

Draft Pending Adoption

Draft: 11/25/24

Valuation of Securities (E) Task Force
Denver, Colorado
November 17, 2024

The Valuation of Securities (E) Task Force met in Denver, CO, Nov. 17, 2024. The following Task Force members participated: Doug Ommen, Chair, represented by Carrie Mears (IA); Andrew N. Mais, Vice Chair, represented by Kenneth Cotrone (CT); Lori K. Wing-Heier represented by David Phifer (AK); Mark Fowler represented by Sheila Travis (AL); Ricardo Lara represented by Laura Clements (CA); Michael Yaworsky represented by Jane Nelson and Carolyn Morgan (FL); Dean L. Cameron represented by Eric Fletcher (ID); Ann Gillespie represented by Vincent Tsang (IL); Vicki Schmidt represented by Chut Tee (KS); Timothy J. Temple represented by Bill Werner (LA); Michael T. Caljouw represented by John Turchi (MA); Marie Grant represented by Greg Ricci (MD); Grace Arnold represented by Fred Andersen (MN); Chlora Lindley-Myers represented by Debbie Doggett (MO); Jon Godfread represented by Matt Fischer (ND); Eric Dunning represented by Tadd Wegner and Andrea Johnson (NE); D.J. Bettencourt represented by Jennifer Li (NH); Justin Zimmerman represented by David Wolf (NJ); Adrienne A. Harris represented by Bob Kasinow (NY); Judith L. French represented by Cameron Piatt (OH); Glen Mulready represented by Diane Carter and Holly Mills (OK); Michael Humphreys represented by Diana Sherman (PA); Cassie Brown represented by Amy Garcia (TX); Jon Pike represented by Jake Garn (UT); Scott A. White represented by Doug Stolte and Greg Chew (VA); Mike Kreidler represented by Katy Bardsley (WA); and Nathan Houdek represented by Amy Malm (WI). Also participating was Dale Bruggeman (OH).

1. Adopted its Oct. 1 and Summer National Meeting Minutes

The Task Force met Oct. 1. During this meeting, the Task Force took the following action: 1) exposed a proposed amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual)* to remove references to Subscript-S and update references to investment risk for a 30-day public comment period that ended Nov. 1; and 2) exposed a proposed P&P Manual amendment to update the list of NAIC credit rating providers (CRPs) and the NAIC policy on the use of CRP credit ratings for a 14-day public comment period that ended Oct. 16.

Malm made a motion, seconded by Drutz, to adopt the Task Force's Oct. 1 (Attachment One) and Summer National Meeting (see *NAIC Proceedings – Summer 2024, Valuation of Securities (E) Task Force*) minutes. The motion passed unanimously.

2. Adopted an Amendment to the P&P Manual to Require Annual Reviews of Regulatory Transactions

Mears said the next item on the agenda is to discuss and consider for adoption a proposed amendment to the P&P Manual to require annual reviews for regulatory transactions. This amendment was first discussed at the Summer National Meeting and exposed for a 30-day public comment period that ended Sept. 13.

Charles Therriault (NAIC) said, as mentioned at the Summer National Meeting, that the P&P Manual has specialized instructions for filing and reporting Regulatory Transactions. These transactions do not receive NAIC designations but instead receive Securities Valuation Office (SVO) Analytical Values. The P&P Manual does not specify that an annual update is required for Regulatory Transactions, but it does for all other filings, so this amendment clarifies that annual updates are required for Regulatory Transactions. One comment letter was received from the American Council of Life Insurers (ACLI), the Private Placement Investors Association (PPIA), and the North American Securities Valuation Association (NASVA) in support of the amendment as drafted. The SVO recommends the Task Force adopt the amendment.

Kasinow made a motion, seconded by Fletcher, to adopt the P&P Manual amendment to require the annual update of Regulatory Transactions with an RTS administrative symbol (Attachment Three). The motion passed unanimously.

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3. Adopted a P&P Manual Amendment to Update the List of NAIC CRPs and the NAIC Use of CRP Credit Ratings

Mears said the next item on the agenda is to discuss and consider for adoption a proposed P&P Manual amendment that updates the list of credit rating providers (CRPs). This amendment was first discussed at the Summer National Meeting and exposed for a 30-day public comment period that ended on Sept. 13. In response to comments received, the amendment was updated to include additional clarifying language on the NAIC's Policy on the Use of CRP Credit Ratings. The revised amendment was discussed at the Task Force's Oct. 1 meeting and was exposed for a 14-day public comment period that ended on Oct. 16. Based upon the additional comments received, the SVO made further revisions to the clarifying language.

Marc Perlman (NAIC) said Part Three of the P&P Manual lists the classes of credit ratings for which each CRP is authorized by the U.S. Securities and Exchange Commission (SEC) to issue credit ratings as a nationally recognized statistical rating organization (NRSRO). The list was last reviewed on Feb. 2, 2021. No class changes were identified, and one minor editing error was corrected.

Comments were received suggesting that there was some confusion caused by the differences between the definitions of asset-based security (ABS) used in *Statement of Statutory Accounting Principles (SSAP) No. 43—Asset-Backed Securities*, which will be effective Jan. 1, 2025, and the ABS definition used by the SEC for purposes of registering NRSROs to rate ABS securities. The revised amendment makes it clear that the SEC definitions used to define classes of credit ratings for NRSROs are distinct from the definitions used for statutory accounting asset classification purposes in SSAPs. Therefore, the SVO could rely on a rating from a CRP that is not licensed to rate ABS as an NRSRO if the security qualifies as an ABS according to statutory accounting principles but not according to the SEC definition. The SVO recommends adopting the revised amendment.

Mike Reis (Northwestern Mutual), representing the ACLI, PPIA, and NASVA, said the groups are supportive of the language as written and understand the intent. The language proposed is a little more explicit and communicates the same message.

Doggett made a motion, seconded by Piatt, to adopt the P&P Manual amendment to update the list of NAIC CRPs and the NAIC use of CRP credit ratings (Attachment Four). The motion passed unanimously.

4. Adopted a P&P Manual Amendment to Remove References to Subscript-S and Update References to Investment Risk

Mears said the next item on the agenda is to discuss and consider for adoption a proposed P&P Manual amendment to remove references to Subscript-S and other non-payment risks and update references to investment risk. At the Summer National Meeting, the Task Force adopted an updated definition of an NAIC designation. This included changing "credit risk" to "investment risk." While credit risk is usually the predominant determinant of what an NAIC designation represents, which focuses on an issuer's ability to make payments in accordance with contractual terms, the Task Force agreed that this was too narrow of a concept for NAIC purposes. The updated definition now defines "investment risk" as the likelihood of the insurer's receipt of full principal and expected interest. As noted at the Summer National Meeting, this use of "investment risk" is also consistent with the language used in the Financial Condition (E) Committee's Investment Framework.

The updated definition also removed the SVO's administrative symbol Subscript-S and the concept of other non-payment risk from the P&P Manual. This proposal was a non-substantive, technical amendment to remove the references to Subscript-S and other non-payment risks along with references to "credit risk" and the related concept of "credit quality." The amendment does not make any policy or instruction changes to

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the P&P Manual. The proposed amendment was received by the Task Force at its Oct. 1 interim meeting and exposed for a 30-day public comment period that ended Nov. 1.

Therriault said the update to the definition of an NAIC designation included the removal of the concept of other non-payment risk and the corresponding SVO administrative symbol Subscript-S. Therriault said he and Perlman reviewed the P&P Manual to identify references to the other non-payment risk concept, the Subscript-S symbol, and references to “credit risk,” “credit quality,” or other language that would be impacted by the definition’s inclusion of the “receipt of full and timely principal and expected interest,” and updated or removed those references, as necessary. The amendment did not add any new instructions or propose any substantive changes. The technical update only removed or updated outdated references.

The ACLI, PPIA, and NASVA submitted a joint comment letter recommending the deletion of paragraphs 50–58 in Part Two of the P&P Manual, which relate to the concept of other non-payment risk. While this would be a substantive change, the SVO agrees that these paragraphs can be deleted from the proposed amendment, as the updated definition of an NAIC designation now addresses the issues highlighted in these paragraphs. The SVO recommends adopting the amendment with the deletion of paragraphs 50–58.

Reis thanked the Task Force for working with the groups on the P&P Manual amendment language throughout the process including the proposal for NAIC discretion of CRP ratings and this follow-up amendment on the definition of an NAIC designation, as some of the language was causing confusion about non-payment risk.

Bardsley made a motion, seconded by Doggett, to adopt the P&P Manual amendment to remove references to Subscript-S and update references to investment risk, including the deletion of paragraphs 50–58 in Part Two of the P&P Manual. (Attachment Five). The motion passed unanimously.

5. Received NAIC Staff Reports on the Projects of the Statutory Accounting Principles (E) Working Group

Dale Bruggeman (OH) said that as part of the Working Group and Task Force coordination initiative, a few items from the Statutory Accounting Principles (E) Working Group focus on investments that may be of interest to Task Force members and interested regulators and parties. As a reminder, these are only specific investment-related items, and the full list of adoptions and exposures should be obtained from the Working Group website.

Bruggeman first discussed Working Group adoptions. He said there was one key adoption: the bond project question and answer implementation guidance (Q&A) in the new *Interpretation (INT) 24-01: Principles-Based Bond Definition Implementation Questions & Answers*. This Q&A addresses application questions of the bond definition/qualifying provisions to specific investment questions. With this adoption, there were no changes to the adopted bond guidance. Although there are 11 questions addressed in the Q&A, a key one to note pertains to single asset, single borrower (SASB) investments. Consistent with the bond definition, ABS structures that are pass-throughs do not qualify as bonds, as they do not put the holder in a different economic position than holding the underlying collateral directly (they lack substantive credit enhancement). These structures shall be captured as non-bond debt securities on Schedule BA within the reporting line specific for “debt securities that lack substantive credit enhancement.” Life reporting entities can file these debt securities with the NAIC SVO to obtain an NAIC designation that can be used for risk-based capital (RBC).

Bruggeman reminded that the bond definition is effective Jan. 1, 2025. Debt securities that do not qualify as bonds under the guidance shall be reported on Schedule BA as non-bond debt securities.

Bruggeman said there were a few exposures to highlight from the Working Group meeting.

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- **Collateral loans:** Discussions are still occurring for more granular reporting of collateral loans, in accordance with the underlying collateral. At the Fall National Meeting, the Working Group re-exposed the agenda item to allow for concurrent exposure with the Blanks (E) Working Group, which exposed Schedule BA and asset valuation reserve (AVR) revisions on Nov. 6.
- **Repacks/debt securities with derivative wrappers:** At the Fall National Meeting, the Working Group directed NAIC staff not to continue with the proposal as exposed to require separation of embedded derivatives from debt securities. Rather, these debt securities will be subject to the bond definition without derivative bifurcation. (If they do not qualify as bonds, they will be reported as non-bond debt securities.) The agenda item will be modified and subsequently re-exposed to clarify disposal and reacquisition reporting requirements when a debt security is sold and then reacquired from a special purpose vehicle (SPV) with those added derivative components.
- **Investment subsidiaries:** A new concept agenda item was exposed to solicit comments on recommendations for the accounting and reporting of investment subsidiaries. The concept of an investment subsidiary existed as an SSAP in 2005, but it was superseded. However, the concept still exists in reporting on D-6-1 and RBC. With an increase in the reporting of investment subsidiaries and questions raised on the reporting and look-through that companies are doing for measurement and RBC, clarification is needed to ensure consistent and appropriate application. The options exposed include re-establishing SSAP guidance, creating new reporting schedules, and/or modifying RBC to allow regulators to verify the calculation of underlying assets in an investment subsidiary.

As additional information, under current reporting and RBC provisions, reporting entities can look through investment subsidiaries to calculate RBC as if the underlying assets were held directly. However, there is no current information to verify these calculations or that the underlying assets meet the requirements for a particular RBC factor. Also, it has been identified that some companies are reclassifying Schedule BA assets (LLC/joint venture) as investment subsidiaries for look-through purposes, and that is outside the scope of what is permitted under the existing guidance as it should only include subsidiary, controlled, and affiliated entities (SCAs) in the scope of *SSAP No. 97—Investments in Subsidiary, Controlled, and Affiliated Entities*.

Bruggeman noted that he provided only a high-level overview of the items addressed at this national meeting that pertain to investments. The Working Group has several high-profile projects ongoing and has plans to meet Dec. 17 to continue discussions.

Eric Kolchinsky (NAIC) said the NAIC Structured Security Group (SSG) is ready to begin modeling SASB commercial mortgage-backed security (CMBS) unitranche deals. To expedite the process, Kolchinsky asked that insurance companies send specific Committee on Uniform Security Identification Procedures (CUSIPs) that may qualify for this year's end. These securities must meet the initial information sufficiency and ongoing information sufficiency requirements as described in the P&P Manual. The initial information sufficiency requirements have a safe harbor if the deal has been publicly registered or has two public 17g-7 letters. If the safe harbor has not been met, an insurance company could file the information with the SSG to meet the requirements. There is time for this work to be done for year-end 2024, and the ongoing information sufficiency requirement just means that there is ongoing information about the deal in a system from an independent trustee like Trepp. To expedite the process, Kolchinsky asked insurers to speedily send the candidate CUSIPs to the SSG to be evaluated.

Due to sound system troubles which made hearing Kolchinsky difficult, Reis requested that Kolchinsky provide a written summary of his comments. Kolchinsky repeated his comments and agreed to send them in writing.

6. Received a Status Update of Private Rating Letter Rationale Report Filings for 2024

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Therriault said the instructions for privately rated securities are in Part Three, paragraphs 9–23 of the P&P Manual. Privately rated securities are separated into three groups: 1) those issued before 2018 before the private rating filing policy was adopted; 2) those issued between 2018 and 2021 after the private rating policy was adopted but before the private rating rationale report filing policy was adopted; and 3) those issued after 2021 beginning Jan. 1, 2022, and subject to the private rating and rationale report filing policy.

For private ratings that require a rationale report to be filed with the SVO: if a rationale report was received, the SVO will include that security in the filing exemption (FE) process and publish an NAIC designation based upon that private rating with the administrative symbol “PL” to denote it is based upon a private rating. However, if the security does not receive a rationale report for a private rating security that requires one, the SVO is required to treat the security as though it is not FE. This is accomplished by deactivating the unsupported private rating in NAIC systems.

Per the instructions in Part Three, paragraphs 14–16 in the P&P Manual, an insurer that owns a privately rating security that is not FE shall either: (a) file the security with the necessary documentation with the SVO for an analytically determined NAIC designation or (b) self-assign an NAIC 5GI and an NAIC designation category of NAIC 5.B GI to the security and report using the interrogatory procedure in either case within 120 days of purchase. No other reporting options are permitted.

The SVO has deferred acting on this deactivation requirement for the past two years, including most of this year, because it was building out functionality in its VISION and AVS+ systems to inform insurers about the filing status of the privately rated securities and whether a rationale report had been received on them. The technology updates to process these securities are now operational, and the status information is published in VISION and AVS+.

Therriault said there were challenges with the development, either not understanding the data coming through from the rating agencies because the data was constantly changing or technology issues working through the development process. At this point, Therriault believes the NAIC has addressed all technology issues.

Therriault said the SVO recommends deferring the deactivation of the privately rating securities that are in 2018 to the end of 2021 issuance group for another year because there appears to be widespread confusion about reporting the confidentiality or contractual restrictions to the SVO in VISION. Many insurers appear to be interpreting the question in VISION as asking if the security itself is confidential, whereas this question is asking if there is a confidentiality or contractual restriction in providing the rating rationale report to the SVO in VISION. There are approximately 2,000 securities in this population. The SVO plans to compare the securities in this group to the required general interrogatory disclosure in the financial statements for the insurers that hold those securities in the coming year and then report back to the Task Force.

For the securities where the instructions are definitive, the group of privately rated securities issued on or after Jan. 1, 2022, there must be a supporting rationale report submitted to the SVO. Therriault said the SVO recommends the deactivation of those private ratings this coming year-end to remove them from FE. Insurers would have the option of filing the security with the SVO where it would be treated as an initial filing or report it as an NAIC 5.B GI. Therriault explained that, in an abundance of caution, the SVO shared with the NASVA leadership a listing of the approximately 1,700 securities that would be impacted and asked them to review the list and report any potential issues in NAIC systems. That process is ongoing, and if a material system defect is found, the SVO will withdraw the deactivation recommendation and look to remediate whatever problem was identified and look to deactivate sometime before March 2025.

Therriault said he wanted to bring this to the Task Force’s attention because it would be the first time the SVO would be proceeding with the deactivation of private ratings under the private rating policy. Before doing so, he wanted to inform the Task Force that it was scheduled to occur and get confirmation that the SVO should proceed as required by the policy.

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Therriault said he also has one procedural request. In SVO discussions with the insurers, it realized that it would be unfair to deactivate a private rating that was renewed close to year-end for which the insurer would not have been given sufficient time to file the rationale report with the SVO. Therriault said the SVO requested that the Task Force permit a 30-day grace period for the filing of the supporting rationale report with the SVO for any private rating which renewed at the end of 2024. This will ensure that the insurance company has a designation to report by year-end 2024. The SVO will draft an amendment to address this in the P&P Manual next year.

Mears said the SVO is working with NASVA on this listing of securities that currently do not have private letter rating (PLR) rationales attached. To the extent that any insurers are having issues, they should work with NASVA so that they are made aware and can coordinate conversations with the SVO. The recommendation is to move forward with deactivation, which was the policy that was put in the P&P Manual over three years ago. Mears said the Task Force wants to move forward but only if there are no issues with the data. If there are any changes, the SVO will ensure that there is an update back to the Task Force and to the public. Mears said the Task Force should also consider whether those private ratings that renew close to year end should get a 30-day grace period.

Reis thanked the SVO for working with NASVA. Therriault said the SVO is appreciative of NASVA, as it has helped identify the problems that were in the system. The SVO has worked hard to remediate those. If NASVA does identify more problems, the SVO looks forward to the feedback. The SVO does not move forward if there are major system problems. Reis said the complication was that companies were saying it was not fair if private ratings were deactivated inappropriately. Identifying the issue would be a big win.

Mears said the SVO will move forward with the deactivation of the private rating securities issued on or after Jan. 1, 2022, that do not have the required rating rationale report submitted to the SVO and permit a 30-day grace period to provide that report for any private ratings that were renewed in December just prior to year-end. However, if an ongoing review by the SVO and NASVA shows that there are any data quality issues that needs to be considered, the deactivation will be deferred but only for three months. The Task Force plans to keep this process moving by working continually with NASVA to address any issues, and the Task Force will continue to receive updates from the SVO.

7. Received an Update on the Proposed CLO Modeling Methodology and AdHoc Working Group

Mears said the next item on the agenda is to hear updates on the proposed collateralized loan obligation (CLO) modeling methodology. Kolchinsky said the next ad hoc meeting will take place in the next few weeks. The SSG has selected a preliminary probability distribution and put together the documentation. Kolchinsky said the approach that SSG used can be summarized as follows: First, SSG calculated the approximate pool RBC for each of the 1,800 CLOs SSG has modeled, whose results were posted. Next, SSG generated a number of random probability distributions and selected the one that minimized the mean squared error. The error here is the difference between the probability-weighted RBC on all the tranches versus the RBC on the pool calculated in the first step. The selected scenario was further fine-tuned to lower mean squared error. SSG will present the algorithm (including the R code where appropriate), risk measures, and will be looking for the industry's comments on the methodology.

SSG also hopes that the industry can present a probability distribution that further lowers the mean squared error. Going forward, SSG hopes that in the early first quarter of 2025, SSG will post monthly results on risk measures. The next batch of results will include the methodology changes discussed at the last ad hoc meeting that was proposed by the industry.

Kolchinsky then provided an update on the work being done with the American Academy of Actuaries (Academy). The C1 subcommittee is currently processing data for Moody's and will look for relationships between the CLO analytics and the risk calculated pursuant to the SSG model. At some point, the Academy

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will ask SSG to adjust the model to better comport with the RBC. SSG continues to work closely with the Academy.

Having no further business, the Valuation of Securities (E) Task Force adjourned.

[https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-11 Fall NM/Minutes/VOSTF_2024-11-17_Fall_NM_Minutes v6 \(Chair review\).docx](https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-11 Fall NM/Minutes/VOSTF_2024-11-17_Fall_NM_Minutes v6 (Chair review).docx)



- Conduct a *look-through assessment*
- Conduct an *credit investment-risk assessment* to determine the *credit investment* risk of the fund's cash flows.
- Conduct a *speculative characteristics analysis*.
- Determine whether the fund's cash flow can or cannot be appropriately characterized as *fixed income like* for regulatory purposes.
- If the SVO determines that the fund's cash flow can be appropriately characterized as fixed income for regulatory purposes, it assigns an NAIC Designation to reflect the *credit investment* risk associated with the fund's cash flow and includes the name of the fund on the appropriate NAIC List.**
- If the SVO determines that the fund's cash flow cannot be appropriately characterized as fixed income for regulatory purposes it shall communicate the determination to the insurance company or fund sponsor in writing.

* **NOTE:** *Italicized text* indicates that the term used is a defined term. Please refer to the definition of the term for a description of SVO criteria associated with the methodology component being described.

** **NOTE:** The NAIC Designation does not address the fund's ability to meet payment obligations because the insurer/shareholder does not own the bonds in the portfolio; the NAIC Designation instead conveys the *credit investment* risk/quality of the fixed income like cash flow generated by the ETF.

Documentation

300. An insurance company or the sponsor of a bond or preferred stock fund that request that the SVO conduct the look through and credit assessment submits the following required documentation to the SVO:

- A completed RTAS Application (Information about the RTAS process is contained here: www.naic.org/documents/svo_rtas_app.pdf). A fund with *derivatives transactions* or other *derivative instruments* may be considered a Highly Customized Transaction if the SVO determines it necessary to review a derivative's operative legal documentation.
- For all funds subject to look-through and *credit investment* risk assessment and to speculative characteristics analysis: the Prospectus and Statement of Additional Information (SAI) for the fund.

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MUNICIPAL BONDS

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Industrial Development Revenue Bonds; Pollution Control Bonds

315. In the case of an industrial development revenue bond or a pollution control bond, the methodology applied by the SVO to assess ~~credit~~ investment risk may derive from any appropriate corporate methodology or from a municipal methodology, whether associated with the revenue or the general obligation approach.



PRINCIPAL PROTECTED SECURITIES

Definition

325. Principal Protected Securities (PPSs) typically have both a principal protected component and a performance component whose payments originate from, or are determined by, non-fixed income like sources and, therefore, pose the risk of non-fixed income like cashflows. PPS do not include the exclusions listed below in this section.
326. The following transaction examples are included for demonstrative purposes only, to highlight the intent behind the principle-based PPS definition and the core regulatory concern (that there are investment risks ~~Other Non-payments Risks~~ associated with PPSs beyond the contractually promised payments that may not be reflected in a CRP rating) but are not intended to encompass all possible PPS variants. Each of these examples meets the definition of a PPS. Any design that circumvents the definition, and related examples, through technical means but which in substance achieves the same ends or poses the same risk, shall be deemed a PPS.

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Filing Requirements

333. Investments in PPSs must be submitted to the SVO for review because they may possess ~~Other Non-Payment Risks~~ investment risks not otherwise reflected in the Eligible CRP Rating. ~~that the SVO must assess under its Subscript S authority.~~ If the SVO determines in its judgement that there are ~~not any~~ no investment risks which are not already reflected in the Eligible CRP Rating. ~~Other Non-Payment Risks,~~ the SVO will permit the security to benefit from Filing Exemption, if it is otherwise eligible.

https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-10-01 VOSTF Interim Meeting/01-Subscript S References/2024-016.01 PP_Manual_Amendment_Subscript-S_References_v4.docx