



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: Purposes and Procedures Manual amendment to add guidance on the designation of Schedule BA assets with fixed income characteristics

DATE: November 17, 2021

Summary – The SVO recommends updating the instructions in Part Three of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (the “P&P Manual”) to include guidance related to the assignment of NAIC Designations to Schedule BA assets with underlying characteristics of bonds or fixed income instruments. Part One of the P&P Manual currently permits the SVO to assign NAIC Designations to Schedule BA assets with underlying characteristics of bonds or fixed income instruments, but there is currently no specific guidance for the SVO in Part Three. Including the proposed provisions would enable the SVO to assign NAIC Designations to Schedule BA assets which are not expressly covered by other sections of the P&P Manual (e.g. Schedule BA Non-Registered Private Funds with Underlying Assets Having Characteristics of Bonds or Preferred Stock). Schedule BA assets for life and fraternal insurers benefit from NAIC Designations because they would be eligible for more favorable RBC treatment.

The SVO’s authority to assign NAIC Designations to certain Schedule BA assets already exists. Part One of P&P Manual states that, “The SVO is assigned to assess investment securities reported to state regulators on Schedule D and Schedule BA.” (Paragraph 40). Additionally, the P&P explains that to be eligible for the assignment of an NAIC Designation a Schedule BA asset must have underlying characteristics of a bond or fixed income instrument.

Insurers may file a Schedule BA asset with the SVO if they can represent that the asset has underlying characteristic of a bond or other fixed income instrument. When an insurer files a Schedule BA asset the SVO assesses the insurer’s fixed income determination and it if agrees that the asset has fixed income characteristics, conducts a credit assessment and a valuation of the asset. Upon conclusion of its analysis, the SVO provides the insurer a response setting forth its determination as to the NAIC Designation and asset classification assigned to the asset. Upon receipt of the SVO response, the insurer reports the aforementioned analytical values obtained from the SVO for the asset on the NAIC Financial Statement Blank. (P&P Manual, Part One, Paragraph 99)

This proposed amendment would potentially make various types of assets eligible for an NAIC Designation which currently are not. Each asset would need to be individually assessed by the SVO for bond or fixed income characteristics.

Proposed Amendment - The text changes to add guidance to the P&P on the designation of Schedule BA assets with fixed income characteristics is shown below with additions in red underline and deletions in ~~red strikethrough~~, as it would appear in the 2021 P&P Manual format.

PART THREE
SVO PROCEDURES AND METHODOLOGY FOR PRODUCTION OF NAIC
DESIGNATIONS

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

...

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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- Schedule BA Assets – Assets eligible for reporting on Schedule BA, and not otherwise subject to the processes or procedures of another section of this Manual, are ineligible for the filing exemption procedure.

SCHEDULE BA ASSETS

NOTE: See “Policies Applicable to Specific Asset Classes” in Part One for policies governing these assets, 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 in this Part.

Definition

320. Pursuant to this section, Schedule BA Assets include any asset eligible for Schedule BA which is not otherwise subject to the processes or procedures of another section of this Manual, and which has underlying characteristics of a bond or other fixed income instrument.

Required Documentation

321. In accordance with Part One of this Manual, when filing a Schedule BA Asset with the SVO, an insurer must submit a representation that the asset has underlying characteristics of a bond or other fixed income instruments. Additionally, the insurer shall submit any other information or documentation which the SVO deems necessary for it to make a determination about the asset’s underlying characteristics and, if thereafter necessary, to perform a credit assessment. An insurer determination that an instrument has fixed income characteristics also suggests it ought to have documentation very similar in nature to what would be presented to the SVO for a Schedule D asset; for example, an Audited Financial Statement, loan documentation or legal agreement.

Legal Review

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

Analysis and Methodology

323. The SVO will first assess the insurer’s fixed income determination. Only if the SVO agrees that the asset has fixed income characteristics and determines that it has the appropriate methodology and sufficient resources with which to conduct its analysis, will the SVO then conduct a credit assessment of the asset for the assignment of an NAIC Designation Category.

Maintenance and Monitoring

323. Maintenance and monitoring of SVO determinations for Schedule BA Assets will be conducting in accordance with “Maintenance and Monitoring of SVO Determinations For Schedule BA Assets” in Part One of this Manual.

<https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2021/12 December FALL NATIONAL METING/Exposed/2021-049.01 Task Force 2021 Amend PP SchBA Fixed Income Comp v2.docx>