

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

RE: Revised 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: July 30, 2024

Summary: The Valuation of Securities (E) Task Force exposed the prior version of this amendment, dated June 4, 2024, for a 38-day comment period that ended on July 26, 2024. The following updates have been made to this prior version and reflect recommendations received from interested parties.

- Clarification that the process will be consistently applied to all CRPs.
- The term “authorized insurers” is defined.
- Clarification of the SVO’s written summary of its analysis during the review phase.
- Including other authorized parties to discuss the security with the SVO.
- IAO shall communicate in writing its opinion of the appropriate NAIC Designation Category.
- The annual summary will be anonymized and will not disclose information on specific securities, CRPs or impacted insurers.
- The SVO will publish within 45 days of a security being removed from the Filing Exemption process an anonymized summary (without references specific to the security or CRP, to avoid disclosing confidential information).
- Impact to issuers that have multiple securities within the same debt class.

Recommendation: 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, 2026. The effective date can be amended, if needed, if additional time is needed to implement the applicable technological enhancements, as previously discussed. The proposed text changes to P&P Manual are shown in red-underline or ~~red-strikethrough~~ below with new text since the last exposure highlighted in yellow.

PART ONE
POLICIES OF THE NAIC VALUATION OF SECURITIES (E) TASK FORCE

...

POLICIES APPLICABLE TO THE FILING EXEMPTION (FE) PROCESS

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 a Subgroup of the Task Force agrees with the determination of the IAO Credit Committee that the resulting NAIC Designation equivalent does not provide a reasonable assessment of investment risk for regulatory purposes.

...

PART TWO
OPERATIONAL AND ADMINISTRATIVE INSTRUCTIONS
APPLICABLE TO THE SVO

SVO ORGANIZATION

...

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:

...

- UR means the NAIC Designation assigned pursuant to the filing exemption process is under review by the NAIC's Investment Analysis Office.
- ER means that one or more otherwise Eligible NAIC CRP Credit Ratings have been excluded from the filing exemption process when determining the NAIC Designation through the Eligible NAIC CRP Rating exclusion procedures in this Manual.

PROCESS FOR EXCLUDING AN ELIGIBLE NAIC CRP RATING FROM FILING EXEMPTION FOR A SPECIFIC SECURITY

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 investment risk of the security for regulatory purposes. The process in this section will be consistently applied to all CRPs, without favor to any individual CRP or class of CRPs, and is not expected to be used often. For purposes of this section, the term “authorized insurers” is defined as: Holders of the affected securities that agree to the confidentiality provisions required by the NAIC.

(Note: The guidance in this part is effective as of January 1, 2026, 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 Credit Committee 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 investment 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 investment 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 Credit Committee will convene to determine if, in its opinion, the NAIC Designation Category assigned pursuant to the filing exemption process is a reasonable assessment of investment risk of the security for regulatory purposes. As part of its review, the Credit Committee may consider observable factors including, but not limited to (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 Credit Committee's opinion is that the assigned NAIC Designation Category is likely a reasonable assessment of investment risk of the security for regulatory purposes, no further action will be taken at that time. If the Credit Committee's opinion is that the assigned NAIC Designation Category is likely not a reasonable assessment of investment risk of the security for regulatory purposes, an information request will be initiated and the security will be put under review.
167. The IAO will notify insurance company holders of the 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. The SVO Analytical Department Symbol of "UR" will not be reported on the statutory investment schedules. The purpose of the information request is to notify insurance company holders of the security to provide the IAO staff with sufficient information to perform a full analysis of the security. The information provided by insurers should be comparable to an Initial Filing, as described in this Manual, and must be accompanied by each insurer's internal analysis. Consistent with the informational deficiency 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 an Initial 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 without convening the Sub-group of the Task Force, as described in this section.

For the avoidance of doubt, if an issuer has multiple securities within the same debt class (i.e. position in the capital stack) whose ratings are placed Under Review, for purposes of this process only, insurers must only provide requested information materials once. After a final determination is made regarding the CRP ratings for the affected securities, should the IAO's proposed NAIC Designation Category prevail, insurers would then need to file all securities/identifiers individually to receive an IAO-assigned NAIC Designation upon NAIC Designation renewal.

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 verbally and in writing with the authorized insurer(s) staff to discuss any questions or issues the IAO may have about the security and answer any question that the authorized insurer(s) staff may have about the IAO's analysis. The IAO will provide a written summary of its analysis and its view of why it believes the CRP's risk assessment is an unreasonable assessment of investment risk for regulatory purposes to authorized insurers. It will also coordinate verbally and in writing with the authorized insurer(s) staff to discuss any questions or issues the IAO may have about the security and answer any question that the authorized insurer(s) staff may have about the IAO's analysis. The authorized insurer(s) staff may invite other authorized parties that have agreed to the confidentiality provisions required by the NAIC to these discussions with the IAO.
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 this symbol will not be reported on the statutory investment schedules.

IAO Determination and Materiality Threshold

170. Upon completion of the IAO's analysis, the Credit Committee will reconvene to determine its own opinion of the NAIC Designation Category. The Credit Committee will then determine whether the NAIC Designation Category assigned through the automated filing exemption process is materially different from its own 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 propose the removal of an otherwise Eligible NAIC CRP Credit Rating from the Filing Exemption process to a Task Force Sub-group only if the Credit Committee 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 Credit Committee shall schedule a call with a VOS/TF Sub-Group (the composition of which shall be determined by the VOS/TF chair) to discuss and explain its analytical basis for any Eligible NAIC CRP Credit Rating being recommended for removal from Filing Exemption eligibility. The Credit Committee will use communication processes that maintain confidentiality and **notify invite the** domiciliary regulators of insurer holders of the security ~~of to~~ **participate in** the Sub-group meeting.
173. If the Credit Committee identifies that there is a recurring analytical pattern or concern, the IAO Director(s) will inform the VOS/TF chair and they will decide if an issue paper, referral, amendment to this Manual or some other action is needed **to be introduced into Task Force proceedings and deliberation.**
174. Insurance company staff, and other parties invited by the insurer, that are authorized to discuss the security and who have agreed to confidentiality provisions required by the NAIC, may present their analytical basis to maintain the Eligible NAIC CRP Credit Rating's eligibility for Filing Exemption to the **joint** meeting of the VOS/TF Sub-group and the Credit Committee. **Prior to inviting insurers to discuss the security and CRP ratings in question, the IAO shall communicate in writing what it believes the NAIC Designation Category to be, citing the main considerations that form the basis of the IAO's proposed NAIC Designation Category.** Any materials shared during, **or in advance of,** this meeting with the VOS/TF Sub-group **and Credit Committee** are considered highly confidential and may not be shared beyond those participants at the meeting that have been identified as having been authorized to receive such materials and have agreed to maintain their confidentiality.
175. At any time, the VOS/TF chair may direct the VOS/TF to review the described process to ensure it remains effective and efficient and to recommend revisions to any components.

Assignment of NAIC Designation Category

176. If the VOS/TF Sub-group disagrees with the Credit Committees' NAIC Designation Category opinion and 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. This determination 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.

177. If the VOS/TF Sub-group agrees with the Credit Committees' NAIC Designation Category opinion and determines that the NAIC Designation Category assigned pursuant to the Filing Exemption process *does* meet the Materiality Threshold, the IAO is authorized to block the otherwise Eligible NAIC CRP Credit Rating in NAIC systems to prevent that otherwise Eligible NAIC CRP Credit Rating from being used in the automated Filing Exempt Securities Process.
178. If an Eligible NAIC CRP Rating has been removed from Filing Exemption eligibility for a security according to this section and the security has other Eligible NAIC CRP Rating(s) which have not been removed or the security receives an additional Eligible NAIC CRP Rating at any time during or after this process, then the security can receive its NAIC Designation Category through the Filing Exemption process based on the Eligible NAIC CRP Rating(s) that have not been removed. If there is no alternate Eligible NAIC CRP Rating in NAIC systems, the Credit Committee's NAIC Designation Category will be entered into NAIC systems to assign an NAIC Designation Category to the security.

Reinstatement of Filing Exemption Eligibility

179. 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

180. The IAO Director(s) will prepare an anonymized summary that does not disclose specific securities, CRPs or impacted insurers of the removed from Filing Exemption Eligibility actions taken over the prior calendar year.
181. Within 45 days of a security being removed from the Filing Exemption process, the IAO will also publish an anonymized summary (without references specific to the security, to avoid disclosing confidential information) of each unique situation encountered for the securities subject to removal from Filing Exemption Eligibility and publish it on an insurer accessible web location.
182. To facilitate transparency as to the SVO's application of discretion, the SVO Analytical Department Symbols "ER" will be added in NAIC Systems to securities with an excluded otherwise Eligible NAIC CRP Credit Rating(s). The SVO Analytical Department Symbols, "ER" *will be* reported on the insurer's statutory investment schedules for the effected security instead of SVO Administrative Symbols "FE" for filing exemption.

...

<https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-08 Summer NM/04-SVO Discretion/2023-005.16a PP SVO Discretion - Revised v6.1.docx>