



## INSURANCE REGULATORY UPDATE

# Takeaways from 2023 NAIC Spring Meeting

The National Association of Insurance Commissioners' (NAIC) spring meeting took place March 20–25 in Louisville, Kentucky. Below we summarize some of the relevant developments.

## Negative Interest Maintenance Reserve is at the Forefront Again

With interest rates much higher than only a year ago, a significant portion of life insurers' bond portfolios has swung from unrealized gain to unrealized loss. Insurers selling bonds at a loss today would be required to reflect the realized loss in their capital and surplus positions immediately, creating a perception of decreased financial strength.

This has made recognizing a net negative interest maintenance reserve (IMR) a hot topic again. It had been a non-issue for many years, with interest rates low and falling. The Statutory Accounting Principles Working Group (SAP WG) addressed the IMR during the session on March 22. A discussion of comments submitted by the American Council of Life Insurers (ACLI) highlighted the urgency of the situation, putting a new impetus on developing a solution before the end of the year.

However, it's important to incorporate appropriate safeguards when allowing negative IMR. One proposal is a cap on the negative IMR as a percentage of surplus. Several percentages have been proposed, from as low as 1% to as high as 10%. Participants zeroed in on 5% as the most logical number for several reasons, not the least one being that 5% of surplus is a materiality threshold in some states.

Other potential safeguards are:

- Allowing negative IMR only if it's included in asset adequacy testing (AAT)
- Allowing negative IMR only for companies with strong risk-based capital (RBC) positions
- Ensuring that fixed income sales are reinvested in new fixed income securities
- An "opt-in" approach, which centers on documentation, controls, governance and regulatory reviews
- Creating a special surplus account for negative IMR
- Shortening the amortization period for negative IMR

The ACLI comment letter spoke out against the last two proposed safeguards.

## Exclusion for Nominal Interest Rate Adjustments under Principles-Based Bond Definition

The SAP WG reacted to the February 10, 2023 comment letter from interested parties—Travelers and Equitable—adding a limited exclusion for nominal interest-rate adjustments to the proposed draft of SSAP 26R. These are adjustments to principal or coupon that are too small to be significant in deciding whether a given security is a bond in substance. They typically don't intend to significantly modify the security's return from the investor's perspective; the goal is usually to incentivize a specific issuer behavior. So, securities falling under the nominal interest rate adjustments umbrella will still be treated as bonds. For example, sustainability-linked bonds are now spelled out as bonds. These changes will be re-exposed for comments until June 9, 2023.

## CLO Modeling and Treatment of Residual Tranches

The Risk-Based Capital Investment Risk and Evaluation Working Group (RBCIRE WG) continued debating the details of modeling collateralized loan obligations (CLOs) for RBC purposes. A few of the questions not yet answered include:

- What should the models' specifications be?
- How can a structure and methodology for CLO modeling be created that can be adapted for other structured assets?
- Should modeling be outsourced, similar to the current approach for RMBS and CMBS, or should it be handled internally by the Structured Securities Group (SSG)?
- How should the NAIC define the very concept of RBC arbitrage that it's trying to eliminate? (Everyone seems to have a different definition.)

A separate but related discussion topic was the interim solution for residual tranches. The RBCIRE WG has again confirmed that it's tasked with finding an approach for residual tranches of all securitized assets, not just CLOs. As CLO modeling is finalized, CLOs are expected to fall out of scope. On the other hand, the interim solution may stick around a lot longer for assets lacking the volume to warrant separate modeling.

The key input for the interim solution is accurate data on residual tranches held by insurers. Last year, the SAP WG moved all residual tranches to Schedule BA for year-end 2022 reporting. As the 2022 statutory data is released, it will be much easier to evaluate the exposure. Once the data are available, it would become the basis for setting the appropriate capital factor—perhaps even for deciding whether residual tranches are material enough to warrant implementing the interim solution in the first place. There's some ambiguity on what constitutes a residual tranche, so the definition needs to be refined, with several participants

pointing out that residual tranches would probably be underreported for year-end 2022 as a result. In any case, the materiality of residual tranches will likely keep increasing in 2023 and beyond. Additionally, it was suggested that instead of looking at materiality from the industry-average perspective, it would be more sensible to look at individual companies with material allocations to residual tranches.

The Working Group intends to proceed with a proposal for a single NAIC6 category, instead of the earlier idea of creating three NAIC6 sub-categories. The increased capital charge will be supplemented by sensitivity tests. A 45% pre-tax capital charge for life insurers seems to be the lower bound for the discussed range, which extends all the way up to 100%. Some industry participants suggest the need for more differentiation, because not all residual tranches are created equal. For example, a residual tranche of a collateralized fund obligation (CFO) can be viewed as “equity on equity,” which could require a higher charge than a residual tranche in a CLO structure—or in a fixed income-backed feeder fund.

There's a desire to implement an interim solution for year-end 2023 reporting.

### Potential Changes to Risk-Based Capital Methodology and Formula

During the discussion of the current working agenda and priorities by the Life Risk-Based Capital Working Group (Life RBC WG), The American Academy of Actuaries (AAA) made several suggestions that may signal profound long term changes to the risk-based capital (RBC) methodology and formula.

First, the different versions, or “phases”, of the C3 calculation may eventually be unified. AAA is ready to start this process by penning down a conceptual proposal. Clearly, this would be a very involved project with many questions unanswered and significant co-dependencies with other workstreams, such as the required economic scenario generator. The ideal end result would be a single, all-encompassing C3 methodology that includes all insurance lines. No timeline has been proposed for this project.

Another aspect of RBC's potential overhaul would be a review of the covariance adjustment, both between different risks and within each risk component. The Academy isn't married to the square-root formula and is willing to explore other ways to address covariance. A good start would be to look at other capital methodologies such as Solvency II, which specifies fixed covariances between risks. Ideally, this work should be coordinated with other RBC Working Groups, with the ultimate goal of synchronizing the covariance approaches for all RBC formulas: life, P&C, and health. The Academy is planning to start this work in 2023.

More generally, 30 years after its debut, the RBC methodology itself is ripe for a holistic reexamination. There's now enough data to try and answer fundamental questions about the effectiveness of the RBC formula, such as:

- Does it effectively serve its main purpose of identifying weakly capitalized companies?
- Does it produce false positives or false negatives?
- What are the inconsistencies between the risk-based capital and statutory reserves or other parts of the balance sheet?

No timeline has been suggested for this methodology review.

### Summary: Ongoing Updates...Ongoing Monitoring

No breaking news came out of the 2023 NAIC Spring meeting, but work continues on many regulatory fronts. Market participants received more clarity, status updates, and indicative timelines on several impactful projects the NAIC is working on. In particular, insurers should expect two significant changes to happen sooner than later—possibly in time for 2023 year-end reporting: 1) net negative IMR recognition and 2) a residual tranche interim solution. AB's Insurance Solutions Team will keep a watchful eye on these and other developments, providing real-time regulatory updates to clients.

### Contributors



**Dmytro Mukhin, PhD, FSA, CFA**  
North America Senior Insurance Strategist  
dmytro.mukhin@alliancebernstein.com

---

**The value of an investment can go down as well as up, and investors may not get back the full amount they invested. Capital is at risk. Past performance does not guarantee future results.**

**Note to All Readers:** The information contained herein reflects the views of AllianceBernstein L.P. or its affiliates and sources it believes are reliable as of the date of this publication. AllianceBernstein L.P. makes no representations or warranties concerning the accuracy of any data. There is no guarantee that any projection, forecast or opinion in this material will be realized. The views expressed herein may change at any time after the date of this publication. This document is for informational purposes only and does not constitute investment advice. AllianceBernstein L.P. does not provide tax, legal or accounting advice. It does not take an investor's personal investment objectives or financial situation into account; investors should discuss their individual circumstances with appropriate professionals before making any decisions. This information should not be construed as sales or marketing material or an offer or solicitation for the purchase or sale of any financial instrument, product or service sponsored by AllianceBernstein or its affiliates. References to specific securities are presented to illustrate the application of our investment philosophy only and are not to be considered recommendations by AB. The specific securities identified and described herein do not represent all the securities purchased, sold or recommended for the Portfolio, and it should not be assumed that investments in the securities identified were or will be profitable.

**Note to Readers in the United Kingdom and Europe: For Investment Professional use only. Not for inspection by, distribution or quotation to, the general public.** This document has been approved by AllianceBernstein Limited, an affiliate of AllianceBernstein L.P.

**Note to Readers in the United Kingdom:** Issued by AllianceBernstein Limited, 60 London Wall, London, EC2M 5SJ, registered in England, No. 2551144. AllianceBernstein Limited is authorised and regulated in the UK by the Financial Conduct Authority (FCA). **Note to Readers in Europe:** This information is issued by AllianceBernstein (Luxembourg) S.à r.l. Société à responsabilité limitée, R.C.S. Luxembourg B 34 305, 2-4, rue Eugène Ruppert, L-2453 Luxembourg. Authorised in Luxembourg and regulated by the Commission de Surveillance du Secteur Financier (CSSF). **Note to Readers in Switzerland:** This information is directed at Qualified Investors only. Issued by AllianceBernstein Schweiz AG, Zürich, a company registered in Switzerland under company number CHE-306.220.501. AllianceBernstein Schweiz AG is a financial service provider within the meaning of the Financial Services Act (FinSA) and is not subject to any prudential supervision in Switzerland. Further information on the company, its services and products, in accordance with Art. 8 FinSA can be found on the Important Disclosures page at [www.alliancebernstein.com](http://www.alliancebernstein.com). **Note to Readers in Canada:** AllianceBernstein provides its investment-management services in Canada through its affiliates Sanford C. Bernstein & Co. LLC and AllianceBernstein Canada, Inc. It should not be construed as advice as to the investing in or the buying or selling of securities, or as an activity in furtherance of a trade in securities. **Note to Readers in Japan: For Institutional Investor use only. Not for inspection by, distribution or quotation to, the general public.** This document has been provided by AllianceBernstein Japan Ltd. AllianceBernstein Japan Ltd. is a registered investment management company (registration number: Kanto Local Financial Bureau no. 303). It is also a member of the Japan Investment Advisers Association; the Investment Trusts Association, Japan; the Japan Securities Dealers Association; and the Type II Financial Instruments Firms Association. The product/service may not be offered or sold in Japan; this document is not made to solicit investment. **Note to Readers in Australia and New Zealand: For Institutional Investor use only. Not for inspection by, distribution or quotation to, the general public.** This document has been issued by AllianceBernstein Australia Limited (ABN 53 095 022 718 and AFSL 230698). Information in this document is intended only for persons who qualify as "wholesale clients," as defined in the Corporations Act 2001 (Cth of Australia) or the Financial Advisers Act 2008 (New Zealand), and should not be construed as advice. **Note to Readers in Singapore: For Institutional Investor use only. Not for inspection by, distribution or quotation to, the general public.** This document has been issued by AllianceBernstein (Singapore) Ltd. ("ABSL", Company Registration No. 199703364C). AllianceBernstein (Luxembourg) S.à r.l. is the management company of the Portfolio and has appointed ABSL as its agent for service of process and as its Singapore representative. AllianceBernstein (Singapore) Ltd. is regulated by the Monetary Authority of Singapore. This advertisement has not been reviewed by the Monetary Authority of Singapore. **Note to Readers in Hong Kong: For Institutional Investor use only. Not for inspection by, distribution or quotation to, the general public.** The issuer of this document is AllianceBernstein Hong Kong Limited (聯博香港有限公司). This document has not been reviewed by the Securities and Futures Commission. **Note to Readers in Vietnam, the Philippines, Brunei, Thailand, Indonesia and India:** This document is provided solely for the informational purposes of institutional investors and is not investment advice, nor is it intended to be an offer or solicitation, and does not pertain to the specific investment objectives, financial situation or particular needs of any person to whom it is sent. This document is not an advertisement and is not intended for public use or additional distribution. AllianceBernstein is not licensed to, and does not purport to, conduct any business or offer any services in any of the above countries. **Note to Readers in Malaysia: For Institutional Investor use only. Not for inspection by, distribution or quotation to, the general public.** This document has been prepared upon request. Nothing in this document should be construed as an invitation or offer to subscribe to or purchase any securities, nor is it an offering of fund-management services, advice, analysis or a report concerning securities. AB is not licensed to, and does not purport to, conduct any business or offer any services in Malaysia. Without prejudice to the generality of the foregoing, AB does not hold a capital-markets services license under the Capital Markets & Services Act 2007 of Malaysia, and does not, nor does it purport to, deal in securities, trade in futures contracts, manage funds, offer corporate finance or investment advice, or provide financial-planning services in Malaysia. **Note to Readers in Taiwan: For Institutional Investor use only. Not for inspection by, distribution or quotation to, the general public.** This document is provided solely for informational purposes and is not investment advice, nor is it intended to be an offer or solicitation, and does not pertain to the specific investment objectives, financial situation or particular needs of any person to whom it is sent. This document is not an advertisement.

AllianceBernstein L.P. is not licensed to, and does not purport to, conduct any business or offer any services in Taiwan. **Note to Readers in China:** This information contained here reflects AllianceBernstein Hong Kong Limited ("AB") or its affiliates and sources it believes are reliable as of the date of this publication. This presentation has been provided to you for the sole use in a private and confidential meeting. AB makes no representations or warranties concerning the accuracy of any data. There is no guarantee that any projection, forecast or opinion in this material will be realized. Past performance does not guarantee future results. The views expressed here may change at any time after the date of this publication. This presentation is for informational purposes only and does not constitute investment advice. AB does not provide tax, legal or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions. This presentation or any information contained or incorporated by reference herein does not constitute an offer to sell or the solicitation of an offer to purchase any financial instrument, product or service sponsored by AB or its affiliates within the People's Republic of China ("PRC", for such purposes, excluding Hong Kong, Macao and Taiwan).

The [A/B] logo is a registered service mark of AllianceBernstein and AllianceBernstein® is a registered trademark used by permission of the owner, AllianceBernstein L.P.

© 2023 AllianceBernstein L.P.

IMA-368092-2023-04-06, ICN2023484