



TO: Carrie Mears, 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, Managing Investment Counsel, NAIC Securities Valuation Office (SVO)

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

RE: Proposed Amendment to update Notice of Credit Deterioration for the List of Qualified U.S. Financial Institutions in the Purposes and Procedures Manual of the NAIC Investment Analysis Office (the “Purposes and Procedures Manual”)

DATE: March 13, 2023

Summary – The SVO maintains the List of Qualified U.S. Financial Institutions (“QUSFI”) which indicates the financial institutions eligible to issue letters of credit (“LOCs”) which, pursuant to Section 3 of the Credit for Reinsurance Model Law (“Model #785”), can be used to reduce an insurers liability when ceding reinsurance to certain assuming insurers. To qualify as a QUSFI the LOC issuing financial institution needs to meet the criteria listed in Section 4 of Model #785, which includes a requirement that the financial institution *“Has been determined by either the commissioner or the Securities Valuation Office of the National Association of Insurance Commissioners to meet such standards of financial condition and standing as are considered necessary and appropriate to regulate the quality of financial institutions whose letters of credit will be acceptable to the commissioner.”*

The SVO has encountered several recent situations in which a financial institution on the QUSFI list (e.g. Silicon Valley Bank and Signature Bank) was not downgraded below the minimum permitted ratings of BBB-/Baa3 in the QUSFI guidelines in Part Two of the Purposes and Procedures Manual prior to regulatory action being taken by their primary regulator(s), such as closure of the bank by the relevant state regulator and appointment of the Federal Deposit Insurance Corp. as receiver. These situations accelerated very rapidly, and the most recent financial statements did not reflect sufficient financial weakness to warrant adding these financial institutions to the QUSFI Watch List.

It should be noted that, pursuant to a drafting note in Section 3 of Model #785, in order to limit market disruptions, when a QUSFI is removed from the list, any existing LOCs issued by it will continue to be acceptable as security until the beneficiary has replaced the credit support facility:

Drafting Note: Providing for the continuing acceptability of letters of credit whose issuers were acceptable when the credit support facility was first obtained is intended to avoid abrupt interruptions in the acceptability of credit support arrangements that run for specific periods of time, and thus unnecessary disruptions in the marketplace, on account of the issuing (or confirming) institution’s subsequent failure to meet applicable standards of issuer acceptability (whether by virtue of a change in the issuing institution’s ability to qualify under the original



standards or as a result of revisions to the applicable standards). The provision stipulates that letters of credit acceptable when first obtained will, in the event of the subsequent nonqualification of the issuing (or confirming) institution, continue to be acceptable as security until the account party and beneficiary would first have, in the normal course of business, an opportunity to replace the credit support facility.

Recommendation – The SVO recommends updating the guidelines for removal of a financial institution from the List of Qualified U.S. Financial Institutions to include actions either announced or taken by their primary regulator(s).

Proposed Amendment - The proposed text changes to the P&P Manual are shown below with additions in red underline and deletions in ~~red strikethrough~~, as it would appear in the 2022 P&P Manual format.



PART TWO
OPERATIONAL AND ADMINISTRATIVE INSTRUCTIONS
APPLICABLE TO THE SVO



LIST OF QUALIFIED U.S. FINANCIAL INSTITUTIONS

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SVO Monitoring of Movements in the Credit Quality of Financial Institution on the List of Qualified U.S. Financial Institutions

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135. **Notice of Credit Deterioration** – The SVO shall provide notice to the NAIC Reinsurance (E) Task Force and state insurance regulators more generally and to insurers about the credit quality of financial institutions on the List of Qualified U.S. Financial Institutions as described below.

- If a financial institution is rated by an NRSRO at “A-/A3” or better and the SVO determines that a financial institution no longer meets one or more of the financial metrics specified above, the SVO will monitor the institution to assess the likelihood of the NRSRO to take a potential negative rating action against the institution.
- If the SVO determines that a financial institution on the List of Qualified U.S. Financial Institutions rated “BBB+/Baa1 or below but not lower than BBB-/Baa3” by an NRSRO no longer meets one or more of the financial metrics specified above or that it has been placed on Negative Outlook or Negative Watch by an NRSRO, the SVO shall perform a more detailed review of the financial condition of the institution.
- If the SVO determines that the noted credit deterioration suggests that the financial institution may soon no longer meet the required minimum, the SVO will place the name of the financial institution on its Watch List. If the name of the financial institution is placed on the SVO Watch List, the financial institution will not be allowed to renew participation on the financial institution list for the next year.
- If a financial institution on the List of Qualified U.S. Financial Institutions is downgraded below “BBB-/Baa3” by an NRSRO, the SVO shall remove the name of the financial institution from the List of Qualified U.S. Financial Institutions.
- If a financial institution on the List of Qualified U.S. Financial Institutions is closed by and/or placed in receivership or conservatorship, or notice is given of such action, by its primary regulator(s), the SVO shall promptly remove the name of the financial institution from the List of Qualified U.S. Financial Institutions. This may result in the SVO being unable to provide Notice of Credit Deterioration.



- A financial institution whose name is deleted from the List of Qualified U.S. Financial Institutions because its NRSRO credit rating dropped below the minimum credit rating may renew participation on the financial institution list when the financial institution's credit rating is restored to BBB-/Baa3 or higher with a stable outlook.

<https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2023/2023-03-23 Spring NM/06-QUSFI Credit Deterioration/2023-004.01 Task Force 2022 Amend PP QUSFI Credit Deterioration v3.docx>