



MEMORANDUM

TO: Kevin Fry, 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  
Robert Carcano, Esq., NAIC Consultant

DATE: March 7, 2019

RE: Revised Proposed Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to Improve Disclosure on Securities Not Eligible for Filing Exemption

**1. Introduction** – In 2018, the SVO proposed an amendment to the P&P Manual to modernize disclosure that the Task Force has excluded certain securities from the filing exempt process. The proposed amendment, shown in Section 2 below, deletes guidance from Part Three, Section 1 (b) (v) and transfers it to Part Three, Section 1 (b) (i). Industry concerns with the inclusion of subsidiary controlled and affiliated, Regulatory Transactions and Credit Tenant Loans as securities ineligible for filing exemption have been resolved. As discussed during the March 4 conference call, the SVO agreed to add an additional paragraph to provide better disclosure that the Task Force may exclude certain securities from filing exemption, as shown in Section 3 below. Although the proposed disclosure amendment would not have modified or deleted the term Bond<sup>1</sup> in the 2018 P&P Manual, the term was not included in the 2019 reformatted P&P because the adoption of policy statements requiring coordination between the Task Force and the Statutory Accounting Principles (E) Working Group meant that the term Bond could only be defined by reference to statutory accounting guidance. Discussions indicate that industry concurs in that assessment. The operative term for Task Force operations; i.e., the term Obligations, which is broader than the term Bonds, was retained. Accordingly, the SVO proposes to revise its original amendment to modify the definition of Bond in the existing 2018 P&P Manual to refer to statutory accounting guidance. This additional amendment is shown below and identified with a comment balloon. *Please note, the amendments shown in paragraph 2 and 3 show the proposed changes to the 2018 P&P Manual. Appendix A shows the proposed amendments as they would appear in the 2019 reformatted P&P Manual.*

**2. Proposed Amendment** – The proposed amendment and the text proposed for deletion are shown below.

*Showing Amendments to and for the 2018 P&P Manual*

**Part Three Credit Assessment**

**b) Procedure Applicable to Filing Exempt (FE) Securities and to Private Letter (PL) Rating Securities**

**(i) Filing Exemption**

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

<sup>1</sup> Bond means any Obligation with a stated maturity at the time of issuance longer than one year.

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Part One, Section 4 (c) (ii) (B) of this Manual, are exempt from filing with the SVO (FE securities) with the exception of Bonds and or Preferred Stock ~~that fall into the categories identified below, explicitly excluded below.~~

**Comment [RC1]:** The red-lined text shown in (i) are an additional amendment proposed as of March 4, 2019.

#### Specific Populations of Securities Not Eligible for Filing exemption

The filing exemption procedure does not apply to:

##### **1) SCA investments**

SCA investments are transactions between insurance company affiliates (called related parties) that are subject to special regulatory considerations identified in *Statement of Statutory Accounting Principles (SSAP) No. 25–Affiliates and Other Related Parties*. The P&P Manual specifies that such transactions are not subject to filing exemption and can only be assigned an NAIC Designation if the SVO has first concluded that the transaction is like those the SVO typically assesses for credit risk. See the SCA section in this Part for further information about how the SVO determines whether an SCA investment will be assigned an NAIC Designation.

##### **2) Catastrophe-Linked Bonds**

Catastrophe-Linked Bonds are deemed to be filing exempt but only if the NAIC CRP has assigned a credit rating based on the type of methodology specified in this Manual.

##### **3) Shares of Funds**

This Manual provides for certain mutual funds, Bond Funds and Exchange Traded Funds be submitted to the SVO for a determination that they meet characteristics identified by the VOS TF for more appropriate regulatory treatment.

##### **4) Regulatory Transactions**

The term Regulatory Transaction is broadly defined in this Manual as a transaction engineered to address a regulatory concern one or more insurers have or may have that should or must be submitted to a state insurance department for approval and that has as a component a security or other instrument which on a stand-alone version may be eligible for assignment of an NAIC Designation by the SVO. The SVO is prohibited from assigning an NAIC Designation to a Regulatory Transaction except in relation to a special assignment conducted for a state insurance department under the Regulatory Transaction procedure discussed in this Manual. Also insurers are prohibited from claiming a Regulatory Transaction as a filing exemption.

##### **5) Credit Tenant Loan (CTL)**

A Credit Tenant Loan is a mortgage loan made primarily in reliance on the credit standing of a major tenant, structured with an assignment of the rental payments to the lender with real property pledged as collateral in the form of a first lien. This Manual identifies four categories of CTLs as eligible for reporting on Schedule D conditioned on an SVO determination that the transaction meets the criteria specified by the VOS/TF for Schedule D treatment. A transaction that purports to be a Credit Tenant Loan, including one that is assigned a credit rating by an NAIC CRP, is not eligible for Schedule D reporting unless the SVO confirms that the transaction is eligible for Schedule D reporting and assigns the transaction an NAIC Designation.

##### **6) Replication (Synthetic Asset) Transactions (RSATS)**

Replication (Synthetic Asset) Transactions (RSATs) structured in accordance with any of the definitions of an Approved RSAT are presumed to be an Approved RSAT but should be submitted to the SVO. RSATs structured to contain elements of risk other than those normally associated with the Defined RSAT descriptions and transactions involving assets that would not normally qualify for an NAIC Designation are not eligible for the Approved RSAT safe harbor and must be submitted to the SVO.

##### **7) Working Capital Finance Investments (WCFI)**

WCFI are programs involving the purchase of confirmed receivables and are submitted to the SVO via the RTAS process.

Part Three Section 1 (b) (v) would be deleted as shown below:

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~~(v) Application of the FE Procedure to Specific Populations~~

- ~~The filing exemption procedure does not apply to investments required to be filed pursuant to Part Two, Section 8 of this Manual (the reference is to SCA Investments);~~
- ~~Catastrophe Linked Bonds are filing exempt provided the credit rating assigned to them by a CRP was derived in a specified manner. Please refer to Part Four, Section 4 of this Manual.~~

**3. Addition of Disclosure That the Task Force Can Exclude Securities From Filing Exemption**

**Part One - Purposes, General Policies and Instructions to the SVO**

**Section 4 – NAIC Policy on the Use of Credit Ratings of NRSROs**

**c) Adding the NRSRO to the NAIC Credit Rating Provider List**

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- (ii) Definition – Credit Ratings Eligible for Translation to NAIC Designations

As disclosed in paragraph C) below, the NAIC may determine that the rated security or investment is of a type that is not eligible to be reported on Schedule D or that the NAIC determines is not appropriate for NRSRO credit ratings to be used to determine the regulatory treatment of a specific asset class, as specified in this manual.

The credit rating of the CRP to which this Section and the NAIC Credit Rating Provider List refers, is the 1) credit rating assigned by the NAIC CRP, 2) by application of its long-term obligation ratings scale and methodology to 3) securities.

Credit ratings of a NAIC CRP that meet this definition are entitled to a presumption of convertibility to the equivalent NAIC Designation published in the NAIC Credit Rating Provider List, in Part Three of this Manual, except that the presumption of convertibility is subject to the following limitations:

- (A) Those rating activities or markets in which the entity has NAIC CRP status;
- (B) Securities with monitored NAIC CRP ratings that:
  - 1) Are monitored at least annually by the CRP that issued the rating,
  - 2) Are assigned to a specific issue that must be specifically identified,
  - 3) Apply to securities where the issuer promises to repay principal and interest or dividends;
  - 4) (X) Convey an opinion as to the likelihood of payment of both principal and interest/dividends due from the issuer to the holders of the security, or
  - (Y) those structured to pay only principal or only interest/dividends, if the monitored NAIC CRP rating addresses the likelihood of payment of either the principal, in the case of a security structured to pay only principal or the interest/dividends, in the case of security structured to pay only interest/dividends (an “Eligible NAIC CRP Rating”); and
- (C) The NAIC may determine that the rated security or investment is of a type that is not eligible to be reported on Schedule D of the NAIC Financial Statement Blank or that the NAIC determines is not appropriate for NRSRO credit ratings

to be used to determine the regulatory treatment of a specific asset class. [Please refer to the discussion of the filing exempt procedures for a complete list of securities that the VOS/TF has determined to be ineligible for filing exemption.](#)

## Appendix

*Showing the Amendments Discussed Above as they would appear in the 2019 Reformatted P&P Manual*

### 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 Part One, Section 4 (c) (ii) (B) of this Manual, are exempt from filing with the SVO (FE securities) with the exception of Bonds and or Preferred Stock ~~that fall into the categories identified below. explicitly excluded~~ below.

The filing exemption procedure does not apply to:

#### 1) SCA investments

SCA investments are transactions between insurance company affiliates (called related parties) that are subject to special regulatory considerations identified in Statement of Statutory Accounting Principles (SSAP) No. 25–Affiliates and Other Related Parties. The P&P Manual specifies that such transactions are not subject to filing exemption and can only be assigned an NAIC Designation if the SVO has first concluded that the transaction is like those the SVO typically assesses for credit risk. See the SCA section in this Part for further information about how the SVO determines whether an SCA investment will be assigned an NAIC Designation.

#### 2) Catastrophe-Linked Bonds

Catastrophe-Linked Bonds are deemed to be filing exempt but only if the NAIC CRP has assigned a credit rating based on the type of methodology specified in this Manual.

#### 3) Shares of Funds

This Manual provides for certain mutual funds, Bond Funds and Exchange Traded Funds be submitted to the SVO for a determination that they meet characteristics identified by the VOS TF for more appropriate regulatory treatment.

#### 4) Regulatory Transactions

The term Regulatory Transaction is broadly defined in this Manual as a transaction engineered to address a regulatory concern one or more insurers have or may have that should or must be submitted to a state insurance department for approval and that has as a component a security or other instrument which on a stand-alone version may be eligible for assignment of an NAIC Designation by the SVO. The SVO is prohibited from assigning an NAIC Designation to a Regulatory Transaction except in relation to a special assignment conducted for a state insurance department under the Regulatory Transaction procedure discussed in this Manual. Also insurers are prohibited from claiming a Regulatory Transaction as a filing exemption.

#### 5) Credit Tenant Loan (CTL)

A Credit Tenant Loan is a mortgage loan made primarily in reliance on the credit standing of a major tenant, structured with an assignment of the rental payments to the lender with real property pledged as collateral in the form of a first lien. This Manual identifies four categories of CTLs as eligible for reporting on Schedule D conditioned on an SVO determination that the transaction meets the criteria specified by the VOS/TF for Schedule D treatment. A transaction that purports to be a Credit Tenant Loan, including one that is assigned a credit rating by an NAIC CRP, is not eligible for Schedule D reporting unless the SVO confirms that the transaction is eligible for Schedule D reporting and assigns the transaction an NAIC Designation.

#### 6) Replication (Synthetic Asset) Transactions (RSATS)

Replication (Synthetic Asset) Transactions (RSATs) structured in accordance with any of the definitions of an Approved RSAT are presumed to be an Approved RSAT but should be submitted to the SVO. RSATs structured to contain elements of risk other than those normally associated with the Defined RSAT descriptions and transactions involving assets that would not normally qualify for an NAIC Designation are not eligible for the Approved RSAT safe harbor and must be submitted to the SVO.

#### 7) Working Capital Finance Investments (WCFI)

WCFI are programs involving the purchase of confirmed receivables and are submitted to the SVO via the RTAS process.

3.4. Any Bond or Preferred Stock that at one time was assigned an Eligible NAIC CRP Credit Rating by an NAIC CRP but is no longer rated must be filed with the SVO within 120 days of the loss of the credit rating, as if the security had never been filing exempt.

### **Definition – Credit Ratings Eligible for Translation to NAIC Designations as shown in the 2019 Reformatted P&P Manual**

#### NAIC POLICY ON THE USE OF CREDIT RATINGS OF NRSROS

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#### Definition - Credit Ratings Eligible for Translation to NAIC Designations

268. As disclosed below, the NAIC may determine that the rated security or investment is of a type that is not eligible to be reported on Schedule D or that the NAIC determines is not appropriate for NRSRO credit ratings to be used to determine the regulatory treatment of a specific asset class, as specified in this manual.

269. The credit rating of the CRP to which this Section and the NAIC Credit Rating Provider List refers, is the 1) credit rating assigned by the NAIC CRP, 2) by application of its long term obligation ratings scale and methodology to 3) securities.

270. Credit ratings of a NAIC CRP that meet this definition are entitled to a presumption of convertibility to the equivalent NAIC Designation published in the NAIC Credit Rating Provider List except that the presumption of convertibility is subject to the following limitations:

- Those rating activities or markets in which the entity has NAIC CRP status;
- Securities with monitored NAIC CRP ratings that:
  - o Are monitored at least annually by the CRP that issued the rating,
  - o Are assigned to a specific issue that must be specifically identified,
  - o Apply to securities where the issuer promises to repay principal and interest or dividends;
  - o (X) Convey an opinion as to the likelihood of payment of both principal and interest/dividends due from the issuer to the holders of the security, or
  - o (Y) those structured to pay only principal or only interest/dividends, if the monitored NAIC CRP rating addresses the likelihood of payment of either the principal, in the case of a security structured to pay only principal or the interest/dividends, in the case of security structured to pay only interest/dividends, (an “Eligible NAIC CRP Rating”); and

271. The NAIC may determine that the rated security or investment is of a type that is not eligible to be reported on Schedule D of the NAIC Financial Statement Blank or that the NAIC determines is not appropriate for NRSRO credit ratings to be used to determine the regulatory treatment of a specific asset class.

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