



TO: Carrie Mears, Chair, Valuation of Securities (E) Task Force  
Members of the Valuation of Securities (E) Task Force

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RE: Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (the "P&P Manual") Authorizing the Procedures for the SVO's Discretion Over NAIC Designations Assigned Through the Filing Exemption Process

DATE: November 3, 2023

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**Summary:** At the Summer National Meeting held on Aug. 14, 2023, the Task Force discussed an initial draft of a proposed amendment to the P&P Manual authorizing the procedures for the SVO's discretion over NAIC designations assigned through the filing exemption (FE) process. The Task Force directed the SVO staff to consider the feedback from Task Force members and interested parties and update the proposal. The revised amendment in this memorandum reflects the actionable comments received from Task Force members and interested parties that align with the following charges given to the Task Force from the Financial Condition (E) Committee (emphasis added):

- Identify potential improvements to the filing exempt (FE) process (the use of credit rating provider [CRP] ratings to determine an NAIC designation) to ensure greater consistency, uniformity, and appropriateness to achieve the NAIC's financial solvency objectives.
- Implement policies to oversee the NAIC's staff administration of rating agency ratings used in NAIC processes, including staff's discretion over the applicability of their use in their administration of FE.
- Establish criteria to permit staff's discretion over the assignment of NAIC designations for securities subject to the FE process (the use of CRP ratings to determine an NAIC designation) to ensure greater consistency, uniformity, and appropriateness to achieve the NAIC's financial solvency objectives.



The revised amendment incorporates the following process steps, many of which were requested by interested parties:

- 1) SVO staff identifies a FE security with an NAIC Designation determined by a rating that appears to be an unreasonable assessment of risk.
- 2) SVO Senior Credit Committee (SCC) meets to determine if it agrees that the rating appears an unreasonable assessment of risk and, if so, places the security "Under Review".
- 3) If the SVO SCC votes to put the security "Under Review" an information request will be sent through VISION to insurers that hold that security in their VISION portfolio and an the SVO Administrative Symbol assigned to identify them in VISION and AVS+.
- 4) If the information request is not responded to, the SVO may reach out to the domiciliary Chief Financial Examiner.
- 5) Upon receipt of all necessary documentation through the information request, the SVO will then perform a full analysis of the security and coordinate with the interested insurer(s) on any questions or issues the SVO may have about the security.
- 6) SVO SCC re-convenes and determines, based on its full analysis of all necessary information, whether the FE NAIC Designation is three (3) or more notches different than the SCC's opinion.
- 7) If the SVO SCC opinion differs from the FE produced NAIC Designation Category by a material three (3) or more notches the specific CRP rating(s) for that security will be removed from FE.
- 8) The SCC will present its analysis to a sub-group of the Task Force to provide oversight over the FE removal process and enable the Task Force to provide feedback to the SVO.
- 9) If there are no alternative CRP ratings, the SVO SCC's assessment will be entered into VISION. If an alternative CRP rating is subsequently received, it will be incorporated into the FE process, if applicable.
- 10) If the SVO SCC assesses the issue is part of a recurring pattern, the SVO Director will inform the chair and decide if an issue paper, referral or amendment is needed.
- 11) An anonymized summary of each unique issue or situation will be published on the SVO webpage or some other insurer accessible location for transparency.
- 12) An insurer may appeal to the Task Force chair if they believe the SVO did not follow the procedures outlined in the P&P Manual.
- 13) If an insurer(s) wishes to appeal the SVO SCC's analytical assessment, it may request the NAIC's IAO to contract, at the insurer(s) expense, with an independent third-party acceptable to the NAIC IAO to perform a blind review of the security (e.g. without knowledge of the SCC's, insurer's or CRP's assessment) with the information provided through the information request. If the independent third-party review results in an NAIC Designation Category that is one (1) or less notches different from the FE produced NAIC Designation Category, then the SVO SCC's opinion will be overridden by the reinstatement



of the CRP rating(s). If the independent third-party review results in an NAIC Designation Category that is more than one (1) notch different from the FE produced NAIC Designation Category, then the SVO SCC's opinion will remain.

- 14) The SVO will identify through SVO Administrative Symbols when a CRP rating(s) has been removed from the Filing Exemption process for a security.
- 15) At the Spring National Meeting, the SVO Director will summarize FE discretion actions take for the preceding year.

**Recommendation:** It is expected that implementation of this process will require enhancements to NAIC's VISION and AVS+ applications. Funding for the application enhancements in the amendment, if adopted, will need to be approved by the Executive (EX) Committee and the initiative will need to go through the NAIC's development process. It could take 1-2 years before this proposal can be fully implemented. The SVO recommends adoption of this proposed amendment authorizing the procedures for the SVO's discretion over NAIC Designations assigned through the FE process with an effective date of January 1, 2025. The effective date can be amended, if needed, because of the dependency mentioned. The proposed text changes to 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 ONE

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

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<b>POLICIES APPLICABLE TO THE FILING EXEMPTION (FE) PROCESS</b>
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**NOTE:** The policies below provide the policy framework for “Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities” in Part Three and are related to “The Use of Credit Ratings of NRSROs in NAIC Processes” discussed above; “NAIC Policy on the Use of Credit Ratings of NRSROs” and the “Definition – Credit Ratings Eligible for Translation to NAIC Designations” in Part Two (“Eligible NAIC CRP Credit Ratings” excludes the use of any credit rating assigned to a security type where the NAIC has determined that the security type is not eligible to be reported on Schedule D or the it is not appropriate for NRSRO credit ratings to be used to determine the regulatory treatment of the security or asset.)

#### Determinations

80. The VOS/TF is resolved that the benefit obtained from the use of credit ratings in state regulation of insurance (i.e. conservation of limited regulatory resources) must be balanced against the risk of blind reliance on credit ratings. To ensure the Task Force properly understands the composition and risk of the filing exempt securities population; promote uniformity in the production of NAIC Designations, reduce reporting exceptions for filing exempt securities and increase the efficiency of this NAIC process, the SVO and SSG (hereafter, the IAO) is charged with administration of the filing exempt process defined in Part Three of this Manual.

#### Directives

81. The IAO shall:

- Recommend improvements to the production of NAIC Designations based on NRSRO credit ratings.
- Identify monitoring and communication procedures that enhance the possibility of regulatory intervention by the VOS/TF to respond to risks to insurer solvency posed by securities in the filing exempt population.

- Identify and develop correctives to the administrative, operational and system-based causes of reporting exemptions in the filing exempt process.
- Change the NAIC Designation equivalent calculated for filing exempt securities when necessary to correct errors or other anomaly that occur in the automated filing exempt process.
- Develop a staff-administered reporting exceptions resolution process that incorporates state insurance regulator and insurance companies' participation.
- In furtherance of the above directives, exclude specific otherwise Eligible NAIC CRP Credit Ratings from the automated filing exemption process in accordance with the administrative procedures outlined in Part Two of this Manual, if the LAO, following a self or state regulator-initiated review, determines the resulting NAIC Designation equivalent does not provide a reasonable assessment of risk for regulatory purposes.

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**PART TWO**  
**OPERATIONAL AND ADMINISTRATIVE INSTRUCTIONS**  
**APPLICABLE TO THE SVO**

## SVO ORGANIZATION

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### SVO Administrative Symbols

153. SVO administrative symbols convey information about a security or an administrative procedure instead of an opinion of credit quality. The administrative symbols in use by the SVO and their meanings are described below.

### SVO Analytical Department Symbols

154. All SVO analytical departments use the following administrative symbols:

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- UR means the NAIC Designation assigned pursuant to the filing exemption process is under review by the NAIC's Investment Analysis Office.
- DR means that one or more otherwise Eligible NAIC CRP Credit Ratings have been removed from the filing exemption process when determining the NAIC Designation through the IAO's discretion procedures.

## **PROCESS FOR PLACING A FILING EXEMPT SECURITY UNDER ANALYTICAL REVIEW FOR POSSIBLE REMOVAL FROM FILING EXEMPTION**

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### **Overview**

164. This section outlines the process by which a state insurance regulator or IAO staff can contest an NAIC Designation Category assigned through the filing exemption process which it thinks is not a reasonable assessment of risk of the security for regulatory purposes.

(Note: The guidance in this part is effective as of January 1, 2025, but this date may be amended if additional time is needed to implement the necessary NAIC technological enhancements to IAO systems.)

### **Request for Information**

165. The IAO staff will bring to the attention of the NAIC IAO Senior Credit Committee (SCC) any filing exemption-eligible security assigned an NAIC Designation Category equivalent through the automated filing exemption process as being a security under review if (i) a state insurance regulator notifies the IAO staff that it has determined the NAIC Designation Category equivalent may not be a reasonable assessment of risk of the security for regulatory purposes, or (ii) the IAO staff, in its opinion, determines that the NAIC Designation Category equivalent may not be a reasonable assessment of risk of the security for regulatory purposes. State insurance regulator notification pursuant to this section does not negate the authority of state insurance regulators under “States May Require a Filing of Exempt or Other Transactions” in Part One of this Manual.

166. The SCC will convene to determine if, in its opinion, the NAIC Designation Category assigned pursuant to the filing exemption process is a reasonable assessment of risk of the security for regulatory purposes. As part of its review, the SCC may consider observable factors, among others, such as (i) a comparison to peers rated by different CRPs, (ii) consistency of the security’s yield at issuance or current market yield to securities with equivalently calculated NAIC Designations rated by different CRPs, (iii) the IAO’s assessment of the security applying available methodologies, and (iv) any other factors it deems relevant. If the SCC’s opinion is that the assigned NAIC Designation Category is likely a reasonable assessment of risk of the security for regulatory purposes, no further action will be taken at that time. If the SCC’s opinion is that the assigned NAIC Designation Category is likely not a reasonable assessment of risk of the security for regulatory purposes, an information request will be initiated and the security will be identified as “Under Review”.



167. The IAO will notify insurance company holders of a security determined to be a Filing Exempt Security “Under Review” by issuing an information request and publishing a separate SVO Analytical Department Symbol of “UR” for Under Review in NAIC systems for that security that will not be reported on the statutory investment schedules. The purpose of the information request is to provide the IAO staff with sufficient information to perform a full analysis of the security. Consistent with the informational deficiencies instructions in this Manual, security information consistent with an Initial Filing should be provided to the IAO within 45 days unless an extension has been granted to the insurance company by the IAO, not to exceed 90 days in total from the date that the IAO issues an information request. The IAO may contact the insurance company’s domiciliary chief financial regulator for assistance after the initial 45 days if there has been no meaningful response. If after 90 days additional information equivalent to a complete filing has not been provided to the IAO, the IAO may proceed with removal of the otherwise Eligible NAIC CRP Credit Rating(s) from the Filing Exempt process.

### **Full Review**

168. At any time during the information request submission period or during the IAO’s subsequent analysis of the security, the insurance company holders of the security are encouraged to provide additional information to the IAO such as their internal analysis, presentations from the issuer, meetings with the issuer’s management team and any other information that may be useful or persuasive in the analysis of the security. The IAO will coordinate with the interested insurer(s) on any questions or issues it may have about the security.

169. Upon satisfactory receipt of the information through the information request, the IAO will perform a full analysis of the security during which time the SVO Analytical Department Symbol “UR” will remain in place but it will not be reported on the statutory investment schedules.

### **Materiality Threshold for IAO Analysis**

170. Upon completion of the IAO’s analysis, the SCC will reconvene to determine whether the NAIC Designation Category assigned through the automated filing exemption process is materially different from the SCC’s assessment of the security’s risk.

171. The IAO will consider the materiality of the difference between the Eligible NAIC CRP Credit Rating used in the filing exempt process and the IAO’s own assessment of the risk. The IAO may elect to remove an otherwise Eligible NAIC CRP Credit Rating from the Filing Exemption process only if the SCC determines, based upon its review, that the Eligible NAIC CRP Credit Rating for the security is three (3) or more notches different than the IAO’s assessment (e.g. NAIC Designation Category 1.G versus 2.C) (the “Materiality Threshold”).

### **Valuation of Securities (E) Task Force Oversight**

172. The SCC shall discuss and explain its analytical basis for any Eligible NAIC CRP Credit Rating being removed from Filing Exemption eligibility with a sub-group of the VOS/TF (the composition of which to be determined by the VOS/TF chair) for so long as the VOS/TF chair deems such meetings necessary.
173. If the SCC identifies that there is a recurring analytical pattern or concern, the IAO Director(s) will inform the VOS/TF chair and decide if an issue paper, referral, amendment to this Manual or some other action is needed.

### **Assignment of NAIC Designation Category**

174. If the IAO SCC determines that the NAIC Designation Category assigned pursuant to the Filing Exemption process *does not* meet the Materiality Threshold, the Eligible NAIC CRP Credit Rating shall remain eligible for Filing Exemption, the SVO Analytical Department Symbol “UR” will be deactivated, and no further action will be taken at that time. The IAO’s determination to maintain the filing exemption eligibility of an Eligible NAIC CRP Credit Rating shall not preclude the IAO from placing the same Eligible NAIC CRP Credit Rating under analytic review at a later date following a subsequent review should changing conditions warrant.
175. If the IAO SCC determines that the NAIC Designation Category assigned pursuant to the Filing Exemption process *does* meet the Materiality Threshold, the IAO will block the otherwise Eligible NAIC CRP Credit Rating in NAIC systems to prevent it from using the automated Filing Exempt Securities Process.
176. If an Eligible NAIC CRP Rating has been removed from Filing Exemption eligibility for a security according to this section and the security has another Eligible NAIC CRP Rating which has not been removed or one is subsequently received, then the security can receive its NAIC Designation Category through the Filing Exemption process based on the other Eligible NAIC CRP Rating(s). If there is no alternate Eligible NAIC CRP Rating in NAIC systems, the SCC’s NAIC Designation Category will be entered into NAIC systems to assign an NAIC Designation Category to the security.
177. As noted in this Manual, any insurer that owns a security for which the SVO has provided an NAIC Designation, a classification or a valuation, may request a clarification of the decision from the SVO (Requests for Clarification of SVO Decisions).

### **Appeal to the VOS/TF**

178. An insurer that thinks the IAO did not make its Filing Exemption determination regarding the insurer’s security in accordance with the procedures in this Manual it may request consideration of the concern by the VOS/TF pursuant to “Review of SVO Decisions by the VOS/TF” in this Manual.

### **Analytical Appeal to an Independent Third-party**

179. An insurer that disagrees with the SCC's final analytical assessment may request, at its own expense, that the NAIC's IAO contract with an independent third-party acceptable to the IAO to perform a blind analysis of the security (e.g. without knowledge of the SCC's, insurer's or CRP's assessment) based upon the information provided through the information request and consistent with the objectives and purposes of an NAIC Designation Category.
180. If the independent third-party's assessment results in an NAIC Designation Category that differs from the NAIC Designation Category assigned pursuant to the Filing Exemption process by no greater than a one (1) notch, the originally assigned NAIC Designation Category will remain in force and the Eligible NAIC CRP Credit Rating remain eligible for Filing Exemption.
181. If the independent third-party's assessment results in an NAIC Designation Category that that differs from the NAIC Designation Category assigned pursuant to the Filing Exemption process by greater than one (1) notch, the SCC's opinion will remain in-force and the Eligible NAIC CRP Credit Rating will remain ineligible for Filing Exemption.

### **Reinstatement of Filing Exemption Eligibility**

182. If an insurer would like the IAO to re-evaluate an Eligible NAIC CRP Credit Rating that was removed from Filing Exemption Eligibility for possible reinstatement in a subsequent filing year, it can follow the operational steps outlined in Appeals of SVO Determinations in this Manual to submit the request.

### **Reporting Securities Removed from Filing Exemption Eligibility**

183. The IAO Director(s) will prepare a summary of the removed from Filing Exemption Eligibility actions take over the prior calendar year.
184. The IAO will also publish an anonymized summary of each unique situation encountered for the securities subject to removal from Filing Exemption Eligibility and publish it on an insurer accessible web location.
185. To facilitate transparency as to the SVO's application of discretion, the SVO Analytical Department Symbols "DR" will be added in NAIC Systems to securities with a blocked otherwise Eligible NAIC CRP Credit Rating(s). The SVO Analytical Department Symbols, "DR" will be reported on the insurer's statutory investment schedules for the effected security as SVO Administrative Symbols.

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<https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2023/2023-11 Fall NM/05-SVO Discretion/2023-005.15 P&P SVO Discretion - Revised v4.docx>