



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

FROM: Dale Bruggeman, Chair of the Statutory Accounting Principles (E) Working Group  
Carrie Mears, Vice-Chair of the Statutory Accounting Principles (E) Working Group

RE: Provisions for NAIC 5GI Designations

DATE: November 15, 2021

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The purpose of this referral is to request that the Valuation of Securities (E) Task Force review the NAIC 5GI guidance detailed in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and consider whether modifications are necessary to clarify the intent of the guidance and mitigate misapplications. As an example, the Working Group was made aware of situations in which residual tranches, which do not have contractual interest or principal payments, were being designated as NAIC 5GI by reporting entities. Although there was broad agreement by key industry representatives and state insurance regulators that the NAIC 5GI should not be permitted for these residual tranches, potential refinement to clarify the NAIC 5GI provisions may prevent future misapplication.

Residual Tranches Defined per SSAP No. 43R–Loan-Backed and Structured Securities: Reference to “residual tranches or interests” intends to capture securitization tranches and beneficial interests as well as other structures captured in scope of this statement, that reflect loss layers without any contractual payments, whether principal or interest, or both. Payments to holders of these investments occur after contractual interest and principal payments have been made to other tranches or interests and are based on the remaining available funds. Although payments to holders can occur throughout an investment’s duration (and not just at maturity), such instances still reflect the residual amount permitted to be distributed after other holders have received contractual interest and principal payments.

In addition to clarifying that the guidance cannot be applied to residual tranches, as defined in SSAP No. 43R, the following concepts are provided as suggestions for possible clarification:

- Clarifications to ensure that the NAIC 5GI self-assigned designation is permitted only for securities that could be reviewed for an NAIC designation if the documentation to support a credit analysis could be submitted. In other words, the 5GI process is not intended to be used for securities that would not qualify for a designation even if a full credit analysis could be performed. Securities that cannot be reviewed for an NAIC designation due to the lack of a process / methodology for the type of security or structure are not permitted to be self-assigned an NAIC 5GI designation.
- Clarification that self-assigning an NAIC 6\* for securities that do not qualify for NAIC 5GI is not a declaration of potential default. Rather, the self-assignment indicates that the security could not be reviewed for a full credit analysis and the requirements for an NAIC 5GI could not be met.

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Thank you for considering these potential clarifications. Please contact Dale Bruggeman, or Carrie Mears, SAPWG Chair and Vice Chair, with any questions.

Cc: Julie Gann, Robin Marcotte, Jim Pinegar, Jake Stultz, Charles Therriault, Marc Pearlman

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