



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 Update Guidance on Initial and Subsequent Annual Filings, and Methodologies and Documentation

DATE: July 15, 2020

- 1. Summary** – The SVO has recently encountered several situations where insurance companies have requested clarification or have declined to provide information necessary to enable it to complete its analysis. The SVO is not a party to the transactions it reviews and, therefore, is dependent upon the insurance companies to provide this information critical to its analysis. The attached proposed amendment reinforces the expectation that insurance companies will provide necessary documentation in a timely manner to the SVO and further outlines the types of information the SVO may require.
- 2. Recommendation** – The SVO recommends that the Task Force update the guidance in the P&P Manual for initial and subsequent annual filings and assessment methodologies to reinforce documentation and information requirements.
- 3. Proposed Amendment** – The following text in red shows the proposed revisions in Part One, Part Two, and Part Three of the P&P Manual.

PART ONE

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

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FILING SECURITIES WITH THE SVO

NOTE: See “General Filing Procedures” and “Filing Process and Required Documents” in Part Two and the various asset specific sections in Part Three for filing instructions and documentation requirements specific to the security or asset type discussed in those section.

Obligation to File Securities with the SVO

48. Insurance companies domiciled in any state of the United States, or any of its territories or possessions, that have adopted laws incorporating the standards in the NAIC Financial Regulation Standards and Accreditation Program that require the use of NAIC Designations or other analytical products for Investment Securities are required by those laws to file purchases of Investment Securities with the SVO as indicated in this Manual to obtain the NAIC Designation or other analytical product required by state law.
49. Investment Security means an instrument that documents a lending transaction between an insurance company as lender and a non-affiliated borrower, where the borrower’s sole motivation is to borrow money and the insurance company’s sole motivation is to make a profit on the loan that the state of domicile regulates by reference to the NAIC Financial Regulation Standards and Accreditation Program.
50. The SVO shall have no authority to issue NAIC Designations or any other NAIC analytical product to an insurance company for a Regulatory Transaction. This Manual provides that the SVO may assist a state insurance department in the assessment of the security component of a Regulatory Transaction and may issue an SVO Analytic Value to the department at the conclusion of the assessment. This Manual also provides instructions to insurance companies on how to report the security component of a Regulatory Transaction on investment schedules.

Who Must File

51. Filing a security with the SVO is the responsibility of the insurance company within 120 days after settlement of the investment. The expectation is that the filing of a security with the SVO is the responsibility of the insurance company lender with the largest dollar investment in the individual security (i.e., CUSIP or issue specific); however, all insurers are responsible to comply with all filing requirements in this Manual.

States May Require a Filing of Exempt or Other Transactions

52. Any provision in this Manual that exempts a transaction, security, financial asset or investment from being filed with the SVO does not prohibit a state insurance regulator from requiring its domiciled insurance company to file the transaction, security, financial asset or investment with the SVO for analysis and/or assignment of an NAIC Designation. Also, nothing in this Manual prohibits a state insurance regulator from asking for SVO or SSG analytical assistance with respect to any investment related activity, or in connection with assessment of investment-related aspects of a Regulatory Transaction, and directing an insurance company to file relevant information with the SVO or the SSG for that purpose.

Filing Requirements

53. **Initial** – Insurers that file a security must provide the SVO with the information necessary to evaluate the credit risk for the security.
54. **Annual** – Insurers that file a security are also required to provide the SVO with the information necessary to evaluate the credit risk for the security on an annual basis.
55. **Material Credit Events Filing** – It is the responsibility of the insurance company to file all information that indicates a change in the credit characteristics of the issuer or a material change in the terms of the agreement. A material change is an event that affects or is substantially likely to affect the issuer's ability to pay the insurer the obligation due to it in accordance with the original terms of the transaction. If an insurer determines that a bond is impaired under the statutory accounting procedures in *SSAP No. 26R—Bonds*, then the impairment should also be considered to be a material change. Material changes should be reported to the SVO on the Material Change/Additional Information ATF.
56. **Information and Documentation Requirements** – This can be found in Part Three as part of the description of the methodology that applies to specific types of securities or investments and the instructions on how to submit through VISION is on the NAIC website: www.naic.org/svo_vision.htm.

PART TWO
OPERATIONAL AND ADMINISTRATIVE INSTRUCTIONS
APPLICABLE TO THE SVO

GENERAL FILING PROCEDURES

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FILING PROCESS AND REQUIRED DOCUMENTS
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Initial and Subsequent Annual Filings

57. An insurance company makes an initial **and subsequent annual** filing by providing the SVO with ~~the~~ **any applicable** completed form(s) and the information, documents and data necessary for the SVO to conduct an analysis of the issuer's creditworthiness and the terms of the security.

Informational Deficiencies

58. When an insurance company submits an initial **or subsequent annual** filing, the SVO logs the submission by date and time received and the filing is assigned to the appropriate staff analyst. If the ~~staff analyst~~ **SVO** determines that there is an informational deficiency, **then the SVO he or she** will advise the insurance company that submitted the filing.
59. If the SVO identifies an information deficiency, the transaction is held by the SVO without processing for a period not to exceed 45 days. If the insurance company has not filed the necessary information with the SVO at the completion of the 45 days, the SVO discards the filing and all documentation submitted with it and enters a note in VISION to reflect that the filing was discarded due to insufficient information.
60. On an exception basis, the SVO may grant an extension to the insurance company not to exceed 90 days in total with the time period to begin on the date that the SVO issues an information request. If the SVO grants this extension, and if the insurance company fails to provide the information requested within the time provided, the SVO will discard the filing and all documentation submitted with it at the end of the 90-day period and Work Flow will reflect that the filing was discarded due to insufficient information.
61. If the SVO determines it requires additional information after it has received a response to its request for additional information, a new 45-day period begins, unless an extension is granted as indicated above, in which case a new 90-day period will begin.

Filing Procedures and Documentation Requirements

62. Filing procedures and documentation requirements can be accessed at <https://vision.naic.org>.

NOTE: See Part Three, which contain filing procedures and documentation requirements for the asset classes identified there.

PART THREE
SVO PROCEDURES AND METHODOLOGY FOR PRODUCTION
OF NAIC DESIGNATIONS

GENERAL CORPORATE AND MUNICIPAL METHODOLOGY FOR INDEPENDENT CREDIT QUALITY ASSESSMENT

NOTE: See “Special Instructions” (discussing Short-Term Investments, Circular Transactions, Mandatory Convertible Securities, Unrated Hybrid Securities and Sub-Paragraph D Companies) in Part One for policies that impact assignment of NAIC Designations.

27. Corporate bonds defined as the Obligations¹ of domestic and foreign corporations, and preferred stock shall be distinguished on the basis of the categories discussed below. The creditworthiness of the issuer of any particular category of Obligation shall be assessed by reference to the general, and any special, rating methodology discussed in this Part, unless the context of the analysis requires a different approach.
28. Consistent with the SVO’s authority to use reasonable analytical discretion in its assessments, the SVO may utilize methodologies or request additional documents and information from insurance companies, if the SVO deems it appropriate and necessary to conduct its analysis for any investment that it reviews.

Independent Assessment

29. If the security under consideration is unrated, or if an analyst has conducted an independent analysis of the NAIC CRP-rated security, the analyst shall make an independent assessment of the issuer, the security or both.

FINANCIAL ANALYSIS

Audited Financial Statement Required

29. As a first step in the independent assessment, the analyst shall conduct an independent financial analysis of the issuer based on the financial information presented in the Audited Financial Statement, as defined in this Manual, **submitted by the insurance company**.
30. The SVO shall base its financial analysis on at least three years of historical audited financial information and a minimum of one year of projected financial information (if available) when the issuer has an operating history of three years or more.
31. **The SVO may request and consider interim financial statements, if the SVO deems the information necessary for its analysis or to maintain a previously assigned NAIC Designation and NAIC Designation Category.**

¹ **Obligation** means bonds, notes, debentures, certificates, including equipment trust certificates, production payments, bank certificates of deposit, bankers’ acceptances, credit tenant loans, loans secured by financing net leases and other evidences of indebtedness for the payment of money (or a participation, certificates or other evidences of an interest in any of the foregoing), whether constituting general obligations of the issuer or payable only out of certain revenues or certain funds pledged or otherwise dedicated for payment.

32. However, the SVO may assign an NAIC Designation based on less than three years of financial information in circumstances where the issuer's operating history is less than three years or because the issuer's legal identity has been subsumed as a result of a merger into a new entity or due to other documentable business circumstances.
33. Where three years of financial information is not available, the analyst shall review such information as is available, and shall determine if the time period for which information is available is sufficient to produce a professionally sound opinion.

Calculation of Ratios

34. Financial analysis shall culminate in the calculation of such financial ratios as the analyst feels highlight appropriate aspects of the financial performance of the issuer that bear on its ability to meet the obligation owed to the insurance company.

LEGAL ANALYSIS

Legal review

35. The SVO shall review legal agreement(s) related to the transaction (e.g. prospectus, indenture, loan agreement, note purchase agreement, guarantee or equivalent legal documents) along with any amendments, waivers, compliance certifications and opinions of counsel it deems necessary for its analysis.

OTHER ANALYSIS

Other information

36. The SVO may review and consider any other public or private information (including insurance company internal credit analysis memoranda) provided by the insurance company or obtained through its own research, that it considers relevant or necessary to analyze the transaction and consistent with its Use of Generally Accepted Techniques or Methodologies.

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