entity shall report the loss in separate AVR and IMR components as appropriate.

- Security Sold at a Loss With Prior OTTI – An entity shall bifurcate the current realized loss into AVR and IMR portions depending on interest and non-interest related declines in accordance with the analysis performed as of the date of sale. An entity shall not adjust previous allocations to AVR and IMR that resulted from previous recognition of other-than-temporary impairments.

- Security Sold at a Gain With Prior OTTI – An entity shall bifurcate the gain into AVR and IMR portions depending on interest and non-interest factors in accordance with the analysis performed as of the date of sale. The bifurcation between AVR and IMR that occurs as of the date of sale may be different from the AVR and IMR allocation that occurred at the time of previous other-than-temporary impairments. An entity shall not adjust previous allocations to AVR and IMR that resulted from previous recognition of other-than-temporary impairments.

- Security Sold at a Gain Without Prior OTTI – An entity shall bifurcate the gain into AVR and IMR portions depending on interest and non-interest factors in accordance with the analysis performed as of the date of sale.

~~Other-than-temporary impairments taken on “interest-related” declines in value that are only required to be impaired in accordance with INT 06-07: Definition of Phrase “Other-Than-Temporary” because management no longer has the intent and ability to retain the investment in the issuer for a period of time sufficient to allow for recovery in value. Credit-related other-than-temporary impairment losses shall be recorded through the Asset Valuation Reserve.~~

~~In accordance with *SSAP No. 43R—Loan-Backed and Structured Securities*, for loan-backed and structured securities only, if the reporting entity wrote the loan backed or structured security down to fair value due to the intent to sell or does not have the intent and ability to retain the investment in the security for a period of time sufficient to recover the amortized cost basis, the non-interest-related portion of the other-than-temporary impairment losses shall be recorded through the AVR; the interest-related other-than-temporary impairment losses shall be recorded through the IMR.~~

The following guidance pertains to instruments in Scope of *SSAP No. 86—Derivatives*:

- For derivative instruments used in hedging transactions, the determination of whether the capital gains/(losses) are allocable to the IMR or the AVR is based on how the underlying asset is treated. Realized gains/(losses) on portfolio or general hedging instruments should be included with the hedged asset. Gains/(losses) on hedges used, as specific hedges should be included only if the specific hedged asset is sold or disposed of.

- For income generation derivative transactions, the determination of whether the capital gains/(losses) are allocable to the IMR or the AVR is based on how the underlying interest (for a put) or covering asset (for a call, cap or floor) is treated. Realized gains/(losses) should be included in the same sub-component where the realized gains/(losses) of the underlying interest (for a put) or covering asset (for a call, cap or floor) is reported. For a more complete and detailed explanation, refer to *SSAP No. 86—Derivatives* for accounting guidance.

- Realized gains/(losses), on derivative transactions entered into solely for the purpose of altering the interest rate characteristics of the company’s assets and/or liabilities (hedging transactions) should be allocated to the IMR and amortized over the life of the hedged assets. Realized gains/(losses), on income generation derivative transactions where the underlying interest (put) or covering asset (call, cap or floor) is subject to IMR, should be allocated to the IMR and amortized over the remaining life of the:

    a. underlying interest for a put
    b. covering asset for a call
    c. derivative contract for a cap or floor

- Capital gains/(losses) associated with the cash components of a replication (synthetic asset) transaction should be categorized as interest-rate related or ~~credit~~ non-interest related and as to sub-component within the AVR ~~Asset Valuation Reserve~~ as they would be in the absence of the replication (synthetic asset) transaction.

- Capital gains/(losses), other than those arising at the time of counterparty default, on the derivative component of a replication (synthetic asset) transaction that is not a swap of prospectively-determined interest rates should be categorized as interest-rate related or ~~credit~~ non-interest related and as to sub-component within the AVR ~~Asset Valuation Reserve~~ as if they were gains and losses on the replicated (synthetic) asset(s).

- Capital gains/(losses) arising from counterparty default or the curing of a previous counterparty default should be separately identified and credited or charged to the bond and preferred stock component of the AVR~~Asset Valuation Reserve~~.

- Interest-rate related gains/(losses) associated with the cash component of a replication (synthetic asset) transaction should be amortized in the same manner as they would be in the absence of the replication (synthetic asset) transaction.

- Interest-rate related gains/(losses) associated with the derivative component of a replication (synthetic asset) transaction that is not a swap of prospectively determined interest rates should be amortized as if they arose from the replicated asset.

- Realized capital gains/(losses) arising from a swap of prospectively-determined interest rates constituting a component of a replication (synthetic asset) transaction should be credited or charged to the Interest Maintenance Reserve using the maturity bucket corresponding to the side of the transaction with the longest interest rate guarantee period.

- Gains/(losses) on dollar repurchase agreements that are traded for the fee have no IMR (or AVR) impact because they are treated as financing.

- The total dollar value of these IMR realized capital gains and (losses), net of capital gains tax will be excluded from the realized gains/(losses) reported on Page 4, Line 34 in the general account.

- In the Separate Accounts Statement, the total dollar value of these IMR realized capital gains/(losses), net of capital gains tax will be excluded from the realized gains/(losses) reported on Page 4, Line 3.

- By capturing the realized capital gains/(losses), net of tax, the capital gains tax associated with those capital gains/(losses) due to an interest rate change is charged or credited to the IMR and amortized in proportion to the before-tax amortization.

Detail Eliminated To Conserve Space

ASSET VALUATION RESERVE

This exhibit and its supporting calculations are designed to address the ~~credit~~non-interest-related (default) and equity risks of the company's assets by calculating a basic contribution, a reserve objective, and a maximum reserve amount and controlling the flow of the reserve from/into surplus. These instructions cover the Asset Valuation Reserve (AVR) for both the General Account Statement and the Separate Account Statement. If an AVR is required for investments in the Separate Accounts Statement, it is combined with the General Account AVR and accounted for in the General Accounts statement. Worksheets supporting the separate accounts portion of the reserve are included with the Separate Accounts Statement. The criteria for determining when an AVR is required for separate accounts are described in the Separate Accounts AVR Worksheet instructions.

Line 1 – Reserve as of December 31, Prior Year

Enter amounts from Line 16 of the prior year's Reserve Calculation.

Line 2 – Realized Capital Gains/(Losses) Net of Taxes – General Account

Report all realized ~~credit~~non-interest-related (default) and equity capital gains/(losses), net of capital gains tax, applicable to the assets in each component and sub-component. All realized capital gains/(losses) transferred to the AVR are net of capital gains taxes thereon. Exclude all interest rate-related capital gains/(losses) from the AVR.

Capital gains tax should be determined using the method developed by the company to allocate taxes used for statutory financial reporting purposes.

Report all realized capital gains/(losses), net of capital gains tax, on each debt security (excluding loan-backed and structured securities) whose NAIC/SVO designation at the end of the holding period is different from its NAIC/SVO designation at the beginning of the holding period by more than one NAIC/SVO designation. The holding period is defined as the period from the date of purchase to the date of sale. For end of period classification, the most recent available designation should be used. For bonds acquired before January 1, 1991, the holding period is presumed to have begun on December 31, 1990.

Determination of AVR gain/(loss) on multiple lots of the same fixed income securities should follow the underlying accounting treatment in determining gain/(loss). Thus, the designation, on a purchase lot basis, should be compared to the designation at the end of the holding period to determine IMR or AVR gain or loss.

In accordance with *SSAP No. 26R—Bonds*, securities with other-then-temporary impairment losses shall be recorded entirely to either AVR or IMR and not bifurcated between interest and non-interest components.

In accordance with *SSAP No. 43R—Loan-Backed and Structured Securities*, for loan-backed and structured securities only:

- Other-Than-Temporary Impairment – Non-interest related other-than-temporary impairment losses shall be recorded through the AVR. If the reporting entity wrote the security down to fair value due to the intent to sell or does not have the intent and ability to retain the investment for a period of time sufficient to recover the amortized cost basis, the non-interest related portion of the other-than-temporary impairment losses shall be recorded through the AVR; the interest related other-than-temporary impairment losses shall be recorded through the IMR. The analysis for bifurcating impairment losses between AVR and IMR shall be completed as of the date when the other-than-temporary impairment is determined.

- Security Sold at a Loss Without Prior OTTI – An entity shall bifurcate the loss into AVR and IMR portions depending on interest and non-interest related declines in accordance with the analysis performed as of the date of sale. As such, an entity shall report the loss in separate AVR and IMR components as appropriate.

- Security Sold at a Loss With Prior OTTI – An entity shall bifurcate the current realized loss into AVR and IMR portions depending on interest and non-interest related declines in accordance with the analysis performed as of the date of sale. An entity shall not adjust previous allocations to AVR and IMR that resulted from previous recognition of other-than-temporary impairments.

- Security Sold at a Gain With Prior OTTI – An entity shall bifurcate the gain into AVR and IMR portions depending on interest and non-interest factors in accordance with the analysis performed as of the date of sale. The bifurcation between AVR and IMR that occurs as of the date of sale may be different from the AVR and IMR allocation that occurred at the time of previous other-than-temporary impairments. An entity shall not adjust previous allocations to AVR and IMR that resulted from previous recognition of other-than-temporary impairments.

- Security Sold at a Gain Without Prior OTTI – An entity shall bifurcate the gain into AVR and IMR portions depending on interest and non-interest factors in accordance with the analysis performed as of the date of sale.

~~Other-than-temporary impairment write-downs are treated as credit-related (losses) and recorded through the AVR, except for other-than-temporary impairments taken on interest-related declines in value, as described in INT 06-07, Definition of Phrase "Other-Than-Temporary." Interest-related other-than-temporary impairments are treated as interest-related losses and recorded through the IMR.~~

~~In accordance with *SSAP No. 43R—Loan-Backed and Structured Securities*, for loan-backed and structured securities only, if the reporting entity wrote the security down to fair value due to the intent to sell or does not have the intent and ability to retain the investment in the security for a period of time sufficient to recover the amortized cost basis, the non-interest-related portion of the other-than-temporary impairment losses shall be recorded through the AVR; the interest-related other-than-temporary impairment losses shall be recorded through the IMR.~~

In addition, all gains/(losses), net of capital gains tax, on mortgage loans where:

- Interest is more than 90 days past due, or
- The loan is in the process of foreclosure, or
- The loan is in course of voluntary conveyance, or
- The terms of the loan have been restructured during the prior two years

Would be classified as ~~credit~~non-interest-related gains/(losses).

The gain/(loss), net of capital gains tax, on any debt security (excluding loan-backed and structured securities) that has had an NAIC/SVO designation of "6" at any time during the holding period should be reported as a ~~credit~~ non-interest related gain/(loss).

All capital gains/(losses), net of capital gains tax, from preferred stock that had an NAIC/SVO designation of RP4, RP5 or RP6 or P4, P5 or P6 at any time during the holding period should be reported as ~~credit~~ non-interest related gains/(losses) in the AVR.

However, for a convertible bond or preferred stock purchased while its conversion value exceeds its par value, any gain/(loss) realized from its sale before conversion must be included in the Equity Component of the AVR. Conversion Value is defined to mean the number of shares available currently or at next conversion date multiplied by the stock's current market price.

Report all realized equity capital gains/(losses), net of capital gains tax, in the appropriate sub-components.

The following guidance pertains to instruments in Scope of *SSAP No. 86—Derivatives*:

- For derivative instruments used in hedging transactions, the determination of whether the capital gains/(losses) are allocable to the IMR or the AVR is based on how the underlying asset is treated. Realized gains/(losses), net of capital gains tax, on portfolio or general hedging instruments should be included with the hedged asset. Gains/(losses), net of capital gains tax, on hedges used, as specific hedges should be included only if the specific hedged asset is sold or disposed of.

- For income generation derivative transactions, the determination of whether the capital gains/(losses) are allocable to the IMR or the AVR is based on how the underlying interest (for a put) or covering asset (for a call, cap or floor) is treated. Realized gains/(losses), net of capital gains tax should be included in the same sub-component where the realized gains/(losses) of the underlying interest (for a put) or covering asset (for a call, cap or floor) is reported. Refer to *SSAP No. 86—Derivatives* for accounting guidance.

Realized gains/(losses), net of capital gains tax, resulting from the sale of U.S. government securities and the direct or guaranteed securities of agencies which are backed by the full faith and credit of the U.S. government are exempt from the AVR. This category is described in the Investment Schedules General Instructions.

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