

Conference Call

VALUATION OF SECURITIES (E) TASK FORCE

Tuesday, September 29, 2020

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 pm. – 1:00 p.m. PT

ROLL CALL

Robert H. Muriel, Chair	Illinois	Gary Anderson	Massachusetts
Doug Ommen, Vice Chair	Iowa	Chlora Lindley-Myers	Missouri
Lori K. Wing-Heier	Alaska	Bruce R. Range	Nebraska
Ricardo Lara	California	Marlene Caride	New Jersey
Andrew N. Mais	Connecticut	Linda Lacewell	New York
Trinidad Navarro	Delaware	Jessica Altman	Pennsylvania
David Altmaier	Florida	Kent Sullivan	Texas
Dean L. Cameron	Idaho	Todd E. Kiser	Utah
Vicki Schmidt	Kansas	Scott A. White	Virginia
James J. Donelon	Louisiana	Mike Kreidler	Washington
Al Redmer Jr.	Maryland	Mark Afable	Wisconsin

NAIC Support Staff: Charles A. Therriault, Marc Perlman

AGENDA

1. Consider Adoption of the Valuation of Securities (E) Task Force Charges for 2021. Attachment A
—Kevin Fry (IL)
2. Consider Adoption of a Proposed Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to Add Instructions for ETFs that Contain a Combination of Preferred Stocks and Bonds Attachment B, B-1, & B-2
(*Doc. ID 2019-011-01, 2019-011-02, 2019-011-03*)
—Kevin Fry (IL), Charles Therriault (NAIC)
3. Receive an Updated Proposed Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) on Guidance for Working Capital Finance Investments Consistent with the Statutory Accounting Principles (E) Working Group Adoption of Changes to *SSAP No. 105R – Working Capital Finance Investments* Attachment C, C-1, C-2, C-3, & C-4
(*Doc. ID 2020-022-01, 2020-022-02, 2020-022-03, 2020-022-04*)
—Kevin Fry (IL), Charles Therriault (NAIC), Marc Perlman (NAIC)
4. Receive a Referral Response from the Statutory Accounting Principles (E) Working Group on the Proposed P&P Manual Amendment to Update Instructions for Non-conforming Credit Tennant Loan (CTL) Transactions that Relied Upon Credit Ratings Attachment D, D-1, D-2, & D-3
(*Doc. ID 2020-020-01, 2020-020-02*)
—Kevin Fry (IL), Charles Therriault (NAIC), Marc Perlman (NAIC)
5. Adjournment

**VALUATION OF SECURITIES (E) TASK FORCE
PROPOSED 2021 CHARGES**

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—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.

NAIC Support Staff: Charles Therriault, Marc Perlman

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MEMORANDUM

TO: Kevin Fry, 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)

CC: Marc Perlman, Investment Counsel, NAIC Securities Valuation Office (SVO)
Eric Kolchinsky, Director, NAIC Structured Securities Group (SSG) and Capital Markets Bureau

RE: Proposed Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to Add Instructions for ETFs that Contain a Combination of Preferred Stocks and Bonds

DATE: September 30, 2019

1. Summary – The P&P Manual authorizes the SVO to review and determine that a fund’s cash flow can be appropriately characterized as fixed income for regulatory purposes, and if so, assign an NAIC Designation to reflect the credit risk associated with the fund’s cash flow and include the name of the fund on the appropriate NAIC List. For inclusion on the SVO-Identified bond or preferred stock ETF list, the ETF must predominantly hold either a portfolio of bonds or preferred stock. This guidance restricts the SVO from reviewing ETFs that hold a portfolio of both bonds and preferred stock. This proposed amendment would provide authorization for the SVO to review ETFs that hold both bonds and preferred stock for possible inclusion on the preferred stock ETF list.

2. Proposed Amendment – The text referencing the Investments in Funds is shown below, edits in red-underline, as it will appear in the 2019 P&P Manual format.

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2019 P&P Manual

**Part Three – SVO Procedures and Methodology for Production of NAIC Designations
Investment in Funds**

The SVO-Identified Bond ETF List and the SVO-Identified Preferred Stock ETF List

255. Description – At this time, ETFs operate under an Exemptive Order granted by the SEC that provides relief from the application of provisions of the Investment Company Act of 1940 that would otherwise apply. ETFs issue creation units to initial investors in exchange for a specified portfolio of bonds. The initial investor can hold the creation units or sell the ETF shares that constitute the creation unit on the exchange on which the ETF is registered. Other investors may purchase ETF shares; including to reconstitute and redeem a creation unit. Shares of ETF are not redeemable to the fund but are traded on registered exchanges at a price set by the market. Shares of ETFs are expected to trade at or near par because of arbitrage related to the value of the portfolio or of the ETF shares. For inclusion on the SVO-Identified bond ETF list, the ETF must hold a portfolio of bonds, ~~preferred stock or a combination of bonds and preferred (or preferred stock)~~ that tracks a specified bond index (a passive investment); or it must a portfolio of bonds, ~~preferred stock or a combination of bonds and preferred (or preferred stock)~~ that it actively manages pursuant to a specified investment objective.

...

257. An ETF on the SVO-Identified Preferred Stock ETF List is in scope of SSAP No. 32—Preferred Stock and reported on Schedule D, Part 2, Section 1. ~~The SVO may include ETFs that hold a portfolio of bonds and preferred stock on the SVO-Identified Preferred Stock ETF List.~~ These investments are reported at either amortized cost or fair value based on assigned NAIC Designation.

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Mike Monahan
Senior Director, Accounting
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September 3, 2020

Mr. Kevin Fry, Chair
NAIC Valuation of Securities (E) Task Force
1100 Walnut Street
Suite 1500
Kansas City, MO 64106-2197

Ms. Carrie Mears, Vice Chair
NAIC Valuation of Securities (E) Task Force
1100 Walnut Street
Suite 1500
Kansas City, MO 64016-2197

Re: NAIC Valuation of Securities (E) Task Force (“the Task Force) Proposal to Amend the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (“P&P Manual”) to Add Instructions for ETFs that Contain a Combination of Preferred Stocks and Bonds (“the Proposal”)

Dear Mr. Fry and Ms. Mears:

ACLI appreciates the opportunity to comment on the Proposal, which has a September 6, 2020 comment period deadline, as exposed by the Task Force on August 7, 2020.

We are supportive of the proposal and its adoption.

Please do not hesitate to contact us should you have any questions. Thank you.

Sincerely,



Senior Director, Accounting Policy
American Council of Life Insurers

cc: Mr. Charles Therriault, Director, SVO

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September 6, 2020

Charles A. Therriault
Director – Securities Valuation Office
National Association of Insurance Commissioners
Capital Markets & Investment Analysis Office
One New York Plaza, Suite 4210
New York, NY 10004

via electronic submission: CTherriault@naic.org and DGenarosado@naic.org

RE: Proposed Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (“P&P Manual”) to Add Instructions for the ETFs that Contain a Combination of Preferred Stocks and Bonds

Dear Director Therriault,

We would like to thank the Valuation of Securities (E) Task Force and the Securities Valuation Office (“SVO”) for this opportunity to offer our comments and observations regarding the proposed amendment to the P&P Manual to add instructions for ETFs that contain a combination of preferred stocks and bonds.

State Street Global Advisors¹, BlackRock², and Invesco³ are supportive of the Proposed Amendment to the P&P Manual. In some instances, bonds with certain characteristics of preferred stocks, such as a \$25 par price or a 30 year or greater maturity, may be eligible for inclusion in a preferred ETF’s portfolio. The SVO should not be restricted from reviewing ETFs that hold a portfolio that includes preferred stocks and bonds, given the similar structural features, risk characteristics, and capital structure seniority between preferred securities and the

¹ For four decades, State Street Global Advisors has served the world’s governments, institutions and financial advisors. As stewards, we help portfolio companies see that what is fair for people and sustainable for the planet can deliver long-term performance. And, as pioneers in index, ETF, and ESG investing, we are always inventing new ways to invest. As a result, we have become the world’s third-largest asset manager with US \$3.05 trillion under our care as of June 30, 2020.

² BlackRock is one of the world’s leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed-income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers, and other financial institutions, as well as individuals around the world. As of June 30, 2020, the firm managed approximately \$7.32 trillion in assets on behalf of investors worldwide.

³ Invesco is a global independent investment management firm dedicated to delivering an investment experience that helps people get more out of life. Our 13 distinctive investment teams deliver a comprehensive range of active, passive and alternative investment capabilities. With offices in 25 countries, Invesco managed \$1.1 trillion in assets on behalf of clients worldwide as of June 30, 2020.

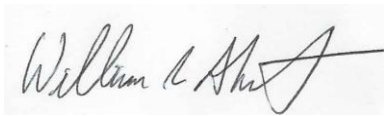
bonds included in such portfolios. From a policy perspective, we believe that the mere inclusion of such securities should not preclude an ETF from being given an SVO classification or NAIC designation.

Furthermore, we endorse the measured approach of assigning such portfolios that include both preferred stocks and bonds to the Preferred Stock ETF List, not the Bond ETF List.

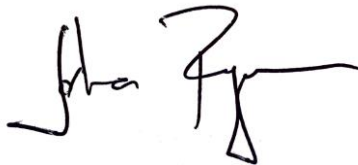
We believe that accessing preferred stocks via the ETF wrapper can provide significant benefits to insurers, including transparency of holdings, intraday liquidity, and operationally efficient diversification of holdings. When eligible for an appropriate NAIC designation, these preferred ETFs can be valuable tools in the portfolio and risk management processes within insurers' portfolios. State Street Global Advisors, BlackRock, and Invesco are committed to working with the insurance industry, including regulators, other ETF providers, and vendors, to ensure that insurers have access to preferred stock ETFs.

We appreciate the opportunity to share our perspective. If you have any questions, please do not hesitate to contact Bill Ahmuty at William_Ahmuty@ssga.com; Josh Penzner at Joshua.Penzner@blackrock.com; and Eric Pollackov at Eric.Pollackov@invesco.com.

Respectfully submitted,



Bill Ahmuty
Head of SPDR Fixed Income
Group
Global SPDR Business
State Street Global Advisors



Josh Penzner
US Head of Institutional
iShares Bond ETFs
BlackRock



Eric Pollackov
Global Head of ETF Capital
Markets
Invesco



MEMORANDUM

TO: Kevin Fry, 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, Investment Counsel, NAIC Securities Valuation Office (SVO)

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

RE: Proposed Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual)* to Incorporate Updates Made to SSAP No. 105R – Working Capital Finance Investments.

DATE: September 10, 2020

1. Summary – The Statutory Accounting Principles (E) Working Group adopted updates to SSAP No. 105R Working Capital Finance Investments on May 20, 2020. Key revisions are summarized as follows:

- Functionally Equivalent Foreign Regulators - Removed the requirement that the Securities Valuation Office (SVO) determine if the International Finance Agent is the functional equivalent of the U.S. regulator.
- Commingling Prohibitions - Removed the finance agent prohibitions on commingling.
- Investor Rights Edit - Removed duplicative text regarding exercising of investor rights.
- Requirements for filer to Certify Perfected Interest – Removed requirements, with revisions allowing the SVO to determine if a first priority perfected interest has been obtained.
- Finance Agent Validation Requirements – Broadened the independent review requirements to allow independent review of the finance agent by either audit or through an internal control report.
- Default Date - Changed the default provisions from 15 to 30 days so the default date and the cure period are consistent.
- Possible Domestic Regulator Approval – Removed the statement that the reporting entity may need to seek approval from the domestic regulator.

2. **Revisions** - The SVO submitted a proposed amendment to the Valuation of Securities (E) Task Force (the Task Force), dated June 15, 2020, to amend the Working Capital Finance Investments (WCFI) section of the P&P Manual to remove any inconsistencies with SSAP No. 105R, as revised. The proposed amendment was received and exposed on July 1, 2020 for a 45-day public comment period that ended on August 17, 2020. The American Council of Life Insurers (ACLI) submitted a detailed comment letter, dated August 17, 2020, recommending additional updates to this section. The SVO staff has reviewed the ACLI's recommendations and has attached an updated proposed amendment that reflects where the SVO agrees with the ACLI and, as explained below, where it does not.

Generally, the ACLI's recommendations fall into two categories: (1) those which remove inconsistencies between SSAP No. 105R and the WCFI section of the P&P Manual, thereby adhering to the original purpose of this amendment and, (2) those which would amend WCFI provisions in the P&P Manual which are not identified in SSAP No. 105R and which would impede the SVO's ability to assess investment risk in WCFI transactions. These analytic provisions were intentionally included in the P&P Manual's WCFI guidelines to enable the SVO to more accurately assess investment risk in WCFI transactions and they reflect the functional differences between the Accounting Practices & Procedures Manual (AP&P), which is intended to define accounting standards, and the P&P Manual, which is intended guide the assessment of investment risk. The AP&P is not intended to be a substitute for the P&P Manual as only the Task Force is charged to, "... establish and maintain all aspects of the NAIC's credit assessment process for insurer-owned securities." The SVO staff has identified the analytical issues below that should be retained in the P&P Manual. These changes are outside of the scope of the SSAP 105R revisions and are necessary for the SVO to perform its responsibility to assess investment risk.

- a. **A Certification** (paragraph 102, bullet 5) from the insurance company Investment Officer that the insurance company, in its capacity as an Investor, is not affiliated with the Obligor or with any Supplier in the Working Capital Finance Program, and that the Working Capital Finance Program does not include any insurance or insurance related assets. *This certification relates to the requirements of SSAP No. 105R, paragraph 19 and provides a means by which the SVO can verify that a transaction meets those requirements.*
- b. **Process and Methodology** (paragraphs 121) - An NAIC Designation shall be assigned to a Working Capital Finance Program on the basis of a thorough assessment of credit, dilution, operational and other risks, an assessment of protections provided by operative documents to the Investor and the quality of transaction participants. *The assessments of credit, dilution and operational risk are core components of the SVO investment risk assessment for WCFI transactions and none of them conflict with SSAP No. 105R.*
- c. **Credit Risk** (paragraphs 122) – The NAIC Designation for a Working Capital Finance Program shall be linked to the credit quality of the Obligor, which may be determined by reference to a credit rating assigned by a NAIC CRP or by an NAIC Designation assigned by the SVO. Credit risk is assessed by the SVO analyst in accordance with any permitted methodology set forth in this Manual for corporate obligors. *The assessments of credit is a core component of the SVO investment risk assessment for WCFI transactions and does not conflict with SSAP No. 105R.*
- d. **Dilution Risk** (paragraphs 107, 121, and 123) – *This element of the SVO's analysis is crucial for an accurate assessment of investment risk because it is necessary for the SVO to consider the risk that disputes or certain contractual provisions may reduce the amount of the obligation owed by the obligor to the supplier and thereby impact the insurance company investor.*

- e. **Operational Risk** (paragraphs 111, 121, and 124) – *This element of the SVO’s analysis is crucial for an accurate assessment of investment risk because it is necessary for the SVO to consider the risk that the parties involved in the program will not fulfill their contractual responsibilities. This is a common investment analysis consideration as reflected in the methodology to review Power Generation Projects in Part Three of the P&P Manual.*
3. **Recommendation** – The SVO staff recommends re-exposure of this amendment with the changes recommended by the ACLI, excluding the analytically necessary items identified above, to align with the adopted updates to *SSAP No. 105R – Working Capital Finance Investments*.
4. **Proposed Amendment** – The following shows the proposed revisions in Part Three with text in **red** identifying the changes proposed on July 15, 2020 and additional revisions and comment letter responses in **yellow highlight**.

PART THREE

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

WORKING CAPITAL FINANCE INVESTMENTS

NOTE: See “Specific Populations of Securities Not Eligible for Filing Exemption” in “Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities” above.

Initial Filing Requirements

102. An insurance company requesting an analysis of a proposed Working Capital Finance Program shall provide the SVO with the documentation described in this subparagraph:

- An RTAS Application.
- The Obligor’s Audited Financial Statements, if the Obligor is not rated for credit risk by a NAIC CRP.
- The insurance company’s Investment Committee Memorandum for the proposed Working Capital Finance Program.
- ~~The audited consolidated financial statements of the group of which the Finance Agent for the Working Capital Finance Program is a part, and o~~One of the following:
 - An annual independent report according to Statement on Standards for Attestation Engagements (SSAE) No. 16 (or functional equivalent), reporting on controls at a service organization related to the administration of the investment.
 - An annual audit of the financial statement and internal controls of the consolidated group of which the Finance Agent is part, which does not note any material weakness related to servicing working capital financial investments.
- A Certification from ~~an the~~ insurance company’s Chief Investment Officer that the insurance company, in its capacity as an Investor, is not affiliated with the Obligor or with any Supplier in the Working Capital Finance Program, and that the Working Capital Finance Program does not include any insurance or insurance related assets.
- ~~A Certification from the insurance company’s Legal Counsel.~~
- ~~In the case of a participation, that it has a commercially reasonable belief that its participation interest meets the Uniform Commercial Code’s standards for creating and preserving first priority security interests in the payments due and in the Confirmed Supplier Receivables.~~

- ~~In the case of a certificate, note or other manifestation, representing a right to payment from a trust, other special purpose entity, or special purpose pool holding confirmed supplier receivables, that it has a commercially reasonable belief that the documents establishing and governing the Working Capital Finance Program create and preserve interests in the Confirmed Supplier Receivables capable of being enforced by the trustee or other entity holding Confirmed Supplier Receivables as first priority perfected security interests under the Uniform Commercial Code.~~

~~NOTE: Please refer to SSAP No. 105 – Working Capital Finance Investments for the definition of a “commercially reasonable belief.”~~

- A copy of:
 - The document(s) that create the Working Capital Finance Investments (i.e., the short-term receivables) that is the subject of the RTAS – Emerging Investment Vehicle Service Application, and establishes the obligations of the Obligor to, and the protection afforded owners of, Working Capital Finance Investments (including the Investors). This agreement is sometimes referred to as the Invoice Payment Terms Acknowledgement, the Payable Services Agreement or the Paying Services Agreement.

NOTE: Please refer to “The Regulatory Treatment Analysis Service – Emerging Investment Vehicle” in Part Two for guidance regarding the filing of an RTAS Application with the SVO.
 - The agreement(s) between the Obligor and the Finance Agent governing the administration of the Working Capital Finance Program and the Working Capital Finance Investments issued thereunder. These agreements may be included in the documents mentioned above or may be a stand-alone agreement which are sometimes referred to as the Settlement Services Agreement or the Invoice-Related Electronic Services Agreement.
 - The agreement governing the sale of the Working Capital Finance Investments from the Supplier to the Finance Agent. This agreement is sometimes referred to as the Receivables Purchase Agreement or the Supplier Agreement. The agreement governing the ongoing purchase of Working Capital Finance Investments or an interest in Working Capital Finance Investments by the Investor from the Finance Agent. This agreement is sometimes referred to as the Agency Agreement, the Participation Agreement or the Program Trust Agreement.

Subsequent Filing Requirements

103. Subsequent filing requirements include:
- Copies of any of the documents originally submitted with the RTAS Application subsequently amended.
 - ~~The audited consolidated financial statements of the group of which the Finance Agent for the Working Capital Finance Program is a part, and o~~One of the following:
 - An annual independent report according to Statement on Standards for Attestation Engagements (SSAE) No. 16 (or functional equivalent), reporting on controls at a service organization related to the administration of the investment; or
 - An annual audit of the financial statements and internal controls of the consolidated group of which the Finance Agent is part, which does not note any material weakness related to servicing working capital financial investments.

Definitions in *SSAP No. 105R—Working Capital Finance Investments*

104. Please refer to *SSAP No. 105R—Working Capital Finance Investments*, for the definitions and associated definitional guidance insurance companies must understand and comply with before applying for an NAIC Designation for Working Capital Finance Programs that would permit them to purchase Working Capital Finance Investments.
105. With the exception of the definitions for Dilution Risk and Operational Risk below, the definitions shown below are summaries of those contained in *SSAP No. 105R—Working Capital Finance Investments* intended only to facilitate a discussion and in all cases subordinate to the definitions in *SSAP No. 105R*.

Summary of Key Definitions

106. **Confirmed Supplier Receivable** – A receivable sold by a Supplier to a Finance Agent or Investor (or by a Finance Agent to an Investor) under a Working Capital Finance Program designated by the SVO that requires the Obligor to confirm to the Finance Agent or Investor, prior to the sale of the receivable from the Supplier to the Finance Agent or Investor, that it has no defenses to payment of the monetary obligation represented by the receivable against the Supplier and, therefore, no defenses to payment of the same monetary obligation to the Finance Agent and/or Investor after such sale. The confirmation by the Obligor that it has no defenses to payment includes confirmation that the Obligor does not have a right to refuse payment that it may have acquired with respect to underlying commercial trade transaction and that, if it has such a right, it will not assert such defenses against the Finance Agent or Investor.
107. **Dilution Risk** – With respect to any Working Capital Finance Program, dilution risk refers to disputes or contractual provisions that may reduce the amount of the obligation owed by the Obligor to the Supplier under the original receivable or the obligation owed by the Obligor to the Finance Agent and/or Investor under the Confirmed Supplier Receivable. Examples of dilution risk are credit for returns of defective goods or an allegation of fraud, such as that the invoice is not legitimate or is a duplicate invoice.
108. **Finance Agent** – A bank, financial institution, financial intermediary or service provider that facilitates the Working Capital Finance Program that arranges the sale, assignment or transfer of the Confirmed Supplier Receivable to the Investor and administers payment.
109. **Investor** – The insurance company that files the RTAS Application with the SVO in order to obtain an NAIC Designation for a proposed Working Capital Finance Program.
110. **Obligor** – An entity that purchases the goods or services from the Supplier and thereby generates the original supplier receivable—and which Obligor has, or can be designated, **NAIC 1** or **NAIC 2** by the SVO or has been assigned an equivalent credit rating by a NAIC CRP.
111. **Operational Risk** – With respect to any Working Capital Finance Program, operational risk refers to the combined effect of the procedures and parties employed to implement the program and their responsibility under the documents and to the determination by the SVO of whether these procedures and parties will ensure full and timely performance by the Obligor of the payment obligation to the Investor. An example of an operational risk is the confirmation process employed to verify that the Obligor has no defenses to payment.

112. **Supplier** – The entity that sells the goods or services to the Obligor, obtains a receivable from the Obligor in exchange and subsequently chooses to sell the right to receive the payment associated with the receivable to the Finance Agent or Investor under the terms of a Working Capital Finance Program designated **NAIC 1** or **NAIC 2** by the SVO.
113. **Working Capital Finance Program** – The program created for the Obligor and its Suppliers by a Finance Agent the terms of which permits Suppliers to the Obligor to negotiate the sale of a right to receive payment from the Obligor (which is associated with and evidenced by a receivable) to the Finance Agent or an Investor.
114. **Working Capital Finance Investment** – The right to receive the payment associated with a Confirmed Supplier Receivable purchased by an Investor under a Working Capital Finance Program designated **NAIC 1** or **NAIC 2** by the SVO and is the subject of *SSAP No. 105R—Working Capital Finance Investments*.

NOTE: *SSAP No. 105R—Working Capital Finance Investments* imposes reporting and statutory accounting requirements on insurance company investments in Working Capital Finance Investments ~~and specifies analytical procedures to be applied or analytical controls to be verified by the SVO that are not detailed above.~~ Insurance companies are strongly advised to become familiar with *SSAP No. 105R* before filing an RTAS Application with the SVO.

Direction and Program Parameters

115. The SVO may assign an NAIC Designation to a Working Capital Finance Program that would generate Working Capital Finance Investment that meet the criterion and standards identified in this Section.
116. **RTAS Submission Required** – A request that the SVO assign an NAIC Designation to a Working Capital Finance Program is made by filing an RTAS Application. The RTAS Application is available at www.naic.org/documents/svo_rtas_app.pdf.
117. Upon completion of its risk assessment, the SVO will issue an RTAS Letter indicating a preliminary NAIC Designation; i.e., the NAIC Designation that would be assigned if the Investor enters into a Working Capital Finance Program with a Finance Agent and sought to report it to the SVO.
- NOTE:** A preliminary NAIC Designation cannot be used for statutory reporting purposes.
118. The SVO shall issue a final NAIC Designation to the Investor for the Working Capital Finance Program and the Working Capital Finance Investments generated thereunder upon receipt of fully executed final copies of the required documentation.

Variations in Structure

119. Working Capital Finance Programs may differ in structure and in the protection afforded the Investor. Structural strength and weaknesses of various structures in such programs will be reflected in the NAIC Designation assigned by the SVO.

Program Quality

120. The SVO shall only assign an NAIC Designation to Working Capital Finance Programs that can be designated **NAIC 1** or **NAIC 2**. Credit quality is measured by reference to a NAIC CRP credit rating or an NAIC Designation assigned by the SVO. The SVO shall withdraw the NAIC Designation assigned to a Working Capital Finance Program on the date the Obligor's NAIC CRP credit rating or NAIC Designation is downgraded to **NAIC 3** or its NAIC CRP equivalent.

NOTE: *SSAP No. 105R—Working Capital Finance Investments* provides that Working Capital Finance Investments generated under a Working Capital Finance Program of an Obligor that falls below the equivalent of **NAIC 1** or **NAIC 2** becomes nonadmitted.

Process and Methodology

121. An NAIC Designation shall be assigned to a Working Capital Finance Program on the basis of a thorough assessment of credit, dilution, operational and other risks, an assessment of protections provided by operative documents to the Investor and the quality of transaction participants.

Risk-Assessment Process

122. **Credit Risk** – The NAIC Designation for a Working Capital Finance Program shall be linked to the credit quality of the Obligor, which may be determined by reference to a credit rating assigned by a NAIC CRP or by an NAIC Designation assigned by the SVO. Credit risk is assessed by the SVO analyst in accordance with any permitted methodology set forth in this Manual for corporate obligors.
123. **Dilution Risk** – To achieve an **NAIC 1** or **NAIC 2** Designation, the Working Capital Finance Program must eliminate dilution risk in the Working Capital Finance Investment proposed to be eligible for purchase by the Investor. The terms governing the Investor's Working Capital Finance Investment must eliminate Obligor recourse to its Supplier as a condition to payment of the obligation to the Investor so as to result in an unconditional right to receive payment on a full and timely basis.
124. **Operational Risk** – To achieve an **NAIC 1** or **NAIC 2** Designation, all operational risks shall be identified and assessed. Key participants shall have a NAIC CRP credit rating or an NAIC Designation assigned by the SVO at a level at least that of the Obligor.

Legal, Structural and Regulatory Considerations

125. Events of default remedies should provide the Investor at least those rights and privileges, unimpaired, of a trade creditor upon default with no Obligor defenses that could cause dilution of principal.
126. ~~The SVO shall verify that either, (i) the Finance Agent is ~~must be~~ an entity regulated or supervised by a financial regulator in one of the countries in the List of Foreign (non-US) Jurisdictions Eligible for Netting for Purposes of Determining Exposures to Counterparties for Schedule DB, Part D, Section 1 and that the regulator is the functional equivalent of the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency (OCC) or the Federal Deposit Insurance Corporation (FDIC). In the alternative, or (ii) the SVO shall verify that payments due the Investor are made directly by the Obligor (a) to the Investor or (b) into an account maintained by a regulated financial institution for the benefit of Investors in the Working Capital Finance Program, and, in either case, the Finance Agent cannot be the beneficiary of such payment. ~~with no commingling of funds or assets with those of the Obligor, Supplier, Servicer or Trust Administrator or other Investors.~~~~
127. The SVO will verify that the Certification from the insurance company's Chief Investment Officer confirms that the Investor is not affiliated with Obligor and that Working Capital Finance Investment excludes insurance or insurance-related assets.
128. ~~The SVO will verify that the Certification from the insurance company's Legal Counsel confirms the existence of a commercially reasonable belief that the documents establishing and governing the Working Capital Finance Program establishes the rights and UCC code standard for preserving first priority perfected interest in Confirmed Supplier Receivables.~~
129. The remedies available to the participants in the Working Capital Finance Program should be expressly identified in the documentation for the Working Capital Finance Investment.
130. Characteristics that shall be present in a proposed Working Capital Finance Investment include, but are not limited to, the following, or a substantial equivalent:
131. ~~The Obligor makes payments directly to the (a) Investor; (b) Finance Agent; or (c) servicer for the Working Capital Finance Program.~~
132. ~~The Investor must have the option, and not an obligation, to purchase subsequent Working Capital Finance Investment so as to ensure the Investor can exit the Working Capital Finance Investment by permitting existing investments to mature.~~

133. *SSAP No. 105R—Working Capital Finance Investments* provides that the documentation governing Working Capital Finance Programs must provide that disputes arising under the agreements shall be submitted to a court of competent jurisdiction in the U.S. or be subject to an alternative dispute resolution process sanctioned by state law. Given the nature of Working Capital Finance Programs, the SVO anticipates that documentation governing Working Capital Finance Investments will be subject to the laws and jurisdiction of the courts of California, Delaware or New York, or a similar legal jurisdiction with significant exposure to sophisticated institutional financial transactions.
134. Events of default must be clearly defined, and provide a mechanism that gives the Investor the ability to pursue collection unfettered by actions taken or not taken by participants such as the Servicer or Trustee, or other named persons performing similar functions.

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Updates to WCFI\2020-022.02 PP Manual Amend - Updates to SSAP No. 105 for WCFI - Revised.docx

Mike Monahan

Senior Director, Accounting Policy
(202) 624-2324 t
mikemonahan@acli.com

August 17, 2020

Mr. Kevin Fry, Chairman
Valuation of Securities Task Force
National Association of Insurance
Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

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

RE: Proposed Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to Incorporate Updates Made to SSAP No. 105R – Working Capital Finance Investments.

Dear Mr. Fry and Ms. Mears:

ACL appreciates the opportunity to comment on the exposure drafts released for comment by the Valuation of Securities Task Force regarding the Statutory Accounting Principles (E) Working Group adopted updates to SSAP No. 105R Working Capital Finance Investments on May 20, 2020. The revisions to the SSAP adopted by the Working Group incorporate seven of the industry requested modifications to the Working Capital Finance Investments program requirements and are effective on June 30, 2020.

We offer the following comments on the proposed revisions dated June 15, 2020 under memorandum from Charles A. Therriault, Director, NAIC Securities Valuation Office (SVO) and Marc Perlman, Investment Counsel, NAIC Securities Valuation Office (SVO) for exposure:

- Paragraph 102, fourth bullet and Paragraph 103, second bullet – SSAP 105R does not require the audited consolidated financial statements of the group of which the Finance Agent is a part. The requirement should be removed from the P&P Manual.
- Paragraph 102, fourth bullet, fourth sub-bullet and Paragraph 128 – SSAP 105R does not require the referenced legal certification. The requirement should be removed from the P&P Manual.
- Paragraph 131 – This language should be updated to align with the exact language of SSAP 105R.

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The American Council of Life Insurers (ACL) 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. ACL'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. ACL's 280 member companies represent 94 percent of industry assets in the United States.

We would like to further observe the following, which do not align with the requirements of SSAP 105R nor with the superseded SSAP 105:

- Paragraph 102, second bullet – The SSAP does not require audited financial statements of the Obligor. It only speaks to the Obligor needing an NAIC 1 or 2 designation or the equivalent from a CRP.
- Paragraph 102, third bullet – The SSAP does not require the insurance company's Investment Committee Memorandum.
- Paragraphs 105 and 107 – “Dilution Risk” is not defined in the SSAP, but the concepts are included.
- Paragraphs 105, 111, 121, and 124 – “Operational Risk” is not defined or contemplated in the SSAP.
- Paragraph 122 – The SSAP does not contemplate the SVO analyst assessing credit risk “in accordance with any permitted methodology” in the P&P Manual.
- Paragraph 132 – The SSAP does not require that the investor only have an option, and not an obligation, to purchase subsequent investments.

Additionally, we point out the following editorial comments:

- Paragraph 102, fourth bullet, first sub-bullet – An “or” should be inserted at the end of this bullet.
- Paragraph 102, fourth bullet, third sub-bullet – We do not believe the requested certification is an alternative to the first and second sub-bullets. The requirement should be promoted to make that clear.

A redline of our proposed changes is attached. Most importantly, we would like to draw your attention to the fact that neither SSAP 105R or the superseded SSAP 105 contain any language about the operational risk or credit risk requirements, other than the Obligors' as determined by reference to a credit rating assigned by a NAIC CRP or by an NAIC Designation assigned by the SVO.

Sincerely,



Mike Monahan
Senior Director, Accounting Policy

Attachment

Copy to Charles A. Therriault, Director, Securities Valuation Office



MEMORANDUM

TO: Kevin Fry, 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, Investment Counsel, NAIC Securities Valuation Office (SVO)

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

RE: Proposed Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to Incorporate Updates Made to SSAP No. 105R – Working Capital Finance Investments.

DATE: June 15, 2020

- 1. Summary** – The Statutory Accounting Principles (E) Working Group adopted updates to SSAP No. 105R Working Capital Finance Investments on May 20, 2020. These updates originate from industry comments that the SSAP’s fixed approach to a number of legal or structural issues in these transactions, which are routinely handled differently, prevents the SVO from exercising proper analytical discretion. Industry therefore requested the Task Force to update the program requirements that was then referred to the Working Group on March 7, 2019. The revisions adopted by the Working Group incorporate seven of the industry requested modifications to the Working Capital Finance Investments program requirements and are effective on June 30, 2020. Key revisions are summarized as follows:
 - Functionally Equivalent Foreign Regulators - Removed the requirement that the Securities Valuation Office (SVO) determine if the International Finance Agent is the functional equivalent of the U.S. regulator.
 - Commingling Prohibitions - Removed the finance agent prohibitions on commingling.
 - Investor Rights Edit - Removed duplicative text regarding exercising of investor rights.
 - Requirements for filer to Certify Perfected Interest – Removed requirements, with revisions allowing the SVO to determine if a first priority perfected interest has been obtained.
 - Finance Agent Validation Requirements – Broadened the independent review requirements to allow independent review of the finance agent by either audit or through an internal control report.
 - Default Date - Changed the default provisions from 15 to 30 days so the default date and the cure period are consistent.
 - Possible Domestic Regulator Approval – Removed the statement that the reporting entity may need to seek approval from the domestic regulator.
- 2. Recommendation** – The SVO staff reviewed the adopted updates to *SSAP No. 105R – Working Capital Finance Investments* to identify edits needed in the P&P to reflect those changes. The proposed amendments reflect only the SSAP changes that are relevant to the P&P guidance. The SVO recommends exposing this amendment.

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3. Proposed Amendment – The following shows the proposed revisions in Part Three with text in red identifying the changes.

PART THREE

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

WORKING CAPITAL FINANCE INVESTMENTS

NOTE: See “Specific Populations of Securities Not Eligible for Filing Exemption” in “Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities” above.







Initial Filing Requirements

102. An insurance company requesting an analysis of a proposed Working Capital Finance Program shall provide the SVO with the documentation described in this subparagraph:

- An RTAS Application.
- The Obligor’s Audited Financial Statements, if the Obligor is not rated for credit risk by a NAIC CRP.
- The insurance company’s Investment Committee Memorandum for the proposed Working Capital Finance Program.
- ~~The audited consolidated financial statements of the group of which the Finance Agent for the Working Capital Finance Program is a part, and one of the following:~~
 - An annual independent report according to Statement on Standards for Attestation Engagements (SSAE) No. 16 (or functional equivalent), reporting on controls at a service organization related to the administration of the investment.
 - An annual audit of the financial statement and internal controls of the consolidated group of which the Finance Agent is part, which does not note any material weakness related to servicing working capital financial investments.
 - A Certification from the insurance company’s Chief Investment Office that the insurance company, in its capacity as an Investor, is not affiliated with the Obligor or with any Supplier in the Working Capital Finance Program, and that the Working Capital Finance Program does not include any insurance or insurance related assets.
- ~~A Certification from the insurance company’s Legal Counsel.~~
- ~~In the case of a participation, that it has a commercially reasonable belief that its participation interest meets the Uniform Commercial Code’s standards for creating and preserving first priority security interests in the payments due and in the Confirmed Supplier Receivables.~~

Summary of Comments on 2020-022.01 PP Manual Amend - Updates to SSAP No. 105 for WCFI -- 8.12.2020 comments.pdf

Page: 4

-  Number: 1 Author: Interested Parties Subject: Sticky Note Date: 8/12/2020 8:26:10 PM
The SSAP does not require financial statements; only speaks to the Obligor needing an NAIC 1 or 2 designation or the equivalent from a CRP.
-  Number: 2 Author: Interested Parties Subject: Sticky Note Date: 8/12/2020 8:26:21 PM
This is not specifically required by the SSAP.
-  Number: 3 Author: Interested Parties Subject: Cross-Out Date: 8/12/2020 8:26:32 PM
This is no longer a requirement under SSAP 105R. See SSAP 105R new paragraph 14 (old paragraph 16) that specifically removed this requirement.
-  Number: 4 Author: Interested Parties Subject: Inserted Text Date: 8/12/2020 2:44:07 PM
or
-  Number: 5 Author: Interested Parties Subject: Sticky Note Date: 8/12/2020 2:48:11 PM
This section is not an alternative to the first two bullets. It should be promoted one level to the black square bullet.
-  Number: 6 Author: Interested Parties Subject: Cross-Out Date: 8/12/2020 8:27:41 PM
This is no longer a requirement under SSAP 105R.

- ~~In the case of a certificate, note or other manifestation, representing a right to payment from a trust, other special purpose entity, or special purpose pool holding confirmed supplier receivables, that it has a commercially reasonable belief that the documents establishing and governing the Working Capital Finance Program create and preserve interests in the Confirmed Supplier Receivables capable of being enforced by the trustee or other entity holding Confirmed Supplier Receivables as first priority perfected security interests under the Uniform Commercial Code.~~

~~NOTE: Please refer to SSAP No. 105 – Working Capital Finance Investments for the definition of a “commercially reasonable belief.”~~

- A copy of:
 - The document(s) that create the Working Capital Finance Investments (i.e., the short-term receivables) that is the subject of the RTAS – Emerging Investment Vehicle Service Application, and establishes the obligations of the Obligor to, and the protection afforded owners of, Working Capital Finance Investments (including the Investors). This agreement is sometimes referred to as the Invoice Payment Terms Acknowledgement, the Payable Services Agreement or the Paying Services Agreement.

NOTE: Please refer to “The Regulatory Treatment Analysis Service – Emerging Investment Vehicle” in Part Two for guidance regarding the filing of an RTAS Application with the SVO.
 - The agreement(s) between the Obligor and the Finance Agent governing the administration of the Working Capital Finance Program and the Working Capital Finance Investments issued thereunder. These agreements may be included in the documents mentioned above or may be a stand-alone agreement which are sometimes referred to as the Settlement Services Agreement or the Invoice-Related Electronic Services Agreement.
 - The agreement governing the sale of the Working Capital Finance Investments from the Supplier to the Finance Agent. This agreement is sometimes referred to as the Receivables Purchase Agreement or the Supplier Agreement. The agreement governing the ongoing purchase of Working Capital Finance Investments or an interest in Working Capital Finance Investments by the Investor from the Finance Agent. This agreement is sometimes referred to as the Agency Agreement, the Participation Agreement or the Program Trust Agreement.

Subsequent Filing Requirements


103. Subsequent filing requirements include:
- Copies of any of the documents originally submitted with the RTAS Application subsequently amended.
 - ~~1. The audited consolidated financial statements of the group of which the Finance Agent for the Working Capital Finance Program is a part, and one of the following:~~
 - An annual independent report according to Statement on Standards for Attestation Engagements (SSAE) No. 16 (or functional equivalent), reporting on controls at a service organization related to the administration of the investment; or
 - An annual audit of the **financial statements and** internal controls of the consolidated group of which the Finance Agent is part, which does not note any material weakness related to servicing **working capital financial investments**.

Definitions in *SSAP No. 105R—Working Capital Finance Investments*


104. Please refer to *SSAP No. 105R—Working Capital Finance Investments*, for the definitions and associated definitional guidance insurance companies must understand and comply with before applying for an NAIC Designation for Working Capital Finance Programs that would permit them to purchase Working Capital Finance Investments.
105. With the exception of the definitions for Dilution Risk and ~~Operational Risk~~ below, the definitions shown below are summaries of those contained in *SSAP No. 105R—Working Capital Finance Investments* intended only to facilitate a discussion and in all cases subordinate to the definitions in *SSAP No. 105R*.

Summary of Key Definitions


106. **Confirmed Supplier Receivable** – A receivable sold by a Supplier to a Finance Agent or Investor (or by a Finance Agent to an Investor) under a Working Capital Finance Program designated by the SVO that requires the Obligor to confirm to the Finance Agent or Investor, prior to the sale of the receivable from the Supplier to the Finance Agent or Investor, that it has no defenses to payment of the monetary obligation represented by the receivable against the Supplier and, therefore, no defenses to payment of the same monetary obligation to the Finance Agent and/or Investor after such sale. The confirmation by the Obligor that it has no defenses to payment includes confirmation that the Obligor does not have a right to refuse payment that it may have acquired with respect to underlying commercial trade transaction and that, if it has such a right, it will not assert such defenses against the Finance Agent or Investor.

 Number: 1 Author: Interested Parties Subject: Cross-Out Date: 8/12/2020 8:27:50 PM

This is no longer a requirement under SSAP 105R. See SSAP 105R new paragraph 14 (old paragraph 16) that specifically removed this requirement.

 Number: 2 Author: Interested Parties Subject: Sticky Note Date: 8/12/2020 8:28:06 PM


"Dilution Risk" is not defined in the SSAP, but the concepts are included.


 Number: 3 Author: Interested Parties Subject: Cross-Out Date: 8/12/2020 8:28:14 PM

"Operational Risk" is not defined in the SSAP.

107. **Dilution Risk** ¹ – With respect to any Working Capital Finance Program, dilution risk refers to disputes or contractual provisions that may reduce the amount of the obligation owed by the Obligor to the Supplier under the original receivable or the obligation owed by the Obligor to the Finance Agent and/or Investor under the Confirmed Supplier Receivable. Examples of dilution risk are credit for returns of defective goods or an allegation of fraud, such as that the invoice is not legitimate or is a duplicate invoice.
108. **Finance Agent** – A bank, financial institution, financial intermediary or service provider that facilitates the Working Capital Finance Program that arranges the sale, assignment or transfer of the Confirmed Supplier Receivable to the Investor and administers payment.
109. **Investor** – The insurance company that files the RTAS Application with the SVO in order to obtain an NAIC Designation for a proposed Working Capital Finance Program.
110. **Obligor** – An entity that purchases the goods or services from the Supplier and thereby generates the original supplier receivable—and which Obligor has, or can be designated, **NAIC 1** or **NAIC 2** by the SVO or has been assigned an equivalent credit rating by a NAIC CRP.
111. ~~**Operational Risk** ² – With respect to any Working Capital Finance Program, operational risk refers to the combined effect of the procedures and parties employed to implement the program and their responsibility under the documents and to the determination by the SVO of whether these procedures and parties will ensure full and timely performance by the Obligor of the payment obligation to the Investor. An example of an operational risk is the confirmation process employed to verify that the Obligor has no defenses to payment.~~
112. **Supplier** – The entity that sells the goods or services to the Obligor, obtains a receivable from the Obligor in exchange and subsequently chooses to sell the right to receive the payment associated with the receivable to the Finance Agent or Investor under the terms of a Working Capital Finance Program designated **NAIC 1** or **NAIC 2** by the SVO.
113. **Working Capital Finance Program** – The program created for the Obligor and its Suppliers by a Finance Agent the terms of which permits Suppliers to the Obligor to negotiate the sale of a right to receive payment from the Obligor (which is associated with and evidenced by a receivable) to the Finance Agent or an Investor.
114. **Working Capital Finance Investment** – The right to receive the payment associated with a Confirmed Supplier Receivable purchased by an Investor under a Working Capital Finance Program designated **NAIC 1** or **NAIC 2** by the SVO and is the subject of *SSAP No. 105R—Working Capital Finance Investments*.

Page: 7

 Number: 1 Author: Interested Parties Subject: Sticky Note Date: 8/12/2020 8:28:18 PM
"Dilution Risk" is not defined in the SSAP, but the concepts are included.

 Number: 2 Author: Interested Parties Subject: Cross-Out Date: 8/12/2020 8:28:26 PM
The term "Operational Risk" and these concepts are not defined in the SSAP.

NOTE: *SSAP No. 105R—Working Capital Finance Investments* imposes reporting and statutory accounting requirements on insurance company investments in Working Capital Finance Investments ~~and specifies analytical procedures to be applied or analytical controls to be verified by the SVO that are not detailed above.~~ Insurance companies are strongly advised to become familiar with *SSAP No. 105R* before filing an RTAS Application with the SVO.

Direction and Program Parameters

115. The SVO may assign an NAIC Designation to a Working Capital Finance Program that would generate Working Capital Finance Investment that meet the criterion and standards identified in this Section.
116. **RTAS Submission Required** – A request that the SVO assign an NAIC Designation to a Working Capital Finance Program is made by filing an RTAS Application. The RTAS Application is available at www.naic.org/documents/svo_rtas_app.pdf.
117. Upon completion of its risk assessment, the SVO will issue an RTAS Letter indicating a preliminary NAIC Designation; i.e., the NAIC Designation that would be assigned if the Investor enters into a Working Capital Finance Program with a Finance Agent and sought to report it to the SVO.

NOTE: A preliminary NAIC Designation cannot be used for statutory reporting purposes.
118. The SVO shall issue a final NAIC Designation to the Investor for the Working Capital Finance Program and the Working Capital Finance Investments generated thereunder upon receipt of fully executed final copies of the required documentation.

Variations in Structure

119. Working Capital Finance Programs may differ in structure and in the protection afforded the Investor. Structural strength and weaknesses of various structures in such programs will be reflected in the NAIC Designation assigned by the SVO.

Program Quality

120. The SVO shall only assign an NAIC Designation to Working Capital Finance Programs that can be designated **NAIC 1** or **NAIC 2**. Credit quality is measured by reference to a NAIC CRP credit rating or an NAIC Designation assigned by the SVO. The SVO shall withdraw the NAIC Designation assigned to a Working Capital Finance Program on the date the Obligor's NAIC CRP credit rating or NAIC Designation is downgraded to **NAIC 3** or its NAIC CRP equivalent.

NOTE: *SSAP No. 105R—Working Capital Finance Investments* provides that Working Capital Finance Investments generated under a Working Capital Finance Program of

an Obligor that falls below the equivalent of **NAIC 1** or **NAIC 2** becomes nonadmitted.

Process and Methodology

121. An NAIC Designation shall be assigned to a Working Capital Finance Program on the basis of a thorough assessment of ¹ ~~credit, dilution, operational and other risks~~, an assessment of protections provided by operative documents to the Investor and the quality of transaction participants.


Risk-Assessment Process


122. **Credit Risk** – The NAIC Designation for a Working Capital Finance Program shall be linked to the credit quality of the Obligor, which may be determined by reference to a credit rating assigned by a NAIC CRP or by an NAIC Designation assigned by the SVO. ² ~~Credit risk is assessed by the SVO analyst in accordance with any permitted methodology set forth in this Manual for corporate obligors.~~
123. **Dilution Risk** – To achieve an **NAIC 1** or **NAIC 2** Designation, the Working Capital Finance Program must eliminate dilution risk in the Working Capital Finance Investment proposed to be eligible for purchase by the Investor. The terms governing the Investor's Working Capital Finance Investment must eliminate Obligor recourse to its Supplier as a condition to payment of the obligation to the Investor so as to result in an unconditional right to receive payment on a full and timely basis.
124. ³ ~~**Operational Risk** – To achieve an **NAIC 1** or **NAIC 2** Designation, all operational risks shall be identified and assessed. Key participants shall have a NAIC CRP credit rating or an NAIC Designation assigned by the SVO at a level at least that of the Obligor.~~


Legal, Structural and Regulatory Considerations

125. Events of default remedies should provide the Investor at least those rights and privileges, unimpaired, of a trade creditor upon default with no Obligor defenses that could cause dilution of principal.

Page: 9

 Number: 1 Author: Interested Parties Subject: Cross-Out Date: 8/12/2020 3:45:55 PM
credit and dilution risks, and

 Number: 2 Author: Interested Parties Subject: Cross-Out Date: 8/12/2020 8:28:30 PM
This is not a requirement of the SSAP.

 Number: 3 Author: Interested Parties Subject: Cross-Out Date: 8/12/2020 8:28:35 PM
The term "Operational Risk" and these concepts are not defined in the SSAP.

126. ~~The SVO shall verify that either, (i) the Finance Agent is ~~must be~~ an entity regulated or supervised by a financial regulator in one of the countries in the List of Foreign (non-US) Jurisdictions Eligible for Netting for Purposes of Determining Exposures to Counterparties for Schedule DB, Part D, Section 1 ~~and that the regulator is the functional equivalent of the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency (OCC) or the Federal Deposit Insurance Corporation (FDIC). In the alternative, or (ii) the SVO shall verify that~~ payments due the Investor are made directly by the Obligor or into an account maintained by a regulated financial institution for the benefit of Investors in the Working Capital Finance Program and, in either case, the Finance Agent cannot be the beneficiary of such payment. ~~with no commingling of funds or assets with those of the Obligor, Supplier, Servicer or Trust Administrator or other Investors.~~~~
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128. ~~¹The SVO will verify that the Certification from the insurance company's Legal Counsel confirms the existence of a commercially reasonable belief that the documents establishing and governing the Working Capital Finance Program establishes the rights and UCC code standard for preserving first priority perfected interest in Confirmed Supplier Receivables.~~
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130. Characteristics that shall be present in a proposed Working Capital Finance Investment include, but are not limited to, the following, or a substantial equivalent:
131. The Obligor makes payments directly to the (a) Investor; ~~(b) Finance Agent, or (c) servicer for the Working Capital Finance Program.~~²
132. ~~³The Investor must have the option, and not an obligation, to purchase subsequent Working Capital Finance Investment so as to ensure the Investor can exit the Working Capital Finance Investment by permitting existing investments to mature.~~
133. *SSAP No. 105R—Working Capital Finance Investments* provides that the documentation governing Working Capital Finance Programs must provide that disputes arising under the agreements shall be submitted to a court of competent jurisdiction in the U.S. or be subject to an alternative dispute resolution process sanctioned by state law. Given the nature of Working Capital Finance Programs, the SVO anticipates that documentation governing Working Capital Finance Investments will be subject to the laws and jurisdiction of the courts of California, Delaware or New York, or a similar legal jurisdiction with significant exposure to sophisticated institutional financial transactions.

Number: 1 Author: Interested Parties Subject: Cross-Out Date: 8/12/2020 8:28:41 PM
This is no longer a requirement under SSAP 105R.

Number: 2 Author: Interested Parties Subject: Inserted Text Date: 8/12/2020 2:45:16 PM
or (b) into an account maintained by a regulated financial institution for the benefit of investors in the working capital finance program.

Number: 3 Author: Interested Parties Subject: Cross-Out Date: 8/12/2020 8:28:46 PM
This is not a requirement of the SSAP.

134. Events of default must be clearly defined, and provide a mechanism that gives the Investor the ability to pursue collection unfettered by actions taken or not taken by participants such as the Servicer or Trustee, or other named persons performing similar functions.

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MEMORANDUM

TO: Kevin Fry, 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, Investment Counsel, NAIC Securities Valuation Office (SVO)

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

RE: Proposed Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to Incorporate Updates Made to SSAP No. 105R – Working Capital Finance Investments.

DATE: June 15, 2020

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- 2. Recommendation** – The SVO staff reviewed the adopted updates to *SSAP No. 105R – Working Capital Finance Investments* to identify edits needed in the P&P to reflect those changes. The proposed amendments reflect only the SSAP changes that are relevant to the P&P guidance. The SVO recommends exposing this amendment.

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3. Proposed Amendment – The following shows the proposed revisions in Part Three with text in red identifying the changes.

PART THREE

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

WORKING CAPITAL FINANCE INVESTMENTS

NOTE: See “Specific Populations of Securities Not Eligible for Filing Exemption” in “Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities” above.

Initial Filing Requirements

102. An insurance company requesting an analysis of a proposed Working Capital Finance Program shall provide the SVO with the documentation described in this subparagraph:

- An RTAS Application.
- The Obligor’s Audited Financial Statements, if the Obligor is not rated for credit risk by a NAIC CRP.
- The insurance company’s Investment Committee Memorandum for the proposed Working Capital Finance Program.
- The audited consolidated financial statements of the group of which the Finance Agent for the Working Capital Finance Program is a part, and one of the following:
 - An annual independent report according to Statement on Standards for Attestation Engagements (SSAE) No. 16 (or functional equivalent), reporting on controls at a service organization related to the administration of the investment.
 - An annual audit of the financial statement and internal controls of the consolidated group of which the Finance Agent is part, which does not note any material weakness related to servicing working capital financial investments.
 - A Certification from the insurance company’s Chief Investment Office that the insurance company, in its capacity as an Investor, is not affiliated with the Obligor or with any Supplier in the Working Capital Finance Program, and that the Working Capital Finance Program does not include any insurance or insurance related assets.
 - A Certification from the insurance company’s Legal Counsel.
- ~~In the case of a participation, that it has a commercially reasonable belief that its participation interest meets the Uniform Commercial Code’s standards for creating and preserving first priority security interests in the payments due and in the Confirmed Supplier Receivables.~~

- ~~In the case of a certificate, note or other manifestation, representing a right to payment from a trust, other special purpose entity, or special purpose pool holding confirmed supplier receivables, that it has a commercially reasonable belief that the documents establishing and governing the Working Capital Finance Program create and preserve interests in the Confirmed Supplier Receivables capable of being enforced by the trustee or other entity holding Confirmed Supplier Receivables as first priority perfected security interests under the Uniform Commercial Code.~~

~~NOTE: Please refer to SSAP No. 105 – Working Capital Finance Investments for the definition of a “commercially reasonable belief.”~~

- A copy of:
 - The document(s) that create the Working Capital Finance Investments (i.e., the short-term receivables) that is the subject of the RTAS – Emerging Investment Vehicle Service Application, and establishes the obligations of the Obligor to, and the protection afforded owners of, Working Capital Finance Investments (including the Investors). This agreement is sometimes referred to as the Invoice Payment Terms Acknowledgement, the Payable Services Agreement or the Paying Services Agreement.

NOTE: Please refer to “The Regulatory Treatment Analysis Service – Emerging Investment Vehicle” in Part Two for guidance regarding the filing of an RTAS Application with the SVO.
 - The agreement(s) between the Obligor and the Finance Agent governing the administration of the Working Capital Finance Program and the Working Capital Finance Investments issued thereunder. These agreements may be included in the documents mentioned above or may be a stand-alone agreement which are sometimes referred to as the Settlement Services Agreement or the Invoice-Related Electronic Services Agreement.
 - The agreement governing the sale of the Working Capital Finance Investments from the Supplier to the Finance Agent. This agreement is sometimes referred to as the Receivables Purchase Agreement or the Supplier Agreement. The agreement governing the ongoing purchase of Working Capital Finance Investments or an interest in Working Capital Finance Investments by the Investor from the Finance Agent. This agreement is sometimes referred to as the Agency Agreement, the Participation Agreement or the Program Trust Agreement.

Subsequent Filing Requirements

103. Subsequent filing requirements include:
- Copies of any of the documents originally submitted with the RTAS Application subsequently amended.
 - The audited consolidated financial statements of the group of which the Finance Agent for the Working Capital Finance Program is a part, and one of the following:
 - An annual independent report according to Statement on Standards for Attestation Engagements (SSAE) No. 16 (or functional equivalent), reporting on controls at a service organization related to the administration of the investment; or
 - An annual audit of the financial statements and internal controls of the consolidated group of which the Finance Agent is part, which does not note any material weakness related to servicing working capital financial investments.

Definitions in SSAP No. 105R—Working Capital Finance Investments

104. Please refer to SSAP No. 105R—Working Capital Finance Investments, for the definitions and associated definitional guidance insurance companies must understand and comply with before applying for an NAIC Designation for Working Capital Finance Programs that would permit them to purchase Working Capital Finance Investments.
105. With the exception of the definitions for Dilution Risk and Operational Risk below, the definitions shown below are summaries of those contained in SSAP No. 105R—Working Capital Finance Investments intended only to facilitate a discussion and in all cases subordinate to the definitions in SSAP No. 105R.

Summary of Key Definitions

106. **Confirmed Supplier Receivable** – A receivable sold by a Supplier to a Finance Agent or Investor (or by a Finance Agent to an Investor) under a Working Capital Finance Program designated by the SVO that requires the Obligor to confirm to the Finance Agent or Investor, prior to the sale of the receivable from the Supplier to the Finance Agent or Investor, that it has no defenses to payment of the monetary obligation represented by the receivable against the Supplier and, therefore, no defenses to payment of the same monetary obligation to the Finance Agent and/or Investor after such sale. The confirmation by the Obligor that it has no defenses to payment includes confirmation that the Obligor does not have a right to refuse payment that it may have acquired with respect to underlying commercial trade transaction and that, if it has such a right, it will not assert such defenses against the Finance Agent or Investor.

107. **Dilution Risk** – With respect to any Working Capital Finance Program, dilution risk refers to disputes or contractual provisions that may reduce the amount of the obligation owed by the Obligor to the Supplier under the original receivable or the obligation owed by the Obligor to the Finance Agent and/or Investor under the Confirmed Supplier Receivable. Examples of dilution risk are credit for returns of defective goods or an allegation of fraud, such as that the invoice is not legitimate or is a duplicate invoice.
108. **Finance Agent** – A bank, financial institution, financial intermediary or service provider that facilitates the Working Capital Finance Program that arranges the sale, assignment or transfer of the Confirmed Supplier Receivable to the Investor and administers payment.
109. **Investor** – The insurance company that files the RTAS Application with the SVO in order to obtain an NAIC Designation for a proposed Working Capital Finance Program.
110. **Obligor** – An entity that purchases the goods or services from the Supplier and thereby generates the original supplier receivable—and which Obligor has, or can be designated, **NAIC 1** or **NAIC 2** by the SVO or has been assigned an equivalent credit rating by a NAIC CRP.
111. **Operational Risk** – With respect to any Working Capital Finance Program, operational risk refers to the combined effect of the procedures and parties employed to implement the program and their responsibility under the documents and to the determination by the SVO of whether these procedures and parties will ensure full and timely performance by the Obligor of the payment obligation to the Investor. An example of an operational risk is the confirmation process employed to verify that the Obligor has no defenses to payment.
112. **Supplier** – The entity that sells the goods or services to the Obligor, obtains a receivable from the Obligor in exchange and subsequently chooses to sell the right to receive the payment associated with the receivable to the Finance Agent or Investor under the terms of a Working Capital Finance Program designated **NAIC 1** or **NAIC 2** by the SVO.
113. **Working Capital Finance Program** – The program created for the Obligor and its Suppliers by a Finance Agent the terms of which permits Suppliers to the Obligor to negotiate the sale of a right to receive payment from the Obligor (which is associated with and evidenced by a receivable) to the Finance Agent or an Investor.
114. **Working Capital Finance Investment** – The right to receive the payment associated with a Confirmed Supplier Receivable purchased by an Investor under a Working Capital Finance Program designated **NAIC 1** or **NAIC 2** by the SVO and is the subject of *SSAP No. 105R—Working Capital Finance Investments*.

NOTE: *SSAP No. 105R—Working Capital Finance Investments* imposes reporting and statutory accounting requirements on insurance company investments in Working Capital Finance Investments ~~and specifies analytical procedures to be applied or analytical controls to be verified by the SVO that are not detailed above.~~ Insurance companies are strongly advised to become familiar with *SSAP No. 105R* before filing an RTAS Application with the SVO.

Direction and Program Parameters

115. The SVO may assign an NAIC Designation to a Working Capital Finance Program that would generate Working Capital Finance Investment that meet the criterion and standards identified in this Section.
116. **RTAS Submission Required** – A request that the SVO assign an NAIC Designation to a Working Capital Finance Program is made by filing an RTAS Application. The RTAS Application is available at www.naic.org/documents/svo_rtas_app.pdf.
117. Upon completion of its risk assessment, the SVO will issue an RTAS Letter indicating a preliminary NAIC Designation; i.e., the NAIC Designation that would be assigned if the Investor enters into a Working Capital Finance Program with a Finance Agent and sought to report it to the SVO.

NOTE: A preliminary NAIC Designation cannot be used for statutory reporting purposes.
118. The SVO shall issue a final NAIC Designation to the Investor for the Working Capital Finance Program and the Working Capital Finance Investments generated thereunder upon receipt of fully executed final copies of the required documentation.

Variations in Structure

119. Working Capital Finance Programs may differ in structure and in the protection afforded the Investor. Structural strength and weaknesses of various structures in such programs will be reflected in the NAIC Designation assigned by the SVO.

Program Quality

120. The SVO shall only assign an NAIC Designation to Working Capital Finance Programs that can be designated **NAIC 1** or **NAIC 2**. Credit quality is measured by reference to a NAIC CRP credit rating or an NAIC Designation assigned by the SVO. The SVO shall withdraw the NAIC Designation assigned to a Working Capital Finance Program on the date the Obligor's NAIC CRP credit rating or NAIC Designation is downgraded to **NAIC 3** or its NAIC CRP equivalent.

NOTE: *SSAP No. 105R—Working Capital Finance Investments* provides that Working Capital Finance Investments generated under a Working Capital Finance Program of

an Obligor that falls below the equivalent of **NAIC 1** or **NAIC 2** becomes nonadmitted.

Process and Methodology

121. An NAIC Designation shall be assigned to a Working Capital Finance Program on the basis of a thorough assessment of credit, dilution, operational and other risks, an assessment of protections provided by operative documents to the Investor and the quality of transaction participants.

Risk-Assessment Process

122. **Credit Risk** – The NAIC Designation for a Working Capital Finance Program shall be linked to the credit quality of the Obligor, which may be determined by reference to a credit rating assigned by a NAIC CRP or by an NAIC Designation assigned by the SVO. Credit risk is assessed by the SVO analyst in accordance with any permitted methodology set forth in this Manual for corporate obligors.
123. **Dilution Risk** – To achieve an **NAIC 1** or **NAIC 2** Designation, the Working Capital Finance Program must eliminate dilution risk in the Working Capital Finance Investment proposed to be eligible for purchase by the Investor. The terms governing the Investor's Working Capital Finance Investment must eliminate Obligor recourse to its Supplier as a condition to payment of the obligation to the Investor so as to result in an unconditional right to receive payment on a full and timely basis.
124. **Operational Risk** – To achieve an **NAIC 1** or **NAIC 2** Designation, all operational risks shall be identified and assessed. Key participants shall have a NAIC CRP credit rating or an NAIC Designation assigned by the SVO at a level at least that of the Obligor.

Legal, Structural and Regulatory Considerations

125. Events of default remedies should provide the Investor at least those rights and privileges, unimpaired, of a trade creditor upon default with no Obligor defenses that could cause dilution of principal.

126. ~~The SVO shall verify that either, (i) the Finance Agent is ~~must be~~ an entity regulated or supervised by a financial regulator in one of the countries in the List of Foreign (non-US) Jurisdictions Eligible for Netting for Purposes of Determining Exposures to Counterparties for Schedule DB, Part D, Section 1 and that the regulator is the functional equivalent of the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency (OCC) or the Federal Deposit Insurance Corporation (FDIC). In the alternative, or (ii) the SVO shall verify that~~ payments due the Investor are made directly by the Obligor or into an account maintained by a regulated financial institution for the benefit of Investors in the Working Capital Finance Program. and, in either case, the Finance Agent cannot be the beneficiary of such payment. ~~with no commingling of funds or assets with those of the Obligor, Supplier, Servicer or Trust Administrator or other Investors.~~
127. The SVO will verify that the Certification from the insurance company's Chief Investment Officer confirms that the Investor is not affiliated with Obligor and that Working Capital Finance Investment excludes insurance or insurance-related assets.
128. The SVO will verify that the Certification from the insurance company's Legal Counsel confirms the existence of a commercially reasonable belief that the documents establishing and governing the Working Capital Finance Program establishes the rights and UCC code standard for preserving first priority perfected interest in Confirmed Supplier Receivables.
129. The remedies available to the participants in the Working Capital Finance Program should be expressly identified in the documentation for the Working Capital Finance Investment.
130. Characteristics that shall be present in a proposed Working Capital Finance Investment include, but are not limited to, the following, or a substantial equivalent:
131. The Obligor makes payments directly to the (a) Investor; (b) Finance Agent; or (c) servicer for the Working Capital Finance Program.
132. The Investor must have the option, and not an obligation, to purchase subsequent Working Capital Finance Investment so as to ensure the Investor can exit the Working Capital Finance Investment by permitting existing investments to mature.
133. *SSAP No. 105R—Working Capital Finance Investments* provides that the documentation governing Working Capital Finance Programs must provide that disputes arising under the agreements shall be submitted to a court of competent jurisdiction in the U.S. or be subject to an alternative dispute resolution process sanctioned by state law. Given the nature of Working Capital Finance Programs, the SVO anticipates that documentation governing Working Capital Finance Investments will be subject to the laws and jurisdiction of the courts of California, Delaware or New York, or a similar legal jurisdiction with significant exposure to sophisticated institutional financial transactions.

134. Events of default must be clearly defined, and provide a mechanism that gives the Investor the ability to pursue collection unfettered by actions taken or not taken by participants such as the Servicer or Trustee, or other named persons performing similar functions.

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Updates to WCFI\2020-022.01 PP Manual Amend - Updates to SSAP No. 105 for WCFI.docx

TO: Kevin Fry (IL), Chair of the Valuation of Securities (E) Task Force
FROM: Dale Bruggeman (OH), Chair of the Statutory Accounting Principles (E) Working Group
DATE: June 4, 2020
RE: Updates to Working Capital Finance Program Requirements

During its May 20, 2020 conference call, the Statutory Accounting Principles (E) Working Group finalized consideration of a referral from the Valuation of Securities (E) Task Force, pertaining to Working Capital Finance program requirements. With the action taken, the Working Group adopted substantive revisions to *SSAP No. 105R—Working Capital Finance Investments* and *Issue Paper No. 163—Working Capital Finance Investments Updates*. The revisions incorporate seven of industry requested modifications to the Working Capital Finance Investments program requirements and are effective on June 30, 2020. Key revisions, which are reflected as tracked changes in the attached, are summarized as follows:

1. **Functionally Equivalent Foreign Regulators** - Removed the requirement that the Securities Valuation Office (SVO) determine if the International Finance Agent is the functional equivalent of the U.S. regulator.
2. **Commingling Prohibitions** - Removed the finance agent prohibitions on commingling.
3. **Investor Rights Edit** - Removed duplicative text regarding exercising of investor rights.
4. **Requirements for filer to Certify Perfected Interest** – Removed requirements, with revisions allowing the SVO to determine if a first priority perfected interest has been obtained.
5. **Finance Agent Validation Requirements** – Broadened the independent review requirements to allow independent review of the finance agent by either audit or through an internal control report.
6. **Default Date** - Changed the default provisions from 15 to 30 days so the default date and the cure period are consistent.
7. **Possible Domestic Regulator Approval** – Removed the statement that the reporting entity may need to seek approval from the domestic regulator.

With the action taken, the Working Group also directed notification to the Valuation of Securities (E) Task Force for purposes of coordinating corresponding revisions to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual). Please contact NAIC staff of the Statutory Accounting Principles (E) Working Group with any questions.

Cc: Charles A. Theriault, Julie Gann, Robin Marcotte, Jim Pinegar, Fatima Sediqzad and Jake Stultz

Attachment: SSAP No. 105R.

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Statement of Statutory Accounting Principles No. 105R

Working Capital Finance Investments

STATUS

Type of Issue	Common Area
Issued	December 15, 2013; <u>Substantively revised May 20, 2020</u>
Effective Date	January 1, 2014; <u>Substantive revisions documented in Issue Paper No. 163 effective June 30, 2020</u>
Affects	No other pronouncements
Affected by	No other pronouncements
Interpreted by	INT 06-07
Relevant Appendix A Guidance	None

STATUS	1
SCOPE OF STATEMENT	1
SUMMARY CONCLUSION	2
Working Capital Finance Program - Definitions and Conditions	2
Confirmation Process	3
Program Requirements	4
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Accounting and Reporting.....	5
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Effective Date and Transition.....	7
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SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for working capital finance investments held by reporting entities. This statement amends *SSAP No. 20—Nonadmitted Assets* (SSAP No. 20) to allow working capital finance investments as admitted assets to the extent they conform to the requirements of this statement.

SUMMARY CONCLUSION

2. Working capital finance investments represent a confirmed short-term obligation¹ to pay a specified amount owed by one party (the obligor) to another (typically a supplier of goods), generated as a part of a working capital finance investment program currently designated by the NAIC Securities Valuation Office. Pursuant to the working capital finance investment program, this short-term obligation has been transferred by the entity entitled to payment (typically a supplier of goods) to a third party investor.
3. Working capital finance investments held by a reporting entity represent a right of the reporting entity to receive future payment. This Statement provides accounting and reporting guidelines for the right to receive payment under working capital finance programs that meet particular criteria.

Working Capital Finance Program - Definitions and Conditions

4. A “working capital finance program” is an open account program under which an investor may purchase interests, or evidence thereof, in commercial non-insurance receivables. A working capital finance program is created for the benefit of a commercial investment-grade obligor and its suppliers of goods or services, and facilitated by a finance agent.
5. A working capital finance program transfers a right to payment to an investor from a short term obligation and arises from transactions among:
- a buyer of goods or services that becomes an obligor to the supplier of goods or services,
 - the supplier(s) of those goods or services,
 - a finance agent, and
 - an investor.
6. A “working capital finance investment” is an interest in payment(s) from a confirmed supplier receivable issued pursuant to a working capital finance program. The payment (maturity) date must not exceed one year from the date of invoice from the supplier to the obligor. This investment is created when the investor purchases from a working capital finance program that is currently designated as NAIC “1” or “2” by the NAIC Securities Valuation Office, any of the following:
- One or more confirmed supplier receivables;
 - in case of a participation, a participation interest in one or more confirmed supplier receivables issued by the finance agent or lead lender holding confirmed supplier receivables; or
 - a certificate, note or other interest manifestation, documented in a way that is verifiable ~~by regulators~~, representing a legally enforceable interest in a right to ~~payment payment either directly to the investor or~~ from a trust, other special purpose entity or pool holding confirmed supplier receivables.
7. “Obligor” is the party that purchases the goods or services that generates the original supplier receivable ~~(and which is the~~ payable for ~~that~~the Obligor). The obligor must ~~be a single entity, which has~~have an NAIC designation of “1” or “2” or a Credit Rating Provider equivalent. The obligor must confirm the supplier receivable described in paragraph 11 as described in the confirmation process in paragraphs 12-~~1314~~.

¹ All references to short-term obligations in this statement to refer to obligations not exceeding one year.

Working Capital Finance Investments

8. “Supplier” is the party that sells the goods or services to the obligor. The supplier sells the confirmed supplier receivable in accordance with the terms of the working capital finance program designated by the NAIC Securities Valuation Office at a price agreed to by the finance agent and/or investor.

9. “Investor” is the party purchasing a working capital finance investment in accordance with the terms of the working capital finance program designated by the NAIC Securities Valuation Office.

10. The “finance agent” is a bank, financial institution, other financial intermediary, or service provider that facilitates the working capital finance program, arranges the sale, assignment or transfer of the confirmed supplier receivable to the investor for a fee and administers the payment mechanism. In the case of participation, the finance agent must inform the reporting entity investor of a default or event of default as soon as it becomes aware of such default or event of default. For the working capital finance program to qualify under this SSAP, the finance agent must meet the requirements of either paragraph 10.a. or 10.b.:

- a. The finance agent is directly regulated by, or falls under the supervision of, a financial regulator of its domiciliary country provided that such country appears on the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* List of Jurisdictions Eligible for Netting ~~and that the Securities Valuation Office determines that the regulator is the functional equivalent of the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, or the Federal Deposit Insurance Corporation;~~ or
- b. Payments from the obligor must ~~1) be paid directly to the reporting entity (investor) or into an account maintained by a regulated financial institution for the benefit of investors in the working capital finance program and, in either case, cannot flow through the finance agent cannot be the beneficiary of such payment and 2) there can be no commingling of payments or assets with those of the obligor, supplier, servicer or trust administrator or other investors.~~

11. A “confirmed supplier receivable” is a first priority perfected security interest or right to payment of a monetary obligation from the obligor arising from the sale of goods or services from the supplier to the obligor the payment of which has been confirmed by the obligor committing and stating that the obligations under the agreement and any payment shall not be affected by the invalidity, unenforceability, existence, performance or non-performance of the underlying commercial trade transaction or any related contract or undertaking nor that it will not protest, delay, or deny, nor offer nor assert any defenses, personal or otherwise, against payment to the supplier or any party taking claims, interests, or rights to payments made by the supplier.

- a. The confirmed supplier receivable must be sold, assigned or otherwise transferred in a manner that results in an absolute, irrevocable and legally enforceable obligation that has been confirmed by the Obligor.
- b. In the case of a participation, the certificates or other evidence of participation provide an absolute, irrevocable, and legally enforceable obligation of the finance agent or holder of the confirmed supplier receivable to pay to the reporting entity investor all of the amounts due to it under the confirmed supplier receivable, without reduction or delay arising from any claims that the finance agent may have against the reporting entity investor. ~~The reporting entity investor’s ability to exercise its rights as creditor, or to direct the finance agent to exercise the rights of a creditor on its behalf, shall not be subject to the discretion of the finance agent or other lenders or investors.~~ The reporting entity investor’s ability to exercise its rights as creditor, or to direct the finance agent to exercise the rights of a creditor on its behalf, shall not be subject to, other than during a cure period not to exceed thirty days, the discretion of the finance agent or other lenders or investors.

Confirmation Process

12. In the case of a purchase, the investor shall verify, prior to the sale that the obligor has confirmed the respective amounts, payment dates and related invoice numbers’ specified dates and has waived all defenses to

payment. In the case of a participation, the finance agent must verify that the obligor has confirmed the respective amounts, payment dates and related invoice reference numbers' specified due dates, and has waived all defenses to payment in accordance with the confirmation process.

13. The obligor must commit and state that upon confirmation of a supplier receivable it is obligated to pay to the investor, the finance agent, or any third party acting as agent or trustee for the investor, a sum equal to the full amount of that confirmed supplier receivable(s) on a date certain stated in the confirmation and that it waives any right of setoff or other defenses to avoid or delay the full and timely payment of that Confirmed Supplier Receivable. The documents establishing the working capital finance program or the confirmation must state and confirm that the obligation to pay must be independent of any other contracts or claims that might be raised in defense arising from any transaction financed in connection with the WCFPWCFI program, the confirmed supplier receivable, or any other courses of performance or courses of dealing with the supplier.

~~14. — In the case of participation, the investor must certify that it has a commercially reasonable belief that its participation interest meets the Uniform Commercial Code's standards for creating and preserving first priority security interests in the payments due and in the confirmed supplier receivables. Commercially reasonable belief shall mean the SVO deems the investor's belief reasonable in light of the systems, policies, or practices commonly recognized in the field of investing in participations. The investor must be able to demonstrate to a regulator or to the SVO, upon either's request, the basis for its commercially reasonable belief that the WCFP creates and preserves the investor's ability to enforce a first priority perfected security interest in the confirmed supplier receivables.~~

~~15. — In the case of a certificate, note, or other manifestation, capable of verification, representing a right to payment from a trust, other special purpose entity, or special purpose pool holding confirmed supplier receivables, the investor must certify that it has a commercially reasonable belief that the documents establishing and governing the working capital finance program create and preserve interests in the confirmed supplier receivables capable of being enforced by the trustee or other entity holding confirmed supplier receivables as first priority perfected security interests under the Uniform Commercial Code. The investor must be able to demonstrate the basis for such belief to a regulator or to the SVO upon either's request. Commercially reasonable belief shall mean the SVO deems the investor's belief reasonable in light of the systems, policies, and practices commonly recognized in the field of investing in securitizations, loan backed, structured, or trust issued securities.~~

Program Requirements

~~16.14.~~ The working capital finance program investor must provide in its annual filing with the Securities Valuation Office ~~an annual audit of the consolidated financial statements of which the finance agent is part, which does not report any qualifications related to servicing, and~~ one of the following:

- a. An annual independent report according to Statement on Standards for Attestation Engagements (SSAE) No. 16 (or functional equivalent), reporting on controls at a service organization related to the administration of the investment; or
- b. An annual audit of the financial statements and internal controls of the consolidated group of which the finance agent is part, which does not note any material weaknesses related to servicing working capital financial investments.

The NAIC Securities Valuation Office would review the materiality of the report findings in making their determination of the assignment of a designation.

~~17.15.~~ If the credit rating of the working capital finance program or obligor falls to non-investment grade (below the equivalent of NAIC designation "1" or "2"), the reporting entity shall nonadmit, the working capital finance investments obtained under the related working capital finance program and/or the related obligor. Due to the short-term nature of these investments, once an investment is nonadmitted due to the credit rating of the working capital finance program or the obligor, those investments will continue to be nonadmitted.

Working Capital Finance Investments

~~18.16.~~ Reporting entity investors must have the ability to monitor the working capital finance program and the credit-related activities of the obligor. Reporting entity investors must provide information as requested to the state of domicile indicating that they have the ability to monitor on an ongoing basis the activities of the working capital finance program. ~~Initial permission to invest in Working Capital Finance Investment Programs may be required by the domiciliary commissioner.~~

~~19.17.~~ All contracts or agreements that are a part of or that together constitute a working capital finance program must provide that if a dispute arises among any of the parties under any of the contracts or agreements that are a part of or that together constitute the working capital finance program, each party agrees that the dispute will be submitted to a court of competent jurisdiction in the United States or a constituent state thereof or of an alternative dispute resolution process recognized thereby. All contracts or agreements that are a part of or that together constitute a working capital finance program must provide that any dispute arising under any of the contracts or agreements that are a part of or that together constitute the working capital finance program must be resolved pursuant to the laws of the United States or a constituent state thereof that address the substance of the dispute but excluding those laws addressing conflicts of law.

Exclusions

~~20.18.~~ A working capital finance investment excludes any receivables financed through:

- a. Factoring: the purchase of receivables in bulk from a supplier where the receivables represent the payment obligations of potentially thousands of buyers to a single supplier, in which the buyers have no relationship with or contractual obligation to pay the factor and retain all legal defenses to payment they may have against the supplier;
- b. Forfaiting: the purchase of one or a series of receivables from exporters by a forfaiter to enable the exporter (seller) to finance a commercial transaction with a buyer in which the Obligor has no relationship with or contractual obligation to pay the forfaiter and retains all legal defenses to pay it may have against the seller; or
- c. Invoice discounting: the advancement of funds by a finance company to a business entity with the funds advanced limited to a defined percentage of the business entity's eligible and outstanding receivables.

~~21.19.~~ Eligible Confirmed Supplier Receivables must not:

- a. Include insurance or insurance related assets;
- b. Be impaired or in default at the time of purchase;
- c. Have a payment (maturity) date longer than one year from the date of the invoice from the Supplier to the Obligor giving rise to the confirmed supplier receivable, and the maturity date must not be subject to change or rolling; nor
- d. Include any receivable of any parent or affiliate of the reporting entity investor, and neither the Obligor nor any Supplier may be affiliated with the reporting entity investor. Working Capital Finance Investments that have obligors or vendors that are affiliated with the investor are ineligible, and therefore, nonadmitted assets.

Accounting and Reporting

~~22.20.~~ The right to receive payment generated by a working capital finance investment issued under a working capital finance program is considered to meet the definition of an asset as defined in *SSAP No. 4—Assets and Nonadmitted Assets*, and is an admitted asset to the extent the investment conforms to the requirements set forth in this Statement and the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. For programs that

comply with all of these elements, working capital finance investments shall be valued and reported in accordance with this Statement, the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*, and the designation assigned in the NAIC Valuations of Securities product. Programs that do not comply with the elements set forth in this Statement, or the provisions set forth in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* are nonadmitted. Working capital finance investments are reported as other invested assets in the financial statements.

23.21. A working capital finance investment shall be recorded on the trade date. At acquisition, the Working Capital Finance Investment shall be initially reported at cost, excluding brokerage and other related fees, and all other costs (internal costs, or costs paid for origination, purchase or commitment to purchase such investments), which shall be expensed as incurred.

24.22. After initial acquisition, the Working Capital Finance Investment shall be reported at amortized cost until the specified maturity date, unless the investment, or a portion thereof, is deemed uncollectible or when an other-than-temporary impairment has occurred. In the event that a working capital finance investment is purchased by a reporting entity investor at a premium (amount to be received by the entity under the confirmed supplier receivable is less than the price paid for the investment), the excess paid by the reporting entity investor in comparison to the amount receivable under the confirmed supplier receivable must be immediately expensed.

25.23. For reporting entities required to maintain an Interest Maintenance Reserve (IMR), the accounting for realized capital gains and losses from working capital finance investments shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve* (SSAP No. 7). For reporting entities not required to maintain an IMR, realized gains and losses from working capital finance investments shall be reported as net realized capital gains or losses in the statement of income. For reporting entities not required to maintain an AVR, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus).

26.24. A Working Capital Finance Investment may provide for a prepayment penalty or acceleration fee in the event the working capital finance investment is liquidated prior to its scheduled termination date. Such fees shall be reported as investment income when received.

27.25. *SSAP No. 34—Investment Income Due and Accrued* shall be followed for determining and recording investment income earned on working capital finance investments acquired at a discount. In accordance with *SSAP No. 34—Investment Income Due and Accrued*, investment income shall be reduced for amounts that have been determined to be uncollectible, however amounts more than 15 days overdue are nonadmitted.

Default

28.26. A working capital finance investment payment that is uncollected by the reporting entity within **fifteen thirty** days after the due date shall be considered in default and nonadmitted. If the reporting entity has any other working capital finance investment assets from the same defaulting counterparty, all other working capital finance investments from that counterparty shall be nonadmitted. All working capital finance investments from a counterparty identified in default shall be evaluated for impairment.

Impairment

29.27. An other-than-temporary impairment^(INT 06-07) shall be considered to have occurred if it is probable that the reporting entity will be unable to collect all amounts due according to the contractual terms of a confirmed supplier receivable including the payment on the established due date. Pursuant to this guidance, assessment of other-than-temporary impairment shall include an evaluation of the financial condition and short-term prospects of the obligor. If it is determined that a decline in the fair value of a working capital finance investment below book/adjusted carrying value is due to an other-than-temporary impairment, an impairment loss shall be recognized as a realized loss equal to the entire difference between the working capital finance investment's carrying value and fair value as of the reporting period for which the assessment is made. Fair value shall be determined in accordance with *SSAP*

Working Capital Finance Investments

No. 100R—Fair Value (SSAP No. 100R), and reflect the price to sell the asset in an orderly market between market participants. As such, the fair value shall reflect the assumptions market participants will use in pricing the asset, including assumptions about risk.

30:28. For reporting entities required to maintain an AVR/IMR, the entire amount of the realized loss from the other-than-temporary impairment shall be recorded through the AVR, in accordance with SSAP No. 7.

31:29. Upon recognition of an other-than-temporary impairment, the fair value of the working capital finance investment on the measurement date shall become the new cost basis of the working capital finance investment and the new cost basis shall not be adjusted for subsequent recoveries in fair value. Once an investment is determined to be other-than-temporarily impaired, until all expected payments are received, the reporting entity must re-evaluate the investment quarterly and reassess fair value, with recognized realized losses for the difference between the book/adjusted carrying value and the current fair value. This process shall continue until either all expected payments are received, or the entity has recognized a realized loss for the entire uncollected carrying value.

Disclosures

32:30. The financial statements shall include the following disclosures:

- a. Fair value in accordance with SSAP No. 100R.
- b. Concentrations of credit risk in accordance with SSAP No. 27—*Off-Balance-Sheet and Credit Risk Disclosures* (SSAP No. 27) in the annual audited statutory financial reports only.
- c. Information regarding the aggregate book/adjusted carrying value of working capital finance investment by designation including gross assets with nonadmitted and net admitted amounts annually. (Note that programs designated 3-6 are nonadmitted.)

	Gross Asset CY	Non-Admitted Asset CY	Net Admitted Asset CY
WCFI Designation 1			
WCFI Designation 2			
WCFI Designation 3			
WCFI Designation 4			
WCFI Designation 5			
WCFI Designation 6			
Total			

- d. Annual and quarterly information regarding the aggregate book/adjusted carrying value maturity distribution on the underlying working capital finance investments by the categories of maturities up to 180 days and 181 to 365 days.
- e. Any events of default of working capital finance investments during the reporting period.

33:31. Refer to the Preamble for further discussion regarding disclosure requirements.

Effective Date and Transition

34:32. This statement is effective for years on or after January 1, 2014. Substantive revisions documented in Issue Paper No. 163—Working Capital Finance Investments Updates are effective for financial reporting periods on or after June 30, 2020. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

SSAP No. 105R

Statement of Statutory Accounting Principles

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 147—Working Capital Finance Investments*
- *Issue Paper No. 163— Working Capital Finance Investments Updates*

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To: Kevin Fry, Chair, Valuation of Securities (E) Task Force
 From: Dale Bruggeman, Chair of the Statutory Accounting Principles (E) Working Group
 Date: August 18, 2020
 Re: Referral Response: Non-conforming Credit Tenant Loan (CTL) Transactions

This memorandum intends to respond to the Valuation of Securities (E) Task Force May 29, 2020 referral requesting an exception to allow non-conforming credit tenant loans (CTLs) held prior to Jan. 1, 2020, which have CRP ratings and an SVO assessment, to be reported in scope of *SSAP No. 43R—Loan-Backed and Structured Securities* and on Schedule D-1: Bonds. In response to this referral, and in identifying accounting and reporting questions with CTLs, during the 2020 virtual Summer National Meeting, the Statutory Accounting Principles (E) Working Group exposed agenda item 2020-24: Accounting and Reporting of Credit Tenant Loans for a comment period ending Sept. 18, 2020.

The agenda item exposed by the Working Group provides information on CTLs and presents two options for the accounting and reporting of these investments:

- Option 1 – CTLs that meet a structural analysis of the NAIC SVO will continue to be captured in scope of SSAP No. 43R. This option will require the NAIC SVO to establish a listing of qualifying CTLs, similar to the process for SVO-Identified Bond ETFs. For CTLs that do not qualify for reporting in scope of SSAP No. 43R (they are not on the NAIC SVO listing), the agenda item requests direction for specific inclusion in *SSAP No. 37—Mortgage Loans* or *SSAP No. 21—Other Admitted Assets*. If captured in scope of SSAP No. 37, the CTL would be reported on Schedule B and subject to the RBC impact similar to directly-held mortgage loans. If captured in scope of SSAP No. 21, the CTL would be reported on Schedule BA as an other invested asset and subject to the RBC impact for other investments held on this schedule. (If reported on Schedule BA, even if the CTL did not meet the structural analysis for SSAP No. 43R scope inclusion, if permitted by the NAIC SVO methodology, it could still be possible for the NAIC SVO to provide a credit assessment for improved RBC impact by life insurance entities.)
- Option 2 – All CTLs would be captured in scope of SSAP No. 21 and reported on Schedule BA. With this approach, all CTLs would be reported on the same schedule, allowing regulators the ability to quickly identify the extent of investments in this asset class. Additionally, CTLs that qualify for an NAIC SVO credit assessment can be reported with an NAIC designation, and life insurance entities could receive RBC treatment based on the credit-quality of the instrument under the SVO methodology. With this option, a structural analysis of the CTL would no longer be required to determine the reporting schedule and the NAIC SVO would not need to product a listing of CTLs that qualify for reporting in scope of SSAP No. 43R.

The exposed agenda item does not provide a recommendation for the two options, but identifies that the Working Group will direct NAIC staff on the approach to utilize in drafting proposed statutory accounting revisions subsequent to the exposure period. In addition to notifying of this exposed agenda item, this memorandum requests an NAIC SVO response on the ability to produce a listing that details the CTLs that qualify under a structural analysis for inclusion in scope of SSAP No. 43R.

The Working Group will continue to evaluate the Task Force referral, particularly the proposed edits to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and the proposed CTL grandfathering provisions, after comments are received regarding the exposed agenda item. The Working Group will respond as timely as possible to that referral request.

Thank you for considering this response memorandum. If you have questions, please contact Julie Gann, NAIC staff of the Statutory Accounting Principles (E) Working Group.

Attachments: SAPWG Agenda Item 2020-24

Cc: Julie Gann, Robin Marcotte, Fatima Sediqzad, Jake Stultz, Jim Pinegar, Charles Therriault and Marc Perlman

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MEMORANDUM

TO: Kevin Fry, 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, Investment Counsel, NAIC Securities Valuation Office (SVO)

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

RE: Proposed Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) with Updated Instructions for Non-conforming Credit Tenant Loan (CTL) Transactions that Relied Upon Credit Ratings

DATE: April 30, 2020

1. Summary – Early in 2019 the SVO became aware that certain insurance company filers were submitting through the Filing Exempt (FE) process credit tenant loan (CTL) transactions that contained variants or deviations from the Bond Lease Based and Credit Lease Based CTL legal and structural characteristics not otherwise contemplated or defined in the P&P Manual (Non-conforming CTLs) and transactions which were subsequently defined in the P&P Manual as ground lease financing (GLF) transactions. For example, several CTLs were submitted to the SVO which contained balloon payments of greater than 5% without residual value insurance or another acceptable mitigant. In another instance, a security was submitted for which the Credit Rating Provider (CRP) analysis explained that its rating relied on the “dark value” of the property to cover payment of principal on the notes. The P&P Manual requires all CTL structures to be submitted to the SVO for review so it can determine if they reflect bond characteristics and, if so, assign an NAIC Designation. The SVO considered the GLF transactions to be distinct from CTL transactions and their related guidance in the P&P Manual. The SVO studied GLF transactions in detail and ultimately recommended new guidance for them to the Valuation of Securities (E) Task Force (the Task Force) which was adopted on December 8, 2019. Now we recommend addressing those Non-conforming CTL transactions that have been submitted through the Filing Exempt (FE) process in reliance on CRP ratings instead of being submitted to the SVO for review, and to prevent future incorrect filing procedures. To effect such changes, the SVO proposes P&P Manual amendments to the policy in Part One, “The Use of Credit Ratings of NRSROS In NAIC Processes,” and in Part Three, “Credit Tenant Loans.”

2. Recommendation – The SVO staff recommends that the Task Force include additional guidance in the policy on the “The Use of Credit Ratings of NRSROS In NAIC Processes” clarifying that there should be no presumption of permanent eligibility to receive an NAIC Designation based upon an NAIC CRP rating. The policy currently states, “The sole NAIC objective in obtaining and using publicly available credit ratings is to conserve limited regulatory resources; e.g., the resources of the SVO.” Additionally, the policy clarifies that in its use of CRP ratings the NAIC is not, “endorsing the credit rating or analytical product of any CRP.” Therefore, nothing about the use of CRP ratings should be interpreted, as was seemingly the case with Non-conforming CTLs and certain other investments, that the Task Force has approved the use of CRP ratings for the determination of NAIC Designations or for any other purpose, other than conserving SVO staff resources. The new policy guidance further

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affirms the Task Force's role in making all decisions on the use of CRP ratings and provides additional guidance to insurance company filers on what to do if they are uncertain about the filing procedure for a particular security or class of securities.

The SVO further recommends a "grandfathering" provision to permit an insurance company filer to file Non-conforming CTLs, which it owned prior to January 1, 2020 and which have CRP ratings, with the SVO for assessment and to authorize the SVO to use its own judgement in assessing eligibility for an NAIC Designation and, if appropriate, to assign an NAIC Designation which need not correspond to the CRP rating. The SVO also recommends referring this memo and proposed amendment to the Statutory Accounting Principles (E) Working Group and requesting the Working Group affirm that they would consider these Non-conforming CTLs to have the characteristics of a bond if assigned an NAIC Designation by the SVO staff.

3. Proposed Amendment – The following text in red shows the proposed revisions in Part One and Part Three.

PART ONE

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

THE USE OF CREDIT RATINGS OF NRSROs IN NAIC PROCESSES

NOTE: See “Policies Applicable to the Filing Exemption (FE) Process” below; “NAIC Policy on the Use of Credit Ratings of NRSROs” (especially “Definition – Credit Ratings Eligible for Translation to NAIC Designations”) in Part Two (the definition of “Eligible NAIC CRP Credit Ratings” excludes the use of any credit rating assigned to a security type *where the NAIC has determined that the security type is not eligible to be reported on Schedule D or that it is not appropriate for NRSRO credit ratings to be used to determine the regulatory treatment of the security or asset*); and “Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities” in Part Three.

Providing Credit Rating Services to the NAIC

57. The NAIC uses credit ratings for a number of regulatory purposes, including, to administer the filing exempt rule. Any rating organization that has been designated a Nationally Recognized Statistical Rating Organization (NRSRO) by the U.S. Securities and Exchange Commission (SEC) and which continues to be subject to federal regulation, may apply to provide Credit Rating Services¹ to the NAIC.

Policy and Legal Disclosure Pertaining to the NAIC Credit Rating Provider (CRP) List

58. The NAIC uses publicly available credit ratings, when available, as one component of the services it provides to state insurance regulators concerned with financial solvency monitoring of insurance company investments.
59. In adopting or in implementing the procedure described in this section, the NAIC acts solely as a private consumer of publicly available credit ratings. The sole NAIC objective in obtaining and using publicly available credit ratings is to conserve limited regulatory resources; e.g., the resources of the SVO. The VOS/TF has established the procedure specified in this section solely to ensure that the NAIC can avail itself of publicly available credit rating opinions.
60. The NAIC is not selecting, approving or certifying NRSROs or other rating organizations or distinguishing among them for any public or policy purpose whatsoever. Nor is the NAIC endorsing the credit rating or analytical product of any CRP or rating organization or distinguishing between CRPs or rating organizations for any specific public purpose. The NAIC disclaims any authority to regulate CRPs or rating organizations.

¹ **Credit Rating Services** is defined as: (a) electronic data feed transmissions of credit ratings assigned by the NRSRO with their corresponding CUSIP number and other pertinent security specific information in English, updated as frequently as provided to other customers; (b) other analytical services or products, in English, provided to other customers; and (c) access to the NRSRO’s rating analysts by SVO staff.

No Waiver/Express Reservation of Authority

61. Nothing in this section should be interpreted or construed as a waiver of the authority of the VOS/TF, in its sole and absolute discretion, to modify or change, in any manner whatsoever, the NAIC Policy on the Use of Credit Ratings of NRSROs, including but not limited to:
- Directing the removal of one or more NRSROs from the NAIC Credit Rating Provider List (subject only to the adjustment of any existing contractual obligations);
 - Directing the SVO to study any issue related to NRSRO operations in furtherance of state insurance regulatory policy;
 - eliminating the NAIC Credit Rating Provider List; or
 - Directing any other action or activity the VOS/TF may deem to be useful or necessary to the creation, maintenance or discharge of state-based regulatory policy.

No Presumption of Permanent Eligibility Based Upon a NAIC CRP Rating

62. Nothing in this Manual should be interpreted or construed as affirming that a security has been explicitly approved by the VOS/TF as being permanently eligible to receive an NAIC Designation solely because it was rated by an NAIC CRP. Investment Securities that have received NAIC Designations based on an Eligible NAIC CRP rating through the filing exempt process could, upon direction from the VOS/TF, become subject to SVO or SSG review or declared ineligible to be assigned an NAIC Designation.
63. Securities that meet the general legal and structural characteristics of any type of Investment Security described in this Manual should be presumed to be governed by the policies specific to that type of Investment Security, including Filing Exemption eligibility, or lack thereof. It is incumbent upon the insurer to seek clarification from the SVO when a classification or regulatory treatment of a security is in doubt. Additionally, the insurer or SVO Director may, together or independently, propose amendments to this Manual as they deem appropriate to further clarify the classification or regulatory treatment of Investment Securities identified in this Manual consistent with the Procedures to Amend This Manual.
64. Insurers or other parties wishing to know the probable regulatory treatment and eligibility of a security are encouraged to utilize the Regulatory Treatment Analysis Service – Emerging Investment Vehicle process in this Manual to initiate such a regulatory review and interpretation by the SVO or SSG.

PART THREE

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

CREDIT TENANT LOANS

FILING INSTRUCTIONS

NOTE: See “Policies Applicable to Specific Asset Classes” in Part One for 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.

Non-conforming Transactions

70. An insurer that acquired a CTL that contains a variant or deviation from the Bond Lease Based and Credit Lease Based CTL legal and structural characteristics not otherwise contemplated or defined herein (a “Non-conforming CTL”) prior to January 1, 2020, may file it with the SVO. Along with each Non-conforming CTL, the insurer shall submit for review an Audited Financial Statement of the lessee, Credit Lease Based CTL Evaluation Form (including the documents described in the Evaluation Form), a separate memorandum identifying and describing the variants or deviations which make the investment a Non-conforming CTL and all Eligible NAIC CRP Rating analyses of the transaction. Subsequent filings shall require the most recent Eligible NAIC CRP Rating analyses of the transaction, if available from the CRP, and the Audited Financial Statement of the lessee. Upon review of the submission, the SVO may assign an NAIC Designation if the risks posed by the Non-conforming CTL’s variants are, in the opinion of the SVO, adequately mitigated and the Non-conforming CTL would be consistent with an investment security that has characteristics of a bond.

The SVO has complete discretion to make the determination of whether the CTL has characteristics of a bond and the NAIC Designation, including rejecting the transaction as not reflecting bond characteristics, or adjusting the NAIC Designation for the transaction downward and away from the Eligible NAIC CRP Rating as the SVO deems analytically appropriate, or requesting additional information the SVO deems necessary for its analysis. If the Non-conforming CTL transaction does not maintain an Eligible NAIC CRP Rating for subsequent filings, the SVO has complete discretion to determine if an NAIC Designation can continue to be assigned. Non-conforming CTL transactions acquired by the insurer after December 31, 2019, shall not be reported as a bond.

71. As directed by the No Presumption of Permanent Eligibility Based Upon a NAIC CRP Rating section of this Manual, the VOS/TF considers securities that generally meet the legal and structural characteristics of Bond Lease Based or Credit Lease Based CTLs, but which do not meet all the specified characteristics, to be CTLs, and therefore not eligible for Filing Exemption and otherwise ineligible for reporting as a bond on Schedule D, except as explained in the paragraph above.

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Mike Monahan
Senior Director, Accounting Policy

Tracey Lindsey
NASVA President

John Petchler, on behalf of PPIA Board of Directors
PPIA President

June 17, 2020

Mr. Kevin Fry, Chair
NAIC Valuation of Securities (E) Task Force
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Ms. Carrie Mears, Vice Chair
NAIC Valuation of Securities (E) Task Force
1100 Walnut Street, Suite 1500
Kansas City, MO 64016-2197

Dear Mr. Fry and Ms. Mears:

The ACLI¹, PPIA² and NASVA³ (the “undersigned”) would like to thank you for the opportunity to comment on the April 30, 2020 exposure entitled “Proposed Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual)* with Updated Instructions for Non-conforming Credit Tenant Loan (CTL) Transactions that Relied Upon Credit Ratings.” Our comments regarding the exposure draft are as follows:

- 1) The undersigned support the exposure recommendation that Non-conforming CTLs (aka “Residual Balloon CTLs”) be referred to the Statutory Accounting Principles (E) Working Group (“SAPWG”). We understand SAPWG will be addressing this issue at the NAIC summer national meeting in August.

The NAIC Policy Statement on Coordination of the Accounting Practices and Procedures Manual and the Purposes and Procedures Manual of the NAIC Investment Analysis Office includes the following:

¹ 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. Learn more at www.acli.com.

² The **Private Placement Investors Association (PPIA)** is a business association of insurance companies, other institutional investors, and affiliates thereof, that are active investors in the primary market for privately placed debt instruments. The association exists to provide a discussion forum for private debt investors; to facilitate the development of industry best practices; to promote interest in the primary market for privately placed debt instruments; and to increase accessibility to capital for issuers of privately placed debt instruments. The PPIA serves 44 member companies and works with regulators, NASVA, the American College of Investors Counsel, and the investment banking community to efficiently implement changes within the private placement marketplace. Learn more at www.usppia.com.

³ The **North American Securities Valuation Association (NASVA)** is an association of insurance company representatives who interact with the National Association of Insurance Commissioners Securities Valuation Office to provide important input, and to exchange information, in order to improve the interaction between the SVO and its users. In the past, NASVA committees have worked on issues such as improving filing procedures, suggesting enhancements to the NAIC’s ISIS electronic security filing system, and commenting on year-end processes. Find more information [here](#).

“The assessment of credit risk for an obligation or asset, as specified in the P&P Manual, is a separate and distinct process from the determination of statutory accounting or reporting under the AP&P Manual. The manner in which an NAIC designation is used within statutory accounting guidance is limited to that, if any, specified in a statement of statutory accounting principle (SSAP) and cannot be derived or implied by language in the P&P Manual. Obtaining an NAIC designation does not change an investment’s applicable SSAP, annual or quarterly statement reporting schedule, or override other SSAP guidance required for the investment to be an admitted asset. There are limited instances in which a SSAP specifically identifies, within its scope, the inclusion of specific SVO-identified investments. The SVO review required for an investment to be included on a SVO listing is a separate evaluation process that focuses on the structure of the investment. This process is distinct from the SVO’s assessment of an investment’s credit risk, which results in a NAIC designation. As stated in the Statutory Hierarchy, Section V of the Preamble, the AP&P Manual is the highest level of authoritative guidance.”

In this regard we believe it is appropriate that these securities be referred to the SAPWG for determination of scope. We further believe Residual Balloon CTLs are a type of hybrid security that has some characteristics of a bond and some characteristics of a commercial mortgage. As such, this asset class may require a unique accounting/RBC solution. We look forward to working with NAIC staff and SAPWG to develop a solution that adequately reflects the risks and benefits associated with these transactions.

- 2) The undersigned also strongly believe the VOS Task Force should delay any proposed changes to the P&P Manual regarding treatment of Residual Balloon CTLs, until SAPWG has adopted appropriate scope and accounting for such transactions. It would be counterproductive to adopt P&P Manual language and then be forced to revise such language, depending upon what SAPWG determines to be appropriate treatment.

For example, should SAPWG determine these are commercial mortgage loans, there is no need for an NAIC designation. Further, statements in paragraph 70 and 71 suggest the SVO has the full power to determine if such securities are bonds. This suggestion runs contrary to NAIC policy and hierarchy. As noted above in the Policy Statement, SAPWG determines scope of investments (unless the SAPWG requires a structural analysis, as with conforming CTLs, where SAPWG has delegated to the SVO a specific role in the confirmation process).

We also call into question the more generic language in paragraph 62 where “upon direction from the VOS/TF, become subject to SVO or SSG review or declared ineligible to be assigned an NAIC designation.” Specifically, we have substantial concerns with regard to the implication that the SVO or VOS/TF would unilaterally declare a security ineligible for an NAIC designation, if it is determined to be a bond by SAPWG. This issue merits further discussion to ensure that it is not at odds with NAIC Policy.

- 3) Given that this issue now must go before SAPWG for review, and SAPWG’s decision holds implications for capital requirements, the undersigned request that insurers be allowed to continue holding these securities without an SVO-assigned designation, and instead hold capital on Residual Balloon CTLs as bonds and commensurate with any assigned CRP ratings. This would be consistent with the 2019 VOS/TF decision to temporarily exempt CRP-rated, Non-conforming CTLs from being filed with the SVO until a solution is found. We understand that such filing exemption and capital treatment would be temporary in nature, until appropriate accounting guidance from SAPWG and related capital requirements can be codified. The undersigned commit to working constructively with NAIC Staff and

SAPWG to develop an acceptable solution for Residual Balloon CTLs. Our hope is that final guidance could be adopted and implemented by year-end 2020.

Thank you again for your consideration. The undersigned look forward to working collaboratively in developing an ultimate solution for Residual Balloon CTLs that reflect the unique, hybrid characteristics of the asset class.

Sincerely,



Mike Monahan
Senior Director, Accounting Policy
American Council of Life Insurers

Tracey Lindsey

Tracey Lindsey
President
North American Securities
Valuation Association

John Petchler

John Petchler
President
Private Placement Investors
Association

cc: Charles Therriault, Director, SVO
Denise Genao-Rosado, NAIC SVO

To: Mr. Kevin Fry, Chair
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Ms. Carrie Mears, CFA®, Vice Chair
NAIC Valuation of Securities (E) Task Force
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From: Lease-Backed Securities Working Group

Re: Proposed Amendment to the *Purposes and Procedures Manual of the NAIC Investment Office* (P&P Manual) with Updated Instructions for Non-Conforming Credit Tenant Loan (CTL) Transactions that Relied Upon Credit Ratings.

We, the Lease-Backed Securities Working Group, are a combined group of insurance company investors, bankers, and attorneys with many years of experience originating, investing in, and holding three main asset classes: Credit Tenant Loans (“CTLs”), Ground Lease Financings, or “GLFs” – approved by this committee last December for inclusion into the P&P Manual -- and a third class of credit lease-backed bonds which do not meet the definitions set forth in the P&P Manual for the other two asset classes.

On behalf of our group, we respectfully request that the implementation of the proposed amendment(s) set forth in the April 30th memorandum from the SVO be delayed pending a full review of this asset class -- alternately referred to as “Non-Conforming CTLs”, “Other Lease-backed Transactions”, or “Residual Balloon CTLs” -- by all industry participants.

We understand that SAPWG will be presenting an exposure draft addressing the proper classification of this asset class, as well as potentially CTLs and GLFs, at the NAIC summer national meeting in August. We also note that SAPWG is currently undertaking a large-scale review of many asset classes currently included in SSAP 43R, “Structured and Loan-Backed Securities” where all conforming CTL transactions have been reported since 2012.

We further note, as referenced in the comment letter submitted to this committee jointly by the ACLI, NASVA, and the PPIA, that the NAIC Policy Statement on Coordination of the Accounting Practices and Procedures Manual and the Purposes and Procedures Manual of the NAIC Investment Analysis Office includes the following:

“The assessment of credit risk for an obligation or asset, as specified in the P&P Manual, is a separate and distinct process from the determination of statutory accounting or reporting under the AP&P Manual. The manner in which an NAIC designation is used within statutory accounting guidance is limited to that, if any, specified in a statement of statutory accounting principle (SSAP) and cannot be derived or implied by language in the P&P Manual. Obtaining an NAIC designation does not change an investment’s applicable SSAP, annual or quarterly statement reporting schedule, or override other SSAP guidance required for the investment to be an admitted asset...(emphasis added)...”.

As such, we believe that the implementation of the changes proposed to the P&P Manual in the April 30th Memorandum, most especially the proposal that “Non-conforming CTL transactions acquired by the insurer after December 31, 2019, shall not be reported as a bond” is premature, pending review of the classification of a number of securities as part of the broader effort.

We wholeheartedly agree with the goal of clarifying how these securities should be reported, and we remain committed to working closely with SAPWG, the members of VOSTF, as well as Director Therriault and the SVO staff, to accomplish this goal.

As we stated at the outset, our group combines many disciplines and many years of experience covering all aspects of originating, structuring, analyzing and investing in these securities, which provide an important investment alternative for the insurance industry. Our combined expertise can provide a valuable contribution to this effort, and we are happy to provide any assistance we can in the ongoing analysis undertaken by the various committees.

This was done last year successfully with Ground Lease Financings (“GLFs”), which were approved by the Task Force in December and are now included as a new Schedule-D eligible asset in the P&P Manual. Chairman Fry, in the December VOSTF meeting you specifically praised this effort as “the best of what the Task Force does when it works with industry”, and pointed out that the framework used for Ground Lease Financings could (and should) be used as a useful template for clarifying the reporting of this additional class of securities which do not meet the requirements to be classified as either “CTLs” or “GLFs”

We respectfully request that the Task Force delay adopting the changes to the Manual proposed in this amendment until such time as all parties have had the opportunity to undertake a full and thorough review of how these securities should be classified and reported.

Sincerely,



John M. Garrison

On behalf of:

The Lease-Backed Securities Working Group