

VALUATION OF SECURITIES (E) TASK FORCE

Valuation of Securities (E) Task Force March 22, 2021, Minutes

Valuation of Securities (E) Task Force February 18, 2021, Minutes (Attachment One)

Valuation of Securities (E) Task Force December 18, 2020, Minutes (Attachment Two)

Draft Pending Adoption

Draft: 3/31/2021

Valuation of Securities (E) Task Force
Virtual Meeting (*in lieu of meeting at the 2021 Spring National Meeting*)
March 22, 2021

The Valuation of Securities (E) Task Force met March 23, 2021. The following Task Force members participated: Dana Popish Severinghaus, Chair, represented by Kevin Fry (IL); Doug Ommen, Vice Chair, represented by Carrie Mears (IA); Lori K. Wing-Heier represented by Wally Thomas (AK); Ricardo Lara represented by Laura Clements (CA); Andrew N. Mais represented by Kathy Belfi (CT); Trinidad Navarro represented by Rylynn Brown (DE); David Altmaier represented by Carolyn Morgan and Ray Spudeck (FL); Dean L. Cameron represented by Eric Fletcher (ID); Vicki Schmidt represented by Tish Becker (KS); James J. Donelon represented by Stewart Guerin (LA); Gary D. Anderson represented by John Turchi (MA); Kathleen A. Birrane represented by Matt Kozak (MD); Chlora Lindley-Myers represented by Debbie Doggett (MO); Bruce R. Ramge represented by Lindsay Crawford (NE); Marlene Caride represented by Nakia Reid and John Sirovets (NJ); Linda A. Laceywell represented by Jim Everett (NY); Doug Slape represented by Amy Garcia (TX); Jonathan T. Pike represented by Jake Garn (UT); Mike Kreidler represented by John Jacobson (WA); and Mark Afable represented by Randy Milquet (WI). Also participating was: Dale Bruggeman (OH).

1. Adopted its Feb. 18, 2021; Dec. 18, 2020; and 2020 Fall National Meeting Minutes

The Task Force met Feb. 18, 2021; Dec. 18, 2020; and Nov. 18, 2020. During its Feb. 18, 2021, meeting, the Task Force took the following action: 1) received a proposed amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to update the financial modeling instructions for residential mortgage-based securities (RMBS)/commercial mortgage-based securities (CMBS); 2) discussed comments received and adopted a proposed amendment to the P&P Manual to require the filing of private rating letter rationale reports; 3) received a referral from the Statutory Accounting Principles (E) Working Group on nonconforming credit tenant loans (CTLs); 4) received a proposed amendment to the P&P Manual to update the list of NAIC credit rating providers (CRPs) to reflect nationally recognized statistical rating organization (NRSRO) changes; and 5) discussed U.S. Securities and Exchange Commission (SEC) Rule 18f-4 under the federal Investment Company Act of 1940 related to the use of derivatives by registered investment companies. During its Dec. 18, 2020, meeting, the Task Force took the following action: 1) exposed an updated amendment to the P&P Manual to include instructions for financially modeled RMBS/CMBS to map NAIC designation categories for a three-day public comment period ending Dec. 22, 2020; and 2) discussed financially modeled RMBS/CMBS price breakpoints and other issues surrounding securities that have a zero-loss in 2020.

Mr. Thomas made a motion, seconded by Ms. Clements, to adopt the Task Force's Feb. 18, 2021 (Attachment); Dec. 18, 2020 (Attachment); and 2020 Fall National Meeting minutes (*see NAIC Proceedings – Fall 2020, Valuation of Securities (E) Task Force*). The motion passed unanimously.

2. Adopted an Amendment to the P&P Manual to Update the Financial Modeling Instructions for RMBS/CMBS Securities

Mr. Fry said at the end of last year, there were some unusual results through the financial modeling process due to the economic scenarios. It produced more securities with losses that were previously zero loss securities that now needed to use the price breakpoint methodology. Coupled with lower interest rates, these securities also traded at a premium. The Task Force did some work last year to temporarily fix the issues with the price breakpoint methodology for year-end 2020, and it was agreed that a longer-term fix was necessary. In front of the Task Force now is that fix to the price breakpoint methodology for securities prior to 2013 and for securities after 2013—move away from price breakpoints and use more of a single-designation process.

Eric Kolchinsky (NAIC) said the proposed amendment P&P Manual is to move to two types of information. For legacy securities, those prior to 2013, the Task Force will continue to provide breakpoints for more post-crisis securities. The process of calculating the expected losses would be the same, except now, instead of converting the intrinsic price into breakpoints, it would be converted into a designation for non-legacy securities—those after 2013. The Structured Securities Group (SSG) believes it to be a good approach to minimize the convexity experienced in the zero loss securities and standardize reporting. The SSG would like to implement this for year-end but realizes that there may be some technical issues for the NAIC and application vendors. Therefore, it is open to a potential 2022 implementation.

Mr. Fry said the Task Force will be in a better position later this year to know whether it can implement by year-end 2021 or if a 2022 implementation is needed, which will give more than enough time.

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Mike Monahan (American Council of Life Insurers—ACLI) said the ACLI would suggest setting a 2021 implementation date. The Task Force will know in a couple of months whether that is reachable by the vendors and by the SSG staff, and it can revisit the issue, if needed.

Francisco Paez (MetLife) said the ACLI is going to be focused on the implementation and making sure that this is done in an orderly way. The proposal is something that is supported. The proposal moving away from the breakpoints, viewed in conjunction with the anticipated change of through the cycle of modeling for CMBS, will avoid some of the distortions to risk-based capital (RBC) experienced for modeled securities at the end of last year. It accomplishes the stated purpose, and it is a positive step to having a longer-term solution for modeled securities. He said there are two points that the ACLI and the National American Securities Valuation Association (NASVA) want to raise. First, the price breakpoints concept, as a concept, is a sound one, and it aligns the incentives in a way that is prudent. Mr. Paez encouraged that this be an open dialogue in the future and evaluate if there are ways to incorporate that concept in a way that deals with some of the distortions experienced last year. There are a few options that could be studied. Realizing that this is a longer-term type of project, he said he wants to see if there are other more workable solutions with respect to price points, given the soundness of the concept and the history of how those breakpoints really played such a key role in helping an orderly navigation during the great financial crisis for insurance companies. The second point is in regard to transparency. Acknowledging all the extensive work that the SSG has undertaken on this front, which is appreciated, he asked to continue this dialogue and to try to identify additional disclosures that may be possible, both in terms of the assumptions and in terms of the results at a more granular level than today so that insurance companies can better understand the drivers of their RBC results at the end of the day. He said he would like insurers to get some discussion on the frequency of these disclosures to have a better sense of the direction of RBC ahead of year-end rather than waiting towards the end of the year.

Mr. Fry said the Task Force always looks for procedures and improvement. He said there will be more time in the future to look at the items mentioned, but for now, these are the right steps to address the problems and get rid of some of the results that are not logical. Mr. Fry asked Charles A. Therriault (NAIC) if the amendment were adopted, is there a part about when it is implemented or is that was something that the Task Force can set along with the motion to adopt. Mr. Therriault said the Task Force can adopt it with a year-end effective date. He said if later this year there is a technology implementation problem, that effective date can be changed to 2022. Mr. Kolchinsky said the SSG staff will work on transparency and, if the Task Force directs it to do so, work on another methodology.

Mr. Everett asked how the cutoff date for the changeover was chosen. Mr. Kolchinsky said the cutoff date is already in the P&P Manual regarding legacy securities for the purposes of re-REMIC (real estate mortgage investment conduit) securities. He said it seemed as good as any date, and it avoids having several legacy dates.

Tracey Lindsey (NASVA) asked, from a vendor's perspective, when the cutoff date would be to make that decision should there be difficulties with technology. Mr. Kolchinsky said the SSG was committed to working with industry, their vendors and NAIC technology. There are some possible changes on the technology side. If together the opinion is that this is doable, it will move on, and if is not doable, it will come back as soon as possible to the Task Force for their advice and consent.

Mr. Thomas made a motion, seconded by Mr. Kozak, to adopt the amendment to the P&P Manual to update the financial modeling instructions for RMBS/CMBS securities. The motion passed unanimously.

3. Discussed Comments Received for an Updated Proposed Amendment to the P&P Manual to Require the Filing of Private Rating Letter Rationale Reports

Mr. Fry said the next item on the agenda is to discuss comments received on a proposed amendment to require the filing of private rating letter rationale reports. The Securities Valuation Office (SVO) worked with the ACLI, NASVA and the Private Placement Investors Association (PPiA) to update the amendment and resolve some of the operational issues that were raised during the Task Force's Feb. 18 meeting. Mr. Fry asked Mr. Therriault to review the updated amendment.

Mr. Therriault said this proposed amendment would require the rating rationale report to be filed with the SVO for privately rated securities. The rating rationale report should provide a more in-depth analysis of the transaction structure, the methodology used to arrive at the private rating, and, as appropriate, a discussion of the transaction's credit, legal and operational risks and mitigants. With both the private rating letter and the private rating letter rationale report, the SVO will be able to better understand the security.

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During the Task Force's Feb. 18 meeting, interested parties raised several issues. The SVO staff held a follow-up meeting with the ACLI, NASVA and the PPIA on Feb. 22 to discuss the issues and revise the amendment based on that discussion. They also met March 4, March 18 and March 19 to review the changes and receive further feedback. The updated amendment reflects many, but not all, of the changes. Summarizing the changes that are in the revised amendment, Attachment Five in the package, the first change was to the transition language in paragraph 11 to permit an option to companies that cannot provide the ratings rationale due to confidentiality or contractual reasons. The next issue, which was an extended discussion during the the Task Force's Feb. 18 meeting, related to the disclosure as to why something was ineligible. An update was made to paragraph 21 for a new brief disclosure visible to all filers in VISION for two specific situations: 1) the security type is ineligible for filing exemption (FE) according to the P&P Manual list of "Specific Populations of Securities Not Eligible for Filing Exemption"; or 2) the security is of a type outside the scope of *Statement of Statutory Accounting Principles (SSAP) No. 26R—Bonds, SSAP No. 32R—Preferred Stock* or *SSAP No. 43R—Loan Backed and Structured Securities*, which would also make it ineligible for FE. This requires a VISION technology change, and it has already been added to the development queue. The last update was to paragraph 22 to provide a reporting option if the private rating rationale report cannot be provided for reasons other than confidentiality or contractual limitations after Jan. 1, 2022.

Another issue raised during the Task Force's Feb. 18 meeting but is not in the updated amendment relates to the required content of the rating rationale report. Rating agencies are in the business of publishing credit analysis opinions and should be familiar with what they typically publish for a specific asset type. The SVO is expecting something comparable to their public reports. Rating agencies often mention that their private ratings are equivalent to their public ratings in terms of the analysis performed. The SVO is looking for something comparable to the publicly rated securities. It was mentioned possibly using the SVO's regulatory treatment analysis service (RTAS) letter as a benchmark. That is not a good comparison because it is just a summary of what the reporting treatment would be for the security, but it does not go into an in-depth analysis of the credit or methodology. There are few changes that still need to be made to the amendment and worked through with the ACLI, NASVA and the PPIA, specifically to the transition period and confidentiality provisions. With the Task Force's permission, the SVO would like to continue working with industry and expose a clean version of the amendment with those revisions and expose it for a short public comment period.

Sasha Kamper (PPIA) said there have been multiple meetings to discuss this amendment and agreed in concept during March 19's meeting to a workable solution. There are a few more changes needed to the amendment that will lay out some of those details.

Mr. Fry directed the SVO to continue working with industry on the amendment to require the filing of private rating letter rationale reports with the SVO and expose a clean version of the amendment, when it is ready, for a 30-day public comment period.

4. Adopted an Amendment to the P&P Manual to Update the List of NAIC CRPs to Reflect NRSRO Changes

Mr. Fry said this agenda item is to discuss comments received and consider for adoption a proposed amendment to update the list of CRPs to reflect NRSRO changes. The proposed amendment reflects the merger of Morningstar and DBRS, and the name update for the Kroll Bond Rating Agency LLC.

Ms. Kamper asked for clarification. She asked if this amendment is to recognize the merger of DBRS and Morningstar or the Kroll Bond Rating Agency name change. Mr. Therriault said on the original exposure, there was a different name for Kroll Bond Rating Agency, which was what was reflected on SEC's Office of Credit Rating (OCR) website. The amendment was revised to correct Kroll's name to reflect what is on their Form NRSRO. The rest of the amendment relates to the DBRS/Morningstar merger and a few other minor CRP name changes. Kroll was only highlighted because it was a change from the last time this amendment was discussed by the Task Force.

Mr. Thomas made a motion, seconded by Ms. Mears, to adopt the amendment to the P&P Manual to update the list of NAIC CRPs to reflect NRSRO changes. The motion passed unanimously.

5. Received a Request from the ACLI to Study the National Financial Presentation Standard for Spanish GAAP.

Mr. Fry said the next agenda item is to receive a request from the ACLI to study the national financial presentation standard for Spanish generally accepted accounting principles (GAAP). The ACLI submitted a letter dated March 1 (Attachment Seven) initiating this formal request for a review by the SVO as required in Part Two of the P&P Manual. In discussions with the SVO staff, the ACLI letter satisfies the pre-condition necessary to conduct the requested study, and the SVO is ready to begin.

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Mr. Monahan said that two large multinational companies have asked to have the SVO study Spain as a national financial reporting standard. The SVO has a great process in place for such a review. The ACLI is close to signing the contract with an accounting firm to assist with the study, and it just needed the Task Force's approval to undertake the study. The accounting partners will not be flying to the U.S. to meet at the SVO office and instead will be meeting virtually via Zoom or RingCentral.

Mr. Fry said this is informational only; no action is required by the Task Force at this time. When the SVO concludes the study, the SVO will report back to the Task Force with their findings, recommendation and, if appropriate, a possible amendment.

6. Discussed and Received a Proposed Amendment to the P&P Manual to Clarify Guidance for Fund Leverage

Mr. Fry said the next agenda item is to discuss and receive a proposed amendment to the P&P Manual to clarify guidance for fund leverage. Mr. Fry asked Marc Perlman (NAIC) to provide a summary.

Mr. Perlman said the P&P Manual currently grants the SVO discretion when determining whether a fund's use of derivatives is consistent with a fixed income like security, meaning it will generate predictable and periodic cash flows and is, therefore, eligible for an NAIC designation. Recognizing that this discretion regarding the use of derivatives by funds can lead to a possible lack of predictability when a fund is submitted to the SVO for potential inclusion on its fund lists, some members of the Task Force requested the SVO propose a P&P Manual amendment that would create a more predictable bright line test.

As explained during the Task Force's Feb. 18 meeting, the SEC adopted a final version of Rule 18f-4 last year, which allows funds to enter into derivative transactions, notwithstanding the federal Investment Company Act's restrictions of them, so long as funds meet certain conditions. The SVO focuses most closely on the exception to these requirements for limited users of derivatives, meaning funds that limit their exposure to derivatives with potential risk of future payment or loss (call it downside risk) to 10% or less of net assets, exclusive of certain derivatives used to hedge certain currency and interest rate risks. The SEC recognized the risk that derivative transactions pose to funds because they involve leverage or the potential for leverage, which can magnify gains and losses compared to the fund's investment, while also obligating the fund to make a payment or deliver assets to a counterparty under specified future conditions. The SVO contends that such leverage is inconsistent with the predictable and periodic standard in the P&P Manual. As such, the SVOs recommend using Rule 18f-4's limited user standards as a kind of guidepost for creating the requested bright line test in the P&P Manual.

Specifically, the SVO is proposing two new tests. Test No. 1: For funds on the SVO-identified Bond ETF List, the SVO-identified Preferred Stock ETF List and the NAIC List of Schedule BA Non-Registered Private Funds with Underlying Assets Having Characteristics of Bonds or Preferred Stock (each of which is granted bond treatment on their respective reporting schedules), the SVO proposes a similar, but not identical, threshold to the limited user exception in Rule 18f-4, whereby the gross notional amount of derivatives that impose no future payment or margin posting obligation on the fund (meaning there is no future "downside" risk), cannot exceed 10% of the net asset value of the fund, except for (and these are the exclusions from the 10% calculation) derivatives that are either used by funds to create more bond-like cash flows or that are common for maintenance of fund portfolios. These acceptable exemptions would include: 1) certain currency and interest rate hedges on fixed-income or preferred stock in the fund portfolio; 2) certain futures or forwards on fixed-income or preferred stock to be held in the fund's portfolio and for which money for the future purchase have been set aside; 3) reserve-repurchase agreements associated with specific fixed income or preferred stock investments held by the fund; and 4) non-margin borrowing for purposes other than investment. While this first test, like the SEC's, caps derivatives at 10% of net asset value (NAV), the SEC only caps derivatives with future payment or downside risk. The SVO proposes not permitting any derivatives with future payment or downside risk, other than the exempt derivatives just listed, and capping derivatives with only upside potential at 10%. The reason for capping derivatives with only potential gain for the fund is that they are still speculative and, therefore, do not meet the periodic and predictable standard.

Test No. 2: Funds on the NAIC Fixed Income-Like SEC Registered Funds List are in scope of *SSAP No. 30R—Unaffiliated Common Stock* and reported on Schedule D, Part 2, Section 2. Based on such reporting, if the Task Force deems it appropriate, NAIC designations assigned to those funds could be permitted to include assessments of risk other than credit risk, including market and liquidity risk—both risks introduced by derivatives. This also addresses requests by several Task Force members that a wider range of funds be eligible to receive an NAIC designation. Therefore, if the Task Force thinks it appropriate, these funds could be permitted a larger derivative threshold of up to 20% of the NAV of the fund, but, unlike the first test, with no exempt derivatives. This threshold would also prevent violation of the P&P Manual fund methodology's predominantly hold requirement that a fund will hold at least 80% of its assets in bonds or preferred stock, depending on the type of fund. For both tests, the SVO recommends incorporating an assessment of counterparty risk into its credit risk assessment. It should also be noted that these increased thresholds for derivatives might not be acceptable under certain state laws. For example, a bill under

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consideration in New York would cap funds' non-reserve investments at 10%, meaning derivatives would likely be capped at that amount.

The SVO thinks the two tests would achieve the goal of providing greater clarity and predictability to fund sponsors and investors regarding the SVO's fund reviews while still maintaining the P&P Manual's predictable and periodic standard. Though, it should be noted, the two tests would be more generous than the current approach in that some speculative derivatives would be permitted. While the second test may permit additional funds on the NAIC Fixed Income-Like SEC Registered Funds List, the inconsistent, and possibly punitive, RBC treatment of funds on this list versus other funds with NAIC designations is not something that the Task Force can address directly. For example, exchange-traded funds (ETFs) on the NAIC Fixed Income-Like SEC Registered Funds List would have a different RBC treatment from ETFs on the SVO Identified Bond or Preferred Stock ETF Lists. For this reason, the Task Force might consider a referral to the Capital Adequacy (E) Task Force and the Financial Condition (E) Committee requesting the assignment of bond RBC factors for all funds whose credit risk has been assessed by the SVO and assigned an NAIC designation pursuant to the Task Force's policies, including the NAIC Fixed Income-Like SEC Registered Funds List. This would be similar to the referral the Task Force made to the Capital Adequacy (E) Task Force in 2018. Equalizing the RBC treatment for assets with similar credit risk, represented by the SVO assigned NAIC designation, would provide a consistent and uniform NAIC process consistent with regulatory needs for funds. With these amendments the Task Force would be redefining what goes on the NAIC fund lists and, therefore, redefining the fund asset. Therefore, it would be appropriate to refer the proposed amendment to the Statutory Accounting Principles (E) Working Group.

Additionally, the SVO is proposing to add an assessment of a fund's management to the fund methodology. Under this assessment, the SVO would have the ability to consider a fund's management and organization, including: 1) key-man risk; 2) its risk management and compliance infrastructure; 3) its credit management standards and credit research capabilities; and 4) its derivatives risk management program for funds required to have one under Rule 18f-4. Based on the management assessment, the SVO would be able to notch down from its credit risk assessment or choose not to assign an NAIC designation.

Mr. Everett said states have defined their bond treatment by NAIC treatment. "Speculative" was mentioned regarding certain funds. Does the SVO know what funds those are? And if states permit these to be used for surplus, that would seem to be a departure. What is being defined as "speculative"? Mr. Perlman said "speculative" is anything with leverage where a fund can have outsized gains or losses. What the SVO is proposing—except for the exempt derivatives discussed, which are derivatives hedging certain risks on assets within the fund portfolio, but other than those preventing risks—where there is potential loss or future payment obligations, capping those with the potentially unlimited upside gain because the P&P Manual has the predictable and periodic standard to be bond-like.

Mr. Everett asked how many states that permit bond ETFs for primary capital surplus may be affected. Mr. Therriault said given the definition change, putting a 10% speculative threshold for those that are on the bond or preferred stock ETF lists, the change is not expected to have any impact for those lists. The threshold is generally consistent with the ETF list today. The other test is a little more generous for the SEC registered fund list, which is reported on the common stock schedule.

Mr. Everett asked if it would it be the Statutory Accounting Principles (E) Working Group or this Task Force that would be looking at standards for the management assessment. Mr. Perlman said the SVO would do that. Mr. Fry said this would be just another thing the SVO assesses in the whole package of things assessed with funds.

Mr. Fry directed the SVO to expose this amendment to the *P&P Manual* to clarify Guidance for Fund Leverage for a 45-day public comment period ending May 6, 2021, and make a referral to the Statutory Accounting Principles (E) Working Group requesting their approval of the proposed changes to these definitions.

7. Received a Staff Report on Projects Before the Statutory Accounting Principles (E) Working Group

Mr. Fry said the next agenda item is to hear a report on projects before the Statutory Accounting Principles (E) Working Group. Mr. Fry asked Julie Gann (NAIC) to provide that report.

Ms. Gann said a there were a few things to highlight from the Statutory Accounting Principles (E) Working Group's March 15 meeting. She said that while the Working Group adopted several items and exposed several items, this update will only highlight four adoptions and two exposures. For the adoptions, the Working Group:

- Incorporated revisions to clarify that publicly traded preferred stock warrants should be treated as preferred stock. This is something similar to what was already in place for publicly traded common stock warrants to be treated as

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common stock. The reason it is required to be specified is all other warrants are captured as derivatives in the scope of *SSAP No. 86—Derivatives*. The Working Group had not seen those preferred stock publicly traded warrants before, but they are out there, so the guidance was clarified accordingly.

- Adopted revisions to indicate that the changes to the Freddie Mac Structured Agency Credit Risk (STACR) and Fannie Mae Connecticut Avenue Securities (CAS) programs, which will be issued through REMIC, which is a REMIC trust, will still be in scope of SSAP No. 43R, and those revisions align the financial model guidance to match the P&P Manual.
- Clarified that perpetual bonds with an effective call option shall be amortized, using the yield to worst method with all other perpetual bonds that do not have an effective call option to be reported at fair value.
- Incorporated guidance and new disclosures to ensure that all related parties, including those with over a 10% ownership that may have disclaimed affiliation, are still reported as related parties in the financial statements. There is also a new schedule Y Part 3 to detail age-related parties.

Regarding exposures, Ms. Gann said comments are due April 30. She reiterated that while the Working Group exposed a long list of items, she will highlight only two of them. The Working Group exposed:

- Exposed revisions to data capture and expanded disclosures in *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* to make it easier to identify when an insurer has transferred an asset and maintains continuing involvement, such as with a self-securitization. There are existing disclosures in SSAP No. 103R, but they are currently in the narrative. It is not possible to aggregate and assess those transactions or to see problems. That is one of the main goals of this new disclosure.
- Exposed a proposed interpretation to clarify that cryptocurrency such as Bitcoin does not meet the definition of cash and is a non-admitted asset under statutory accounting. With that exposure, the Working Group requested for industry to provide information regarding the extent that insurers hold cryptocurrency.

Ms. Gann said the Working Group plans to meet May 20 to hear comments on those exposed items and take action, particularly with regards to those that have blanks-related revisions.

Ms. Gann said the Working Group also discussed the SSAP No. 43R project. She said there has been a small group of industry that has been meeting with Iowa and NAIC staff weekly since Fall 2020. The initiative is to draft a definition of what should be captured as a bond on Schedule D-1. The project was undertaken as an initial first step in the 43R substantive project as it was identified that some investments that caused regulator concern are not necessarily limited to SSAP No. 43R, and they could have been either captured or reclassified to SSAP No. 26R. By identifying what should be captured as a bond first, the project removes the concern of potential reclassification for those investments. The small group has made significant progress in drafting this definition, and it is anticipated that this preliminary definition will be publicly exposed by the end of May, possibly in accordance with the Working Group's May 20 meeting.

Ms. Gann added that the draft definition currently focuses on investments that reflect issuer credit obligations and asset backed securities. It establishes definitions and criteria of what should be captured within both classifications. Once the definition has been publicly discussed, it is anticipated that SSAP revisions will occur to incorporate the definitional concepts. Those are currently anticipated to occur within SSAP No. 26R and SSAP No. 43R; future discussions will determine the best approach. She said it is also anticipated the investments that no longer qualify for D-1 will move to Schedule BA. It is anticipated that the discussions will include accounting and reporting concepts for those investments and that referrals will be sent to the Capital Adequacy (E) Task Force to determine RBC.

Ms. Gann said the Working Group has received questions regarding CTLs and how the current project for D-1 assessment will affect that specific investment. These questions also asked about the purpose of the prior referral that the Working Group sent to the Task Force. To provide some clarity on this situation, there are two workstreams: 1) the Statutory Accounting Principles (E) Working Group project on the D-1 bond definition; and 2) the Valuation of Securities (E) Task Force project to revisit the structural requirements that are in the P&P Manual. It is anticipated that these will ultimately converge. However, with the specific discussion on CTLs last fall, specific focus is being given to these investments concurrently with the bond project. The determination of whether an investment qualifies within an SSAP and a particular reporting schedule is a decision of the Statutory Accounting Principles (E) Working Group. However, in certain cases, such as with CTLs, a structural analysis by the SVO under the requirements of the P&P Manual is necessary to satisfy this requirement. The original determination of residual risk allowing the reporting on Schedule D was made by the Invested Asset (E) Working Group, which has since been disbanded. Since that residual risk threshold is currently housed in the P&P Manual and information on the CTLs filed with the NAIC is reviewed by the Task Force, the prior referral intends to solicit the expertise of the Task Force and the NAIC SVO staff from their knowledge of those filed CTLs, which includes an assessment of whether that residual risk threshold should be revised.

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Both the structural parameters and the ultimate role of the structural analysis in relation to the principles developed through the Statutory Accounting Principles (E) Working Group bond project will require coordination between both groups as these projects progress. Statutory Accounting Principles (E) Working Group staff will continue to work closely with the Valuation of Securities (E) Task Force staff regarding those investments.

8. Heard an Update on CTLs

Mr. Fry said he would cover the CTL update next. The Statutory Accounting Principles (E) Working Group recently did an interpretation on CTLs that are called nonconforming CTLs and have a rating agency rating. These could be reported on Schedule D for year-end 2020 as long as they were filed with the SVO before Feb. 15, 2021. These securities were also required to be listed in the notes of the financial statement for year-end 2020. It was agreed that if the SVO assigns a designation to these securities, they would be allowed to be reported on Schedule D through the third quarter of 2021. The reason why the Working Group selected that date was that it was anticipated by then that the SSAP No. 43R project would provide a framework that would address these securities. If that framework has not been provided by that time, it might be possible for an extension of that policy until the SSAP No. 43R project matures. The SVO is committed to applying its methodology for CTLs or any other securities that have a residual risk up to 50%. If that residual risk is over 50%, on a case-by-case basis, the SVO would assess whether there are enough mitigating factors to designate these securities. The SVO is looking at the securities that were filed for last year-end. If there are any new securities in the market, the SVO will look at those it can designate. A designation does not mean that it goes on a specific schedule; that is the Statutory Accounting Principles (E) Working Group's responsibility. If the SVO designates one of these and Statutory Accounting Principles (E) Working Group decides that it is not eligible for bond treatment on Schedule D, there may still be a Schedule BA home for these with fixed income like RBC, provided the Capital Adequacy (E) Task Force and everyone else signs off on this treatment. Mr. Fry asked Ms. Gann if she had anything to add or if he had mis-characterized anything. She responded that Mr. Fry had summarized the issues correctly and that she had nothing to add. Ms. Mears and Mr. Theriault both also responded that Mr. Fry's summary was accurate.

Ms. Belfi said there was a lot of confusion on direction from some of the interested parties and Task Force members. Hopefully, there will be a resolution. Mr. Everett said that if this unfreezes the market, then the Task Force is moving in the right direction.

Tom Sargent (Waterway Capital), representing the Lease-Backed Securities Industry Group, asked how Mr. Fry sees this moving forward. He asked, "If there is a CTL with a residual in the neighborhood of 20% to 50%, do we proceed in placing that in front of the SVO to get a designation?" Mr. Fry said it should be filed with the SVO as it has been looking at the ones that came in last at the end of last year, and the SVO will use that same methodology. This is a new area, looking at ones where there is a greater than 5% residual. The SVO is in a position where it is looking at them through 50%, verifying the structure and then looking through to the lessee. The SVO is going to look at those that will need mitigating factors. There is the project before the Statutory Accounting Principles (E) Working Group, and as that framework becomes more mature, everything will come together by the end of the year.

Mr. Sargent asked if they should be submitted as an RTAS. Mr. Theriault said insurers can be submit them to the SVO as a regular filing. The SVO did receive 21 filings that were identified as nonconforming by the Feb. 15 deadline. There were an additional 27 filings that have not been reviewed but were submitted by the deadline. Any direction the SVO receives from the Task Force, including accepting additional residual risk, will be taken into consideration during the SVO's assessment, but the rest of the CTL criteria would still apply, just that the residual component would widen up to 50%.

Mr. Sargent asked if the definition of "residual risk" was using the original loan balance or the appraised loan to value. Mr. Theriault referred the question to Mr. Perlman who said it would be the loan balance. Mr. Theriault suggested they take this up "off-line".

Mr. Bruggeman asked that since the Statutory Accounting Principles (E) Working Group sent over the letter to evaluate the old 5% threshold, is 50% the new standard or is that still ongoing, and is the SVO still evaluating it. Mr. Fry said the SVO can safely go to 50% in this interim period and can look at ones higher, but they will need other mitigating factors. The Task Force will formally change it in the P&P Manual up to the 50% mark once the interim solution becomes permanent. Mr. Bruggeman asked if the 50% is temporary just as the SVO is going through the process for the year-end files and then the Task Force will evaluate whether to make it permanent. Mr. Fry said that is right and probably any new securities so that the market is not frozen. They will still be at the mercy of the Statutory Accounting Principles (E) Working Group ruling and if they do not belong on the bond schedule, they will likely end up with a Schedule BA and will still need to go through the Capital Adequacy (E) Task Force to get RBC certainty.

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Mr. Kozak asked if there was a potential that some of this would go on Schedule B as opposed to Schedule BA. Mr. Fry said that is not completely off the table. As the SSAP No. 43R project plays out, there will be some things that are in or out. If they are not in scope of SSAP No. 43R, it is possible one could consider those going on Schedule B. Some people may also see them on Schedule BA with a designation for fixed income, but that is only available to life insurers and fraternal insurers. That would not be available to the property/casualty (P/C) insurers. Ms. Gann said it really depends on the structure of the investment. If it is not a security, then technically it would go on the mortgage loan schedule, which is Schedule B. The ones that are securities are where there may be a gray area, whether they should be SSAP No. 43R or Schedule BA. All of this is expected to be discussed further as part of the bond project.

Mr. Therriault said as the SVO receives filings with increasing amounts of residual exposure, the SVO will need additional documentation on the property because that additional component will now need to be assessed. This will be additional documentation beyond what is currently identified in the P&P Manual now.

9. Received a Report from SVO on Year-End Carry-Over Filings

Mr. Fry said once a year, the SVO gives the Task Force an update on its backlog and how that is looking. Mr. Fry asked Mr. Therriault for a quick update on that.

Mr. Therriault said for 2020, the SVO reviewed 12,696 filings comprised of: 3,092 initial filings; 7,866 annual updates; 1,209 additional issuances; and 529 other filing types. The total filing numbers included 2,027 manually processed private rating letters. For year-end 2020, there were 795 carry-over filings, 351 that received an "IF" for an accepted initial filing and 444 that received a "YE" for an accepted annual update. This was a carry-over rate of 6.3% for 2020, well below the rate of 10% or higher that the SVO considers concerning or reflective of a resource constraint.

As of March 16, there were only 70 remaining carry-over filings, 45 accepted initial filings and 25 accepted annual update filings. The remaining carry-over rate was 0.6% as of that date and has only gotten lower since then. This was an impressive performance by the SVO staff and managers given the significant disruptions introduced by working 100% remotely starting March 10, 2020, along with the team absorbing the new analytical work related to ground lease financing (GLF) transactions. At this time, Mr. Therriault said he is not seeing any SVO analyst resource constraint issues, but there are significant resource limitations with technology support for the office that have affected the SVO's ability to improve the core systems, VISION, Automated Valuation Service+ (AVS+) and Structured Securities (STS), or fully use the SVO's investment data. Also, if additional analytical tasks are assigned to the SVO, which the SVO is happy to take on for the Task Force, additional resources may be needed.

Mr. Monahan said a suggestion for the future is to add the report as an attachment, and he thanked and congratulated the SVO for their hard work.

Having no further business, the Valuation of Securities (E) Task Force adjourned.

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