



TO: Kevin Fry, Chair, Valuation of Securities (E) Task Force
Members of the Valuation of Securities (E) Task Force

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

RE: Filing Exemption for Real Estate Lease-Backed Securities

DATE: May 27, 2021

Summary – The SVO staff drafted the attached amendment at the request of the Task Force, based on a proposal referred to the Task Force by the Statutory Accounting Principles (E) Working Group (the Working Group) chairs, intended to clarify the difference between Credit Tenant Loans and real estate lease-backed securities for purposes of amending the Filing Exemption eligibility for each. Initially, at the Task Force’s request, the SVO drafted an amendment to the P&P to permit Credit Tenant Loan (CTL) and Ground Lease Financing (GLF) transactions to use NAIC Credit Rating Provider ratings in the Filing Exemption process and update the residual asset exposure from the current 5% limitation to 50%. If these transactions have greater than a 50% residual asset exposure, they would be ineligible for Filing Exemption. The Working Group chairs proposed an alternate amendment intended to achieve a similar outcome but without requiring the Task Force to opine on acceptable residual thresholds, which is under the purview of the Working Group.

The Working Group chairs contend that the original intent of the CTL provisions when adopted in the 1990s was to allow certain mortgage loans, as currently defined in SSAP No. 37, to be reported on Schedule D-1 as opposed to Schedule B due to the reliance on the creditworthiness of a credit tenant. CTLs have evolved from direct “mortgage loan” structures to “securities” which are expressly excluded from the definition of “mortgage loan” in SSAP No. 37. As such, the Working Group chairs proposed modifying the P&P definition of CTL by clarifying that CTLs only refer to “mortgage loans in scope of SSAP No. 37,” and, by default, not “securities,” which would be in scope of SSAP Nos. 26R or 43R. Real estate lease-backed securities would include CTL-like transactions which meet all the CTL guidelines in the P&P but for a feature making it a security, such as a trust issued certificate, CTL-like securities with balloon payments in excess of 5%, and ground lease financings which do not include a direct mortgage loan from the investor.

Pursuant to the proposed amendment the Working Group would not need to opine on a residual threshold at this time and the Task Force could make its own determination about the Filing Exempt status of these transactions. At the request of the Task Force the amendment would only require CTLs with mortgage loans in scope of SSAP No. 37 to be filed with the SVO for review and potential assignment of an NAIC Designation. All other real estate lease-backed transactions which meet the definition of a “security” would be eligible for Filing Exemption, and have the option to file with the SVO.

Proposed Amendment - The text impacting Credit Tenant Loan and Ground Lease Financing Transactions is shown below, addition edits in red underline and deletions in ~~red strikethrough~~, as it would appear in the 2020 P&P Manual format.

PART ONE

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

CREDIT TENANT LOANS

CTL Categories

100. Mortgage loans, [in the scope of SSAP No. 37](#), that are made primarily in reliance on the credit standing of a major tenant, structured with an assignment of the rental payments to the lender with real property pledged as collateral in the form of a first lien, are referred to as a Credit Tenant Loan. Four categories of CTLs are recognized as eligible for reporting on Schedule D: Bond Lease Based CTLs; Credit Lease Based CTLs; Acceptable CTL Variants (ACVs); and Multiple Property Transactions (MPTs).

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GROUND LEASE FINANCING TRANSACTIONS
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108. The ground lease itself typically meets the Credit Tenant Loan (CTL) criteria for Bond Lease Based or Credit Lease Based CTLs in this Manual [and is in scope of SSAP No. 37 – Mortgage Loans](#). Additionally, there can be one or several space tenants or business operators (which (a) may or may not be NAIC CRP rated entities or (b) whose credit worthiness can or cannot be evaluated by the SVO) making lease payments under separate space leases (which may or may not meet the CTL criteria) or a business operation. As such, the SVO cannot rely solely on the CTL criteria for its analysis of GLF transactions and instead must rely on a combination, as necessary and available, of the CTL criteria, the CMBS criteria, the documented analysis of NAIC CRPs, and the SVOs own analytic judgement.

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PART THREE
SVO PROCEDURES AND METHODOLOGY FOR PRODUCTION
OF NAIC DESIGNATIONS

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

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FE SECURITIES

Filing Exemption

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

Specific Populations of Securities Not Eligible for Filing Exemption

4. The filing exemption procedure does not apply to:

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- **Credit Tenant Loan (CTL)** – A CTL is a mortgage loan, in scope of SSAP No. 37, made primarily in reliance on the credit standing of a major tenant, structured with an assignment of the rental payments to the lender with real property pledged as collateral in the form of a first lien. This Manual identifies four categories of CTLs as eligible for reporting on Schedule D conditioned on an SVO determination that the transaction meets the criteria specified by the VOS/TF for Schedule D treatment. A transaction that purports to be a Credit Tenant Loan, including one that is assigned a credit rating by an NAIC CRP, is not eligible for Schedule D reporting unless the SVO confirms that the transaction is eligible for Schedule D reporting and assigns the transaction an NAIC Designation. A security which resembles a CTL but is not in scope of SSAP No. 37 – Mortgage Loans, can be filed with the SVO for an NAIC Designation and, if appropriate, the SVO can apply the CTL guidelines in this Part to its review.

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- **Ground Lease Financing Transactions** – A Ground Lease Financing (GLF) transaction typically has two components: (a) a ground lease for a long period (e.g., 99 years) between a ground lessor who owns the land and a ground lessee who attains a leasehold for the purpose of developing the land; and (b) the subleasing of space or operation of a business such as a hotel, warehouse, intermodal facility, etc., in an existing or to-be-constructed building to one or more tenants (space tenants) under shorter (e.g., 5–15 year) leases (space leases) or to the operator of a business such as a hotel, warehouse, intermodal facility, etc., under a franchise agreement or other arrangement. GLF transactions, in scope of SSAP No. 37 – Mortgage Loans, are not eligible for filing exemption. The GLF section in this Part provides further guidance on how the SVO analyzes GLF transactions for purposes of determining Schedule D eligibility and whether the SVO can assign an NAIC Designation. A security which resembles a GLF transaction but is not in scope of SSAP No. 37 – Mortgage Loans, can be filed with the SVO for an NAIC Designation and, if appropriate, the SVO can apply the GLF guidelines in this Part to its review.

CREDIT TENANT LOANS

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GENERAL

SVO Procedure

85. Upon receipt of an Evaluation Form, the SVO analyst shall first review the Evaluation Form and other documents submitted by an insurer to verify that the transaction reflects appropriate CTL criteria. If the information provided on the Evaluation Form suggests that the transaction is likely to reflect all appropriate CTL criteria, the analyst shall proceed to determine either: (a) the transaction reflects risk consistent with the definition and other criteria for the category; or (b) the transaction contains risks different from those normally associated with Schedule D transactions.
86. Where, in the opinion of the analyst and where otherwise appropriate, the risk presented by the transaction is inconsistent with the definition and other criteria for the CTL category but is consistent with ~~Schedule D~~ reporting a security with an NAIC Designation, the analyst may reflect the additional risk by adjusting the Designation for the transaction downward and away from the credit rating category assigned to the lessee. ~~If the analyst concludes that the transaction contains risks different from those normally associated with Schedule D, the transaction shall be rejected as ineligible for Schedule D reporting.~~

ACCEPTABLE CTL VARIANTS

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Guidelines for Acceptable CTL Variants

97. Transactions that exhibit the following variations from the definitions of Bond Lease or Credit Lease Based CTL contained above will nevertheless be eligible for Schedule D treatment in accordance with these guidelines and the definitions if the following standards are met:

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- Use of collateral trustee and issuance of trust certificates. The use of a collateral trustee, or trust certificates, has no impact on eligibility for CTL treatment if the transaction continues to be a mortgage loan in scope of SSAP No. 37. Staff will, of course, review appropriate documentation associated with the arrangement.

GROUND LEASE FINANCING TRANSACTIONS

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DEFINITION AND OVERVIEW

Ground Lease Financing Transaction – Definition and Overview

108. A ground lease financing (GLF) transaction is in scope of SSAP No. 37 – Mortgage Loans and typically has two components: (a) a ground lease for a long period (e.g., 99 years) between a ground lessor who owns the land and a ground lessee who attains a leasehold for the purpose of developing the land; and (b) the subleasing of space or operation of a business such as a hotel, warehouse, intermodal facility, etc., in an existing or to-be-constructed building to one or more tenants (space tenants) under shorter (e.g., 5–15 year) leases (space leases) or to the operator of a business such as a hotel, warehouse, intermodal facility, etc., under a franchise agreement or other arrangement.

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