



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

RE: Add Zero Loss Criteria for Legacy Modeled RMBS and CMBS

DATE: August 31, 2021

---

**Summary** – The SVO and SSG staff drafted the attached amendment to the *Purposes and Procedures Manual for the NAIC Investment Analysis Office (P&P Manual)* at the request of the American Council of Life Insurers (ACLI) and North American Securities Valuation Association (NASVA) in their memorandum to the Task Force dated July 9, 2021 commenting on the implementation of the March 22 adopted amendment to Update the Financial Modeling Instructions for RMBS/CMBS Securities and Direct IAO Staff to Produce NAIC Designation and NAIC Designations Categories for Non-Legacy Securities. The ACLI and NASVA were supportive of the adopted amendment referenced above and the change to a “through the cycle” modeling approach that the Structured Securities Group (SSG) is planning to implement. With the adoption of the new bond risk-based capital (RBC) factors, the ACLI and NASVA requested a phased implementation to minimize operational and reporting issues. SSG is planning such a phased approach and will continue for 2021 with the existing six price breakpoints to determine an NAIC Designation with the result mapped to an NAIC Designation Category as was done for year-end 2020. SSG plans to introduce twenty price breakpoints for 2022 and at that time the mapping instructions to an NAIC Designation Category will be deleted from the P&P Manual.

**Requested Changes** - The ACLI and NASVA requested four changes, identified in underline-italics, with a staff recommended action identified in **bold**.

1. *NAIC designation mapping of non-modeled structured securities follows the same filing-exempt (FE) process as all other FE bond investments that are currently granted filing exemption under the P&P manual of the IAO.*

**The P&P Manual already permits non-modeled RMBS and CMBS securities that cannot be financially modeled but are rated by a credit rating provider to rely upon the filing exemption process (Part Four, paragraph 5). No change or update is necessary at this time.**

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

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

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

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

2. NAIC designation mapping of non-legacy modeled securities should follow the below outlined process:
  - a. Price breakpoints for non-legacy modeled securities are eliminated this year and the SSG follows the adopted intrinsic price approach.
  - b. Companies receive a file from the SSG with CUSIP-level designations that can be directly consumed by vendors.
  - c. In the absence of a more detailed methodology for mapping under the 20 NAIC designations, SSG will map “zero-loss” securities to 1A, and all other securities to the middle designation of their category.

**SSG will be producing NAIC Designation Categories for all non-legacy modeled securities consistent with the methodology already published for mortgage reference securities.**

3. NAIC designation mapping of legacy modeled securities should follow the below outlined process:
  - a. Companies receive a file from the SSG with CUSIP-level price points that can be directly consumed by vendors (one set for Life and one set for PC). This file will have the exact same layout as in 2020. To that end, the SSG will derive the CUSIP-level price breakpoints from the new RBC factor of the middle designation of each designation category.
  - b. In the absence of a more detailed methodology for mapping under the 20 NAIC designations, companies will map “zero-loss” securities to 1A, and all other securities to the middle designation of their category.

**SSG will be producing five price breakpoints for legacy modeled securities in the same data layout as the 2020 file but deriving the price breakpoints from the RBC factors assigned to the middle NAIC Designation Category for each NAIC Designation. Legacy securities that exhibit “zero-loss” under any scenario will be mapped to an NAIC Designation Category 1.A.**

4. Implementation of “through the cycle” modeling for CMBS is postponed to 2022, provided that if 2021 modeling results lead to visibly distorted NAIC designations as in 2020, the SSG retains flexibility to calibrate results in a way that alleviates such distortions.

**SSG plans to use “through the cycle” for modeling RMBS in 2021 and CMBS in 2022.**

**Recommendation** – The SVO and SSG staff recommends that only the action steps for request item 3 be considered at this time as the other requested changes have a process in place to address the concern or will be a future change.

**Proposed Amendment** - The text impacting Part Four is shown below, addition edits in red underline and deletions in ~~red strikethrough~~, as it would appear in the 2021 P&P Manual format given interim adopted changes through July 15<sup>th</sup>.

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

...

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

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

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

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

...