

Date: 10/5/2022

**Valuation of Securities (E) Task Force**

Thursday, October 20, 2022

3:00 p.m. – 4:00 p.m. ET / 2:00 p.m. – 3:00 p.m. CT / 1:00 p.m. – 2:00 p.m. MT / 12:00 p.m. – 1:00 p.m. PT

**ROLL CALL**

<b>Member</b>	<b>Representative</b>	<b>State</b>
Doug Ommen, Chair	Carrie Mears	Iowa
Scott A. White, Vice Chair	Doug Stolte	Virginia
Lori K. Wing-Heier		Alaska
Evan G. Daniels		Arizona
Ricardo Lara	Laura Clements	California
Andrew N. Mais	Kathy Belfi	Connecticut
Trinidad Navarro	Rylynn Brown	Delaware
David Altmaier	Carolyn Morgan	Florida
Dean L. Cameron	Eric Fletcher	Idaho
Dana Popish Severinghaus	Vincent Tsang	Illinois
Vicki Schmidt	Tish Becker	Kansas
James J. Donelon	Stewart Guerin	Louisiana
Kathleen A. Birrane	Matt Kozak	Maryland
Gary D. Anderson	John Turchi	Massachusetts
Chlora Lindley-Myers	Debbie Doggett	Missouri
Eric Dunning	Lindsay Crawford	Nebraska
Marlene Caride	Nakia Reid	New Jersey
Adrienne A. Harris	James Everett	New York
Cassie Brown	Amy Garcia	Texas
Jon Pike	Jake Garn	Utah
Mike Kreidler	Tim Hays	Washington

NAIC Support Staff: Charles Therriault/Marc Perlman

**AGENDA**

***Discuss Comments and Consider for Adoption:***

1. Discuss and Consider Adoption of the Task Force’s 2023 Proposed Charges Attachment A  
(Doc. ID: 2022.009-01)  
—Carrie Mears (IA), Charles Therriault (NAIC), Marc Perlman (NAIC)

***Discuss, Receive Comments and Consider for Exposure or Referral:***

2. Discuss and Consider Exposure of a Proposed P&P Manual Attachment B  
Amendment to Add Instructions for the Financial Modeling of CLOs Attachment B – 1  
(Doc. ID: 2022.004-12, 2022.004-13)  
—Carrie Mears (IA), Eric Kolchinsky (NAIC), Charles A. Therriault (NAIC), and Marc Perlman (NAIC)
3. Discuss and Consider Exposure of a Proposed P&P Manual Attachment C  
Amendment to Update Instructions for Related Party and Attachment C – 1 – C- 3  
Subsidiary, Controlled and Affiliated Investments  
(Doc. ID: 2022.008-04, 2022-008.01, 2022-008.02, 2022-008.03)

—Carrie Mears (IA), Charles Therriault (NAIC), Marc Perlman (NAIC)

4. Receive and Discuss a Proposed P&P Manual Amendment to Clarify the Definition of an NAIC Designation in Part One and Part Two  
(*Doc. ID: 2022.012.01*)  
—Carrie Mears (IA), Charles Therriault (NAIC), Marc Perlman (NAIC)

Attachment D

5. Any other matters

<https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2022/2022-10-20 - Interim Meeting/00-Agenda/VOSTF Agenda 2022-10-20 v1.docx>



## 2023 Proposed Charges

### VALUATION OF SECURITIES (E) TASK FORCE

The mission of the Valuation of Securities (E) Task Force is to provide regulatory leadership and expertise to establish and maintain all aspects of the NAIC's credit assessment process for insurer-owned securities, as well as produce insightful and actionable research and analysis regarding insurer investments.

#### Ongoing Support of NAIC Programs, Products or Services

##### 1. The Valuation of Securities (E) Task Force will:

- A. Review and monitor the operations of the NAIC Securities Valuation Office (SVO) and the NAIC Structured Securities Group (SSG) to ensure they continue to reflect regulatory objectives.
- B. Maintain and revise the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to provide solutions to investment-related regulatory issues for existing or anticipated investments.
- C. Monitor changes in accounting and reporting requirements resulting from the continuing maintenance of the *Accounting Practices and Procedures Manual*, as well as financial statement blanks and instructions, to ensure that the P&P Manual continues to reflect regulatory needs and objectives.
- D. Consider whether improvements should be suggested to the measurement, reporting and evaluation of invested assets by the NAIC as the result of: 1) newly identified types of invested assets; 2) newly identified investment risks within existing invested asset types; or 3) elevated concerns regarding previously identified investment risks.
- E. Identify potential improvements to the credit filing process, including formats and electronic system enhancements.
- F. Provide effective direction to the NAIC's mortgage-backed securities modeling firms and consultants.
- G. Coordinate with other NAIC working groups and task forces—including, but not limited to, the Capital Adequacy (E) Task Force, ~~the Investment Risk Based Capital (E) Working Group~~, the Statutory Accounting Principles (E) Working Group, ~~and~~ the Blanks (E) Working Group ~~and Risk-based Capital Investment Risk & Evaluation (E) Working Group~~—to formulate recommendations and to make referrals to such other NAIC regulator groups to ensure expertise relative to investments, or the purpose and objective of guidance in the P&P Manual, is reflective in the guidance of such other groups and that the expertise of such other NAIC regulatory groups and the objectives of their guidance is reflected in the P&P Manual.
- H. Identify potential improvements to the filing exempt process (the use of credit rating provider ratings to determine an NAIC designation) to ensure greater consistency, uniformity and appropriateness to achieve the NAIC's financial solvency objectives.

Executive Office | 444 North Capitol Street NW | Suite 700 | Washington, DC 20001 | (202) 471-3990

Central Office | 1100 Walnut Street | Suite 1500 | Kansas City, MO 64106-2197 | (816) 842-3600

Capital Markets & Investment Analysis Office | One New York Plaza | Suite 4210 | New York, NY 10004 | (212) 398-9000

[www.naic.com](http://www.naic.com)

- I. Implement policies to oversee the NAIC's staff administration of rating agency ratings used in NAIC processes, including staff's discretion over the applicability of their use in its administration of filing exemption.
- J. Establish criteria to permit staff's discretion over the assignment of NAIC designations for securities subject to the filing exempt process (the use of credit rating provider ratings to determine an NAIC designation) to ensure greater consistency, uniformity and appropriateness to achieve the NAIC's financial solvency objectives.
- K. Implement additional and alternative ways to measure and report investment risk.

NAIC Support Staff: Charles Therriault, Marc Perlman

[https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2022/2022-10-20 - Interim Meeting/01-Proposed Charges/2022-009.01 VOSTF\\_Proposed\\_2023\\_Charges\\_v2.docx](https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2022/2022-10-20 - Interim Meeting/01-Proposed Charges/2022-009.01 VOSTF_Proposed_2023_Charges_v2.docx)



TO: Carrie Mears, Chair, Valuation of Securities (E) Task Force  
Members of the Valuation of Securities (E) Task Force

FROM: Eric Kolchinsky, Director, NAIC Structured Securities Group (SSG) and Capital Markets Bureau  
Charles A. Therriault, Director, NAIC Securities Valuation Office (SVO)  
Marc Perlman, Managing Investment Counsel, NAIC Securities Valuation Office (SVO)

RE: Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office  
(the "P&P Manual") to Include Collateralized Loan Obligations (CLO) as a Financially Model  
Security in Part Four

DATE: September 16, 2022

---

**Summary** – A collateralized loan obligation (CLO) is type of structured security backed by a pool of debt, typically corporate loans with low credit ratings. An insurer that purchases every tranche of a CLO holds the exact same investment risk as if it had directly purchased the entire pool of loans backing the CLO. The aggregate risk-based capital (RBC) factor for owning all of the CLO tranches should be the same as that required for owning all of the underlying loan collateral. If it is less, it means there is risk-based capital (RBC) arbitrage. As noted in the Investment Analysis Office’s (IAO) memo of May 25, 2022, “Risk Assessment of Structured Securities – CLOs”, it is currently possible to materially (and artificially) reduce C1 capital requirements just by securitizing a pool of assets.

**Recommendation** – The Investment Analysis Office recommends the Task Force assign the Structured Securities Group (SSG) the responsibility of financially modeling CLO investments. SSG can model CLO investments and evaluate all tranche level losses across all debt and equity tranches under a series of calibrated and weighted collateral stress scenarios to assign NAIC Designations that create equivalency between securitization and direct holdings, thereby eliminating RBC arbitrage.

The Task Force sent a referral to the Capital Adequacy (E) Task Force (CATF) and its Risk-Based Capital Investment Risk and Evaluation (E) Working Group (RBCIREWG) requesting those groups consider adding two new RBC factors. These recommended new RBC factors would account for the tail risk in any structured finance tranche. Staff also recommends adding NAIC Designation Categories (e.g. 6.A, 6.B and 6.C) with possible interim RBC factors of 30%, 75% and 100%, respectively, until those groups can further study structured securities. Staff request approval to draft a Blanks proposal for the new NAIC Designation Categories.

**Proposed Amendment** - The proposed text changes to P&P Manual are shown below with additions in red underline, deletions in ~~red strikethrough~~ as it would appear in the 2022 P&P Manual format.



**PART FOUR**  
**THE NAIC STRUCTURED SECURITIES GROUP**



## DEFINITIONS

---

1. The following terms used in this Part Four have the meaning ascribed to them below.
  - **ABS** stands for asset-backed securities and means structured securities backed by consumer obligations originated in the United States.
  - **CLO** stands for collateralized loan obligation and means structured securities backed by a pool of debt, typically corporate loans with low credit ratings. The loans are managed by a collateral manager which bundles the initial loans (generally 150 or more) together and then actively manages the portfolio -- buying and selling loans. To fund the purchase of new debt, the CLO manager sells various tranches of the CLO to outside investors, such as insurers. Each tranche differs based on the order in which the investors will be paid when the underlying loan payments are made. As a result, they also differ with respect to the risk associated with the investment since investors who are paid last have a higher risk of default from the underlying loans. To compensate for the risk, the interest coupon payments on the subordinate tranches are higher. Investors who are paid out first have lower overall risk, but they receive smaller interest coupon payments, as a result.
  - **CMBS** stands for commercial mortgage-backed securities and means structured securities backed by commercial real estate mortgage loans originated in the United States. The definition of CMBS may refer to securitizations backed by commercial mortgages, respectively, originated outside of the United States if and to the extent that the vendor selected by the NAIC to conduct the financial modeling: (a) has the necessary information about the commercial mortgage and commercial mortgage loans originated outside of the United States to fully model the resulting securities; and (b) can adapt the modeling process to account for any structural peculiarities associated with the jurisdiction in which the mortgage was originated.
  - **Initial Information** means the documentation required to be filed with an Initial Filing of an **CLO**, RMBS or a CMBS CUSIP, pursuant to the section below and pertaining to Loan Information, Reps and Warranty Information and Structure and Formation Information for the transaction, where:
    - *Loan Information* means a review of the loan files by a third party to assess the sufficiency of legal title and other related issues.



- *Reps and Warranty Information* means the actual representation and warranties in effect for the securitization given by the mortgage originator(s) to the Trust pertaining to loan origination processes and standards, compliance with applicable law, loan documentation and the process governing put backs of defective mortgages back to the originator(s).
- *Structure and Formation Information* means the waterfall, as described in the definition of Ongoing Information, information and documentation in the form of legal opinions and documentation governing the formation of the securitization and its entities relative to issues such as bankruptcy remoteness, true sale characterization, the legal standards and procedures governing the securitization and other similar issues.
- **Intrinsic Price** is an output of financial modeling, defined as ‘1 – weighted average of discounted principal loss’ expressed as a percentage, reflecting the credit risk of the security.
- **Legacy Security**, for the purposes of this section shall mean any RMBS and any CMBS that closed prior to January 1, 2013.
- **Official Price Grids** means and refers to those generated by the SSG and provided to an insurance company or insurance companies that own the security for regulatory reporting purposes.
- **Ongoing Information** consists of: (a) tranche level data; such as principal balance, factors, principal and interest due and paid, interest shortfalls, allocated realized losses, appraisal reductions and other similar information for the specific tranche; (b) trust level data, such as aggregate interest and principal and other payments received, balances and payments to non-tranche accounts, aggregate pool performance data and other similar information; (c) loan level performance information; and (d) a computerized model of rules that govern the order and priority of the distribution of cash from the collateral pool (i.e., the “waterfall”) to the holders of the certificates/securities—provided in the format and modeling package used by the NAIC financial modeling vendor.





- **Original Source**, with respect to a specific set of data, means the Trustee, Servicer or similar entity that is contractually obligated under the agreement governing the RMBS or CMBS to generate and maintain the relevant data and information in accordance with standards specified in applicable agreements or an authorized re-distributor of the same.
- **NAIC Designation Intrinsic Price Mapping** is the mapping of the Intrinsic Price to a single NAIC Designation and Designation Category employing the midpoints between each adjoining AVR RBC charges (pre-tax). The midpoints are directly used as the minimum Intrinsic Prices (weighted average loss points) for corresponding NAIC Designations and Designation Categories.
- **Price Grids** means and refers to CUSIP-specific price matrices containing six price breakpoints; i.e., each price corresponding to a specific NAIC Designation category. Each breakpoint on a Price Grid is the price point that tips the NAIC Designation for the RMBS CUSIP into the next NAIC Designation (credit quality/credit risk) category. The plural is used because two Price Grids are generated for any CUSIP. This reflects the difference in RBC for those insurance companies that maintain an asset valuation reserve and for those insurance companies that do not.
- **Re-REMIC** is a securitization backed by: (a) otherwise eligible RMBS from one or two transactions; or (b) otherwise eligible CMBS from one or two transactions at closing. Re-REMICs cannot acquire any Underlying Securities after closing.



- **RMBS** stands for residential mortgage-backed securities and means structured securities backed by non-agency residential mortgages originated in the United States, where the collateral consists of loans pertaining to non-multi-family homes. That includes prime, subprime and Alt-A mortgages, as well as home-equity loans, home-equity lines of credit and Re-REMICs of the above. Excluded from this definition is agency RMBS, where the mortgages are guaranteed by federal and federally sponsored agencies such as the Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA) or Federal Home Loan Mortgage Corporation (FHLMC) and loans against manufactured or mobile homes or collateralized debt obligations backed by RMBS. The exclusion covers bonds issued and guaranteed by, or only guaranteed by, the respective agency. Also not included are loans guaranteed by the U.S. Department of Veteran Affairs or the U.S. Department of Agriculture's Rural Development Housing and Community Facilities Programs. The definition of RMBS may refer to securitizations backed by residential mortgages, respectively, originated outside of the United States if and to the extent that the vendor selected by the NAIC to conduct the financial modeling: (a) has the necessary information about the residential mortgage and residential mortgage loans originated outside of the United States to fully model the resulting securities; and (b) can adapt the modeling process to account for any structural peculiarities associated with the jurisdiction in which the mortgage was originated.
- **Underlying Security** means the RMBS or CMBS backing a Re-REMIC. A Re-REMIC cannot be an Underlying Security.

**NOTE:** The definitions of **CLO**, RMBS and CMBS reflect limitations associated with the financial modeling process, NAIC credit rating provider (CRP) internal naming conventions and SSG processes, as more fully discussed below and may, therefore, be subject to a narrower or a broader reading in any reporting period. Please call the SSG with any concerns or questions about the scope of the definitions for a given reporting period. Also note:

- It is possible that the scope of the **CLO**, RMBS and CMBS definitions may be broadened because the financial modeling vendors indicate other collateral or waterfall structures can be modeled.



- NAIC CRPs may adopt different internal conventions with respect to what market or asset segments are within their rated populations of CLO, RMBS, CMBS or ABS. This could affect the application of the adopted NAIC methodology or require the NAIC to select which naming process it wishes to adopt.
- It is possible that the SSG will acquire analytical assessment capabilities that permit the assessment of existing, additional or different structured securities that cannot now be modeled or that are not currently rated.



## **ADMINISTRATIVE AND OPERATIONAL MATTERS**

---

### **Certain Administrative Symbols**

2. The following administrative symbols are used in the Valuation of Securities (VOS) Products to identify RMBS and CMBS that the NAIC vendor has confirmed will be subject to the financial modeling methodology and application of Price Grids described in this Part.
  - **FMR** – Indicates that the specific CUSIP identifies a Legacy Security RMBS that is subject to the financial modeling methodology and the application of Price Grids to determine a NAIC Designation and Designation Category.
  - **FMC** – Indicates that the specific CUSIP identifies a Legacy Security CMBS that is subject to the financial modeling methodology and the application of Price Grids to determine a NAIC Designation and Designation Category
  - Non-Legacy RMBS and CMBS subject to the financial modeling methodology would be assigned an NAIC Designation and Designation Category by the SSG without an administrative symbol.
  - **CLO subject to the financial modeling methodology would be assigned an NAIC Designation and Designation Category by the SSG without an administrative symbol.**

**NOTE:** The administrative symbols **FMR** and **FMC** are related to symbols that insurers are required to use in the financial statement reporting process. Under applicable financial statement reporting rules, an insurer uses the symbol **FM** as a suffix to identify Legacy Security modeled RMBS and CMBS CUSIPs. The symbol **FM** is inserted by the insurer in the financial statement as a suffix following the NAIC Designation Category for Legacy Security RMBS and CMBS; (e.g., **2.B FM**), and for **CLO and** Non-Legacy RMBS and CMBS it would be left blank (e.g. **3.C**).

The use of these administrative symbols in the VOS Product means the insurer should not use the filing exempt process for the security so identified.



### Quarterly Reporting of RMBS and CMBS

3. To determine the NAIC Designation to be used for quarterly financial statement reporting for a **CLO**, RMBS or CMBS purchased subsequent to the annual surveillance described in this Part, the insurer uses the prior year-end modeling data for that CUSIP (which can be obtained from the NAIC) and follows the instructions in contained under the heading "Use of Net Present Value and Carrying Value for Financially Modelled Legacy Security RMBS and CMBS" or "Use of Intrinsic Price for Financially Modelled non-Legacy Security RMBS and CMBS" below, subject to, and in accordance with, *SSAP No. 43R—Loan-Backed and Structured Securities*.



## FILING EXEMPTIONS

---

### Limited Filing Exemption for RMBS and CMBS

4. **CLO, RMBS and CMBS that Can be Financially Modeled** – CLO, RMBS and CMBS that can be financially modeled are exempt from filing with the SVO. NAIC Designations for CLO, RMBS and CMBS that can be financially modeled are determined by application of the methodology discussed in this Part, not by the use of credit ratings of CRPs.
5. **CLO, RMBS and CMBS securities that Cannot be Financially Modeled**
  - **But Are Rated by a CRP** – CLO, RMBS and CMBS that cannot be financially modeled but that are rated by a CRP are exempt from filing with the SSG. The NAIC Designations for these CLO, RMBS and CMBS are determined by application of the filing exemption procedures discussed in this Manual.
  - **But Are Not Rated by a CRP** – CLO, RMBS and CMBS that cannot be financially modeled and that are not rated by a CRP are not filing exempt and must be filed with the SSG or follow the procedures, as discussed below in this Part.

### Filing Exemption for ABS

6. ABS rated by a CRP are exempt from filing with the SSG.

### Review of Decisions of the SSG

7. Analytical decisions made through the application of financial modeling are not subject to the appeal process. In the absence of an appeal, the SSG shall provide whatever clarification as to the results of financial modeling is possible to any insurer who requests it and owns the security, provided that it is not unduly burdensome for the SSG to do so. Any decision made by the SSG that results in the assignment of an NAIC Designation and does not involve financial modeling methodology, whether developed by the SSG on its own or in collaboration with the SVO, is subject to the appeal process.



## **REQUIRED DATA AND DOCUMENTS FOR TRANSACTIONS SUBMITTED TO THE SSG**

---

8. The policy statement set forth in this section shall be applicable generally to any transaction filed with the SSG for an analytical assessment, including, but not limited to, a Price Grid or for assignment of an NAIC Designation. Any filing with the SSG is deemed to be incomplete unless the insurer has provided the information, documentation, and data in quantity and quality sufficient to permit the SSG to conduct an analysis of the creditworthiness of the issuer and the terms of the security to determine the requested analytical value. It is the obligation of the reporting insurance company to provide the SSG with all necessary information. It is the responsibility of the SSG to determine whether the information provided is sufficient and reliable for its purposes and to communicate informational deficiencies to the reporting insurance company.

### **Documentation Standards**

9. In order for an insurer-owned **CLO**, RMBS or CMBS to be eligible for the year-end modeling process, conducted pursuant to this section below, the analysis must be based on information, documentation and data of the utmost integrity. A Legacy Security must meet the Ongoing Information requirements. A **CLO**, RMBS, CMBS or Re-REMIC that is not a Legacy Security must meet the Initial Information and Ongoing Information requirements. For the purposes of determining a Re-REMIC's status as a Legacy Security, the closing date of the Re-REMIC (not the Underlying Security) shall be used. The SSG may, in its sole discretion, determine that the Initial Information and/or Ongoing Information is not sufficient and/or not reliable to permit the **CLO**, RMBS or CMBS CUSIP to be eligible for financial modeling. If the SSG determines that the Initial Information and/or Ongoing Information is not sufficient and/or not reliable to permit the **CLO**, RMBS or CMBS CUSIP to be eligible for financial modeling, it will communicate this decision to the insurer and invite a dialogue to ascertain whether alternative information is available that would be deemed sufficient and/or reliable by the SSG.

### **Initial Information Requirements**

10. A **CLO**, RMBS or CMBS meets the Initial Information Requirements if the security meets one of the following three conditions:



- **RTAS** – The RMBS or CMBS was assigned a preliminary price grid or designation as described in this Part;
- **Initial Sufficiency Filing** – The **CLO**, RMBS or CMBS was reviewed by SSG through an Initial Sufficiency Filing; or
- **Safe Harbor** – The **CLO**, RMBS or CMBS meets the Safe Harbor requirements.

### Initial Sufficiency Information Filing

11. An insurance company may file Initial Sufficiency Information with the SSG for the purpose of obtaining a determination that a **CLO**, RMBS or CMBS CUSIP is eligible for financial modeling under the annual surveillance process discussed below. Initial Sufficiency Information is only filed once for any given **CLO**, RMBS or CMBS. Reporting insurance companies are solely responsible for providing the SSG with Initial Information. A determination by the SSG that a given **CLO**, RMBS or CMBS CUSIP is eligible for financial modeling after an Initial Sufficiency Filing assessment is subject to the further and continuing obligation that the SSG obtain or the insurer provide the SSG with updated Ongoing Information close to the date of the annual surveillance.
12. **Required Documents for Initial Sufficiency Filing** – An insurer that owns a **CLO**, RMBS or a CMBS for which Initial Information is not publicly available shall provide the SSG with the following documentation.
13. **CLO** – Unless otherwise specified by the SSG in a Modeling Alert, as further described below, an Initial Filing for a CLO consists of submission of Initial Information and Ongoing Information in the form of the following documentation:
  - Pooling and Servicing Agreement or similar
  - Prospectus, Offering Memorandum or similar; Accountant’s comfort letter
  - If applicable, ISDA Schedules and Confirmations or similar
  - Legal opinions given in connection with the transaction
  - Any other documents referenced by the above
  - Third-Party Due diligence scope document and raw results. If less than 100% due diligence, detailed description of the loan selection process
  - If applicable, loan purchase agreements or similar.





- Loan Tape
  - All eligible CRP ratings for underlying loan portfolio.
  - For each unrated underlying loans, the Prospectus, Offering Memorandum or similar; 3-years of audited financial statements for the issuing entity.
14. **RMBS** – Unless otherwise specified by the SSG in a Modeling Alert, as further described below, an Initial Filing for an RMBS consists of submission of Initial Information and Ongoing Information in the form of the following documentation:
- Pooling and Servicing Agreement or similar
  - Prospectus, Offering Memorandum or similar; Accountant’s comfort letter
  - If applicable, ISDA Schedules and Confirmations or similar
  - Legal opinions given in connection with the transaction
  - Any other documents referenced by the above
  - Third-Party Due diligence scope document and raw results. If less than 100% due diligence, detailed description of the loan selection process
  - If applicable, loan purchase agreements or similar. Loan Tape
15. **CMBS** – Unless otherwise specified by the SSG in a Modeling Alert, as further described below, an Initial Filing for a CMBS consists of submission of Initial Information and Ongoing Information in the form of the following documentation:
- Pooling and Servicing Agreement or similar
  - Prospectus, Offering Memorandum or similar; Accountant’s comfort letter
  - If applicable, ISDA Schedules and Confirmations or similar
  - Legal opinion given in connection with the transaction
  - Any other documents referenced in the above
  - Asset Summaries
  - Loan Tape



- Loan documents, including reliable information about the terms of the transaction; including, but not limited to, financial covenants, events of default, legal remedies and other information about financial, contractual or legal aspects of the transaction in form and substance consistent with industry best practices for CMBS issuance.
- In certain cases, additional documents below will enable the SSG to verify and validate initial underwriting information of the property securing the CMBS. These documents may be required in form and substance consistent with best practices for typical CMBS issuance.
- Historical operating statements and borrower's budget
- Underwriter's analysis of stabilized cash flow with footnotes of assumptions used
- Property type specific, rent roll information
- Appraisals and other data from recognized industry market sources
- Independent engineering report (Property Condition Assessment)
- Environmental Site Assessment (ESA) – Phase I/Phase II
- Documentation related to seismic, flood and windstorm risks
- Franchise agreements and ground leases, if applicable
- Management agreements

### **SSG Modeling Alerts**

16. The SSG shall at all times have discretion to determine that differences in the structure, governing law, waterfall structure or any other aspect of a securitization or a class of securitization requires that insurance companies provide Initial Information and/or Ongoing Information additional to or different from that identified in this Part. The SSG shall communicate such additional or different documentation requirements to insurers by publishing a Modeling Alert on the NAIC website and scheduling a meeting of the VOS/TF to ensure public dissemination of the decision.



### Safe Harbor

17. Safe Harbor options serve as proxies for the Initial Sufficiency filing. The options reflect publicly available information that a third party has analyzed the Initial Information. Because the structured securities market is quite dynamic, the list of Safe Harbor options may change frequently, with notice and opportunity for comment, as described in this section. A CLO, RMBS or CMBS meets the Initial Information requirement if:

- At least two Section 17(g)-7 reports issued by different CRPs are publicly available; or
- A security that is publicly registered under the federal Securities Act of 1933.

### Ongoing Information Requirements

18. A CLO, RMBS or CMBS meets the Ongoing Information Requirements if Ongoing Information is available to the SSG and the relevant third-party vendor from an Original Source. The SSG, in its sole discretion and in consultation with the relevant third-party vendor, may determine that the Ongoing Information is not sufficient or reliable to permit a given CLO, RMBS or CMBS CUSIP to be financially modeled. However, in making such a determination, the SSG shall take into account reasonable market practices and standards.

### Special Rules for Certain Re-REMICs

19. Re-REMICs are generally simple restructurings of RMBS or CMBS. An Initial Sufficiency Filing for a Re-REMIC (a) which is not a Legacy Security itself but (b) where each Underlying Security is a Legacy Security shall not require submission of information regarding the Underlying Securities. In most cases, a prospectus for the Re-REMIC will be sufficient. If the SSG determines that additional information about the Re-REMIC structure or formation is required, it will communicate this decision to the insurer and invite a dialogue to ascertain whether additional information is available that would be deemed sufficient by the SSG.



## ANALYTICAL ASSIGNMENTS

---

### ANNUAL SURVEILLANCE OF **CLO**, RMBS AND CMBS – MODELED AND NON-MODELED SECURITIES

#### Scope

20. This section explains the financial modeling methodology applicable to all **CLO**, RMBS and CMBS (defined above) securitizations, the book/adjusted carrying value methodology applicable to a modeled Legacy Security, the NAIC Designation Intrinsic Price Mapping applicable to a modeled non-Legacy Security, and non-modeled securities subject to *SSAP No. 43R—Loan-Backed and Structured Securities*. Please refer to SSAP No. 43R for a description of securities subject to its provisions. The VOS/TF does not formulate policy or administrative procedures for statutory accounting guidance. Reporting insurance companies are responsible for determining whether a security is subject to SSAP No. 43R and applying the appropriate guidance.

#### Important Limitation on the Definitions of RMBS and CMBS

21. The definitions of **CLO**, RMBS and CMBS above are intended solely to permit the SSG to communicate with financial modeling vendors, insurance company investors who own **CLO**, RMBS and CMBS subject to financial modeling and/or the book/adjusted carrying value methodology and their investment advisors to facilitate the performance by the SSG of the financial modeling methodology described below. The definitions contained in this section are not intended for use and should not be used as accounting or statutory statement reporting instructions or guidance.

**NOTE:** Please refer to *SSAP No. 43R—Loan-Backed and Structured Securities* for applicable accounting guidance and reporting instructions.

### ANALYTICAL PROCEDURES APPLICABLE TO **CLO**, RMBS AND CMBS SECURITIZATIONS SUBJECT TO FINANCIAL MODELING METHODOLOGY

#### Filing Exemption Status of RMBS and CMBS

22. **CLO**, RMBS and CMBS are not eligible for filing exemption because credit ratings of CRPs are no longer used to set risk-based capital (RBC) for **CLO**, RMBS or CMBS. However, **CLO**, RMBS and CMBS are not submitted to the SSG.



### Use of Financial Modeling for Year-End Reporting for **CLO**, RMBS and CMBS

23. Beginning with year-end 2009 for RMBS, and 2010 for CMBS, probability weighted net present values will be produced under NAIC staff supervision by an NAIC-selected vendor using its financial model with defined analytical inputs selected by the SSG. The vendor will provide the SSG with a Intrinsic Price and/or a range of net present values for each RMBS or CMBS corresponding to each NAIC Designation category. The NAIC Designation for a specific Legacy Security RMBS or CMBS is determined by the insurance company, based on book/adjusted carrying value ranges, and the NAIC Designation for a specific non-Legacy Security RMBS or CMBS is determined by the NAIC Designation Intrinsic Price Mapping by SSG.
24. Beginning with year-end 2023 for CLO, probability weighted net present values will be produced by SSG with defined analytical inputs selected by the SSG. SSG will model CLO investments and evaluate all tranche level losses across all debt and equity tranches under a series of calibrated and weighted collateral stress scenarios to assign NAIC Designations for a specific CLO tranche is determined by the NAIC Designation Intrinsic Price Mapping by SSG.

**NOTE:** Please refer to *SSAP No. 43R—Loan-Backed and Structured Securities* for guidance on all accounting and related reporting issues.

### Analytical Procedures for **CLO**, RMBS and CMBS

25. The SSG shall develop and implement all necessary processes to coordinate the engagement by the NAIC of a vendor who will perform loan-level analysis of insurer-owned CLO, RMBS and CMBS using the vendor's proprietary models.

<b>CLO, RMBS AND CMBS SUBJECT TO FINANCIAL MODELING</b>
---

### Setting Microeconomic Assumptions and Stress Scenarios

26. Not later than September of each year, the SSG shall begin working with the vendor to identify the assumptions, stress scenarios and probabilities (hereafter model criteria) the SSG intends to use at year-end to run the vendor's financial model.

### The Financial Modeling Process

27. Information about the financial modeling process can be found at [www.naic.org/structured\\_securities/index\\_structured\\_securities.htm](http://www.naic.org/structured_securities/index_structured_securities.htm).



**Use of Net Present Value and Carrying Value for Financially Modeled Legacy Security RMBS and CMBS**

28. For each modeled Legacy Security RMBS and CMBS, the financial model determines the net present value at which the expected loss equals the midpoint between the RBC charges for each NAIC Designation; i.e., each price point, if exceeded, changes the NAIC Designation. Net present value is the net present value of principal losses, discounted using the security’s coupon rate (adjusted in case of original issue discount securities to book yield at original issue and in case of floating rate securities, discounted using LIBOR curve + Origination spread). Because of the difference in RBC charge, the deliverable is five values for each RMBS and CMBS security for companies required to maintain an asset valuation reserve (AVR) and five values for companies not required to maintain an AVR. This is illustrated in the chart below.

**RBC charge / NAIC designation (pre-tax)**

<b>P&amp;C</b>	<b>RBC</b>	<b>Midpoint</b>
<b>1</b>	0.3%	0.65%
<b>2</b>	1.0%	1.50%
<b>3</b>	2.0%	3.25%
<b>4</b>	4.5%	7.25%
<b>5</b>	10.0%	20.00%
<b>6</b>	30.0%	
<b>Life</b>	<b>RBC</b>	<b>Midpoint</b>
<b>1</b>	0.4%	0.85%
<b>2</b>	1.3%	2.95%
<b>3</b>	4.6%	7.30%
<b>4</b>	10.0%	16.50%
<b>5</b>	23.0%	26.50%
<b>6</b>	30.0%	



29. The NAIC Designation and NAIC Designation Category for a given modeled Legacy Security RMBS or CMBS CUSIP owned by a given insurance company depends on the insurer’s book/adjusted carrying value of each RMBS or CMBS, whether that carrying value, in accordance with *SSAP No. 43R—Loan-Backed and Structured Securities*, paragraphs 25 through 26a, is the amortized cost or fair value, and where the book/adjusted carrying value matches the price ranges provided in the model output for each NAIC Designation and the mapped NAIC Designation Category, reflected in the table below, to be used for reporting an NAIC Designation Category until new prices ranges are developed to reflect the full range of new Risk Based Capital factors adopted for each NAIC Designation Category; except that a modeled Legacy Security RMBS or CMBS tranche that has no expected loss under any of the selected modeling scenarios would be assigned an **NAIC 1 Designation** and **NAIC 1.A Designation Category** regardless of the insurer’s book/adjusted carrying value.

**NOTE:** Please refer to the detailed instructions provided in SSAP No. 43R.

<u>NAIC Designation Determined by Modeled Price Ranges</u>	<u>Mapped NAIC Designation Category</u>
1	1.D
2	2.B
3	3.B
4	4.B
5	5.B
6	6

**Use of Intrinsic Price for Financially Modeled **CLO and** non-Legacy Security RMBS and CMBS**

30. The NAIC Designation and NAIC Designation Category for a given modeled **CLO and** non-Legacy Security RMBS or CMBS CUSIP owned by a given insurance is assigned by SSG and **does not** depend on the insurer’s book/adjusted carrying value of each **CLO**, RMBS or CMBS. The NAIC Designation and Designation Category assigned will be determined by applying the Intrinsic Price to the NAIC Designation Intrinsic Price Mapping, as defined in this Part.



**Securities Not Modeled by the SSG and Not Rated by an NAIC CRP or Designated by the SVO**

31. Securities subject to *SSAP No. 43R—Loan-Backed and Structured Securities* that cannot be modeled by the SSG and are not rated by an NAIC CRP or designated by the SVO are either: (a) assigned the NAIC administrative symbol **ND** (not designated), requiring subsequent filing with the SVO; or (b) assigned the NAIC Designation for Special Reporting Instruction [i.e., an **NAIC 5GI**, NAIC Designation Category **NAIC 5.B GI** or **NAIC 6\*** (six-star)].





## **MORTGAGE REFERENCED SECURITIES**

---

### **Definition**

32. A Mortgage Referenced Security has the following characteristics: A Mortgage Referenced Security's coupon and/or principal payments are linked, in whole or in part, to prices of, or payment streams from, real estate, index or indices related to real estate, or assets deriving their value from instruments related to real estate, including, but not limited to, mortgage loans.

### **Not Filing Exempt**

33. A Mortgage Referenced Security is not eligible for filing exemption but is subject to the filing requirement.

### **NAIC Risk Assessment**

34. In determining the NAIC Designation of a Mortgage Referenced Security, the SSG may use the financial modeling methodology discussed in this Part, adjusted (if and as necessary) to the specific reporting and accounting requirements applicable to Mortgage Referenced Securities.

### **Quarterly Reporting for Mortgage Reference Securities**

35. To determine the NAIC Designation to be used for quarterly financial statement reporting for a Mortgage Reference Security purchased subsequent to the annual surveillance described in this Part, the insurer uses the prior year-end modeling data for that CUSIP (which can be obtained from the NAIC) until the annual surveillance data is published for the current year. For a Mortgage Reference Security that is not in the prior year-end modeling data for that CUSIP, the insurer may follow the instructions in Part Two of this manual for the assignment of the SVO Administrative Symbol "Z" provided the insurer owned security meets the criteria for a security that is in transition in reporting or filing status.

**NOTE:** Please refer to SSAP No. 26R and SSAP No. 43R for the definition of and guidance on Structured Notes and Mortgage Referenced Securities. Please also refer to Part Three of this Manual for guidance about the filing exempt status of Structured Notes.



## **GROUND LEASE FINANCING TRANSACTIONS**

---

### **Definition**

36. Ground Lease Financing (GLF) transactions are defined and explained in “Ground Lease Financing Transactions” in Part Three of this Manual.

### **SSG Role and Process**

37. On occasion, the SVO may refer a GLF transaction to the SVO for financial modeling of the GLF space leases or business operation, as applicable, in accordance with the process set forth in “Ground Lease Financing Transactions” in Part Three of this Manual. Following an SVO referral the SSG and SVO will maintain open communication related to requests for additional data, analytical questions and analytical conclusions. Any GLF transaction NAIC Designation will be assigned by the SVO.



## **THE RTAS – EMERGING INVESTMENT VEHICLE**

---

### **Purpose**

38. Price grids and/or NAIC Designation and Designation Categories are generated for the exclusive use of insurance companies and the NAIC regulatory community. Insurance companies use official Prices Grids and/or NAIC Designations and Designation Categories by following the instructions in *SSAP No. 43R—Loan-Backed and Structured Securities* to derive a final NAIC Designation for the **CLO**, RMBS or CMBS, which they use to derive the RBC applicable for the **CLO**, RMBS or CMBS.

**NOTE:** Please refer to SSAP No. 43R for a full explanation of the applicable procedure.

### **Extension of Authority**

39. The Regulatory Treatment Assessment Service – Emerging Investment Vehicle procedure is extended to the SSG, and the SSG is authorized to determine probable regulatory treatment for **CLO**, RMBS and CMBS pursuant to this Part or for other securities, where, in the opinion of the SSG, financial modeling methodology would yield the necessary analytical insight to determine probable regulatory treatment or otherwise enable the SSG to make recommendations to the VOS/TF as to regulatory treatment for a security.

### **Interpretation**

40. To facilitate this purpose, wherever in the Regulatory Treatment Assessment Service – Emerging Investment Vehicle procedure reference is made to the SVO, it shall be read to also refer to and apply to the SSG, adjusting for differences in the operational or methodological context. The Regulatory Treatment Assessment Service – Emerging Investment Vehicle procedure shall also be read as authority for collaboration between SVO and SSG staff functions so as to encompass RTAS assignments that require the use of SVO financial, corporate, municipal, legal, and structural analysis and related methodologies, as well as of financial modeling methodologies.



## Translation of Preliminary into Official Price Grids and/or NAIC Designations and Designation Categories

41. Price Grids and/or Designations and Designation Categories (“PGD”) generated by the SSG pursuant to an RTAS are preliminary within the meaning of that term as used in the Regulatory Treatment Assessment Service – Emerging Investment Vehicle procedure and accordingly cannot be used for official NAIC regulatory purposes. Preliminary NAIC Designations are translated into official NAIC Designations by the SVO when an insurance company purchases and files the security and the SVO conducts an official assessment. However, this Manual does not require the filing of **CLO**, RMBS and CMBS subject to financial modeling methodology with the SSG. It is, therefore, necessary to specify a procedure for the translation of preliminary Price Grids and/or Designations and Designation Categories (“Preliminary PGD”) into official PGD that can be used for NAIC regulatory purposes. Preliminary PGDs generated by the SSG become an official PGD within the meaning of this section when an insurance company has purchased the security for which the PGD was generated and reported that security for quarterly reporting purposes using the SSG generated PGD. A PGD for a security reported by an insurance company for quarterly reporting is effective until the SSG conducts the next annual surveillance pursuant to this Part at which the time the PGD generated by the SSG at year-end shall be the official PGDs for that security.



Steve Clayburn, FSA, MAAA  
Senior Actuary, Health Insurance & Reinsurance  
[steveclayburn@acli.com](mailto:steveclayburn@acli.com)

September 12, 2022 Ms.

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

Via email: [ctherriault@naic.org](mailto:ctherriault@naic.org) and [dgenaorosado@naic.org](mailto:dgenaorosado@naic.org)

Re: Capital Markets Bureau CLO Stress Test Methodology YE2020 and SSG report on the IAO issue paper on the risk assessment of structured securities – CLOs

Dear Ms. Mears:

ACLI appreciates the Valuation of Securities Task Force's (VoSTF) instructions on August 11, 2022, to initiate the process for the Securities Valuation Office (SVO) modeling of collateralized loan obligations (CLOs). ACLI also appreciates the opportunity to review and comment on (1) the SVO's 2020 CLO stress testing methodology, and (2) the SVO's reply to comment letters received on the IAO issue paper.

ACLI thanks the VoSTF for exposing the previously published 2020 CLO Stress Testing Methodology, as this has allowed all our members interested in this important issue to understand the basis of the suggested methodology for CLO modeling. We also appreciate that this methodology is not the final solution as there will be future discussions and finalization of the assumptions that will go in the model utilized. We look forward to those discussions.

In addition, we appreciate the time to review the SSG staff's responses to the comment letters received when the IAO issue paper was exposed. We look forward to discussing the items listed as this project progresses.

Thank you for the opportunity to continue to participate and comment on these materials. We look forward to future discussions and continued collaboration with the NAIC on this important initiative.

Sincerely,

A handwritten signature in cursive script that reads 'Steve M. Clayburn'.

Steve Clayburn

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

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.

[acli.com](http://acli.com)

<https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2022/2022-10-20 - Interim Meeting/02-CLOs Part Four/2022-004.13 ACLI Comment Letter on SVO Exposures 9-12-2022.docx>



TO: Carrie Mears, Chair, Valuation of Securities (E) Task Force  
Members of the Valuation of Securities (E) Task Force

FROM: Charles A. Therriault, Director, NAIC Securities Valuation Office (SVO)  
Marc Perlman, Managing Investment Counsel, NAIC Securities Valuation Office (SVO)

CC: Eric Kolchinsky, Director, NAIC Structured Securities Group (SSG) and Capital Markets Bureau

RE: Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (the "P&P Manual") regarding Subsidiary, Controlled and Affiliated (SCA) Debt or Preferred Stock Investments

DATE: September 16, 2022

---

**Summary** – On June 10, 2022 the Statutory Accounting Principles (E) Working Group sent a referral to the Task Force resulting from the Working Group’s May 24, 2022 adoption of agenda item 2021-21: *Related Party Report* which revised both *SSAP No. 25 – Affiliates and Other Related Parties* and *SSAP No. 43 – Loan-Backed and Structured Securities* which raised comments about eligibility for filing exemption for various affiliated structures.

The amendment required new reporting information for investments that involve a related party as sponsor, originator or other similar transaction party, regardless of whether the investment is captured on the affiliate reporting line. The referral further explained that because the definition of affiliation is determined by an evaluation of control of the issuer, which for structure securities is typically a special purpose entity (SPE), it is possible for an investment that involves an affiliate or related party issuer to not be considered affiliated (because the insurer has no control over the issuing SPE), while it is also possible for an affiliated debt investment to lack underlying affiliated credit exposure (because the underlying obligors are not affiliate or related parties).

The Working Group referred this matter to the Task Force stating that, “the SVO may need to develop additional procedures to add a methodology to designate this type of asset-backed security investment structure, or to clarify that affiliated investments that do not have underlying affiliated credit exposure [meaning the affiliate exposure is to the SPE issuer, originator, sponsor or servicer rather than the underlying obligor] qualify for FE.”

The Subsidiary, Controlled and Affiliated (SCA) Debt or Preferred Stock Investments section of the P&P Manual currently only requires insurers to file with the SVO bonds or preferred stock issued by an insurance or non-insurance SCA entity. Therefore, a transaction with an affiliate or related party obligor, sponsor or underlying obligor, as opposed to issuer, or other non-issuer party which transfers risk, directly or indirectly, to the reporting insurance company, would not constitute an SCA investment as currently

defined. Transactions in which the issuer is not an affiliate or related party could, nonetheless, and as stated in SSAP No. 25, be “subject to abuse because reporting entities may be induced to enter transactions that may not reflect economic reality or may not be fair and reasonable to the reporting entity or its policyholders.” For example, an affiliated or related entity could originate several loans to unaffiliated and unrelated obligors and, for various reasons, sell those loans to a SPE which could then issue a note to the reporting insurance company. The fact the reporting insurance company is assuming the risk of the loans originated by an affiliate or related party could pose risks of abuse or unfairness even though the underlying loan obligors (the credit exposure) are not affiliates or related parties. A similar risk of possible abuse exists if the underlying credit exposure has a relationship to the reporting insurance company, even if the issuer does not. Therefore, the amendment would also make investments ineligible for filing exemption if the underlying credit exposure would qualify as a related party pursuant to paragraph 4.a. in *SSAP No. 43R – Loan-Backed and Structured Securities*, even if the issuer is not an SCA or related party.

Transactions with an affiliate or related party that is not the issuer (typically a securitization or other structured finance structure) are currently eligible for filing exemption. Such investments, however, would likely be in scope of *SSAP No. 25—Affiliates and Other Related Parties* and subject to reporting as an affiliate or related party transaction in the appropriate investment schedules. State insurance regulators could, based upon the reporting of an affiliate or related party relationship, require that the reporting insurance company file an investment with the SVO for analysis and/or assignment of an NAIC Designation.

Additionally, while we are opening up the SCA section for revisions, the SVO proposes clarifying that SCA investments, according to the P&P Manual, has always referred not only to affiliate transactions in which there is direct or indirect control between the reporting insurance company and a transaction entity, but referred also to related parties where relationships other than control, as listed in SSAP No. 25, might exist. For example, the SVO reviewed a transaction in which there was no direct or indirect control between the reporting entity and the issuer, but there was a father/son relationship between the owner of the issuer and CEO of the reporting insurance company, a relationship which poses a risk of abuse, unfairness, or unreasonableness.

**Recommendation** – The SVO proposes renaming the Subsidiary, Controlled and Affiliated (SCA) Debt or Preferred Stock Investments section of the P&P Manual to Subsidiary, Controlled and Affiliated (SCA) and Related Party Debt or Preferred Stock Investments to clarify that it includes non-control relationships, and amending SCA investment, SCA debt and SCA preferred stock definitions to include related parties.

The SVO also proposes expanding the definition of SCA and related party debt to include structures in which the non-issuer underlying credit exposure would qualify as a related party pursuant to paragraph 4.a. in *SSAP No. 43R – Loan-Backed and Structured Securities*.

Lastly, the SVO also proposes creating a new category of SCA and related party investment called SCA and Related Party Filing Exempt Investments which would mean any investment (i) issued by an affiliate or related party special purpose entity (SPE) which itself is not an obligor or ultimate source of the investment repayment, or (ii) issued as part of a structure in which the originator, sponsor, manager, servicer, other influential transaction party is an affiliate or related party of the reporting insurance company. SCA and Related Party Filing Exempt Investments would be eligible for filing exemption unless otherwise ineligible (for reasons other than their affiliate or related party status). The P&P Manual would also be amended to clarify that state insurance regulators are permitted, as specified in Part One of the P&P, to require an insurance company to file what would otherwise be an SCA and Related Party Filing Exempt Investment for analysis and/or assignment of an NAIC Designation only by the SVO, thereby making it ineligible for filing exemption in the future.

**Proposed Amendment** - The proposed text changes to P&P Manual are shown below with additions in red underline, deletions in ~~red strikethrough~~ as it would appear in the 2022 P&P Manual format.



**PART ONE**

**POLICIES OF THE NAIC VALUATION OF SECURITIES (E) TASK FORCE**

**POLICIES APPLICABLE TO SPECIFIC ASSET CLASSES**

---

...

**SUBSIDIARY, CONTROLLED AND AFFILIATED (SCA) AND RELATED PARTY INVESTMENTS**

110. SCA and related party bond and preferred stock investments (each, as defined in Part Three) in the form of a debt instrument purchased (or otherwise acquired) from an insurance or non-insurance entity (~~SCA debt~~) and preferred stock issued by an insurance or non-insurance entity (~~SCA preferred~~) may be assessed by the SVO to determine eligibility for reporting as an Investment Security as defined in this Manual. The SVO is required to determine that a filed SCA and related party investment has terms, structure, complexity and purpose like those in transactions between unaffiliated parties so that credit risk assessment methodologies applied to transactions between unaffiliated parties can be meaningfully applied to transactions between affiliated parties; as a condition to assigning an NAIC Designation to the investment.

**NOTE:** See “Subsidiary, Controlled and Affiliated (SCA) and related party Debt Bond or Preferred Stock” in Part Three for filing instructions, documentation requirements and methodology applicable to SCAs.

**PART THREE**

**SVO PROCEDURES AND METHODOLOGY FOR PRODUCTION OF NAIC  
DESIGNATIONS**

**PROCEDURE APPLICABLE TO FILING EXEMPT (FE) SECURITIES AND PRIVATE LETTER (PL)  
RATING SECURITIES**

---

...

**FE SECURITIES**

**Filing Exemption**

3. Bonds, within the scope of SSAP No. 26R and SSAP No. 43R (excluding RMBS and CMBS subject to financial modeling) and Preferred Stock within scope of SSAP No. 32, that have been assigned an Eligible NAIC CRP Rating, as described in this Manual, are exempt from filing with the SVO (FE securities) with the exception of Bonds and/or Preferred Stock explicitly excluded below.

**Specific Populations of Securities Not Eligible for Filing Exemption**

4. The filing exemption procedure does not apply to:

...

- **SCA and Related Party Bond and Preferred Stock Investments** – SCA and related party bond and preferred stock investments (each, as defined in this Part) are transactions between insurance company affiliates SCA's (as defined in SSAP No. 97—*Investments in Subsidiary, Controlled and Affiliated Entities*) (called or other related parties) (as defined in SSAP No. 25—*Affiliates and Other Related Parties*) that are subject to special regulatory considerations identified in SSAP No. 25—*Affiliates and Other Related Parties*. This Manual specifies that such **SCA and related party bond and preferred stock investments transactions** are not **subject to eligible for** filing exemption and can only be assigned an NAIC Designation if the SVO has first concluded that the transaction is like those the SVO typically assesses for credit risk. See the SCA **and Related Party** section in this Part for further information about how the SVO determines whether an SCA **and Related Party** investment will be assigned an NAIC Designation and how a state insurance regulator can require an insurance company to file an otherwise filing exempt structure containing an SCA or related party with the SVO.

**SUBSIDIARY, CONTROLLED AND AFFILIATED (SCA) AND RELATED PARTY DEBT BOND OR  
PREFERRED STOCK INVESTMENTS**

---

**NOTE:** See “Policies Applicable to Specific Asset Classes” in Part One for the policies governing this activity, as well as “Specific Populations of Securities Not Eligible for Filing Exemption” in “Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities” above.

**Filing Instructions**

244. **Common Stock** – An investment in the form of common stock issued by an insurance or non-insurance subsidiary, controlled or affiliated (SCA) entity of the reporting insurance company or an investment in the form of a preferred stock issued by an insurance subsidiary, controlled or affiliated company of the reporting insurance company **is required to be filed with the NAIC Financial Regulatory Services Division** in the manner and form and with the documentation provided for in the Appendix to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.
245. **Bonds** – An investment in the form of a bond (i) issued by an insurance or noninsurance SCA entity or related party of the reporting insurance company (except for issuers that fit the example in subclause (i) of the “SCA and Related Party Filing Exempt Investments” section), or (ii) issued as part of a structure which would, pursuant to paragraph 4.a. of SSAP No. 43 – Loan-Backed and Structured Securities, qualify as a related party investment due to the reporting insurance company’s relationship with the underlying credit exposure (“SCA and related party bond”), is filed with the SVO. To file an SCA and related party bond investment, the reporting insurance company files an Audited Financial Statement for the subsidiary, a copy of the corporate resolution authorizing the issuance of the debt, written evidence that the transaction has been approved by the state of domicile or that no such approval is necessary and, if the subsidiary is an insurance company, the subsidiary’s most recent NAIC Financial Statement Blank, together with the reporting insurance company’s NAIC Financial Statement Blank, internal investment committee memorandum for the investment and loan documentation appropriate to the transaction.

246. **Preferred Stock** – An investment in the form of a preferred stock (i) issued by a noninsurance SCA entity or related party of the reporting insurance company (except for issuers that fit the example in subclause (i) of the “SCA and Related Party Filing Exempt Investments” section), or (ii) issued as part of a structure which would, pursuant to paragraph 4.a. of SSAP No. 43 – Loan-Backed and Structured Securities, qualify as a related party investment due to the reporting insurance company’s relationship with the underlying credit exposure (“SCA and related party preferred stock”), is filed with the SVO. To file an SCA and related party preferred stock issued by a non-insurer, the reporting insurance company files an Audited Financial Statement for the issuer of the preferred stock, a copy of the corporate resolution authorizing the issuance of the preferred stock, written evidence that the transaction has been approved by the state of domicile or that no such approval is necessary, together with details of the terms of the preferred stock, as well as the NAIC Financial Statement Blank for the reporting insurance company.

**NOTE:** Please see the section on preferred stock in this Part for additional analytical procedures applicable to that asset class.

247. **SCA and Related Party Filing Exempt Investments** – Certain investments might contain SCA or related party relationships with non-issuer or non-credit exposure entities. For example, an investment could be (i) issued by an SCA or related party special purpose entity (SPE) which itself is not an obligor or credit exposure, or (ii) issued as part of a structure in which the originator, sponsor, manager, servicer, other influential transaction party, is an affiliate or related party of the reporting insurance company. Such investments are eligible for filing exemption unless otherwise ineligible pursuant to guidance in this Manual unrelated to SCA or related party status. However, such investments may be in scope of SSAP No. 25—Affiliates and Other Related Parties and subject to reporting as an affiliate or related party transaction in the appropriate investment schedules. For the avoidance of doubt, nothing in this section prohibits a state insurance regulator, in accordance with Part One of this Manual, from requiring its domiciled insurance company to file an otherwise filing exempt investment with the SVO for analysis and/or assignment of an NAIC Designation, thereby making it ineligible for future filing exemption.

## Purpose

248. This section applies to credit assessment of any SCA and related party investment in the form of a debt instrument purchased (or otherwise acquired) from an insurance or non-insurance entity (SCA and related party ~~debt~~ bond) and preferred stock issued by an insurance or non-insurance entity (SCA and related party preferred stock). This procedure is used to determine whether an SCA and related party ~~debt~~ bond or SCA and related party preferred transaction is eligible for reporting as an Investment Security pursuant to this Manual. The determination of “Investment Security” and credit assessment provided by the SVO shall not be construed to reflect assessments specific to affiliated transactions contained in *SSAP No. 25—Affiliates and Other Related Parties*. As such, an SVO-assigned NAIC Designation for affiliated and related party transactions:

- Does not reflect collectability based on independent payment ability of a parent reporting entity.
- Does not reflect whether the transaction was conducted at arm’s-length.
- Does not reflect whether the transaction is considered “economic” under SSAP No. 25.

## Notification Procedure

249. Prior to applying the procedures required below, the SVO shall:

- Confirm that the SCA relationship has been reported to the NAIC Financial Reporting Services Division, if required.
- If the SCA common and preferred stock transaction was reported (or if not required to be reported), the SVO shall:
  - Inform the state insurance department of the reporting insurance company’s state of domicile that the SCA debt bond or ~~SCA~~-preferred stock has been filed with the SVO.
  - Evaluate whether the SCA debt bond or ~~SCA~~ preferred stock transaction is circular within the meaning of that phrase as discussed in this Manual.
  - In the case of SCA preferred stock, determine the SCA preferred stock issuer’s senior unsecured debt designation and obtain the appropriate designation level for the preferred stock by applying the methodology specified in this Manual.

250. Although an NAIC Designation does not provide assurances regarding arm's-length or economic, if the SVO becomes aware of any information that indicates further review is warranted, the SVO shall contact the reporting entity to discuss, with subsequent notification (by the reporting entity or SVO) to the domiciliary state regulator, as needed. Pursuant to SSAP No. 25, affiliate transactions that are not arm's-length and/or economic are subject to additional accounting and reporting guidelines and each reporting entity is required to be knowledgeable about its domiciliary state regulatory requirements for approval of these transactions.

### Definitions

251. The following definitions/concepts are from SSAP No. 25:

- **Arm's-Length** – An arm's-length transaction is defined as a transaction in which willing parties—each being reasonably aware of all relevant facts and neither under compulsion to buy, sell or loan—would be willing to participate.
- **Economic** – An economic transaction is defined as an arm's-length transaction which results in the transfer of the risks and rewards of ownership and represents a consummated act thereof; i.e., “permanence.” The appearance of permanence is also an important criterion in assessing the economic substance of a transaction. In order for a transaction to have economic substance and thus warrant revenue (loss) recognition, it must appear unlikely to be reversed. An economic transaction must represent a bona fide business purpose demonstrable in measurable terms. A transaction which results in the mere inflation of surplus without any other demonstrable and measurable betterment is not an economic transaction. The statutory accounting shall follow the substance, not the form of the transaction.

### Procedure for Credit Assessment of Filed SCA Transaction

252. The procedure specified in this section applies to bonds and preferred stock whose terms, structure, complexity and purpose are like those in transactions between unaffiliated parties filed with the SVO so that credit risk assessment methodologies applied to transactions between unaffiliated parties can be meaningfully applied to transactions between affiliated parties.

253. A determination that a bond or a preferred stock submitted for an assessment under this section is not like a transaction between unaffiliated parties and/or that analytical methodologies applied to transactions between unaffiliated parties cannot be meaningfully applied to the filed transaction shall be in the sole discretion of the SVO.



254. An insurer apprised of the SVO's determination may request a conference call with the SVO to evaluate whether focused disclosure and documentation pertaining to the terms, structure, complexity and purpose of the transaction may enable the SVO to develop a credit assessment methodology specific to the transaction. If the insurer and the SVO agree that a transaction specific credit assessment approach can be developed, administrative details pertaining to the conduct of the assessment shall be as negotiated between the SVO and the insurer.

255. Instead of filing a transaction under this section, an insurer may choose to file an RTAS submission (discussed in this Manual) to solicit an opinion and rationale from the SVO whether or not an SCA and related party transaction would be considered to be like those between unaffiliated entities or ask its domiciliary state regulator to consider requesting that the SVO assist the department in the determination of an NAIC Designation for the transaction under the Regulatory Transactions procedure discussed in this Manual.

[https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2022/2022-10-20 - Interim Meeting/03-Related Parties/2022-008.04\\_VOSTF\\_Amend\\_SVO\\_RelatedParties\\_v5.docx](https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2022/2022-10-20 - Interim Meeting/03-Related Parties/2022-008.04_VOSTF_Amend_SVO_RelatedParties_v5.docx)



## MEMORANDUM

TO: Carrie Mears, Chair Representative, Valuation of Securities (E) Task Force

FROM: Dale Bruggeman, Chair of the Statutory Accounting Principles (E) Working Group  
Kevin Clark, Co-Vice-Chair of the Statutory Accounting Principles (E) Working Group

DATE: 6/10/2022

RE: SAPWG Adoption of the Related Party Reporting Agenda Item

---

The purpose of this referral is to notify the Valuation of Securities (E) Task Force that on May 24, 2022, the Statutory Accounting Principles (E) Working Group adopted agenda item *2021-21: Related Party Reporting*, and accordingly the Working Group recommends that the Task Force assess whether edits are needed to the *Practices and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual)* related to comments raised regarding filing exemption for affiliated structured securities with unaffiliated underlying credit exposure.

For background, agenda item 2021-21 was in response to recent discussions on the reporting and disclosure requirements for investments that involve related parties. This item resulted with revisions to both *SSAP No. 25—Affiliates and Other Related Parties* and *SSAP No. 43R—Loan-Backed and Structured Securities* to clarify guidance, although there were no revisions to the definition of an affiliate or the definition of control. The main intent of the agenda item was to sponsor new reporting information for investments that involve a related party (e.g. as sponsor or originator, etc), regardless of whether the investment is captured on the affiliate reporting line. Because the definition of affiliation is determined by an evaluation of control of the issuer (typically a special purpose entity (SPE) for structured securities), it is possible for an investment that involves an affiliate or related party to not be considered affiliated, while it is also possible for an affiliated debt investment to lack underlying affiliated credit exposure. The adopted reporting changes provide more granular disclosure of the differing types of related party involvement in investment transactions. These reporting changes have also been adopted by the Blanks (E) Working Group and are effective for year-end 2022 statutory financial statements.

During the discussion of this agenda item, comments from industry indicated that many insurers have adopted a practice for structured securities that the Working Group concluded is not consistent with the requirements of SSAP No. 25 or the *Insurance Holding Company System Regulatory Act (Model #440)*. That is, rather than determine affiliation based on an evaluation of control of the issuer (the SPE), these insurers have determined affiliation based solely on whether the underlying collateral exposure was affiliated. In some cases, insurers have identified the issuing SPE as an affiliate in Schedule Y, while not reporting the investments issued by those affiliates as affiliated investments on Schedule D. The Working Group concluded that there is no basis in the existing

---

Washington, DC 444 North Capitol Street NW, Suite 700, Washington, DC 20001-1509 p | 202 471 3990

Kansas City 1100 Walnut Street, Suite 1500, Kansas City, MO 64106-2197 p | 816 842 3600

New York One New York Plaza, Suite 4210, New York, NY 10004 p | 212 398 9000

www.naic.org

statutory accounting principles for this reporting conclusion and adopted the proposed edits which remove any perceived ambiguity.

Upon further discussion of this item, interested parties also noted that there is a presumption that affiliated investments are required to be reviewed by the NAIC Securities and Valuation Office (SVO), and if certain investments previously reported as unaffiliated are now required to be reported as affiliated, they could lose their filing exempt (FE) status. Accordingly, the SVO may need to develop additional procedures to add a methodology to designate this type of asset-backed security investment structure, or to clarify that affiliated investments that do not have underlying affiliated credit exposure qualify for FE status. As a result, the working group recommended a referral to the Task Force to evaluate any needed updates to the P&P Manual pertaining to this matter.

The Working Group appreciates your time and looks forward to your response. If you have any questions, please contact Dale Bruggeman, or Kevin Clark, SAPWG Chair and Vice Chair, with any questions.

Cc: Julie Gann, Robin Marcotte, Jim Pinegar, Jake Stultz, Jason Farr, Charles Therriault, Marc Pearlman  
Attachments: Ref # 2021 adopted revisions, May 24 SAPWG minutes

[https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/Stat\\_Acctg\\_Statutory\\_Referrals/2022/SAPWG\\_to\\_VOSTF\\_Related\\_Party.docx](https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/Stat_Acctg_Statutory_Referrals/2022/SAPWG_to_VOSTF_Related_Party.docx)

**Statutory Accounting Principles (E) Working Group  
Maintenance Agenda Submission Form  
Form A**

**Issue:** Related Party Reporting

**Check (applicable entity):**

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Description of Issue:** This agenda item has been drafted in response to recent discussions on the reporting and disclosure requirements for investments with related parties. This agenda item intends to encompass two main goals:

1. Clarify the reporting of affiliate transactions within existing reporting lines in the investment schedules. This clarification intends to be consistent with the definition of an “affiliate” pursuant to the *Insurance Holding Company System Regulatory Act* (Model #440), *SSAP No. 25—Affiliates and Other Related Parties* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.
2. Incorporate new reporting requirements for investment transactions with related parties. Pursuant to recent discussions, regulators desire additional information on investment transactions involving related parties, regardless of whether the related party is “affiliated” pursuant to Model #440. To preserve the affiliate definition and reporting categories, these additional proposed reporting elements will be captured outside of the current affiliate reporting requirements.

Affiliate Definition and Identified Reporting Issues:

The *Insurance Holding Company System Regulatory Act* (Model #440) defines “affiliate” and “control” as:

- **Affiliate:** An “affiliate” of, or person “affiliated” with, a specific person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.
- **Control:** The term “control” (including the terms “controlling,” “controlled by” and “under common control with”) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract other than a commercial contract for goods or nonmanagement services, or otherwise, unless the power is the result of an official position with or corporate office held by the person. Control shall be presumed to exist if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing, ten percent (10%) or more of the voting securities of any other person. This presumption may be rebutted by a showing made in the manner provided by Section 4K that control does not exist in fact. The commissioner may determine, after furnishing all persons in interest notice and opportunity to be heard and making specific findings of fact to support the determination, that control exists in fact, notwithstanding the absence of a presumption to that effect.

The guidance / concepts from Model #440 are reflected in SSAP No. 25, paragraphs 5-7 and SSAP No. 97, paragraphs 5-7 and are summarized as follows:

- An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships,

joint ventures, and limited liability companies as defined in *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*. An affiliate is any person that is directly or indirectly, owned or controlled by the same person or by the same group of persons, that, directly or indirectly, own or control the reporting entity.

- Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by contract for goods or nonmanagement services where the volume of activity results in a reliance relationship (d) by common management, or (e) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity.
- Control shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13%, and therefore, each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment based on the criteria in *FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18*. The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting securities of an investee. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. Examples of situations where the presumption of control may be in doubt include the following:
  1. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.
  2. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.
  3. An entity where the insurer has given up participation rights as a shareholder to the investee.

The Annual Statement Instructions identifies what is captured in the reporting lines for “Parent, Subsidiary and Affiliates” as “Defined by *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.”

Under the existing guidance, the following investments would likely not be reported as affiliated unless a domiciliary state has directed otherwise:

- Qualifying affiliated investments for which the domiciliary state has approved a disclaimer of affiliation or disclaimer of control from the affiliated entity. Once a disclaimer has been granted, the qualifying affiliate relationship is no longer considered an affiliate and any investments issued or held from the entity would not be reported as affiliated.
- Investments held from entities that do not qualify as affiliates, even if the entity qualifies as a related party. The determination of an affiliate is based on direct or indirect control. If the control determinants are not met, investments held from related parties are not reported as affiliated.
- Any investments acquired that were sponsored / originated by an affiliate, but the actual investment is not in the affiliate or other companies within the controlled holding company structure.

Model #440 explicitly excludes the purchase of securities solely for investment purposes from the determination of a change in control, so long as the securities are not used by voting or otherwise to cause or attempt to cause the

substantial lessening of competition in any insurance market in the state. This guidance further states that if the purchase of securities results in a presumption of control, then the acquisition of securities would not be considered solely for investment purposes unless the commissioner of the insurer's state of domicile accepts a disclaimer of control of affirmatively finds that control does not exist.

### Proposed Related Party Revisions

Although the affiliate definition may preclude certain investments from being captured in the "affiliated" reporting lines, there is a regulator desire to have improved information on investments with non-affiliated related parties as well as investments acquired from affiliates and non-affiliated related parties that do not reflect an investment within the affiliate/related party. For example, if the affiliate/related party was to sponsor or originate the investment, such investment would likely not be captured in the designated affiliate reported lines. This agenda item proposes revisions to SSAP No. 25 and SSAP No. 43R, as well as proposed concepts for an annual statement reporting change to capture information on these investments. Additionally, the proposed revisions would provide clarity, consistent with the existing affiliate definition, on scenarios that would qualify as affiliated transactions.

As an additional item, the existing reference in SSAP No. 25 to *FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18* (FIN 35) has been proposed to be removed. Although the intent was to originally update the U.S. GAAP reference to reflect the current Accounting Standards Codification (ASC) citations, it was noted that the original provisions in FIN 35 (captured now in ASC 323-10-15-8, 323-10-15-10 and 323-10-15-11) only reiterate that the presumption that the investor has the ability to exercise significant influence over the investee's operating and financial policies based on ownership of voting stock stands until overcome by prominent evidence to the contrary. The ASC includes the following indicators originally in FIN 35 for when investors would be unable to exercise significant influence over the operating and financial policies of an investee:

- Opposition by the investee, such as litigation or complaints to government regulatory authorities, challenges the investor's ability to exercise significant influence.
- The investor and investee sign an agreement (such as a standstill agreement) under which the investor surrenders significant rights as a shareholder.
- Majority ownership of the investee is concentrated among a small group of shareholders who operate the investee without regards to the views of the investor.
- The investor wants or needs more financial information to apply the equity method than is available to the investee's other shareholders, tries to obtain that information, and fails. (The ASC example is a request for quarterly info when the investee only provides public information annually.)
- The investor tries and fails to obtain representation on the investee's board of directors.

The ASC also notes that these situations are just indicators and are not all-inclusive and that none of the individual circumstances are necessarily conclusive that the investee is unable to exercise significant influence over the investee's operating and financial policies. Rather, if any of these situations exist, an investor with controlling voting ownership shall evaluate all facts and circumstances related to the investment to reach a judgment about whether the presumption that the investor has the ability to exercise significant influence over the investee's operating and financial policies is overcome. Furthermore, the guidance indicates that it may be necessary to evaluate the facts and circumstances over a period of time before reaching a judgment.

After a review of the ASC / FIN 35 guidance, it is proposed that the reference be deleted from SSAP No. 25. The general concepts for a review of all facts and circumstances, as well as example indicators, are already reflected directly in SSAP No. 25. Lastly, the reference to FIN 35 / ASC could be confusing as U.S. GAAP utilizes a different (higher) percentage of voting ownership than statutory accounting.

### Existing Authoritative Literature:

- *Insurance Holding Company System Regulatory Act* (Model #440) – This model is an accreditation standard and is adopted by all states in a substantially similar manner. Only the territories of America Samoa, Guam and the Northern Mariana Islands do not have this model adopted.
- *SSAP No. 25—Affiliates and Other Related Parties* establishes statutory accounting principles and disclosure requirements for related party transactions. This statement shall be followed for all related party transactions, even if the transaction is also governed by other statutory accounting principles. As detailed in paragraph 1, related party transactions are subject to abuse as reporting entities may be induced to enter transactions that may not reflect economic realities or may not be fair and reasonable to the reporting entity or its policyholders. As such, related party transactions require specialized accounting rules and increased regulatory scrutiny. The guidance in paragraphs 4-8 include the definition of related parties and affiliates:
  4. Related parties are defined as entities that have common interests as a result of ownership, control, affiliation or by contract. Related parties shall include but are not limited to the following:
    - a. Affiliates of the reporting entity, as defined in paragraph 5;
    - b. Trusts for the benefit of employees, such as pension and profit-sharing trusts and Employee Stock Ownership Plans that are managed by or under the trusteeship of management of the reporting entity, its parent or affiliates;
    - c. The principal owners, directors, officers of the reporting entity;
    - d. Any immediate family member of a principal owner, director or executive officer of the reporting entity, which means any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, or individual related by blood or marriage whose close association is equivalent to a family relationship of such director, executive officer or nominee for director, or any person (other than a tenant or employee) sharing the household of such director, executive officer or nominee for director;
    - e. Companies and entities which share common control, such as principal owners, directors, or officers, including situations where principal owners, directors, or officers have a controlling stake in another reporting entity;
    - f. Any direct or indirect ownership greater than 10% of the reporting entity results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation;
    - g. The management of the reporting entity, its parent or affiliates (including directors);
    - h. Members of the immediate families of principal owners and management of the reporting entity, its parent or affiliates and their management;
    - i. Parties with which the reporting entity may deal if either party directly or indirectly controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interest;
    - j. A party which can, directly or indirectly, significantly influence the management or operating policies of the reporting entity, which may include a provider who is contracting with the reporting entity. This is not intended to suggest that all provider contracts create related party relationships;

- k. A party which has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests;
- l. Attorney-in-fact of a reciprocal reporting entity or any affiliate of the attorney-in-fact; and
- m. A U.S. manager of a U.S. Branch or any affiliate of the U.S. manager of a U.S. Branch.

5. An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies as defined in SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies. Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity method for all such investments. An affiliate is any person that is directly or indirectly, owned or controlled by the same person or by the same group of persons, that, directly or indirectly, own or control the reporting entity.

6. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by contract for goods or nonmanagement services where the volume of activity results in a reliance relationship (d) by common management, or (e) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity.

7. Control as defined in paragraph 6 shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13%, and therefore, each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment based on the criteria in FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18. The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting securities of an investee. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. Examples of situations where the presumption of control may be in doubt include the following:

- a. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.
- b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.
- c. An entity where the insurer has given up participation rights<sup>1</sup> as a shareholder to the investee.
- d. Agreements where direct or indirect non-controlling ownership interest is less than 10% where the parties have structured the arrangement in this structure to avoid the 10% threshold in paragraph 4.f. and paragraph 8.

---

<sup>1</sup> The term "participating rights" refers to the type of rights that allows an investor to effectively participate in significant decisions related to an investee's ordinary course of business and is distinguished from the more limited type of rights referred to as "protective rights". Refer to the sections entitled: "Protective Rights" and "Substantive Participating Rights" in EITF 96-16, *Investor's Accounting for an Investee When the Investor Owns a Majority of the Voting Stock but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights*. The term "participating rights" shall be used consistent with the discussion of substantive participating rights in this EITF.



8. Any direct or indirect ownership interest of the reporting entity greater than 10% results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation. The *Insurance Holding Company System Regulatory Act* (#440) and the *Insurance Holding Company System Model Regulation* (#450) include a provision that allows for the disclaimer of affiliation and/or the disclaimer of control for members of an insurance holding company system. The disclaimer must be filed with the state insurance commissioner. Entities whose relationship is subject to a disclaimer of affiliation or a disclaimer of control are related parties and are subject to the related party disclosures within this statement. Such a disclaimer does not eliminate a “related party” distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

- *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* establishes guidance for these investments. The guidance in this SSAP provides different guidance when there is a “more than minor” or “minor ownership interest.” Pursuant to existing guidance, reporting entities must also identify whether the investment is a related-party transaction.

9. Investments in these ventures, except for joint ventures, partnerships and limited liability companies with a minor ownership interest<sup>1</sup>, shall be reported using an equity method as defined in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, paragraphs 8.b.i. through 8.b.iv. (The equity method calculation may result with a negative valuation of the investment; therefore, the SSAP No. 97 equity method calculation shall occur regardless of whether the investment is supported by an audit and the reporting entity will nonadmit the investment.) A reporting entity whose shares of losses in a SSAP No. 48 entity exceeds its investment in the SSAP No. 48 entity shall disclose the information required by SSAP No. 97, paragraph 35.a.

*Footnote:* With the identification of whether the reporting entity has a minor ownership interest, reporting entities must also identify whether the investment is a related-party transaction. Pursuant to the concepts reflected in *SSAP No. 25—Affiliates and Other Related Parties*, consideration shall be given to the substance of the transaction and the parties whose action or performance materially impacts the insurance reporting entity holding the security. For example, if the underlying assets within a SSAP No. 48 entity represent assets issued by an affiliate, then the SSAP No. 48 entity shall be considered a related party (affiliate) investment, with the transaction subject to the accounting and reporting provisions of SSAP No. 25. As identified in SSAP No. 25, it is erroneous to conclude that the inclusion of a non-related intermediary, or the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to identify and assess the investment transaction as a related party arrangement.

- *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* establishes statutory accounting principles for investments in subsidiaries, controlled and affiliated entities. The guidance in paragraphs 3-6 include the definitions for parent, subsidiary, and affiliate. (The definition for an affiliate and control is identical to SSAP No. 25.) (As noted, the Annual Statement reporting lines for “Parent, Subsidiary and Affiliates” refers to the definition within SSAP No. 97. If an investment is held for an entity that does not meet the SSAP No. 97 definitions, or for which a disclaimer of control or affiliation has been received, then the investment would not be captured within the Parent, Subsidiary or Affiliate reporting line.)

3. Parent and subsidiary are defined as follows:

- a. Parent—An entity that directly or indirectly owns and controls the reporting entity;
- b. Subsidiary—An entity that is, directly or indirectly, owned and controlled by the reporting entity.

4. An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint

ventures, and limited liability companies as defined in *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*. Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity method for all such investments.

5. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by common management, or (d) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity<sup>2</sup>.

6. Control as defined in paragraph 5 shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13% and therefore each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment based on the criteria in *FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18*. The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting securities of an investee. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. An investment in an SCA entity may fall below the level of ownership described in paragraph 5, in which case, the reporting entity would discontinue the use of the equity method, as prescribed in paragraph 13.g. Additionally, through an increase in the level of ownership, a reporting entity may become qualified to use the equity method of accounting (paragraph 8.b.), in which case, the reporting entity shall add the cost of acquiring additional interest to the current basis of the previously held interest and shall apply the equity method prospectively, as of the date the investment becomes qualified for equity method accounting. Examples of situations where the presumption of control may be in doubt include the following:

- a. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.
- b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.
- c. An entity where the insurer has given up participating rights<sup>3</sup> as a shareholder to the investee.

**Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):** In March 2021, the Statutory Accounting Principles (E) Working Group adopted revisions to SSAP No. 25 pursuant to agenda item 2019-34: Related Parties, Disclaimers of Affiliation and Variable Interest Entities. Additionally, a new reporting Schedule Y, Part 3 was adopted by the Blanks (E) Working Group in proposal 2020-37BWG, with an initial

---

<sup>2</sup> Investments in an exchange traded fund (ETF) or a mutual fund (as defined by the SEC) does not reflect ownership in an underlying entity, regardless of the ownership percentage the reporting entity (or the holding company group) has of the ETF or mutual fund unless ownership of the ETF actually results in "control" with the power to direct or cause the direction of management of an underlying company. ETFs and mutual funds are comprised of portfolios of securities subject to the regulatory requirements of the federal securities laws. ETFs and mutual funds held by a reporting entity shall be reported as common stock, unless the ETF qualifies for bond or preferred stock treatment per the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. Reporting entities are not required to verify that SCAs (subject to SSAP No. 97) are represented in the portfolio of securities held in ETFs or mutual funds or to adjust the value of SCAs as a result of investments in ETFs or mutual funds.

<sup>3</sup> The term "participating rights" refers to the type of rights that allows an investor to effectively participate in significant decisions related to an investee's ordinary course of business and is distinguished from the more limited type of rights referred to as "protective rights". Refer to the sections entitled: "Protective Rights" and "Substantive Participating Rights" in *EITF 96-16, Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights*. The term "participating rights" shall be used consistent with the discussion of substantive participating rights in this EITF.

effective date of Dec. 31, 2021, to capture information on all entities with ownership greater than 10%, the ultimate controlling parties of those owners and other entities that the ultimate controlling party controls.

The adopted revisions to SSAP No. 25 from agenda item 2019-34 are summarized as follows:

- Clarify the identification of related parties and ensure that any related party identified under U.S. GAAP or SEC reporting requirements would be considered a related party under statutory accounting principles.
- Clarify that non-controlling ownership over 10% results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation.
- Clarify the impact of a disclaimer of control or disclaimer of affiliate under SAP. As detailed, such disclaimers impact holding company group allocation and reporting as an SCA under SSAP No. 97, but do not eliminate the classification as a “related party” and the disclosure of material transactions as required under SSAP No. 25.
- Rejected several U.S. GAAP standards addressing variable interest entities.

**Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:**

None

**Convergence with International Financial Reporting Standards (IFRS):** Not applicable.

**Staff Recommendation:**

**NAIC staff recommends that the Working Group move this item to the active listing, categorized as a nonsubstantive change, and expose revisions to SSAP No. 25 and SSAP No. 43R to clarify application of the existing affiliate definition as well as to incorporate new disclosure requirements for investments acquired through, or in, related parties, regardless of if they meet the affiliate definition. (Staff Note: Pursuant to the NAIC Policy Statement on Maintenance of Statutory Accounting Principles, new disclosures and modifications to existing disclosures are considered nonsubstantive changes.)**

**Proposed edits to SSAP No. 25: (New paragraph 9. Remaining paragraphs would be renumbered.)**

*This new paragraph 9 clarifies the application of the existing affiliate and control definitions to limited partnerships, trusts and other special purpose entities when control is held by an affiliated general partner, servicer or other arrangement. (The proposed deletion of FIN 35 is discussed earlier in the agenda item, but is noted as not necessary with the existing statutory accounting guidance.)*

5. An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies as defined in SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies. Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity method for all such investments. An affiliate is any person that is directly or indirectly, owned or controlled by the same person or by the same group of persons, that, directly or indirectly, own or control the reporting entity.

6. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by contract for goods or nonmanagement services where the volume of activity results in a reliance relationship (d) by common management, or (e) otherwise. Control shall be presumed to exist if a reporting entity and

its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity.

7. Control as defined in paragraph 6 shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13%, and therefore, each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. Examples of situations where the presumption of control may be in doubt include the following:

- a. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.
- b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.
- c. An entity where the insurer has given up participation rights<sup>4</sup> as a shareholder to the investee.

8. Any direct or indirect ownership interest of the reporting entity greater than 10% results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation. The *Insurance Holding Company System Regulatory Act* (#440) and the *Insurance Holding Company System Model Regulation* (#450) include a provision that allows for the disclaimer of affiliation and/or the disclaimer of control for members of an insurance holding company system. The disclaimer must be filed with the state insurance commissioner. Entities whose relationship is subject to a disclaimer of affiliation or a disclaimer of control are related parties and are subject to the related party disclosures within this statement. Such a disclaimer does not eliminate a “related party” distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

9. For entities not controlled by voting interests, such as limited partnerships, trusts and other special purpose entities, control may be held by a general partner, servicer, or by other arrangements. The ability of the reporting entity or its affiliates to direct the management and policies of an entity through such arrangements shall constitute control as defined in paragraph 6. Additionally, a reporting entity or its affiliates may have indirect control of other entities through such arrangements. For example, if a limited partnership were to be controlled by an affiliated general partner, and that limited partnership held greater than 10% of the voting interests of another company, indirect control shall be presumed to exist. If direct or indirect control exists, whether through voting securities, contracts, common management or otherwise, the arrangement is considered affiliated under paragraph 5. Consistent with paragraph 8, a disclaimer of affiliation does not eliminate a “related party” distinction or disclosure requirements for material transactions pursuant to SSAP No. 25

#### **Proposed edits to SSAP No. 43R:**

*These revisions move the existing guidance in paragraph 4.a. to paragraph 6 and notes the requirement to identify related party investments in the investment schedules. (Note Footnote 5 is just moved to a new paragraph.)*

4. Loan-backed securities are issued by special-purpose corporations or trusts (issuer) established by a sponsoring organization. The assets securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee until the issuer’s obligation has been fully satisfied. The investor only has

---

<sup>4</sup> The term “participating rights” refers to the type of rights that allows an investor to effectively participate in significant decisions related to an investee’s ordinary course of business and is distinguished from the more limited type of rights referred to as “protective rights”. Refer to the sections entitled: “Protective Rights” and “Substantive Participating Rights” in EITF 96-16, *Investor’s Accounting for an Investee When the Investor Owns a Majority of the Voting Stock but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights*. The term “participating rights” shall be used consistent with the discussion of substantive participating rights in this EITF.

direct recourse to the issuer's assets, but may have secondary recourse to third parties through insurance or guarantee for repayment of the obligation. As a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the responsibility for servicing the underlying assets. Some sponsors do guarantee the performance of the underlying assets.

5. Mortgage-referenced securities do not meet the definition of a loan-backed or structured security but are explicitly captured in scope of this statement. In order to qualify as a mortgage-referenced security, the security must be issued by a government sponsored enterprise<sup>6</sup> or by a special purpose trust in a transaction sponsored by a government sponsored enterprise in the form of a "credit risk transfer" in which the issued security is tied to a referenced pool of mortgages and the payments received are linked to the credit and principal payment risk of the underlying mortgage loan borrowers captured in the referenced pool of mortgages. For these instruments, reporting entity holders may not receive a return of their full principal as principal repayment is contingent on repayment by the mortgage loan borrowers in the referenced pool of mortgages. Unless specifically noted, the provisions for loan-backed securities within this standard apply to mortgage-referenced securities.

6. Investments within the scope of this statement issued by a related party or acquired through a related party transaction or arrangement are also subject to the provisions, admittance assessments and disclosure requirements of SSAP No. 25. In determining whether a security is a related party investment, consideration should be given to the substance of the transaction, and the parties whose action or performance materially impacts the insurance reporting entity holding the security. Loan-backed and structured securities meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement and SSAP No. 25.

- a. Although a loan-backed or structured security may be acquired from a non-related issuer, if the assets held in trust predominantly<sup>8</sup> reflect assets issued by affiliates of the insurance reporting entity, and the insurance reporting entity only has direct recourse to the assets held in trust, the transaction shall be considered an affiliated investment. In such situations where the underlying collateral assets are issued by related parties that do not qualify as affiliates, these securities shall be identified as related party investments in the investment schedules.
- b. A loan-backed or structured security may involve a relationship with a related party but not be considered an affiliated investment. This may be because the relationship does not result in direct or indirect control of the issuer or because there is an approved disclaimer of control or affiliation. Regardless of whether investments involving a related party relationship are captured in the affiliated investment reporting lines, these securities shall be identified as related party investments in the investment schedules. Examples of related party relationships would include involvement of a related party in sponsoring or originating the loan-backed or structured security or any type of underlying servicing arrangement. For the avoidance of doubt, investments from any arrangement that results in direct or indirect control, including control through a servicer or other controlling arrangement, shall be reported as affiliated in accordance with *SSAP No. 25—Affiliates and Other Related Parties*.

---

<sup>6</sup> Currently, only Fannie Mae and Freddie Mac are the government sponsored entities that either directly issue qualifying mortgage-referenced securities or sponsor transactions in which a special purpose trust issues qualifying mortgage-reference securities. However, this guidance would apply to mortgage-referenced securities issued by any other government sponsored entity that subsequently engages in the transfer of mortgage credit risk.

<sup>8</sup> In applying this guidance, a reporting entity is not required to complete a detailed review of the assets held in trust to determine the extent, if any, the assets were issued by related parties. Rather, this guidance is a principle concept intended to prevent situations in which related party transactions (particularly those involving affiliates) is knowingly captured in a SSAP No. 43R structure and not identified as a related party transaction (or not reported as an affiliated investment on the investment schedule) because of the involvement of a non-related trustee or SSAP No. 43R security issuer. As identified in *SSAP No. 25—Affiliates and Other Related Parties*, it is erroneous to conclude that the inclusion of a non-related intermediary, or the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to identify and assess the investment transaction as a related party arrangement.

**Proposed Annual Statement Reporting Changes: *(These will be captured in a blanks proposal.)***

*These reflect a new electronic-only column for the investment schedules and the related instructions.*

Column XX: Investments Involving Related Parties:

Required for all investments involving related parties including, but not limited to, those captured as affiliate investments. This disclosure intends to capture information on investments held that reflect interactions involving related parties, regardless of whether the related party meets the affiliate definition, or the reporting entity has received domiciliary state approval to disclaim control / affiliation.

Enter one of the following codes to identify the role of the related party in the investment.

1. Direct loan or direct investment (excluding securitizations) in a related party, for which the related party represents a direct credit exposure.
2. Securitization or similar investment involving a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role and for which 50% or more of the underlying collateral represents investments in or direct credit exposure to related parties.
3. Securitization or similar investment involving a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role and for which less than 50% (including 0%) of the underlying collateral represents investments in or direct credit exposure to related parties.
4. Securitization or similar investment in which the structure reflects an in-substance related party transaction but does not involve a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role.
5. The investment is identified as related party, but the role of the related party represents a different arrangement than the options provided in choices 1-4.

**Staff Review Completed by:** Julie Gann, NAIC Staff – October 2021

**Status:**

On December 11, 2021, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 25 and SSAP No. 43R, as illustrated above, to clarify application of the existing affiliate definition and incorporate disclosure requirements for all investments that involve related parties, regardless of if they meet the affiliate definition. In addition, draft annual statement reporting revisions were also exposed, in anticipation of incorporating those revisions into a Blanks (E) Working Group proposal.

On April 4, 2022, the Statutory Accounting Principles (E) Working Group exposed this agenda item, incorporating proposed revisions after considering comments from interested parties shown highlighted in gray below. The changes from the prior exposure only clarify previous components of the proposed revisions. Similar changes to the blanks proposal are also concurrently exposed by the Blanks (E) Working Group in their corresponding agenda item (2021-22BWG) to allow for a year-end 2022 effective date. This item was exposed with a shortened comment period ending May 6.

**Proposed edits to SSAP No. 25: *(New paragraph 9. Remaining paragraphs would be renumbered.)***

*This new paragraph 9 clarifies the application of the existing affiliate and control definitions to limited partnerships, trusts and other special purpose entities when control is held by an affiliated general partner, servicer*

*or other arrangement. (The proposed deletion of FIN 35 is discussed earlier in the agenda item, but is noted as not necessary with the existing statutory accounting guidance.)*

5. An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies as defined in SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies. Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity method for all such investments. An affiliate is any person that is directly or indirectly, owned or controlled by the same person or by the same group of persons, that, directly or indirectly, own or control the reporting entity.

6. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by contract for goods or nonmanagement services where the volume of activity results in a reliance relationship (d) by common management, or (e) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity.

7. Control as defined in paragraph 6 shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13%, and therefore, each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. Examples of situations where the presumption of control may be in doubt include the following:

- a. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.
- b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.
- c. An entity where the insurer has given up participation rights<sup>9</sup> as a shareholder to the investee.

8. Any direct or indirect ownership interest of the reporting entity greater than 10% results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation. The *Insurance Holding Company System Regulatory Act* (#440) and the *Insurance Holding Company System Model Regulation* (#450) include a provision that allows for the disclaimer of affiliation and/or the disclaimer of control for members of an insurance holding company system. The disclaimer must be filed with the state insurance commissioner. Entities whose relationship is subject to a disclaimer of affiliation or a disclaimer of control are related parties and are subject to the related party disclosures within this statement. Such a disclaimer does not eliminate a “related party” distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

9. For entities not controlled by voting interests, such as limited partnerships, trusts and other special purpose entities, control may be held by a general partner, servicer, or by other arrangements. The ability of the reporting entity or its affiliates to direct the management and policies of an entity through such arrangements shall constitute control as defined in paragraph 6. Additionally, a reporting entity or its

---

<sup>9</sup> The term “participating rights” refers to the type of rights that allows an investor to effectively participate in significant decisions related to an investee’s ordinary course of business and is distinguished from the more limited type of rights referred to as “protective rights”. Refer to the sections entitled: “Protective Rights” and “Substantive Participating Rights” in EITF 96-16, *Investor’s Accounting for an Investee When the Investor Owns a Majority of the Voting Stock but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights*. The term “participating rights” shall be used consistent with the discussion of substantive participating rights in this EITF.

affiliates may have indirect control of other entities through such arrangements. For example, if a limited partnership were to be controlled by an affiliated general partner, and that limited partnership held greater than 10% of the voting interests of another company<sup>10</sup>, indirect control **shall** be presumed to exist **unless the presumption of control can be overcome as detailed in paragraph 7. If direct or indirect control exists, whether through voting securities, contracts, common management or otherwise, the arrangement is considered affiliated under paragraph 5.** Consistent with paragraph 8, a disclaimer of affiliation does not eliminate a “related party” distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

### **Proposed edits to SSAP No. 43R:**

*These revisions move the existing guidance in paragraph 4.a. to paragraph 6 and notes the requirement to identify related party investments in the investment schedules. (Note Footnote 5 is just moved to a new paragraph.)*

4. Loan-backed securities are issued by special-purpose corporations or trusts (issuer) established by a sponsoring organization. The assets securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee until the issuer’s obligation has been fully satisfied. The investor only has direct recourse to the issuer’s assets, but may have secondary recourse to third parties through insurance or guarantee for repayment of the obligation. As a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the responsibility for servicing the underlying assets. Some sponsors do guarantee the performance of the underlying assets.

5. Mortgage-referenced securities do not meet the definition of a loan-backed or structured security but are explicitly captured in scope of this statement. In order to qualify as a mortgage-referenced security, the security must be issued by a government sponsored enterprise<sup>12</sup> or by a special purpose trust in a transaction sponsored by a government sponsored enterprise in the form of a “credit risk transfer” in which the issued security is tied to a referenced pool of mortgages and the payments received are linked to the credit and principal payment risk of the underlying mortgage loan borrowers captured in the referenced pool of mortgages. For these instruments, reporting entity holders may not receive a return of their full principal as principal repayment is contingent on repayment by the mortgage loan borrowers in the referenced pool of mortgages. Unless specifically noted, the provisions for loan-backed securities within this standard apply to mortgage-referenced securities.

6. Investments within the scope of this statement issued by a related party or acquired through a related party transaction or arrangement are also subject to the provisions, admittance assessments and disclosure requirements of SSAP No. 25. In determining whether a security is a related party investment, consideration should be given to the substance of the transaction, and the parties whose action or performance materially impacts the insurance reporting entity holding the security. Loan-backed and structured securities meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement and SSAP No. 25.

---

<sup>10</sup> Consistent with SSAP No. 97, footnote 1, investments in an exchange traded fund (ETF) or a mutual fund (as defined by the SEC) does not reflect ownership in an underlying entity, regardless of the ownership percentage the reporting entity (or the holding company group) has of the ETF or mutual fund unless ownership of the ETF actually results in “control” with the power to direct or cause the direction of management of an underlying company. ETFs and mutual funds are comprised of portfolios of securities subject to the regulatory requirements of the federal securities laws.

<sup>12</sup> Currently, only Fannie Mae and Freddie Mac are the government sponsored entities that either directly issue qualifying mortgage-referenced securities or sponsor transactions in which a special purpose trust issues qualifying mortgage-reference securities. However, this guidance would apply to mortgage-referenced securities issued by any other government sponsored entity that subsequently engages in the transfer of mortgage credit risk.



- a. Although a loan-backed or structured security may be acquired from a non-related issuer, if the assets held in trust predominantly<sup>14</sup> reflect assets issued by affiliates of the insurance reporting entity, and the insurance reporting entity only has direct recourse to the assets held in trust, the transaction shall be considered an affiliated investment. In such situations where the underlying collateral assets are issued by related parties that do not qualify as affiliates, these securities shall be identified as related party investments in the investment schedules.
- b. A loan-backed or structured security may involve a relationship with a related party but not be considered an affiliated investment. This may be because the relationship does not result in direct or indirect control of the issuer or because there is an approved disclaimer of control or affiliation. Regardless of whether investments involving a related party relationship are captured in the affiliated investment reporting lines, these securities shall be identified as related party investments in the investment schedules. Examples of related party relationships would include involvement of a related party in sponsoring or originating the loan-backed or structured security or any type of underlying servicing arrangement. For the avoidance of doubt, investments from any arrangement that results in direct or indirect control, including control through a servicer or other controlling arrangement, shall be reported as affiliated in accordance with *SSAP No. 25—Affiliates and Other Related Parties*.

**Proposed Annual Statement Reporting Changes: (These in a blanks proposal 2021-22BWG.)**

*These reflect a new electronic-only column for the investment schedules and the related instructions.*

**Column XX: Investments Involving Related Parties:**

Required for all investments involving related parties including, but not limited to, those captured as affiliate investments. This disclosure intends to capture information on investments held that reflect interactions involving related parties, regardless of whether the related party meets the affiliate definition, or the reporting entity has received domiciliary state approval to disclaim control / affiliation.

Enter one of the following codes to identify the role of the related party in the investment.

1. Direct loan or direct investment (excluding securitizations) in a related party, for which the related party represents a direct credit exposure.
2. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies involving a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role and for which 50% or more of the underlying collateral represents investments in or direct credit exposure to related parties.
3. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies involving a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role and for which less than 50% (including 0%) of the underlying collateral represents investments in or direct credit exposure to related parties.

---

<sup>14</sup> In applying this guidance, a reporting entity is not required to complete a detailed review of the assets held in trust to determine the extent, if any, the assets were issued by related parties. Rather, this guidance is a principle concept intended to prevent situations in which related party transactions (particularly those involving affiliates) is knowingly captured in a SSAP No. 43R structure and not identified as a related party transaction (or not reported as an affiliated investment on the investment schedule) because of the involvement of a non-related trustee or SSAP No. 43R security issuer. As identified in *SSAP No. 25—Affiliates and Other Related Parties*, it is erroneous to conclude that the inclusion of a non-related intermediary, or the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to identify and assess the investment transaction as a related party arrangement.

4. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies in which the structure reflects an in-substance related party transaction but does not involve a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role.
5. The investment is identified as related party, but the role of the related party represents a different arrangement than the options provided in choices 1-4.

On May 24, 2022, the Statutory Accounting Principles (E) Working Group took the following actions:

1. Adopted, as final, the exposed revisions to SSAP No. 25 and SSAP No. 43R, as illustrated below, to clarify application of the existing affiliate definition and incorporate disclosure requirements for all investments that involve related parties, regardless of if they meet the affiliate definition. The revisions to SSAP No. 43R also included additional minor edits to paragraph 6.b., clarifying that the investments from any arrangements that results in direct or indirect control, which include but are not limited to control through a servicer, shall be reported as affiliated investments.
2. In addition, to the adopted revisions, the Statutory Accounting Principles (E) Working Group expressed support for the corresponding Blanks (E) Working Group proposal (2021-22BWG), which will incorporate 6 reporting codes to identify the role of the related party in any investment, on any reporting line, in schedules: B – Mortgage Loans, D – Long-Term Bonds, DB – Derivatives, BA – Other Long-Term Invested Assets, DA – Short-Term Investments, E2 – Cash Equivalents, and DL – Securities Lending Collateral Assets, with an effective date of December 31, 2022.
3. Direct NAIC staff to draft the following for future Working Group discussion: 1) possible footnote revisions pursuant to interested parties’ comments, and 2) examples for possible inclusion in SSAP No. 43R, to further clarify investments that should be classified as affiliated. and
4. Send a referral to the Valuation of Securities (E) Task Force, notifying of this adopted agenda item, and to assess whether corresponding edits are needed to the *Practices and Procedures Manual of the NAIC Investment Analysis Office* regarding CLO investments that may now be classified as affiliated.

**Adopted revisions to SSAP No. 25: (New paragraph 9. Remaining paragraphs would be renumbered.)**

*This new paragraph 9 clarifies the application of the existing affiliate and control definitions to limited partnerships, trusts and other special purpose entities when control is held by an affiliated general partner, servicer or other arrangement. (The proposed deletion of FIN 35 is discussed earlier in the agenda item, but is noted as not necessary with the existing statutory accounting guidance.)*

5. An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies as defined in SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies. Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity method for all such investments. An affiliate is any person that is directly or indirectly, owned or controlled by the same person or by the same group of persons, that, directly or indirectly, own or control the reporting entity.

6. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by

contract for goods or nonmanagement services where the volume of activity results in a reliance relationship (d) by common management, or (e) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity.

7. Control as defined in paragraph 6 shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13%, and therefore, each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. Examples of situations where the presumption of control may be in doubt include the following:

- a. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.
- b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.
- c. An entity where the insurer has given up participation rights<sup>15</sup> as a shareholder to the investee.

8. Any direct or indirect ownership interest of the reporting entity greater than 10% results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation. The *Insurance Holding Company System Regulatory Act* (#440) and the *Insurance Holding Company System Model Regulation* (#450) include a provision that allows for the disclaimer of affiliation and/or the disclaimer of control for members of an insurance holding company system. The disclaimer must be filed with the state insurance commissioner. Entities whose relationship is subject to a disclaimer of affiliation or a disclaimer of control are related parties and are subject to the related party disclosures within this statement. Such a disclaimer does not eliminate a “related party” distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

9. For entities not controlled by voting interests, such as limited partnerships, trusts and other special purpose entities, control may be held by a general partner, servicer, or by other arrangements. The ability of the reporting entity or its affiliates to direct the management and policies of an entity through such arrangements shall constitute control as defined in paragraph 6. Additionally, a reporting entity or its affiliates may have indirect control of other entities through such arrangements. For example, if a limited partnership were to be controlled by an affiliated general partner, and that limited partnership held greater than 10% of the voting interests of another company<sup>16</sup>, indirect control shall be presumed to exist unless the presumption of control can be overcome as detailed in paragraph 7. If direct or indirect control exists, whether through voting securities, contracts, common management or otherwise, the arrangement is considered affiliated under paragraph 5. Consistent with paragraph 8, a disclaimer of affiliation does not eliminate a “related party” distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

---

<sup>15</sup> The term “participating rights” refers to the type of rights that allows an investor to effectively participate in significant decisions related to an investee’s ordinary course of business and is distinguished from the more limited type of rights referred to as “protective rights”. Refer to the sections entitled: “Protective Rights” and “Substantive Participating Rights” in EITF 96-16, *Investor’s Accounting for an Investee When the Investor Owns a Majority of the Voting Stock but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights*. The term “participating rights” shall be used consistent with the discussion of substantive participating rights in this EITF.

<sup>16</sup> Consistent with SSAP No. 97, footnote 1, investments in an exchange traded fund (ETF) or a mutual fund (as defined by the SEC) does not reflect ownership in an underlying entity, regardless of the ownership percentage the reporting entity (or the holding company group) has of the ETF or mutual fund unless ownership of the ETF actually results in “control” with the power to direct or cause the direction of management of an underlying company. ETFs and mutual funds are comprised of portfolios of securities subject to the regulatory requirements of the federal securities laws.

**Adopted revisions SSAP No. 43R:**

*These revisions move the existing guidance in paragraph 4.a. to paragraph 6 and notes the requirement to identify related party investments in the investment schedules. (Note Footnote 5 is just moved to a new paragraph.)*

4. Loan-backed securities are issued by special-purpose corporations or trusts (issuer) established by a sponsoring organization. The assets securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee until the issuer's obligation has been fully satisfied. The investor only has direct recourse to the issuer's assets, but may have secondary recourse to third parties through insurance or guarantee for repayment of the obligation. As a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the responsibility for servicing the underlying assets. Some sponsors do guarantee the performance of the underlying assets.

5. Mortgage-referenced securities do not meet the definition of a loan-backed or structured security but are explicitly captured in scope of this statement. In order to qualify as a mortgage-referenced security, the security must be issued by a government sponsored enterprise<sup>18</sup> or by a special purpose trust in a transaction sponsored by a government sponsored enterprise in the form of a "credit risk transfer" in which the issued security is tied to a referenced pool of mortgages and the payments received are linked to the credit and principal payment risk of the underlying mortgage loan borrowers captured in the referenced pool of mortgages. For these instruments, reporting entity holders may not receive a return of their full principal as principal repayment is contingent on repayment by the mortgage loan borrowers in the referenced pool of mortgages. Unless specifically noted, the provisions for loan-backed securities within this standard apply to mortgage-referenced securities.

6. Investments within the scope of this statement issued by a related party or acquired through a related party transaction or arrangement are also subject to the provisions, admittance assessments and disclosure requirements of SSAP No. 25. In determining whether a security is a related party investment, consideration should be given to the substance of the transaction, and the parties whose action or performance materially impacts the insurance reporting entity holding the security. Loan-backed and structured securities meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement and SSAP No. 25.

- a. Although a loan-backed or structured security may be acquired from a non-related issuer, if the assets held in trust predominantly<sup>20</sup> reflect assets issued by affiliates of the insurance reporting entity, and the insurance reporting entity only has direct recourse to the assets held in trust, the transaction shall be considered an affiliated investment. In such situations where the underlying collateral assets are issued by related parties that do not qualify as affiliates, these securities shall be identified as related party investments in the investment schedules.
- b. A loan-backed or structured security may involve a relationship with a related party but not be considered an affiliated investment. This may be because the relationship does not result in direct or indirect control of the issuer or because there is an approved disclaimer

---

<sup>18</sup> Currently, only Fannie Mae and Freddie Mac are the government sponsored entities that either directly issue qualifying mortgage-referenced securities or sponsor transactions in which a special purpose trust issues qualifying mortgage-reference securities. However, this guidance would apply to mortgage-referenced securities issued by any other government sponsored entity that subsequently engages in the transfer of mortgage credit risk.

<sup>20</sup> In applying this guidance, a reporting entity is not required to complete a detailed review of the assets held in trust to determine the extent, if any, the assets were issued by related parties. Rather, this guidance is a principle concept intended to prevent situations in which related party transactions (particularly those involving affiliates) is knowingly captured in a SSAP No. 43R structure and not identified as a related party transaction (or not reported as an affiliated investment on the investment schedule) because of the involvement of a non-related trustee or SSAP No. 43R security issuer. As identified in *SSAP No. 25—Affiliates and Other Related Parties*, it is erroneous to conclude that the inclusion of a non-related intermediary, or the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to identify and assess the investment transaction as a related party arrangement.

of control or affiliation. Regardless of whether investments involving a related party relationship are captured in the affiliated investment reporting lines, these securities shall be identified as related party investments in the investment schedules. Examples of related party relationships would include involvement of a related party in sponsoring or originating the loan-backed or structured security or any type of underlying servicing arrangement. For the avoidance of doubt, investments from any arrangement that results in direct or indirect control, which include but are not limited to control through a servicer or other controlling arrangement, shall be reported as affiliated in accordance with *SSAP No. 25—Affiliates and Other Related Parties*.

### **Supported Annual Statement Reporting Changes: (Reflected in 2021-22BWG.)**

*These reflect a new electronic-only column for the investment schedules and the related instructions.*

Column XX: Investments Involving Related Parties:

Required for all investments involving related parties including, but not limited to, those captured as affiliate investments. This disclosure intends to capture information on investments held that reflect interactions involving related parties, regardless of whether the related party meets the affiliate definition, or the reporting entity has received domiciliary state approval to disclaim control / affiliation.

Enter one of the following codes to identify the role of the related party in the investment.

1. Direct loan or direct investment (excluding securitizations) in a related party, for which the related party represents a direct credit exposure.
2. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies involving a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role and for which 50% or more of the underlying collateral represents investments in or direct credit exposure to related parties.
3. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies involving a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role and for which less than 50% (including 0%) of the underlying collateral represents investments in or direct credit exposure to related parties.
4. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies in which the structure reflects an in-substance related party transaction but does not involve a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role.
5. The investment is identified as related party, but the role of the related party represents a different arrangement than the options provided in choices 1-4.
6. The investment does not involve a related party.

Draft: 5/27/22

Statutory Accounting Principles (E) Working Group  
Virtual Meeting  
May 24, 2022

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met May 24, 2022. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark and Carrie Mears, Co-Vice Chairs (IA); Sheila Travis (AL); Kim Hudson (CA); Michael Estabrook (CT); Rylynn Brown and Tom Hudson (DE); Eric Moser (IL); Judy Weaver (MI); Doug Bartlett and Pat Gosselin (NH); Bob Kasinow (NY); Melissa Greiner (PA); Jamie Walker and Shawn Frederick (TX); David Smith (VA); and Amy Malm (WI).

1. Reviewed Comments on Exposed Items

The Working Group held a public hearing to review comments (Attachment 1) on previously exposed items.

a. Agenda Item 2022-03

Mr. Bruggeman directed the Working Group to agenda item 2022-03: Premium Adjustment Allocated to Jurisdictions. Robin Marcotte (NAIC) stated that while this agenda item does not propose statutory revisions, it proposes blanks instructional changes to Schedule T, the State Page, and the Accident and Health Policy Experience Exhibit (AHPEE) to clarify guidance for premium adjustments. She stated that NAIC staff received inquiries regarding a minor number of entities that primarily wrote health business related to the federal Affordable Care Act (ACA), who did not properly allocate premium adjustments by jurisdiction but instead reported the adjustments on the “aggregate other alien line” in the statutory financial statements. The proposed instruction changes clarify that all premium adjustments, both increases and decreases, including but not limited to, ACA premium adjustments related to the risk adjustment program, shall be allocated as premium in the respective jurisdiction and are effective for year-end 2022 reporting.

Ms. Malm made a motion, seconded by Mr. Hudson, to adopt agenda item 2022-03 (Attachment 2), noting that the agenda item did not result in statutory revisions; however, it expressed support for the sponsored Blanks (E) Working Group proposal 2022-10BWG. The motion passed unanimously.

b. Agenda Item 2022-08

Mr. Bruggeman directed the Statutory Accounting Principles (E) Working Group to agenda item 2022-08: Treatment of Freddie Mac WI Certificates and the related *Interpretation (INT) 22-01T: Freddie Mac When-Issued K-Deal (WI Trust) Certificates*. Julie Gann (NAIC) stated that this sponsored agenda item is to address the accounting and reporting for Freddie Mac When-Issued K-Deal (WI Trust) Certificates. This program, in essence, creates an additional trust where the investor buys certificates in the WI trust, which is initially backed by cash; and within 90 days, the WI trust uses the cash to purchase the mortgage securities from the real estate mortgage investment conduit trust. Ms. Gann stated that although there is a short delay in acquiring the mortgage-backed securities, the performance of the investment is guaranteed by Freddie Mac. The tentative statutory accounting interpretation clarifies that investments in the Freddie Mac WI Program shall be captured in scope of *Statement of Statutory Accounting Principles (SSAP) No. 43R—Loan-Backed and Structured Securities* from initial acquisition.

Mr. Hudson made a motion, seconded by Ms. Greiner, to adopt the exposed INT 22-01 to clarify that Freddie Mac When-Issued K-Deal (WI Trust) Certificates are in scope of SSAP No. 43R from acquisition (Attachments 3 and 4). The motion passed unanimously.

c. Agenda Item 2021-21

Mr. Bruggeman directed the Working Group to agenda item 2021-21: Related Party Reporting. Jake Stultz (NAIC) stated that this agenda item was drafted in response to recent discussions on the reporting and disclosure requirements for investments that involve related parties. He stated that the agenda item proposes revisions to *SSAP No. 25—Affiliates and Other Related Parties* and *SSAP No. 43R*, clarifying related party and affiliate guidance, as well as requiring new reporting information for investments that are acquired from a related party, regardless of whether the investment is captured on the affiliate reporting line. He stated that the main goals are to: 1) clarify the reporting of affiliate transactions within existing reporting lines in the investment schedules; and 2) incorporate new reporting requirements for investment transactions with related parties using new reporting codes. He stated that interested parties requested the deletion of a proposed addition to *SSAP No. 43R*; i.e., an addition that seeks to clarify that investments with arrangements that result in a direct or indirect control shall be reported as affiliated. He stated that in response to these comments, pursuant to existing guidance in the *Insurance Holding Company System Regulatory Act (#440)* and *SSAP No. 25*, affiliation is determined through direct or indirect control, and that control can be based on voting rights, management and policies, contract, or otherwise. He also stated that the addition to *SSAP No. 43R* does not modify the current affiliation designation process. He stated that NAIC support staff recommended retaining the sentence requested for deletion; however, they modified it slightly to clarify that these scenarios are examples and not limitations in the determination of control. He stated that NAIC staff recommended that the Working Group adopt this agenda item and confirm that:

1. The new disclosures are effective for year-end 2022 reporting, as this date is in line with other state insurance regulators' initiatives, including the Macroprudential (E) Working Group.
2. The related party new electronic code column is effective for all noted investment schedules: B—Mortgage Loans, D—Long-Term Bonds, DB—Derivatives, BA—Other Long-Term Invested Assets, DA—Short-Term Investments, E2—Cash Equivalents, and DL—Securities Lending Collateral Assets.
3. The related party new electronic code column shall be completed for all investments on any reporting line.
4. The Statutory Accounting Principles (E) Working Group supports the inclusion of Code 6 (no related party relationship), as exposed by the Blanks (E) Working Group (2021-22 BWG), to eliminate potential confusion on whether the absence of a code represents incomplete reporting or a non-related party relationship.

Mr. Stultz stated that information contained in the interested parties' comment letter regarding the determination of affiliation under Model #440, and that it is solely based on voting rights of an equity holder, is incorrect. He stated that although ownership of 10% of voting securities results in a presumption of control, voting securities are not the sole basis for determining control. Determination of the affiliation of an investment is based on an evaluation of control of the investee, whether through voting interests or other means; accordingly, this agenda item does not propose to change the affiliate determination or definition. Mr. Stultz stated that interested parties also recommended other revisions to *SSAP No. 25* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* to include open-ended foreign regulated investments that are currently captured in *SSAP No. 30R—Unaffiliated Common Stock*; however, it was recommended that any other changes to the exposed language be considered in a separate agenda item.

Angelica Tamayo-Sanchez (New York Life), representing interested parties, stated that there remain interpretation questions regarding the objectives of the agenda item versus what reporting will result upon adoption. She stated that while interested parties agree that guidance states that control can be achieved through means other than ownership, specific questions remain regarding collateral loan obligations (CLOs). She stated that language being proposed for adoption implies that CLOs managed by an affiliated party would be deemed to be an affiliated transaction; i.e., an interpretation that differs from industry's interpretation of current reporting requirements.

She stated that most insurance companies would not have reported CLOs as affiliated investments if the underlying investments do not have affiliated credit exposure, despite it being managed or originated by a related party. She stated that while the agenda item states that it is not intended to change current affiliated reporting requirements, if these investments should be deemed affiliated, most insurers have likely misinterpreted the guidance regarding their reporting. Discussions among industry indicate that if it is the will of the Statutory Accounting Principles (E) Working Group to classify these investments as affiliated, it will be a change from current, prevalent practice. In addition, there is a presumption that affiliated investments are required to be reviewed by the NAIC Securities Valuation Office (SVO), and if certain CLOs are required to be reported as affiliated, they could lose their filing exempt (FE) status. If FE status is lost, the SVO may need to develop additional procedures, as it does not currently have a methodology to designate this type of asset-backed security investment structure.

Mr. Clark stated that there is a mistaken interpretation that affiliation designation based on securitizations should be based on the affiliated credit exposure of the underlying collateral. He stated this interpretation is not consistent with Model #440 or SSAP No. 25. The affiliate designation is determined based on the ability to direct activities, not credit exposure. If an entity can control the activities of another entity, then all transactions, regardless of credit exposure, should be deemed affiliated. Mr. Clark stated that there is nothing in Model #440 that would scope out securitizations, and to exclude them for any purpose, including through the insertion of an unaffiliated intermediary, is incorrect. He stated that investments without an affiliated credit exposure that are originated or managed through an affiliated entity should be deemed affiliated. The need to distinguish between affiliated and unaffiliated credit exposure, despite being on an affiliated reporting line, is an important goal of this agenda item and is achieved through the new, supplemental reporting codes. Currently, since affiliation is based on control, without the use of these reporting codes, there is no way to differentiate between various types of credit exposure. In addition, some investments could be structured in a manner that the control threshold is not met, thus an investment would not be classified as affiliated; however, it does have underlying affiliated investment involvement; i.e., affiliated origination. This agenda item would assist state insurance regulators in the identification of such circumstances. Mr. Clark stated that the specificity proposed for SSAP No. 25 does not imply that any affiliated involvement causes an investment to become affiliated; it only clarifies that a control evaluation is still required by the insurer. He stated that as an example, for affiliated investment managers who originate investments that are ultimately determined not to be affiliated, the fee structure is certainly an affiliated transaction and should have been reviewed by the state of domicile through an appropriate Model #440 filing. He stated that he would support a referral to the Valuation of Securities (E) Task Force to address FE questions regarding CLOs, as the intent was not to modify FE status of these investments.

Keith Bell (Travelers), representing interested parties, stated that the language as proposed will likely not yield the results desired by state insurance regulators, specifically the reporting of certain investments as affiliated if they are managed by an affiliated asset manager. He stated that Model #440 was drafted prior to the prevalence of securitizations, and the emphasis of the model is on equity investments, not debt investments. He stated that debt investments are the rights to contractual cashflows, which do not represent equity investments; thus, determining control based on a debt investment for the determination of affiliate classification is not consistent with current practice. He stated that interested parties do not disagree with the objectives of state insurance regulators, but they believe the added language changes the scope of affiliated transactions, and if that is the ultimate wish of state insurance regulators, alternate guidance should be considered. Mr. Bruggeman stated that the spirit of the model is that if the underlying entity is affiliated, all associated transactions should also be deemed affiliated. However, increased reporting granularity of underlying credit exposure would be achieved through the new proposed reporting codes. The proposed language is only to clarify control, and it is not modifying Model #440, nor modifying affiliated reporting requirements. Mr. Clark stated that he agrees with Mr. Bruggeman in that if a company is deemed to be affiliated, all transactions, debt, equity, or other should also be reported as affiliated transactions. He also stated that the proposed language only clarifies when control exists, not necessarily how to determine if control exists. He stated that if there is a desire to further clarify how to determine control, that



would need to be in a project separate from this agenda item. Ms. Weaver stated that the interpretive disconnect of industry could leave open the possibility of other investments to not be reported as affiliated, and she inquired if interested parties have suggestions to the proposed revisions. Mr. Bell stated that interested parties do not have any suggestions but believe the current language is not sufficient to meet the needs of state insurance regulators, as there will still be ambiguity in reporting requirements. Rose Albrizio (Equitable), representing interested parties, stated that she concurs with Mr. Bell, and there will be difficulty for industry with applying the clarified affiliated reporting standard.

In response to Mr. Clark's comments regarding determination of control for consolidated reporting purposes, Ms. Tamayo-Sanchez stated that U.S. generally accepted accounting principles (GAAP) generally require the determination of who controls the significant activities or economics in the initial determination of control for consolidated reporting purposes. She stated that if U.S. GAAP were used as a basis to determine if a CLO should be reported as affiliated due to exercising control, they would likely not be deemed as affiliates; however, industry struggles with how to define control of these instruments for statutory reporting purposes. As the insurer likely has a very passive involvement in the underlying investment and is only involved in the investment in the event of certain default situations, an affiliated designation for statutory accounting purposes is not consistent with current processes. Accordingly, many insurers will likely need to now move many debt investments to affiliated reporting lines.

Mr. Bruggeman stated that the challenge is that the intent of the agenda item is not to change affiliated reporting requirements; however, as many insurers believe this is a change, this likely represents an interpretation disconnect between insurers and state insurance regulators. He stated that this agenda will likely: 1) communicate the scope of affiliation determination and the associated reporting desires of state insurance regulators; and 2) supplement the reporting of all investments with the proposed reporting codes. The agenda item is not changing related party or affiliation determination pursuant to Model #440, especially as some states have adopted slight variations to the model. Mr. Clark stated that he agrees with Mr. Bruggeman, and he added that the determination of control has not changed. If detailed guidance regarding the evaluation of control were desired, it should be considered in a separate agenda item; however, insurers should continue to consult with their domestic regulators in the determination of affiliation designation. Mr. Bell stated that Mr. Bruggeman's summation of the challenge was accurate; however, many in industry would not report affiliated debt investments as affiliated transactions, as they interpret Model #440 to be limited to equity interests. He stated that the interpretation of state insurance regulators is that investments originated through, or debt issued by, an affiliated entity is an approach not commonly interpreted by industry. Mr. Clark stated that his interpretation is that if an entity is determined to be affiliated, all transactions—i.e., debt or equity issued by an affiliate—would also be classified as affiliated; and to the extent that this has not been done previously, he supports corrected reporting going forward. Ms. Tamayo-Sanchez stated that the interpretation of industry based on today's discussion was wrong, as they believe Model #440 only requires affiliated reporting if the investment has underlying affiliated credit exposure or if the insurer has control in the underlying investment, not an asset manager who originates the investment. Ms. Albrizio stated that the guidance should be supplemented using examples to clarify which investments should be reported as affiliated, as interested parties do not believe the current guidance is adequate to ensure that the reporting desired by state insurance regulators will be achieved. Mr. Bruggeman stated he appreciates the comments of industry to help articulate the interpretation differences; however, state insurance regulators believe that if an entity is deemed to be affiliated, all investments—debt or equity—should be reported as affiliated, regardless of underlying affiliated credit exposure. With the agenda item, the investments would have supplemental reporting to help further differentiate those with varying degrees of underlying related party credit exposure. Ms. Tamayo-Sanchez, not speaking on behalf of interested parties, stated that the interpretation of applying the affiliated designation to debt instruments only when there was an underlying affiliated credit exposure was incorrect and not in line with state insurance regulator expectations. She stated that for insurers who have not been a party to

the discussions related to this agenda item, they would likely continue existing practices for the determination of affiliation designation.

Mr. Clark made a motion, seconded by Mr. Smith, to:

1. Adopt the exposed revisions in SSAP No. 25; exposed revisions, with minor edits, in SSAP No. 43R; and new reporting disclosures for investments acquired from a related party, regardless of whether the investment is captured on an “affiliate” reporting line (Attachment 5).
2. Confirm that the new reporting codes applicable for investment schedules B, D, DB, BA, DA, E2, and DL shall apply to all investments on any reporting line and are effective for year-end 2022 reporting.
3. Confirm support for the inclusion of Code 6 (no related party relationship), as exposed by the Blanks (E) Working Group (2021-22 BWG) to eliminate potential confusion on whether the absence of a code represents incomplete reporting or a non-related party relationship.
4. Direct NAIC staff to draft the following for future Statutory Accounting Principles (E) Working Group discussion: 1) possible footnote revisions pursuant to interested parties’ comments; and 2) examples for possible inclusion in SSAP No. 43R to further clarify investments that should be classified as affiliated.
5. Send a referral to the Valuation of Securities (E) Task Force, notifying of this adopted agenda item, and assess whether corresponding edits are needed to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual)* regarding CLO investments that may now be classified as affiliated.

The motion passed unanimously.

Ms. Gann stated that as a reminder, the Blanks (E) Working Group has a public call scheduled for May 25, and the Statutory Accounting Principles (E) Working Group has a public call scheduled for July 18 to hear comments on the exposed bond definition and related issue paper.

Having no further business, the Statutory Accounting Principles (E) Working Group adjourned.

[https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2022/5-24-22/minutes/sapwg minutes 5.24.22tpr.docx](https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national%20meetings/a.%20national%20meeting%20materials/2022/5-24-22/minutes/sapwg%20minutes%205.24.22tpr.docx)



TO: Carrie Mears, Chair, Valuation of Securities (E) Task Force  
Members of the Valuation of Securities (E) Task Force

FROM: Eric Kolchinsky, Director, NAIC Structured Securities Group (SSG) and Capital Markets Bureau  
Charles A. Therriault, Director, NAIC Securities Valuation Office (SVO)  
Marc Perlman, Managing Investment Counsel, NAIC Securities Valuation Office (SVO)

RE: Clarify the Definition of an NAIC Designation in Parts One and Two of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*

DATE: September 30, 2022

---

**Summary:** As noted in Part One of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual), NAIC Designations and NAIC Designation Categories serve many purposes. NAIC Designations and other Securities Valuation Office (SVO) and Structured Security group (SSG) (collectively, the Investment Analysis Office (IAO)) products are standards identified in the NAIC Policy Statement and Financial Regulation Standards (SFRS) that states, as participants in the Accreditation Program administered by the Financial Regulation Standards and Accreditation (F) Committee, have incorporated into law. Part A of the SFRS identifies laws and regulations deemed necessary to financial solvency regulation, which includes, directly or indirectly, the analytical products of the IAO. These standards include the following:

- Standard 5 requires that insurer-owned securities be assessed in accordance with the standards promulgated by the NAIC IAO.
- Standard 2 refers to the NAIC Risk-Based Capital (RBC) for Insurers Model Act (#312) which assigns RBC factors for securities based on their credit risk as quantified by NAIC Designations.
- Standard 3 refers to the NAIC Accounting Practices and Procedures Manual, which uses NAIC Designations produced by the SVO and/or Price Grids produced by the SSG for statutory accounting purposes including to identify the valuation rules that apply to an investment.
- Standard 8 refers to state investment regulations which often incorporate NAIC model law provisions that relate asset allocations to credit quality or credit risk quantified by NAIC Designations.

- Standard 10 refers to the NAIC Credit for Reinsurance Model Law (#785), which refers to insurer-owned securities compiled by the SVO and identified on the List of Investment Securities, and in a separate provision, letters of credits issued by the banks and non-bank financial institutions whose name is placed on the NAIC List of Qualified U.S. Financial Institutions administered by the SVO, as eligible for use as collateral in reinsurance transactions.

These standards have been included in this memorandum to highlight the many ways in which NAIC Designations are used within NAIC guidance for different purposes. These varied uses in regulatory guidance also highlight why NAIC Designations differ from Credit Rating Provider (CRP) ratings. The current definition of an NAIC Designation in the P&P Manual does not clearly associate its use for these purposes and standards. The attached amendment proposes changes in Part One and Part Two of the P&P Manual to clearly articulate that the assignment of an NAIC Designation to a security considers and/or reflects the following:

- The likelihood of timely payment of principal and/or interest, as appropriate.
- The probability of default.
- The appropriateness and consistency of the risk-based capital model factor that will be applied to the security given its level of risk.
- Statutory accounting, reporting, state investment laws and other purposes identified in the NAIC Financial Regulation Standards and Accreditation Program and/or other NAIC developed regulatory guidance embodied in state law.

**Recommendation:** The SVO recommends adoption of this proposed amendment updating the definition of an NAIC Designation in the P&P Manual to clearly link its use in the NAIC Policy Statement and Financial Regulation Standards (SFRS). The proposed text changes to P&P Manual are shown below with additions in red underline, deletions in ~~red strikethrough~~ as it would appear in the 2022 P&P Manual format.

**PART ONE:  
POLICIES OF THE NAIC VALUATION OF SECURITIES (E) TASK FORCE**

**ABOUT THIS MANUAL**

---

...

**Expression of NAIC Standards in State Law and Regulatory Processes**

6. NAIC Designations and other SVO and SSG products are standards identified in the NAIC Policy Statement and Financial Regulation Standards (SFRS) that have been incorporated into state law by the States as participants in the Accreditation Program administered by the Financial Regulation Standards and Accreditation (F) Committee. Information about the F Committee and the Accreditation Program can be accessed here: [www.naic.org/cmte\\_f.htm](http://www.naic.org/cmte_f.htm).
7. Part A of the SFRS identifies laws and regulations deemed necessary to financial solvency regulation. Analytical products of the SVO and SSG [sometimes collectively called the Investment Analysis Office (IAO)] are directly or indirectly incorporated into SFRS Part A standards.
  - Standard 5 requires that insurer-owned securities be assessed in accordance with the standards promulgated by the NAIC IAO.
  - Standard 2 refers to the NAIC Risk-Based Capital (RBC) for Insurers Model Act (#312) which assigns RBC factors for securities based on their credit risk as quantified by NAIC Designations.
  - Standard 3 refers to the NAIC Accounting Practices and Procedures Manual, which uses NAIC Designations produced by the SVO and/or Price Grids produced by the SSG for statutory accounting purposes including to identify the valuation rules that apply to an investment.
  - Standard 8 refers to state investment regulations which often incorporate NAIC model law provisions that relate asset allocations to credit quality or credit risk quantified by NAIC Designations.
  - Standard 10 refers to the NAIC Credit for Reinsurance Model Law (#785), which refers to insurer-owned securities compiled by the SVO and identified on the List of Investment Securities, and in a separate provision, letters of credits issued by the banks and non-bank financial institutions whose name is placed on the NAIC List of Qualified U.S. Financial Institutions administered by the SVO, as eligible for use as collateral in reinsurance transactions.

8. NAIC Designations and other analytical products of the SVO and SSG are produced solely for the benefit of NAIC members in their capacity as state insurance department officials for use in the NAIC Financial Regulation Standards and Accreditation Program as described above. To ensure NAIC members have a central source from which to obtain information about insurer-owned securities (including their NAIC Designations) the VOS/TF has identified the AVS+ Products as the depository for information compiled by the SVO in the SVO List of Investment Securities.

...

## NAIC Designations

37. The SVO's analysis of credit risk (hereafter defined), is expressed as an opinion of credit quality by assignment of an NAIC Designation that is notched to reflect the position of the specific liability in the issuer's capital structure. Collectively, NAIC Designations as defined in this Manual describe a credit quality-risk gradation range from highest quality (least risk) to lowest quality (greatest risk). NAIC Designations express opinions about credit risk except when accompanied by the NAIC Designation subscript, described below.
  - Credit risk is defined as the relative financial capability of an obligor to make the payments contractually promised to a lender. Credit analysis is performed solely for the purpose of designating the quality of an investment made by an insurance company so that the NAIC member's department of insurance can better identify regulatory treatment.
  - Credit risk is assessed by analyzing the information and documentation provided to the SVO by the reporting insurance company and its advisors. The SVO does not audit the information submitted and assumes the information to be timely, accurate and reliable.
  - The ability of an insurance company to realize payment on a financial obligation can be affected by factors not related to credit risk or by the manner in which the repayment promise has been structured.
  - An NAIC Designation reflects the likelihood of timely payment of principal and interest, as appropriate, and the probability of principal and interest payment default.
  - An NAIC Designation reflects the appropriateness and consistency of the risk-based capital model factor that will be applied to the security given its level of risk.

- An NAIC Designation must be considered in the context of its appropriateness and consistency of use in the NAIC Policy Statement and Financial Regulation Standards (SFRS).
- NAIC Designations do not measure other risks or factors that may affect repayment, such as volatility/interest rate, prepayment, extension or liquidity risk.
- An NAIC Designation must be interpreted by the NAIC member in context of the NAIC Financial Regulation Standards and Accreditation Program, other characteristics of the investment, and the specific financial and regulatory status of the insurance company.

...

**PART TWO  
OPERATIONAL AND ADMINISTRATIVE INSTRUCTIONS  
APPLICABLE TO THE SVO**

**PRODUCTION OF NAIC DESIGNATIONS**

---

---

<b>NAIC DESIGNATIONS</b>
--------------------------

18. NAIC Designations are proprietary symbols of the NAIC. The SVO and sometimes the SSG produce NAIC Designations for insurer-owned securities using the policies, procedures or methodologies adopted by the VOS/TF in this Manual. NAIC Designations identify a category or band of credit risk that reflects the likelihood of timely payment of principal and interest, as appropriate, the probability of principal and interest payment default, and the appropriateness and consistency of its use in the NAIC Policy Statement and Financial Regulation Standards (SFRS) including the risk-based capital model factor that will be applied to the security given its level of risk. NAIC Designations are produced for statutory accounting, reporting, state investment laws and other purposes identified in the NAIC Financial Regulation Standards and Accreditation Program and/or other NAIC developed regulatory guidance embodied in state law. NAIC Designations are adjusted in accordance with the notching procedures described below so that an NAIC Designation for a given security reflects the position of that specific security in the issuer's capital structure, the likelihood of timely payment and risk of payment default. NAIC Designations may also be adjusted by notching to reflect the existence of other non-payment risk in the specific security in accordance with the procedures described in this Manual.

...

<https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2022/2022-10-20 - Interim Meeting/04-Definition of NAIC Designation Part Two/2022-012.01 P&P Definition of NAIC Desig.docx>