To: Commissioner David Altmaier, Chair of the Capital Adequacy (E) Task Force
From: Dale Bruggeman, Chair of the Statutory Accounting Principles (E) Working Group
Date: August 12, 2019
Re: SIRI – Line 13: Equity Interests

This referral provides notification of a current Statutory Accounting Principles (E) Working Group exposure and requests comments. The comment deadline for the public exposure is October 11, 2019, but the Working Group can give additional time to the Task Force to review and provide comment.

As historical background, revisions have been incorporated, in effect for year-end 2019, to clarify what should be captured in the Supplemental Investment Risk Interrogatory (SIRI) for Line 2: 10 Largest Exposures to a Single Issuer / Borrower / Investment. The revisions clarify that reporting entities do not need to “look-through” diversified funds to aggregate exposures in determining the 10 largest exposures. However, reporting entities shall look-through non-diversified funds to aggregate exposures held in the fund with other exposures in determining the 10 largest exposures. Ultimately, this guidance ensures consistency in practice when assessing diversified and non-diversified funds and prevents use of non-diversified funds in shielding exposures from identification as one of the 10 largest exposures. (A diversified fund is one that is diversified in accordance with the Investment Company Act of 1940.)

With the adopted revisions to SIRI Line 2, the Working Group is considering similar revisions to SIRI Line 13: 10 Largest Equity Interests. The proposed edits follow the same concepts as those adopted to Line 2, in which a reporting entity would not be required to look-through a diversified fund in identifying individual equity exposures, but a non-diversified fund would require a look-through to aggregate exposures held in the fund with other equity exposures in determining the 10 largest equity interests. The revisions also clarify that an equity interest, whether diversified or not, that individually qualifies as one of the largest equity interests shall be reported. Lastly, the revisions propose to expand funds excluded from Line 13 to include SVO identified Bond ETFs and SVO-Identified fund investments with underlying equity interests from the scope of the listing. (SVO identified Bond Mutual Funds (government funds) and Money Market Mutual Funds are already excluded from the listing.)

The entire agenda item has been provided as a supplement to this referral, and comments from the Task Force are welcome on all aspects, but comments are specifically requested on whether the proposed revisions will have inadvertent impact to risk-based capital charges.

Please contact NAIC staff of the Statutory Accounting Principles (E) Working Group with any questions.

Cc: Julie Gann, Robin Marcotte, Fatima Sediqzad, Jake Stultz, Jim Pinegar, Jane Barr, Lou Felice
Issue: SIRI – Equity Interests

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Description of Issue:
This agenda item has been drafted pursuant to direction received during the 2019 Spring National Meeting to clarify what shall be captured in Line 13: 10 Largest Equity Interests of the Supplemental Investment Risks Interrogatories (SIRI). The intent of the SIRI is to assist regulators in reviewing compliance with state investment limitations and analyzing the risks inherent in an entity’s investment portfolio. However, from questions received on certain categories, it has been identified that clarity is needed to ensure consistent reporting and that the desired aggregation of risks is reported.

This agenda item is being considered subsequent to revisions incorporated to SIRI Line 2: 10 Largest Exposures to a Single Issuer / Borrower / Investment and the proposal of a new reporting category for “fund managers.” These clarification items were exposed by the Blanks (E) Working Group during the 2019 Spring National Meeting and adopted for 2019 year-end reporting during the Blanks (E) Working Group June 24 conference call.

Pursuant to the revisions previously recommended, it is suggested that the following concepts be followed in aggregating investments for SIRI:

- Investments held in diversified funds do not need to be separately aggregated with other investments due to the fund diversification. For this exclusion, only funds in which the issuer can assert that the fund is diversified in accordance with the 1940 Investment Act are excluded from aggregation.

- Investments held in non-diversified funds shall be aggregated with other exposures for reporting in SIRI. This aggregation shall be based on the underlying investments in funds (or other commingled investment structures). For example, if a non-diversified was issued by BlackRock, the investment exposure is not to BlackRock, but the investments captured within the non-diversified fund. To further expand, if the non-diversified fund held investments from Exxon Mobile, then those investments shall be aggregated with other investments held from Exxon Mobile (held directly or in a non-diversified fund) to determine the overall aggregate exposure to Exxon Mobile. (This requires a look-through into non-diversified funds.)

During the 2019 Spring National Meeting, two options were presented to clarify the aggregation of equity interests in Line 13. Pursuant to informal comments received, as well as the concepts noted above, this agenda item proposes revisions in accordance with the proposed “Option 2”. This approach excludes diversified funds from the look-through / aggregation requirement and clarifies that a look-through is required to non-diversified equity funds for aggregation and reporting. It also clarifies that any equity interest (regardless of diversification) that individually qualifies as one of the largest equity interests shall be captured in SIRI Line 13.

Existing Authoritative Literature:

Supplemental Investment Risk Interrogatories (SIRI)

This set of Supplemental Interrogatories is to assist regulators in identifying and analyzing the risks inherent in the entity’s investment portfolio. The Supplemental Investment Risks Interrogatories apply only
to general account assets. These lines were determined based upon the investment categories contained in the NAIC Statutory Statement and considered as invested assets. The reported amounts are to be consistent with net admitted amounts reported by the entity in the statement and supporting schedules, not on a consolidated basis. Compute the percentage calculations by dividing the reported amount by the total admitted assets reported in Line 1 of the Interrogatories unless otherwise indicated. It is recommended that the first step in responding to this set of Interrogatories is for the person preparing this document to read through the Interrogatories to gain an understanding of the reporting requirements.

Line 13.02 through 13.11  Report the amounts and percentages of admitted assets held in the ten largest equity interests (including investments in the shares of mutual funds, preferred stocks, publicly traded equity securities, and other equity securities (including Schedule BA equity interests), and excluding money market and bond mutual funds listed in Part Six, Sections 2(f) and (g) of the Purposes and Procedures Manual of the NAIC Investment Analysis Office as exempt or NAIC 1).

Determine the ten largest equity interests by first aggregating investments included in this line by issuer. For example, the reporting entity owns preferred stock of the XYZ Company of $600,000 and common stock of the XYZ Company of $300,000. The total is $900,000 ($600,000+$300,000). The reporting entity also owns bonds issued by the XYZ Company of $500,000 that are excluded from this calculation because bonds are debt instruments. Other equity securities include partnerships and Limited Liability Companies (LLC) and any other investments reported in Schedule BA classified as equity.

SIRI – As Modified Following the Blanks (E) Working Group June 2019 Conference Call – 2019-13BWG:

Line 2  Report the single 10 largest exposures to a single issuer/borrower/investment.

Determine the ten largest exposures by first, aggregating investments from all investment categories (except the excluded categories) by issuer. The first six digits of the CUSIP number can be used as a starting point; however, please note that the same issuer may have more than one unique series of the first six digits of the CUSIP. For example, the reporting entity owns bonds issued by the XYZ Company of $500,000 and common stock of the XYZ Company of $600,000. In addition, the reporting entity has a mortgage loan to the XYZ Company of $300,000. The total exposure to Issuer XYZ Company is $1.4 million ($500,000+$600,000+$300,000).

For funds that are not diversified within the meaning of the Investment Company Act of 1940, insurance reporting entities are required to identify actual exposures and aggregate those exposures with directly held investments to determine the 10 largest exposures. For example, if a reporting entity directly holds a significant number of investments in Exxon Mobil and holds a non-diversified closed-end fund with a high concentration of Exxon Mobil, the reporting entity shall aggregate the direct investments with the investments in the closed-end funds to determine the aggregate investment risk to Exxon Mobil.

Excluding:

U.S. government securities (Part Six, Section 2(e)), U. S. government agency securities (Part Six, Section 2(e)),

those U. S. Government money market funds (Part Six, Section 2(f)) listed in the Purposes and Procedures Manual of the NAIC Investment Analysis Office as exempt;

property occupied by the company; and

policy loans.
Also exclude asset types that are investment companies (mutual funds) and common trust funds that are diversified within the meaning of the Investment Company Act of 1940 [Section 5(b) (1)].

All SEC and foreign registered funds (open-end, closed-end, UIT and ETFs) and common trust funds that are diversified within the meaning of the Investment Company Act of 1940 [Section 5(b) (1)].

Line 14.06 through 14.15 Report the investments held in the ten largest fund managers, with allocation between funds that are diversified or non-diversified in accordance with the meaning of the Investment Company Act of 1940. This should include all “funds” regardless of the type of fund (private placement, mutual fund, exchange-traded fund, closed-end fund, money market mutual fund, etc.), reporting schedule or underlying investments captured in a fund.

Determine the ten largest fund managers by aggregating all “fund” investments by fund manager. For example, if a reporting entity holds a BlackRock SVO-Identified Bond ETF (diversified within the meaning of the Investment Company Act of 1940) reported on Schedule D-1 at $500,000, four BlackRock diversified mutual funds reported on Schedule D-2-2 at $2,200,000 and two BlackRock non-diversified closed-end funds totaling $1,500,000, the reporting entity shall report their aggregated investment in BlackRock funds of $4,200,000, with $2,700,000 in diversified funds and $1,500,000 in non-diversified funds.

Activity to Date (issues previously addressed by the Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

During the 2019 Spring National Meeting, the Statutory Accounting Principles (E) Working Group sponsored a blanks proposal (2019-13BWG) to clarify the instructions for Line 2: 10 Largest Exposures and to incorporate a new category for fund managers (Line 14). These revisions were adopted during the Blanks (E) Working Group June 24, 2019 conference call. (The revisions are detailed above.) Also, during the 2019 Spring National Meeting, the Working Group received two options to consider revisions to Line 13: 10 Largest Equity Interests. These proposed revisions would clarify that reporting entities should always look-through funds for aggregation (option one) or add provisions that would remove diversified funds from the look-through requirement (option two):

- **Option One**: Further expansion of the instruction to identify that reporting entities shall look-through all funds (except for the money market mutual funds and SVO-Identified bond funds) to aggregate equity interests, with explicit identification of any equity fund that qualifies as one of the 10 largest interests. (This option would not be a change in guidance but would explicitly clarify the existing requirement.)

Report the amounts and percentages of admitted assets held in the ten largest equity interests (including equity funds that qualify individually as one of the largest equity interests, and a look-through of investments in the shares of mutual funds, preferred stocks, publicly traded equity securities, and other security securities (including Schedule BA equity interests), and excluding money market and bond mutual funds listed in Part Six, Section 2(f) and (g) of the Purposes and Procedures Manual of the NAIC Investment Analysis Office as exempt or NAIC 1.

Determine the ten largest equity interested by first aggregating investments included in this line by issuer. For example, the reporting entity owns preferred stock of the XYZ Company of $600,000 and common stock of XYZ Company of $300,000 and $100,000 of XYZ identified through a look-through of a diversified stock mutual fund reported on Schedule D-2-2. The total is $91,000,000 (600,000+300,000+100,000). The reporting entity also owns bonds issued by XYZ Company of $500,000 that are excluded from this calculation because bonds are debt.
Ref #2019-19

Option Two: Incorporate revisions to exclude aggregation of equity interests in diversified funds. With this approach, an entity would only need to look-through funds that are not diversified in accordance with the Investment Company Act of 1940 to aggregate their ten largest equity interests. (This change would still require explicit identification of any equity funds that qualifies as one of the 10 largest interests.)

Report the amounts and percentages of admitted assets held in the ten largest equity interests (including equity funds that qualify individually as one of the largest equity interests, and a look-through of investments in the shares of non-diversified mutual funds and ETFs, preferred stocks, publicly traded equity securities, and other security securities (including Schedule BA equity interests), and excluding money market and bond mutual funds listed in Part Six, Section 2(f) and (g) of the Purposes and Procedures Manual of the NAIC Investment Analysis Office as exempt or NAIC 1. Equity interests in all funds that are diversified in accordance with the Investment Company Act of 1940 do not need to be individually assessed and aggregated to determine the ten largest equity interests. For funds that are not diversified within the meaning of the Investment Company Act of 1940, insurance reporting entities are required to identify actual equity interests within the fund and aggregate those equity interests to determine their ten largest equity interests.

Determine the ten largest equity interested by first aggregating investments included in this line by issuer. For example, the reporting entity owns preferred stock of the XYZ Company of $600,000 and common stock of XYZ Company of $300,000 and $50,000 of XYZ identified through a look-through of a non-diversified stock closed-end fund reported on Schedule D-2. The total is $900,000 (600,000+300,000+50,000). The reporting entity also owns bonds issued by XYZ Company of $500,000 that are excluded from this calculation because bonds are debt instruments. The reporting entity may also have exposure to equity interests in XYZ through mutual funds that are excluded from this calculation as the funds are diversified within the meaning of the Investment Company Act of 1940. Other equity securities include partnerships and Limited Liability Companies (LLC) and any other investments reported in Schedule BA as equity.

Information or issues (included in Description of Issue) not previously contemplated by the Working Group: None


Staff Recommendation: NAIC staff recommends that the Working Group expose this agenda item with the intent to sponsor a blanks proposal to clarify what should be captured in SIRI Line 13: 10 Largest Equity Interests. These proposed blanks revisions clarify that a look-through should only occur for non-diversified funds, and that investments within a diversified fund investment shall be excluded from an aggregation requirement to other equity investments. It also clarifies that any equity interest (regardless of diversification) that individually qualifies as one of the largest equity interests shall be captured in SIRI Line 13. This is consistent with the Option 2 approach presented at the 2019 Spring National Meeting. Additionally, the revisions expand the guidance to include SVO-Identified Bond ETFs, and SVO-Identified investments with characteristics of fixed-income investments as specific exclusions from the listing. (The exclusions for money market mutual funds and SVO bond mutual funds are currently in the guidance.) Comments from regulators are specifically requested on these exclusions.

Proposed Revisions to the annual statement instructions for SIRI Line 13: Ten Largest Equity Interests:
Report the amounts and percentages of admitted assets held in the ten largest equity interests (including equity funds that qualify individually as one of the largest equity interests, and a look-through of investments in the shares of non-diversified mutual funds and ETFs, preferred stocks, publicly traded equity securities, and other security securities (including Schedule BA equity interests), and excluding money market and bond mutual funds listed in Part Six, Section 2(f) and (g) of the Purposes and Procedures Manual of the NAIC Investment Analysis Office as exempt or NAIC 1. Equity interests in all funds that are diversified in accordance with the Investment Company Act of 1940 do not need to be individually assessed and aggregated to determine the ten largest equity interests. For funds that are not diversified within the meaning of the Investment Company Act of 1940, insurance reporting entities are required to identify actual equity interests within the fund and aggregate those equity interests to determine their ten largest equity interests.

Determine the ten largest equity interested by first aggregating investments included in this line by issuer. For example, the reporting entity owns preferred stock of the XYZ Company of $600,000 and common stock of XYZ Company of $300,000 and $50,000 of XYZ identified through a look-through of a non-diversified stock closed-end fund reported on Schedule D-2-2. The total is $950,000 (600,000+300,000+50,000). The reporting entity also owns bonds issued by XYZ Company of $500,000 that are excluded from this calculation because bonds are debt instruments. The reporting entity may also have exposure to equity interests in XYZ through mutual funds that are excluded from this calculation as the funds are diversified within the meaning of the Investment Company Act of 1940. Other equity securities include partnerships and Limited Liability Companies (LLC) and any other investments reported in Schedule BA as equity.

The following funds shall also be excluded from aggregation as equity interests: SVO-Identified U.S. Direct Obligations / Full Faith And Credit Exempt List of Money Market Mutual Funds, SVO-Identified Bond ETFs, SVO-Identified Bond Mutual Funds and SVO Identified fund investments with underlying characteristics of fixed-income instruments, which do not contain underlying equities and that are outlined within the Purposes and Procedures Manual of the NAIC Investment Analysis Office.

**Staff Review Completed by: Julie Gann – May 2019**

**Status:**
On August 3, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions that clarify what should be captured in SIRI Line 13: 10 Largest Equity Interests, noting that a look-through should only occur for non-diversified funds. The revisions also exclude Securities Valuation Office (SVO)-Identified Bond Exchange-Traded Funds (ETFs) and SVO-Identified investments with underlying characteristics of fixed-income investments from this equity interrogatory. With exposure, a referral was directed to the Capital Adequacy (E) Task Force with a request for clarification on the impact, if any, these changes may have to risk-based capital.