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April 17, 2023

Rachel Hemphill

Chair, NAIC Life Actuarial (A) Task Force (LATF)

Re: NAIC Valuation of Securities (E) Task Force (VOSTF) Referral to LATF – Bond Risk Measures

Dear Ms. Hemphill:

The American Council of Life Insurers (ACLI) appreciates the opportunity to comment on the VOSTF referral to LATF regarding Bond Risk Measures. ACLI believes that it is premature for LATF to weigh in on the creation of this capacity within the NAIC Securities Valuation Office (SVO).

As stated in the attached joint comment letters, the memorandum from the SVO does not fully discuss or specify how the SVO, VOSTF, and other regulators who would receive the analytic data included in the proposal would utilize that information and why it is of value to them. This is especially important given the costs associated with compliance by the industry.

We also understand some of the data proposed to be gathered would be used to help identify rating agency disparity concerns by the SVO (e.g., “excess yields”), but much of the other data would be used for other means and/or by other parts of the NAIC or individual regulators.

Therefore, given the costs associated with this request, we believe clear articulation on how the data would be utilized by regulators is very important before deciding on the creation of this capacity.

**American Council of Life Insurers** | 101 Constitution Ave, NW, Suite 700 | Washington, DC 20001-2133

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The American Council of Life Insurers (ACLI) is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI's member companies are dedicated to protecting consumers' financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI's 280 member companies represent 94 percent of industry assets in the United States.

Thank you once again and we look forward to future discussion.

Sincerely,

Handwritten signature of B. Banerjee in cursive script.Handwritten signature of M. Monahan in cursive script.

Colin Masterson

cc: Scott O'Neal, NAIC

**Mike Monahan**

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September 12, 2022

Ms. Carrie Mears, Chair

Valuation of Securities Task Force

National Association of Insurance Commissioners

110 Walnut Street, Suite 1500

Kansas City, MO 64106-2197

**Re: SVO Memorandum on Alternative to Add Fixed Income Analytical Risk Measures to Investments Reported on Schedule D, Part One, Insurer Credit Obligations (Bonds)**

Dear Ms. Mears,

The undersigned (ACLI, PPIA, NASVA, NAMIC, APCI) appreciate the opportunity to comment on the exposure draft, referred to above, that was released for comment by the Valuation of Securities Task Force (VOSTF) at the NAIC Summer National Meeting.

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PPIA is a business association of insurance companies, other institutional investors, and affiliates thereof, that are active investors in the primary market for privately placed debt instruments. The association exists to provide a discussion forum for private debt investors; to facilitate the development of industry best practices; to promote interest in the primary market for privately placed debt instruments; and to increase accessibility to capital for issuers of privately placed debt instruments. The PPIA serves 63 member companies and works with regulators, NASVA, the American College of Investors Counsel, and the investment banking community to efficiently implement changes within the private placement marketplace.

NASVA is an association of insurance company representatives who interact with the NAIC Securities Valuation Office ("SVO") to provide important input, and to exchange information, in order to improve the interaction between the SVO and its users. In the past, NASVA committees have worked on issues such as improving filing procedures, suggesting enhancements to the NAIC's ISIS electronic security filing system, and commenting on year-end processes.

NAMIC membership includes more than 1,500 member companies. The association supports regional and local mutual insurance companies on main streets across America and many of the country's largest national writers. NAMIC member companies write \$323 billion in annual premiums. Our members account for 67 percent of homeowners, 55 percent of automobile, and 32 percent of the business insurance markets. Through our advocacy programs NAMIC promotes public policy solutions that benefit NAMIC member companies and the policyholders they serve and foster greater understanding and recognition of the unique alignment of interests between management and policyholders of mutual companies.

*The American Property Casualty Insurance Association (APCIA) is the primary national trade association for home, auto, and business insurers. APCIA promotes and protects the viability of private competition for the benefit of consumers and insurers, with a legacy dating back 150 years. APCIA members represent all sizes, structures, and regions—protecting families, communities, and businesses in the U.S. and across the globe.*

The undersigned are also appreciative that the Securities Valuation Office (SVO) and VOSTF took into consideration our concerns and recommendation from our previous letter on this topic dated May 20, 2022, and we will not reiterate any previous points unless they are specifically relevant to additional concerns and considerations within the proposed alternative.

### **Centralized Aggregation of Data at the SVO**

If it is determined by the VOSTF that the members of the VOSTF would like the SVO to collate additional data on investment risk, for a variety of potentially different reasons, we appreciate that the proposed alternative recommends that such data is best aggregated and centralized by the SVO. This is consistent with the recommendation from our previous letter as well as consistent with many of the reasons stated in the proposed alternative.

However, given the significant cost and effort involved, prior to embarking on any effort to aggregate such data, we would encourage the VOSTF to ensure there is broad agreement by regulators on the specific objectives for such data. This would help prevent a situation where, after expending significant cost and effort on aggregating such data and developing the appropriate systems, it is found that both the data and systems subsequently do not adequately fulfill those objectives.

As noted in our previous letter, our understanding was that the data was primarily centered around comparing market yields for securities with rating agency (CRP) ratings in order to identify outlier ratings (of 2x plus variances) where the market (through demanding higher yields) ascribes more risk to a particular security than the CRP rating would imply (e.g., the excess spread above the “risk free”, or US Treasury rate, exceeds the expectation for the security’s inherent credit risk) and if applicable, for illiquidity and/or complexity premium. The current proposal more specifically states that the benefits of such data would be several, including:

- Assist in SVO identification of securities with credit rating provider (CRP) ratings which may be inconsistent with a security’s actual overall risk.
- Greater transparency for regulators into risks and characteristics of insurer investments.
- Incorporation of insurer investment portfolio analysis into the examination process.
- Availability of more Level 1 and 2 inputs which will be included in the AVS+ pricing data for all securities compared to the mostly Level 3 inputs for only some securities today.
- Allow state insurance regulators to assess the capabilities of an insurer’s investment management or risk management process by reviewing the quality and accuracy of market data fields.
- Provide NAIC staff with the capability to run cash flow simulations on insurer investments.

This would appear to be a material change to the SVO’s current mandate and capabilities. Should this be desired by the VOSTF, and more broadly regulators in general, it would benefit from clear regulatory objectives to ensure the appropriate data is being aggregated and the appropriate systems are being developed, prior to embarking on an admittedly costly undertaking.

### **Insurance Company Risk Management Practices**

We also note the concern stated in the proposal that “these data fields are very common in the management of a bond portfolio, and it would be a significant enterprise risk deficiency if an insurer’s investment managers did not have them.”

We would caution that insurance companies have very sophisticated risk management practices that monitor investment risk, liquidity risk, as well as company risk related to asset and liability management, among many other risks, that incorporate many factors above and beyond the data fields suggested as well as in a fashion that is not as linearly implied in the current proposal.

These practices, which vary by individual company, and are highly dependent upon each company's overall specific risk management framework which is informed by their industry, product mix, and size, among many other factors, including different emphases based overall philosophy. To suggest that such data should be readily available in the format requested, is a significant simplification that is not necessarily reflective of insurance companies' risk management practices.

In conclusion, we continue to believe it is more cost effective for this data to be aggregated and centralized at the SVO if the VOSTF determines this information will benefit regulators. However, given the significant cost and effort involved, prior to embarking on any effort to aggregate such data, we would encourage the VOSTF to ensure there is broad agreement by regulators on the specific objectives for such data, to ensure the appropriate data is being aggregated.

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We stand ready to assist regulators and staff with regards to this proposal. If you have any questions in the interim, please do not hesitate to contact us.

Sincerely,



Mike Monahan  
Senior Director, Accounting Policy

*Tracey Lindsey*

Tracey Lindsey  
NASVA

*John Petchler*

John Petchler  
on behalf of PPIA  
Board of Director



Jonathan Rodgers

Director of Financial and Tax Policy

A handwritten signature in black ink, appearing to read "Stephen W. Brodie". The signature is written in a cursive, flowing style.

Stephen W. Brodie  
Vice President, Financial & Counsel

**Mike Monahan**  
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May 20, 2022

Ms. Carrie Mears, Chair  
Valuation of Securities Task Force  
National Association of Insurance Commissioners  
1100 Walnut Street, Suite 1500  
Kansas City, MO 64106-2197

**Re: A Proposed Referral to the Blanks (E) Working Group to Add Fixed Income Analytical Measures to Investments Reported on Schedule D, Part One – Additional Market Data Fields for Bond Investments – Comments Due May 20, 2022**

Dear Ms. Mears,

The undersigned (ACLI, APCIA, PPIA, NASVA) appreciate the opportunity to comment on the exposure entitled “Additional Market Data Fields for Bond Investments” that was released for comment by the NAIC Valuation of Securities Task Force (VOSTF).

The undersigned note that the memorandum from the Securities Valuation Office (SVO) does not fully discuss or specify how the SVO, VOSTF and/or other regulators who would receive the analytic

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data included in the proposal would utilize that information and why it is of value to them. This is especially important given the costs associated with compliance by the industry.

The undersigned understand that one of the reasons for requesting this analytic data is to compare market yields for securities with rating agency (CRP) ratings, in order to identify outlier ratings (of 2x plus variances) where the market (through demanding higher yields) ascribes more risk to a particular security than the CRP rating would imply (e.g., the excess spread above the “risk free”, or US Treasury rate, exceeds the expectation for the security’s inherent credit risk, and if applicable, for illiquidity and/or complexity premium).

The undersigned also understand this is especially desired for privately offered structured securities – e.g., as noted under item 10 of the Summary of Referrals from Macroprudential Working Group “Regulatory Considerations Related to but not exclusive to PE” exposure, with comments due June 13, 2022, as well as from comments from various NAIC staff and regulators.

Given the costs associated with this request, the undersigned would appreciate further dialogue on how the data will be utilized and the tangible benefits to regulators. This discussion would allow the benefits to be weighed against the substantial costs associated with providing the data, i.e., compliance with the proposal.

For public securities much, if not all, of this data is already available from other commercially available sources (e.g., Bloomberg, Clearwater, Aladdin, etc.) and it may be more feasible for the SVO to aggregate this data, rather than have each individual insurance company incur the costs to implement systems changes and provide the data. This is especially true when considering that much of the requested data is based on somewhat complex modeling and outputs are heavily dependent upon inputs, which by their nature require significant judgment and therefore will vary by company.

For private securities, the SVO has (or will have) meaningful data from Private Rating Rationale Reports which are likely meant to help address rating agency disparity concerns.

Our comments below are organized into two different sections – 1) Utility of the Data for Regulators and 2) Compliance Costs for Industry. The undersigned’s desire is to help address valid regulator concerns in the most cost beneficial way.

### **Utility of the Data for Regulators**

This section of our letter will address each requested piece of data individually.

Market Yield – The Market Yield is the internal rate of return discount rate that makes the net present value (NPV) of all expected cash flows equal to zero in a discounted cash flow analysis. Therefore, Fair Value, which is already reported, is the present value (PV) of all expected cash flows at the Market Yield.

We would not expect this data to be very useful or insightful for the vast majority of securities that will be reported as Issuer Credit Obligations under the new Statutory Accounting Principles Working Group (SAPWG) Proposed Bond Definition (e.g., US Treasuries, US Government Agency, Municipal Bonds, Public Corporate Bonds or Private Corporate Bonds that are designated by the SVO and issued from operating entities). Further, for publicly rated securities, the NAIC has access to analytic data through public information sources, such as Bloomberg.



In addition, the vast majority (~75%) of what will be reported as asset-backed securities (ABS) under the new SAPWG Proposed Bond Definition (e.g., CMBS, RMBS, and potentially CLOs) are, or potentially will be, modeled by the SVO and provided an SVO designation with no weight given to CRP ratings.

For much of the remaining securities, both private credit issuer obligations and private ABS, with a private letter rating, pricing is frequently done via “matrix pricing”. While there is a variety of different methodologies utilized, this pricing methodology often uses some type of yield attributed to internal designations (e.g., use of a CRP rating, and related public index-derived yield, or an internal rating, with a similar index-derived yield). Some companies, in whole or in part, also utilize broker provided spreads or quotes for determining market values. At a minimum, there will be meaningful inconsistencies in the data supplied, as each insurer may bring different methodologies to bear in the market valuation process.

Worse, the data could be of dubious usefulness. For example, if a company internally rates a security as a BBB (based on an external CRP’s BBB rating) and uses a BBB index bond yield to determine fair value, the market yield reflected will closely approximate average BBB yields for public bonds and will not signal whether a security is more or less risky than a typical BBB bond. Said differently, because CRP ratings are a critical variable in determining matrix-based market pricing, it would be a circular process to then use a matrix pricing-derived market yield to identify CRP rating outliers.

The undersigned therefore question the utility of this data to the SVO and regulators.

Market Price – The Market Price per unit of Par Value, which is already reported, is reflected in the Fair Value as of the financial statement date. The Market Price, which excludes accrued interest, multiplied by Par Value and divided by 100 will be equal to the Fair Value.

This information is already currently reported in column 8 of Schedule D. The electronic only columns further identify the source of the market price and the fair value level attributed to it. It is unclear if the SVO is looking for something more on this item.

Purchase Yield – The Purchase Yield is the internal rate of return discount rate that makes the net present value (NPV) of all expected cash flows equal to zero in a discounted cash flow analysis as of the Acquired Date. Therefore, Actual Cost is the present value of all expected cash flows discounted at the Purchase Yield as of the Acquired Date.

The undersigned note that the Effective Rate of Interest is already included on Schedule D (Column 17) and defined in the reporting instructions as follows:

*For issuer obligations, include the effective rate at which the purchase was made. For mortgage-backed/loan-backed and structured securities, report the effective yield used to value the security at the reporting date. The Effective Yield calculation should be modified for other-than-temporary impairments recognized.*

The undersigned note that both of these definitions essentially equate book value to the future expected cash flows, which is the same as  $NPV = 0$ . Therefore, it makes sense to align these definitions to ensure the information being utilized by regulators is being efficiently obtained. Further, book yield is an objective yield that may be more beneficial for the stated intent (i.e., yield disparity for an initial CRP rating).

The utility of purchase yield for purposes of identifying excess spread, is the most relevant as it compares the excess spread, to a CRP rating when the deal is committed to. Purchase yield is a fact. For private securities, all valuations assigned subsequent to time of commitment are educated estimates. These estimates may vary for any number of reasons, beyond just the CRP rating including: short-term market movements, impairments, changing circumstances with respect to specific companies or industries, delay in rating agency downgrades, etc. For outliers, the SVO can certainly dig deeper to identify the root causes – e.g., for private securities, note purchase agreements, rating rationale reports, copies of the notes, etc. which the SVO should already have; for public securities, Bloomberg or SEC websites are readily available. In short, in attempting to identify 2x plus variances, the spread over the US Treasury rate (utilizing purchase yield at the time of commitment is going to be the most significant indicator of an outlier CRP rating. The remaining data has very limited additional value in identifying such outliers – e.g., duration matters but is less impactful as it pertains to identifying 2x variances.

Weighted Average Life (WAL) – The Weighted Average Life is the average length of time that each dollar of unpaid principal remains outstanding. The time weightings used in weighted average life calculations are based on payments to the principal. The calculation is "weighted" because it considers when the payments to the principal are made—if, for example, nearly all the principal payments are made in five years, WAL will be close to five years. Weighted average life does not consider payments to interest on the loan. This value is recalculated at each statement date for the remaining principal payments.

WAL can be thought about as a way of estimating the tenor of an investment and is often considered in establishing the interest rate. On a stand-alone basis, the undersigned do not understand why the WAL is particularly useful as other factors related to each investment are considered. The value of WAL as a measure may be diminished when there is potential variability in cash flows due to embedded options or in asset-backed securities. This potential for cash flow variability also increases the likelihood that the WAL measure will vary by company. Therefore, focusing on spread over the US Treasury rate (utilizing purchase yield) should be sufficient to identify outliers. See our discussion on duration below.

Spread to Average Life UST (UST Spread) - The spread is the difference between the interpolated U.S. Treasury bond yield that matches the reported debt security's Weighted Average Life. Spreads between interpolated U.S. Treasuries and other bond issuances are measured in basis points, with a 1% difference in yield equal to a spread of 100 basis points.

Option Adjusted Spread (OAS) - The option-adjusted spread is the measurement of the spread of a fixed income security rate and the risk-free rate of return (typically U.S. Treasury yield), which is then adjusted to take into account an embedded option and expressed in basis points. The spread is added to the fixed income security price to make the risk-free bond price the same as the bond. The option-adjusted spread considers historical data such as the variability of interest rates and prepayment rates. These calculations are complex since they attempt to model future changes in interest rates, prepayment behavior of mortgage borrowers, and the probability of early redemption.

Both the UST Spread and OAS are certainly different ways to calculate the spread over the US Treasury rate, just as with using purchase yield and market yield.

For securities without embedded prepayment or extension risk, we believe spread at time of commitment (e.g., utilizing the purchase yield) will be the most relevant metric and will be most meaningful to the SVO and regulators.

For securities with embedded prepayment or extension risk, while OAS could provide some incremental additional insight, it also has some additional drawbacks. Calculating the OAS involves projecting many future interest-rate scenarios and their probabilities, as well as assumed borrower behavior. To the extent that each insurer has its own proprietary optionality model, OAS for the same security will differ insurer to insurer.

In any case, these are just other forms of spread over treasury which the undersigned believe are unnecessary when trying to identify 2x plus variances, especially considering the costs for each company to comply, and their reliability due to subjective inputs in a complex calculation. Therefore, focusing on spread over the US Treasury rate at time of commitment (utilizing purchase yield) should be sufficient to identify outliers.

Lastly, there is concern among industry that this data would be inconsistent with other data utilized by insurance companies (e.g., the NAIC Valuation Manual for Life and Annuity Reserves requires the use of spreads in very prescriptive form).

Effective Duration - This is a duration calculation for bonds that have embedded options. This measure of duration takes into account the fact that expected cash flows will fluctuate as interest rates change and is, therefore, a measure of risk given the security's Fair Value. As a formula, Effective Duration =  $(P(1) - P(2)) / (2 \times P(0) \times Y)$ , where P(0) = the bond's Market Price per \$100 worth of par value, P(1) = the price of the bond if the yield were to decrease by Y percent, P(2) = the price of the bond if the yield were to increase by Y percent, and Y = the estimated change in yield used to calculate P(1) and P(2).

Convexity - This is a measure of the curvature, or the degree of the curve, in the relationship between bond prices and bond yields. Convexity demonstrates how the duration of a bond changes as the interest rate changes.

Both Effective Duration and Convexity are interest rate risk measures and are not indicators of credit risk. While such measures are certainly useful for a life insurance company, it is primarily in the context of comparing the duration and convexity of their asset portfolios to the duration and convexity of their liabilities. These data are most useful in estimating prices given changes in interest rates, while the price drivers are based on an investor's view of cash flows, including any embedded options. Because of this, we question their ability to explain a 2x variance in the purchase yield. Additionally, these calculations require very challenging assumptions on volatility which would certainly lead to different outcomes for different companies. Thus, in the context of the varying assumptions on the inputs, and the limited value in identifying 2x variances, the undersigned do not believe there is sufficient value in pursuing the creation of these fields.

VISION ISSUE ID - The NAIC VISION system security ID reported in AVS+.

The undersigned are not aware of any instance in which the VISION ISSUE ID is currently captured by industry, nor included on any reporting schedule. If a company is a filer of a particular security, they typically do not save the VISION ISSUE ID, and if they are not the filer, they would have no reason to seek and retain it.

Due to these factors and our limited understanding of the technical architecture of the NAIC VISION system, the undersigned wonder whether the SVO could utilize the identifiers (e.g., CUSIP) for each investment on Schedule D to cross-reference the VISION ISSUE ID.

## Compliance Costs for Industry

The effort and cost of supplying this data is significant. We see the effort broken into two challenges: data capture and creation of the electronic Schedule D:

The data capture challenge fits into one of the following scenarios:

- The data in whole or in part is not utilized by some companies for a variety of reasons, including because some companies do not manage their investment portfolio internally,
- The data is utilized by companies on an ad hoc basis and is not saved or stored, or
- If the data is saved or stored, it is done so on a de-centralized basis and not maintained in the companies' reporting systems.

Capturing the data is only one of the challenges. In order to deliver the requested data fields, the data would need to be included in the electronic Schedule D that is included in a Company's Annual Statement software package. There are several vendors that provide annual statement packages, and they work similarly. Each schedule is loaded to the package as a flat file in the specified format. Flat files are a collection of records in which the data follows a uniform format and follows rules on value types where applicable. The database is flat because every line only holds one data input, depending on the categorization of the columns within the file. The software packages can't take feeds from multiple sources to prepare the schedule. The annual statement software providers likely won't change their requirements to facilitate creation of the schedule that includes these fields so it would be up to companies to create the reporting in the required flat file.

Today, the Schedule D flat files are generated by the investment accounting system used by the company. There are several of these systems in the market. Most, if not all, of these systems do not contain information or programming to calculate the requested fields. Nor do they have a place to store the data with programming to reference such stored fields to facilitate the requested reporting. To do this would be a significant, and likely expensive, development project.

Because of these circumstances, the creation of the requested electronic Schedule D would require a manual process that combines information from multiple data sources. Beyond the cost of creating this manual process and previously stated concerns about data availability, implementing this process in a controlled manner that is required for all financial reporting would require development and testing, which would take considerable time, in addition to the implementation and ongoing cost, given the complexity. Coupled with the other significant NAIC activities, the resources to implement this broad and extensive proposal are very challenging even with a proposed year-end 2023 effective date.

These data capture and schedule creation scenarios present varying degrees of significant challenges in providing the requested information on potentially thousands or tens of thousands of securities for a single company. Each would require companies to develop and maintain processes and internal controls over centralized data capture and financial reporting protocols for data elements which currently don't exist.

## Conclusion

Given the concerns expressed above; the data may be available from other sources, the potential lack of utility of the requested data, and the costs and efforts to comply, the undersigned would like to work with regulators to get a better understanding of the actual need for this data, as well as how

the SVO expects to use the data. This would allow us to provide more constructive feedback on this proposal so it can be implemented in the most cost-efficient manner. Due to the significant effort and cost associated with complying with this proposal, for each and every insurance company, it should be evaluated against the actual benefits that will accrue to regulators, especially in the context of other SVO/VOSTF initiatives. The undersigned believe it would be unwise to hastily implement this proposal "as is" only to acknowledge later that the utility of this data is of limited value. Furthermore, we would like to explore whether it is more cost efficient for such data, or a subset of such data, to be centrally aggregated by the SVO for their use in analysis, rather than by insurers individually.

Thank you for considering the undersigned comments. If you have any questions in the interim, please do not hesitate to contact us.

Sincerely,



Mike Monahan  
Senior Director, Accounting Policy

*Tracey Lindsey*

Tracey Lindsey  
NASVA

*John Petchler*

John Petchler  
on behalf of PPIA  
Board of Directors



Stephen W. Broadie  
Vice President, Financial & Counsel

Cc: NAIC Staff  
Interested Parties