

VALUATION OF SECURITIES (E) TASK FORCE

Valuation of Securities (E) Task Force October 1, 2024, Minutes (Attachment One)

Amendment to the P&P Manual to Require Annual Reviews of Regulatory Transactions (Attachment Two)

Amendment to the P&P Manual to Update the list of NAIC CRPs and the NAIC use of CRP Credit Ratings (Attachment Three)

Amendment to the P&P Manual to Remove References to Subscript-S and Update References to Investment Risk (Attachment Four)

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 Two). The motion passed unanimously.

Draft Pending Adoption

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 Three). 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

Draft Pending Adoption

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 Four). 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.

Draft Pending Adoption

- **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

Draft Pending Adoption

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.

Draft Pending Adoption

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

Draft Pending Adoption

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)

Draft Pending Adoption

Draft: 10/14/24

Valuation of Securities (E) Task Force
Virtual Meeting
October 1, 2024

The Valuation of Securities (E) Task Force met Oct. 1, 2024. The following Task Force members participated: Doug Ommen, Chair, represented by Carrie Mears (IA); Andrew N. Mais, Vice Chair, represented Kenneth Cotrone (CT); Lori K. Wing-Heier represented by David Phifer (AK); Mark Fowler represented by Sheila Travis and Sanjeev Chaudhuri (AL); Ricardo Lara represented by Laura Clements (CA); Michael Yaworsky represented by Ray Spudeck (FL); Dean L. Cameron represented by Eric Fletcher (ID); Vicki Schmidt represented by Tish Becker (KS); Timothy J. Temple represented by Bill Werner (LA); Marie Grant represented by Greg Ricci (MD); Chlora Lindley-Myers represented by Debbie Doggett (MO); Jon Godfread represented by Matt Fischer (ND); 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 Eli Snowbarger (OK); Cassie Brown represented by Amy Garcia (TX); Jon Pike represented by Jennifer Heaps (UT); Scott A. White represented by Doug Stolte and Greg Chew (VA); Mike Kreidler represented by Katy Bardsley (WA); and Nathan Houdek represented by Levi Olson (WI). Also participating was: Tadd Wegner (NE).

1. Exposed a Proposed P&P Manual Amendment to Remove References to Subscript-S and Update References to Investment Risk

Mears said the first agenda item was to discuss and consider for exposure a proposed *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) amendment to remove references to Subscript-S 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 a concept for NAIC purposes. Focusing solely on credit risk could limit the NAIC’s ability to assess the risk of investments like principal protected securities (PPS) or funds that currently fall under the Securities Valuation Office’s (SVO’s) purview. By looking at what is called “investment risk,” defined as the likelihood of the insurer’s receipt of full principal and expected interest, the NAIC can account for the performance component of a PPS, the share of a fund, and a variety of the risks that may be present in both traditional and more complex securities, particularly those that do not qualify as bonds under the upcoming principles-based bond definition. This use of “investment risk” is also consistent with the language used in the Financial Condition (E) Committee’s Investment Framework.

As the SVO mentioned at the Task Force’s June 18 meeting and in its memorandum on the definition of an NAIC designation, there are a number of lingering references to Subscript-S and other non-payment risks throughout the P&P Manual. The SVO committed to identifying those references in the P&P Manual and has submitted 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.”

Charles Therriault (NAIC) 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. The P&P Manual was reviewed by the SVO to identify references to the concept and symbol and propose removing them in this amendment. Additionally, with the adoption of the term “investment risk” in the definition of an NAIC designation, the P&P Manual was also reviewed to identify references to “credit risk,” “credit quality,”

Draft Pending Adoption

or other language that would be impacted by the definition's inclusion of the "receipt of full and timely principal and expected interest," and update those references, as necessary. One suggestion was to change the following proposed language in Part One, paragraph 32, "This process is distinct from the SVO's

assessment of an investment's risk, which results in an NAIC Designation," to "This process is distinct from the SVO's investment risk assessment, which results in an NAIC Designation." With the Task Force's approval, the amendment would be updated with that change in the exposure.

Mears directed the SVO to expose the P&P Manual amendment, including the change to remove references to Subscript-S and update references to investment risk, for a 30-day public comment period ending Nov. 1. The goal is to adopt the amendment at the Fall National Meeting.

2. Exposed a Proposed P&P Manual Amendment to Update the List of NAIC CRPs and the NAIC Policy on the Use of CRP Credit Ratings

Mears said the next agenda item was an update to the previously exposed P&P Manual amendment to update the List of NAIC Credit Rating Providers (CRPs), with an addition to clarify the NAIC's use of CRP ratings. A suggestion was made regarding the CRP status amendment to clarify some confusion caused by the difference between the two asset-backed security (ABS) definitions. The ABS definition in *Statement of Statutory Accounting Principles (SSAP) No. 43—Asset-Backed Securities* that will be effective Jan. 1, 2025, with the principles-based bond definition used for NAIC regulatory and reporting purposes is not necessarily consistent with the US Securities and Exchange Commission's (SEC's) ABS definition used for purposes of registering nationally recognized statistical rating organizations (NRSROs) to rate ABS transactions. The two definitions are distinct and, therefore, may not align. A transaction could qualify as ABS according to SSAP No. 43 but not according to the SEC, and does not impact the NRSRO's ability to rate that transaction.

Therriault said that some confusion has been caused between these two separate definitions. When determining if a rating is eligible for use in the filing exempt (FE) process, the P&P Manual requires that it has been produced by a rating agency that is registered with the SEC as an NRSRO for the rating class of the security (i.e., corporate, government, financial institutions, insurance, or ABS). The update to this amendment would add the following clarifying sentence to the end of Part One, paragraph 57: "In its administration of the filing exempt rule, the NAIC only uses credit ratings from those classes of credit ratings for which the NAIC Credit Rating Provider is registered with the SEC as an NRSRO, as identified in this Manual." The update that is being added to the list of classes of securities each NRSRO is eligible to rate. This change does not in any way affect the NAIC's policy on using CRP ratings; rather, it clarifies the existing policy that those ratings must be NRSRO ratings. The SVO recommends a brief exposure period to allow interested parties to review the sentence being added to the existing amendment.

Mears reminded the Task Force that this amendment was exposed at the Summer National Meeting. That comment period has closed; therefore, this is a re-exposure with this addition as the Task Force has not adopted this amendment.

Mears directed the SVO to expose the revised P&P Manual amendment to update the List of NAIC CRPs and the NAIC Policy on the Use of CRP Credit Ratings for a 14-day public comment period ending Oct. 16.

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/01-Minutes/VOSTF_2024-10-01_Interim_Minutes v6 \(Final\).docx](https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-11 Fall NM/01-Minutes/VOSTF_2024-10-01_Interim_Minutes v6 (Final).docx)

SVO



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
Marc Perlman, Managing Investment Counsel, NAIC Securities Valuation Office
Eric Kolchinsky, Director, NAIC Structured Securities Group and Capital Markets Bureau

RE: Proposed P&P Manual Amendment to Require Annual Reviews of Regulatory Transactions

DATE: July 1, 2024

Summary: The Regulatory Transactions instructions in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) in Part Three, paragraphs 301 – 312, do not specifically provide instructions for a periodic review by the Securities Valuation Office (SVO) or Structured Securities Group (SSG). All other assessments of investment risk by the SVO or SSG in the P&P Manual must be updated at least annually and the insurer is required to notify the SVO of any material changes. This proposed amendment would update the instructions for the production of SVO Analytical Values for Regulatory Transactions to require an annual review, require the relevant insurance company to notify to the SVO or SSG of any material changes and to clarify the an insurance company’s limited ability to self-assign an SVO Analytical Value with a ”Z”.

Recommendation: The SVO recommends adoption of this proposed amendment to require an annual review of Regulatory Transactions by the SVO or SSG and notification when there is a material change. The SVO believes this is a non-substantive change as it is otherwise assumed throughout the P&P Manual that SVO and SSG opinions are updated at least annually and the lack of this instruction was a drafting oversight. 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 2023 P&P Manual format.



PART THREE
SVO PROCEDURES AND METHODOLOGY FOR PRODUCTION
OF NAIC DESIGNATIONS



REGULATORY TRANSACTIONS

NOTE: See “Policies Applicable to Specific Asset Classes” in Part One for the policies governing this activity, as well as “Specific Populations of Securities Not Eligible for Filing Exemption” in “Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities” above.

Defined

301. **Regulatory Transaction** means a security or other instrument in a transaction submitted to one or more state insurance departments for review and approval under the regulatory framework of the state or states. The term Regulatory Transaction is more broadly defined as a transaction engineered to address a regulatory concern one or more insurers have or may have that should 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 an Investment Security, as defined in this Manual, that is eligible for assignment of an NAIC Designation.

Status of Regulatory Transactions

302. A Regulatory Transaction is not eligible for:
- Assignment of an NAIC Designation by the SVO;
 - The filing exemption process for publicly rated securities;
 - The private letter rating component of the filing exemption or for use of the PLGI designation symbol;
 - Self-assignment by an insurer of the administrative symbol Z under the 120-rule;
 - Self-reporting by an insurer on the general interrogatory for securities eligible for filing exemption but for which no NAIC CRP credit rating is available (i.e., 5.B GI) and
 - Inclusion in the SVO List of Investment Securities or any other NAIC electronic system or processes maintained for operations for the VOS/TF.



Intent

303. This section provides guidance to the SVO and the SSG on how to manage requests for assistance made by a state insurance department as authorized in this Manual. Insurance companies shall not report a Regulatory Transaction as a Filing Exempt security, and the NAIC staff shall not assign an NAIC Designation to the security component of a Regulatory Transaction or to the Regulatory Transaction or add them to the Filing Exempt Securities Process of the SVO List of Investment Securities. See the instructions on Regulatory Transactions contained in the compilation instructions in this Manual. This does not preclude the SVO from working directly with a state insurance department and issuing an opinion to the department consistent with the instructions outlined in this Manual.

The Security Component of a Regulatory Transaction

304. However, as discussed above, the security component of the broadly defined Regulatory Transaction—i.e, a transaction engineered to address a regulatory concern one or more insurers have or may have that should be submitted to a state insurance department for approval—may be an Investment Security that may be eligible for designation under filing exemption or by the SVO on a stand-alone basis. For example:

- An insurance company entered into a coinsurance reinsurance transactions that requires regulatory approval and as part of that transaction, received an IBM bond. The IBM bond, when owned by an insurance company as a stand-alone investment, would be considered eligible for Filing Exemption but the whole regulatory transaction would not be eligible for Filing Exemption. In this example, the IBM bond is assumed to be an Investment Security, as defined in this Manual.
- An IBM bond that was eligible for Filing Exemptions was sold/transferred from an insurance company to an affiliated insurance company that requires regulatory approval. Such an IBM bond would still be considered eligible for Filing Exemptions when owned by an insurance company as a stand-alone investment. In this example, the IBM bond is assumed to be an Investment Security, as defined in this Manual. Any other parts of the transaction requiring regulatory approvals, if any, would not be eligible for Filing Exemption.

Procedure: Assessment of the Security Component of a Regulatory Transaction

305. If an insurance company files a Regulatory Transaction with the SVO via the ATF process or under the Regulatory Treatment Analysis Service (RTAS) process, the SVO shall first contact the state insurance department of the insurance company's state of domicile to disclose that a Regulatory Transaction has been submitted and inquire whether the state insurance department wants SVO analytical assistance.



306. The SVO or SSG is authorized to conduct an analytical assessment on behalf of any state insurance department that requests such assistance. If the state insurance department of the insurer's state of domicile requests such assistance, the SVO shall engage in the requested analytical assessments of the security component of the Regulatory Transaction. In its assessment, the SVO would make use of NAIC analytical benchmarks, such as those used to produce NAIC Designations, valuation or classification assessments, and such determinations may be given by the SVO or SSG to the state insurance department.
307. Determinations made by the SVO or SSG given to a state insurance department in connection with assessment of the security component of a Regulatory Transaction shall be referred to as an SVO Analytical Value (defined below) to prevent confusion in the reporting by an insurer of the Regulatory Transaction or the security component of a Regulatory Transaction to the domiciliary state insurance department and the reporting of a stand-alone Investment Security under the general procedures applicable to them.
308. SVO or SSG determinations given in connection with the assessment of a Regulatory Transaction given to the state insurance department may be adopted by the state insurance department as part of that state's internal determination of the regulatory issues presented by the Regulatory Transaction. However, SVO assessments for security component of a Regulatory Transaction will not be entered into NAIC computer systems reserved for Investment Securities or added to the SVO List of Investment Securities as defined in this Manual. The insurance department may give the SVO Analytical Value to the insurer and instruct the insurer to use the SVO Analytical Value to report the security component of the Regulatory Transaction to the state, as more fully discussed below.

Reporting Regulatory Transactions on Investment Schedules

309. A security component of a Regulatory Transaction is reported on an investment schedule. The security component of a Regulatory Transaction reported on Schedule D, Part 1, must be reported with one of the two codes described below, unless it would otherwise qualify as an Investment Security eligible for designation under filing exemption or by the SVO on a stand-alone basis absent the broadly defined Regulatory Transaction (as discussed above). The codes track the security component. Other investment schedules do not require that an NAIC Designation be reported. (For example, Schedule BA items are not required to be reported with an NAIC Designation.) The codes apply ONLY to the security component of the Regulatory Transaction. Each of the two codes identifies a different reporting paradigm and requires the reporting entity to report an SVO Analytical Value, defined below.



Definition of SVO Analytical Value

310. An SVO Analytical Value produced by the SVO is an expression of the credit quality of the security component of a Regulatory Transaction which is expressed with the numerical symbols 1 through 6 in the case of a Regulatory Transaction within the reporting paradigm associated with the RTS code and can be expressed with the grade indicated by the letters A through G for Analytical Value of 1, and three delineations each for the Analytical Value 2, 3, 4 and 5 indicated by the letters A, B and C, and one delineation for Analytical Value 6. In the case of the security component of a Regulatory Transaction within the reporting paradigm associated with the RT code the SVO has not developed the SVO Analytical Value but in that case the Value is expressed with the numerical symbol 6.

Codes and Their Meaning

311. **RTS** is reported for the security component of a Regulatory Transaction for which:
- A state insurance department requested SVO assistance in assessing the credit quality of the security component of the Regulatory Transaction; and
 - The SVO provided an SVO Analytical Value for the security to the department; and
 - The department thereafter directed its insurer to report the SVO Analytical Value.

For the security component of a Regulatory Transaction within the RTS reporting paradigm, the reporting entity reports the analytical value it received from the department, which is the same one the SVO provided to the department. The SVO Analytical Value associated with the RTS code is expressed as a numerical symbol from 1 through 6; e.g., 4RTS. The RTS SVO Analytical Value may be used in conjunction with the SVO Analytical Department Symbols and instructions defined in this manual and assigned by the SVO associated with IF, YE and Z (but only for RTS securities issued within 120 days of the reporting period end date, otherwise the reporting entity self-assigns and reports the SVO Analytical Value 6; e.g., 6 RT as described below); e.g., 1.G RTSYE, 4.B RTSIF, 3.A RTSZ, as detailed in the Annual Statement Instructions.

An SVO Analytical Value is ONLY assigned if the SVO determines the security component of the Regulatory Transaction would not qualify as an Investment Security eligible for designation under filing exemption or by the SVO if engaged on a stand-alone basis. An SVO Analytical Value is not a preliminary or an official NAIC Designation and cannot be entered into NAIC systems maintained to support the operations of the VOS/TF either by the SVO or anyone else.



312. **RT** is reported for the security component of a Regulatory Transaction for which:
- A state insurance department did not request assistance from the SVO in assessing the credit quality of the security component of the Regulatory Transaction; or
 - The department requested the assistance of the SVO but the SVO determined the security component of the Regulatory Transaction was not an Investment Security if engaged in on a stand-alone basis; or
 - The SVO was unable to provide an SVO Analytical Value for the security component of the Regulatory Transaction.

For the security component of Regulatory Transactions within the RT reporting paradigm, the reporting entity always self-assigns and reports the SVO Analytical Value 6; e.g., 6 RT.

Annual Updates and Material Changes

313. SVO or SSG determinations of an SVO Analytic Value are only applicable for the calendar year of the request and do not represent a permanent assessment of the risk of the Regulatory Transaction. The SVO Analytic Value will be withdrawn by the SVO the calendar year after it was requested, consistent with all other Initial and Annual assessments of investment risk in this Manual. In the absence of an updated assessment, the insurance company, with the insurance department's approval, will need to self-assign and report the SVO Analytical Value 6; e.g., 6 RT.
314. If the insurance company and/or insurance department requests an updated SVO Analytic Value for a subsequent calendar year, the SVO or SSG will reassess the Regulatory Transaction consistent with other Annual assessments of investment risk in this Manual. The insurer is expected to provide the necessary information to the SVO or SSG for its review. Any missing information will be requested by the SVO or SSG and expected to be provided promptly by the insurance company consistent with the Informational Deficiencies instructions in this Manual. At the completion of its assessment the SVO or SSG will inform the insurance company and insurance department of the updated SVO Analytic Value.
315. If the insurer becomes aware of a material change to the Regulatory Transaction at any time, it is the responsibility of the insurance company to provide the SVO or SSG with the necessary information to update the SVO Analytic Value assessment to reflect the change consistent with the Material Credit Events Filing instructions in this manual.



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
Marc Perlman, Managing Investment Counsel, NAIC Securities Valuation Office
Eric Kolchinsky, Director, NAIC Structured Securities Group and Capital Markets Bureau

RE: Proposed P&P Manual Amendment to Update the List of NAIC Credit Rating Providers (CRP) and the NAIC Use of CRP Credit Ratings

DATE: September 27, 2024

Summary: The *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) in Part Three, paragraph 24 lists the credit rating providers (CRP) to the NAIC along with the classes of credit ratings for which they have CRP status. Only those classes of credit ratings for which the CRP is registered by the U.S. Securities and Exchange Commission (SEC) as a nationally recognized statistical ratings organization (NRSRO) are eligible to be used for NAIC CRP purposes. This amendment updates the review date and corrects one editing error.

Additionally, the updated amendment includes clarification that the NAIC only uses credit ratings from those classes of credit rating for which the NAIC Credit Rating Provider is registered with the SEC as an NRSRO.

Recommendation: The SVO recommends adoption of this proposed amendment to update the NRSRO status review date for the P&P Manual List of NAIC Credit Rating Providers. The SVO believes this is a non-substantive change. 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 2023 P&P Manual format.



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



THE USE OF CREDIT RATINGS OF NRSROs IN NAIC PROCESSES

NOTE: See “Policies Applicable to the Filing Exemption (FE) Process” below; “NAIC Policy on the Use of Credit Ratings of NRSROs” (especially “Definition – Credit Ratings Eligible for Translation to NAIC Designations”) in Part Two (the definition of “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 that it is not appropriate for NRSRO credit ratings to be used to determine the regulatory treatment of the security or asset*); and “Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities” in Part Three.

Providing Credit Rating Services to the NAIC

57. The NAIC uses credit ratings for a number of regulatory purposes, including, to administer the filing exempt rule. Any rating organization that has been designated a Nationally Recognized Statistical Rating Organization (NRSRO) by the U.S. Securities and Exchange Commission (SEC) and which continues to be subject to federal regulation, may apply to provide Credit Rating Services¹ to the NAIC. In its administration of the filing exempt rule, the NAIC only uses credit ratings from those classes of credit ratings for which the NAIC Credit Rating Provider is registered with the SEC as an NRSRO, as identified in this Manual.

¹ **Credit Rating Services** is defined as: (a) electronic data feed transmissions of credit ratings assigned by the NRSRO with their corresponding CUSIP number and other pertinent security specific information in English, updated as frequently as provided to other customers; (b) other analytical services or products, in English, provided to other customers; and (c) access to the NRSRO’s rating analysts by SVO staff.



PART THREE
SVO PROCEDURES AND METHODOLOGY FOR PRODUCTION
OF NAIC DESIGNATIONS



LIST OF NAIC CREDIT RATING PROVIDERS

58. The CRPs that provide Credit Rating Services to the NAIC are:

- **Moody’s Investors Service, Inc.** for credit ratings issued to financial institutions, brokers, or dealers; insurance companies; corporate issuers; issuers of asset-backed securities and issuers of government securities, municipal securities, or securities issued by a foreign government.
- **S&P Global Ratings**, for credit ratings issued to financial institutions, brokers, or dealers; insurance companies; corporate issuers; issuers of asset-backed securities and issuers of government securities, municipal securities, or securities issued by a foreign government.
- **Fitch Ratings, Inc.** – For credit ratings issued to financial institutions, brokers, or dealers; insurance companies; corporate issuers; issuers of asset-backed securities and issuers of government securities, municipal securities, or securities issued by a foreign government.
- **A.M. Best Rating Services, Inc. (A.M. Best)** – For credit ratings issued to insurance companies; corporate issuers and issuers of asset-backed securities.
- **DBRS, Inc. (DBRS Morningstar)** – For credit ratings issued to financial institutions, brokers, or dealers; insurance companies; corporate issuers; issuers of asset-backed securities and issuers of government securities, municipal securities, or securities issued by a foreign government.
- **Kroll Bond Rating Agency, LLC.** – For credit ratings issued to financial institutions, brokers, or dealers; insurance companies; corporate issuers; issuers of asset-backed securities and issuers of government securities, municipal securities, or securities issued by a foreign government.
- **Egan-Jones Ratings Co.** – For credit ratings issued to financial institutions, brokers, or dealers; insurance companies and corporate issuers.
- **HR Ratings de Mexico, S.A. de C.V.** – For credit ratings issued to financial institutions, brokers, or dealers; corporate issuers and issuers of government securities, municipal securities, or securities issued by a foreign government.

NOTE: The information shown above for each NRSRO was obtained from the SEC’s website: www.sec.gov/ocr on ~~February 2, 2021~~ June 28, 2024 and confirmed against each NRSRO’s annual Form NRSRO certification.

NOTE: The Credit Rating Providers identified above include those of its affiliates that the credit rating provider identified to the U.S. Securities and Exchange Commission (SEC) as part of its Form NRSRO Application as a separate legal entity or a separately identifiable



department or division of the credit rating provider that determines credit ratings that are credit ratings of the credit rating provider and which the SEC treats as a credit rating issued by the credit rating provider for purposes of Section 15E of the Exchange Act and the SEC's rules thereunder.

https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-10-01 VOSTF Interim Meeting/02-CRP status/2024-015.02 PP_Manual_Amend_CRP_NRSRO_Status v2.docx

SVO



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
Marc Perlman, Managing Investment Counsel, NAIC Securities Valuation Office
Eric Kolchinsky, Director, NAIC Structured Securities Group and Capital Markets Bureau

RE: Proposed P&P Manual Amendment to Remove References to Subscript-S and Update References to Investment Risk

DATE: September 18, 2024

Summary: At the 2024 Summer National Meeting the Valuation of Securities (E) Task Force adopted an updated definition of an NAIC Designation. The update included the removal of the concept “Other Non-Payment Risk” and the corresponding SVO administrative symbol “Subscript S”, and the replacement of the term “credit risk” with the newly defined term “investment risk.”

The attached technical amendment removes references to Other Non-payment Risk, “subscript S” and, where appropriate, “credit risk,” with “investment risk” or the corresponding meaning. This amendment does not introduce any new policies or procedures.

Recommendation – The SVO recommends a brief exposure period for the amendment with a request for technical changes or updates for references that may have been missed as there is no policy change being proposed.

Proposed Amendment –The proposed changes to the current P&P Manual are shown below with additions in red underline font color, and deletions in ~~red strikethrough~~.



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



ABOUT THE NAIC, THE VALUATION OF SECURITIES (E) TASK FORCE AND THE SVO

...

The VOS/TF and the SVO Staff

4. The NAIC has determined that ~~credit quality~~ the assessment of investment risk, which includes credit quality, of insurance company investments provide a sound empirical anchor for certain regulatory functions related to financial solvency regulation. The VOS/TF formulates and implements NAIC's ~~credit~~ investment risk assessment and related policies. The SVO is the professional staff assigned to support the VOS/TF. The SVO conducts ~~credit quality~~ investment risk assessments of securities owned by state-regulated insurance companies and performs such other duties specified by VOS/TF in this Manual or assigned by other NAIC regulator groups, from time to time.

...



POLICIES PERTAINING TO SVO AND SSG OPERATIONS

...

NAIC Designations Do Not Communicate Statutory Accounting or Reporting

32. The assessment of ~~investment credit~~ risk for an obligation or asset, as specified in the P&P Manual, is a separate and distinct process from the determination of statutory accounting or reporting under the AP&P Manual. The manner in which an NAIC Designation is used within statutory accounting guidance is limited to that, if any, specified in a Statement of Statutory Accounting Principles (SSAP) and cannot be derived or implied by language in the P&P Manual. Obtaining an NAIC Designation does not change an investment's applicable SSAP, annual or quarterly statement reporting schedule, or override other SSAP guidance required for the investment to be an admitted asset. There are limited instances in which a SSAP specifically identifies, within its scope, the inclusion of specific SVO-Identified investments. The SVO review required for an investment to be included on an SVO listing is a separate evaluation process that focuses on the structure of the investment. This process is distinct from the SVO's ~~investment risk~~ assessment ~~of an investment's credit risk~~, which results in a NAIC Designation. As stated in the Statutory Hierarchy, Section V of the Preamble, the AP&P Manual is the highest level of authoritative guidance.

...

Impact on SVO Operations

34. Because SVO analytical determinations of ~~credit-quality investment risk~~ do not convey opinions, conclusions or informational content relative to statutory accounting status, the SVO may assign an NAIC Designation to any obligation or asset that is filed by an insurer, provided that its ~~credit-quality investment risk~~ can be assessed consistently with the policies and methodologies specified in the P&P Manual.

SECURITIES VALUATION OFFICE (SVO)
--

Ongoing SVO Operations

36. The SVO shall conduct the following ongoing operations:

- Analysis of ~~investment credit~~ risk for purposes of assigning an NAIC Designation.
- ~~Identification and analysis of securities that contain other non-payment risk and communication of this information by assignment of the NAIC Designation subscript to such securities.~~

...



FILING SECURITIES WITH THE SVO

Filing Requirements

53. **Initial** – Insurers that file a security must provide the SVO with the information necessary to evaluate the ~~credit~~ investment risk for the security.
54. **Annual** – Insurers that file a security are also required to provide the SVO with the information necessary to evaluate the ~~credit~~ investment risk for the security on an annual basis.

...

APPLICATION OF THE FE PROCEDURE TO SPECIFIC POPULATIONS
--

...

85. **NAIC Designation is Capped to Highest NAIC CRP Rating** – The SVO shall not assign an NAIC Designation for a security that has a credit rating assigned by an NAIC CRP when the NAIC Designation would express an opinion of ~~credit quality~~ investment risk higher than that indicated by the rating assigned by the NAIC CRP, except that the SVO may assign the NAIC Designation it deems appropriate to Municipal bonds and Military housing bonds or securities.

...

87. **Unrated Transaction of Issuer with NAIC CRP-Rated Debt** – When an insurer files an unrated security of an issuer that has another issue rated by an NAIC CRP, SVO may consider the rated issue and its position in the capital structure of the issuer to arrive at an NAIC Designation for the unrated security, provided staff first consults with the rating agency and independently consider the terms of the unrated security and its impact on credit or investment ~~other non-payment~~ risk.

...



SUBSIDIARY, CONTROLLED AND AFFILIATED (SCA) AND RELATED PARTY INVESTMENTS

110. SCA and related party bond and preferred stock investments (each, as defined in Part Three) in the form of a debt instrument purchased (or otherwise acquired) from an insurance or non-insurance entity and preferred stock issued by an insurance or non-insurance entity may be assessed by the SVO to determine eligibility for reporting as an Investment Security as defined in this Manual. The SVO is required to determine that a filed SCA and related party investment has terms, structure, complexity and purpose like those in transactions between unaffiliated parties so that ~~credit~~ investment risk assessment methodologies applied to transactions between unaffiliated parties can be meaningfully applied to transactions between affiliated parties; as a condition to assigning an NAIC Designation to the investment.

NOTE: See “Subsidiary, Controlled and Affiliated (SCA) and related party Bond or Preferred Stock” in Part Three for filing instructions, documentation requirements and methodology applicable to SCAs.

...

PRINCIPAL PROTECTED SECURITIES

Intent

116. Transactions meeting the criteria of a PPS as defined in Part Three of this Manual may possess investment risks not reflected in the otherwise Eligible CRP Rating ~~Other Non-Payment Risks~~ and must be submitted to the SVO for review ~~under its Subscriber S~~ authority.

...



PART TWO OPERATIONAL AND ADMINISTRATIVE INSTRUCTIONS APPLICABLE TO THE SVO

...

SVO NOTCHING GUIDELINES

...

Definition and Purpose

40. Notching is defined as the process used to make distinctions between different liabilities in an issuer capital structure to reflect differences in credit or ~~other non-payment~~ investment risk smaller than a whole grade. Notching expresses differences in expected loss (i.e., severity) of an issuer's liabilities by their relative priority of claim in bankruptcy or the receipt of full and timely principal and expected interest.

...

Notching ~~for~~ NAIC Designation ~~Subscript~~ (to Reflect ~~Non-Payment~~ Investment Risks Unrelated to Credit Risk)

50. **Grant of Significant Discretion** – The SVO is granted significant discretion to determine the number of notches it will assign to a security to reflect ~~other non-payment~~ investment risk. This discretion is to be exercised in the context of the regulatory objective and purpose of this procedure. SVO determinations made under this subparagraph are subject to review in accordance with the procedures described of this Part, above.

Relevant Considerations

51. The name given to the security is not relevant to a determination whether this subparagraph should be applied. The relevant criterion is whether the risks in the security are clearly credit risks or whether they ~~are not clearly credit~~ include other investment risks.
52. Factors the SVO may deem relevant to the question of notching for ~~other non-payment~~ investment risk may include:



- Any security or financial instrument denominated with a term associated with fixed income investments must contain a clearly stated obligation to pay a return and to repay the amount of the principal repayment. Otherwise it is not rational or possible to assign an NAIC Designation.
- Any security or financial instrument denominated as fixed income that does not contain a legally binding obligation to pay shall not be assigned an NAIC Designation and instead will be reported to the VOS/TF and the Chief Examiner of the State of Domicile.
- Any security or financial instrument that is denominated as fixed income and that contains a promise to pay that is otherwise conditional may be notched either under this subparagraph to reflect ~~other non-payment~~ the investment risks posed by the conditions or under the notching procedure for credit risk to reflect the expected loss of that obligation in the issuer’s specific capital structure, depending on which approach seems more appropriate to the SVO.

...

56. Notching differentials are expected to be wider for **NAIC 3, NAIC 4** and **NAIC 5** issuers because the issuer’s credit or the issue’s investment risk is deemed to increase the likelihood that the issuer will avail itself of contractually provided flexibility to not pay or increase the likelihood of a loss as a result of the insurer’s participatory activity.
57. Deferral of dividends in a security denominated preferred stock is presumed to be subject to notching for credit risk subject to an SVO determination that the denomination is not truly reflective of the terms of the agreement in which case it may be more appropriately notched for ~~other than credit~~ investment risk.
58. In a given capital structure, the priority of payment due to an investor may be so subordinated as to require treatment under these guidelines that the insurers will not receive full and timely principal and expected interest ~~for other non-payment risk~~. This is especially true where deep subordination is combined with a right to defer interest.

...

TRANSACTIONS SUBJECT TO RSAT APPROVAL REVIEW

...

63. The documentation should demonstrate that the combined cash flows will achieve the economic performance sought to be produced by the insurer and, therefore, qualify the transaction as an Approved RSAT. If the SVO receives a transaction that does not qualify for an NAIC Designation but would otherwise qualify as an Approved RSAT, the SVO will bring the transaction to the attention of the VOS/TF and await instructions on how to proceed with it.



- **Basket** – A composite of specific financial instruments that are determined by agreement between two parties to be used as a statistical benchmark.
- **Cash Component** – The instrument, or portfolio of instruments, owned by the insurance company that is identified by the insurer as the cash instrument component of the RSAT. In an RSAT, the credit quality of the Cash Component may differ from the credit quality of the reference securities.
- **Change in ~~Credit~~ Investment Profile** – An RSAT where the ~~credit~~ investment risk denoted by NAIC Designation and/or credit risk of the NAIC CRP rating, of the Cash Component is different from the ~~credit~~ investment risk of the replicated (synthetic) asset. Examples of transactions that constitute a change in credit profile may include:

...



THE REGULATORY TREATMENT ANALYSIS SERVICE – EMERGING INVESTMENT VEHICLE

...

Definition of Probable Regulatory Treatment

97. For purposes of this section, probable regulatory treatment means the professional opinion of the SVO as to the ~~credit-quality~~ investment risk designation; and/or asset classification for statutory reporting purposes; and/or the valuation that would be accorded to the EIV under this Manual if it were purchased by an insurance company and reported to the SVO.

...

Standing of EIV Application in the NAIC Financial Condition Framework

...

112. A preliminary NAIC Designation will not be published in the Database or the AVS+ Products and, therefore, cannot be used to report the investment risk ~~credit-quality~~ of the security to the NAIC or any state insurance department. Only NAIC Designations published in the AVS+ Products may be used to report an investment to an NAIC member's state insurance department.

...



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~~ investment risk. The administrative symbols in use by the SVO and their meanings are described below.



APPEALS OF SVO DETERMINATIONS

APPEALS OF SVO ANALYTICAL DECISIONS

...

Procedure for Filing an Appeal

188. Filing an appeal with the SVO is accomplished through a computer linkup with the VISION computer system of the SVO. This appeal procedure applies only to situations where the SVO has expressed an analytical conclusion in the exercise of its quality assessment, ~~credit~~ investment risk assessment, classification, or valuation functions. The stated procedure encompasses initial filings, annual updates and securities not rated by an NAIC CRP. Securities rated by an NAIC CRP may be appealed only if the SVO designates securities differently than the NAIC CRP and the SVO retains responsibility for review of NAIC CRP-rated transactions.

....



MAINTENANCE AND MONITORING OF SVO DETERMINATIONS FOR SCHEDULE BA ASSETS

NOTE: See “Policies Applicable to Specific Asset Classes” in Part One for the policies governing this activity.

Maintaining and Publishing SVO Determinations

...

210. The SVO monitors improvement or deterioration of investment risk ~~credit quality~~ for Schedule BA assets entered into the VOS Process. On at least an annual basis, the SVO reviews the investment risk ~~credit quality~~ and value of the Schedule BA assets in the VOS Process.



PART THREE

SVO PROCEDURES AND METHODOLOGY FOR PRODUCTION OF NAIC DESIGNATIONS

...

FE SECURITIES

...

Specific Populations of Securities Not Eligible for Filing Exemption

4. The filing exemption procedure does not apply to:

...

- **SCA and Related Party Bond and Preferred Stock Investments** – SCA and related party bond and preferred stock investments are comprised of two types of transactions: (1) SCA and related party bond and SCA and related party preferred stock investments (each, as defined in this Part) that have direct or indirect ~~credit~~ investment risk exposure to the SCA or related party, whether as issuer or otherwise, which are not filing exempt; and (2) SCA and related party investments that do not have any direct or indirect ~~credit~~ investment risk exposure to the SCA or related party, whether as issuer or otherwise, which are filing exempt. Transactions under (1) are transactions between insurance company SCAs (as defined in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*) or other related parties (as defined in *SSAP No. 25 – Affiliates and Other Related Parties*) that are subject to special regulatory considerations identified in *SSAP No. 25-Affiliates and Other Related Parties*. This Manual specifies that such SCA and related party bond and preferred stock investments are not eligible for 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~~ investment risk. See the SCA and Related Party section in this Part for further information about how the SVO determines whether an SCA and Related Party investment will be assigned an NAIC Designation and how a state insurance regulator can require an insurance company to file an otherwise filing exempt structure containing an SCA or related party with the SVO.



- **Principal Protected Securities (PPS)** - Transactions meeting the criteria of a PPS as specified in this Manual may possess ~~Other Non-Payment Risks~~ investment risks not reflected in the otherwise Eligible CRP Rating and must be submitted to the SVO for review. ~~under its Subscriber S authority.~~ *(NOTE: This change is effective as of Jan. 1, 2021. PPS acquired prior to Jan. 1, 2021 must be filed with the SVO by Jul. 1, 2021.)*

...

LIMITATIONS ON USE OF NAIC CRP RATINGS

NAIC Designation is Capped to Highest NAIC CRP Rating

26. The SVO shall not assign an NAIC Designation for a rated security that reflects an opinion of investment risk ~~credit quality~~ greater than that indicated by the rating assigned by an NAIC CRP, except as provided below, and except that the SVO may assign the NAIC Designation it deems appropriate to:

- Municipal bonds.
- Military housing bonds or securities.

...



GENERAL CORPORATE AND MUNICIPAL METHODOLOGY FOR INDEPENDENT ~~CREDIT~~ QUALITY INVESTMENT RISK ASSESSMENT

...

<p>VALUATION AND CREDIT <u>INVESTMENT RISK</u> ASSESSMENT OF DEFAULTED SECURITIES AND ANALYTICAL CONVENTIONS</p>

General Instructions

71. Issuers of defaulted securities often emerge from reorganization or private restructuring and their pre-default liabilities may have been modified but remain viable as modified. When this is the case, and the insurance company can demonstrate that it has accounted for the loss of fair value consistently with *SSAP No. 36—Troubled Debt Restructuring*, the SVO will assign a ~~credit-quality~~ NAIC De designation to the defaulted security to reflect the issuer's post-default ~~credit~~ investment risk.

...

Required Documents for ~~Credit~~ Investment Risk Assessment

...

79. If amended, then:
- Breakdown and explanation of any write-off, realized loss or waiver of:
 - ...
 - Pricing rationale, including basis for current ~~credit~~ investment risk assessment and comps



SUBSIDIARY, CONTROLLED AND AFFILIATED (SCA) AND RELATED PARTY BOND OR PREFERRED STOCK INVESTMENTS

...

256. **Bonds** – An investment (except for those investments that fit the examples detailed in the “SCA and Related Party Filing Exempt Investments” section below), in the form of a bond (i) *issued* by an insurance or noninsurance SCA or related party of the reporting insurance company, or (ii) issued as part of a structure which would, pursuant to paragraph 4.a. of *SSAP No. 43 – Loan-Backed and Structured Securities*, qualify as a related party investment due to the reporting insurance company’s ~~credit~~ **investment** risk exposure to the SCA or related party (“SCA and related party bond”), is filed with the SVO. To file an SCA and related party bond investment, the reporting insurance company files an Audited Financial Statement for the subsidiary, a copy of the corporate resolution authorizing the issuance of the debt, written evidence that the transaction has been approved by the state of domicile or that no such approval is necessary and, if the subsidiary is an insurance company, the subsidiary’s most recent NAIC Financial Statement Blank, together with the reporting insurance company’s NAIC Financial Statement Blank, internal investment committee memorandum for the investment and loan documentation appropriate to the transaction.
257. **Preferred Stock** – An investment (except for those investments that fit the examples detailed in the “SCA and Related Party Filing Exempt Investments” section below), in the form of a preferred stock (i) *issued* by a noninsurance SCA or related party of the reporting insurance company, or (ii) issued as part of a structure which would, pursuant to paragraph 4.a. of *SSAP No. 43 – Loan-Backed and Structured Securities*, qualify as a related party investment due to the reporting insurance company’s ~~credit~~ **investment** risk exposure to the SCA or related party (“SCA and related party preferred stock”), is filed with the SVO. To file an SCA and related party preferred stock issued by a non-insurer, the reporting insurance company files an Audited Financial Statement for the issuer of the preferred stock, a copy of the corporate resolution authorizing the issuance of the preferred stock, written evidence that the transaction has been approved by the state of domicile or that no such approval is necessary, together with details of the terms of the preferred stock, as well as the NAIC Financial Statement Blank for the reporting insurance company.

NOTE: Please see the section on preferred stock in this Part for additional analytical procedures applicable to that asset class.



258. **SCA and Related Party Filing Exempt Investments** – Certain investments might contain SCA or related party relationships without any direct or indirect ~~credit~~ investment risk exposure to such SCAs or related parties. For example, an investment could be (i) issued by an SCA or related party special purpose entity (SPE) which itself is not an obligor or party to whom the insurance reporting entity has direct or indirect ~~credit~~ investment risk exposure, or (ii) issued as part of a structure in which the originator, sponsor, manager, servicer, or other influential transaction party, is an affiliate or related party of the reporting insurance company but the investment does not have direct or indirect ~~credit~~ investment risk exposure to SCAs or related parties of the insurer. Such investments are eligible for filing exemption unless otherwise ineligible pursuant to guidance in this Manual unrelated to SCA or related party status. However, such investments may be in scope of *SSAP No. 25—Affiliates and Other Related Parties* and subject to reporting as an affiliate or related party transaction in the appropriate investment schedules. For the avoidance of doubt, nothing in this section prohibits a state insurance regulator, in accordance with Part One of this Manual, from requiring its domiciled insurance company to file an otherwise filing exempt investment with the SVO for analysis and/or assignment of an NAIC Designation, thereby making it ineligible for future filing exemption.

Purpose

259. This section applies to credit assessment of any SCA and related party investment in the form of a debt instrument purchased (or otherwise acquired) from an insurance or non-insurance entity (SCA and related party bond) and preferred stock issued by an insurance or non-insurance entity (SCA and related party preferred stock) where the insurer has ~~credit~~ investment risk exposure to the SCA or related party. This procedure is used to determine whether an SCA and related party bond or SCA and related party preferred stock transaction is eligible for reporting as an Investment Security pursuant to this Manual. The determination of “Investment Security” and credit assessment provided by the SVO shall not be construed to reflect assessments specific to SCA and related party transactions contained in *SSAP No. 25—Affiliates and Other Related Parties*. As such, an SVO-assigned NAIC Designation for SCA and related party transactions:

- Does not reflect collectability based on independent payment ability of a parent reporting entity.
- Does not reflect whether the transaction was conducted at arm’s-length.
- Does not reflect whether the transaction is considered “economic” under *SSAP No. 25*.

...



Procedure for Credit Assessment of Filed SCA Transaction

263. The procedure specified in this section applies to bonds and preferred stock whose terms, structure, complexity and purpose are like those in transactions between unaffiliated parties filed with the SVO so that credit investment risk assessment methodologies applied to transactions between unaffiliated parties can be meaningfully applied to transactions between affiliated parties.

...



NAIC FUND LISTS

...

REQUIRED DOCUMENTATION, ANALYTICAL PROCEDURES AND ELIGIBILITY CRITERIA

...

291. **Credit Investment Risk Assessment** – A calculation of the ~~credit~~ investment risk of a fund’s underlying investment portfolio using a weighted average rating factor methodology (WARF). The WARF factor for each portfolio security (issue/security specific) is determined by first translating its NAIC CRP rating into an NAIC Designation. For securities that are unrated but have an NAIC Designation, the Designation is used. The WARF factor for that NAIC Designation is then market value-weighted. The weighted factor for each investment is summed to determine the fund’s credit rating which is then translated into the equivalent NAIC Designation. For funds which use any *derivatives instrument* or *derivatives transaction*, the WARF analysis may incorporate each derivative counterparty and the ~~credit~~ investment risk assessment may include a determination of *derivatives exposure*.

...

298. **Speculative Characteristics Analysis** – Means: an assessment of the fund’s use of *derivatives transactions*, to examine the impact they may have on the fund’s portfolio cash flow as assessed under the ~~credit~~ investment risk assessment under normal and abnormal market conditions, the resulting *derivatives exposure* not to exceed 10% of the fund’s net assets in normal market conditions, excluding, for this purpose, currency or interest rate derivatives that hedge currency or interest rate risks associated with one or more specific (i) equity or fixed-income investments held by the fund (which must be foreign-currency-denominated in the case of currency derivatives), or (ii) the fund’s borrowings, provided that the currency or interest rate derivatives are entered into and maintained by the fund for hedging purposes and that the notional amounts of such derivatives do not exceed the value of the hedged investments (or the par value thereof, in the case of fixed-income investments, or the principal amount, in the case of borrowing) by more than 10 percent (each, an “*excluded derivatives transaction*”).

NOTE: For the avoidance of doubt, Funds on the NAIC U.S. Government Money Market Fund List are not permitted to use any *derivatives transaction* or other *derivatives instrument*.

Methodology*

299. The SVO shall:



- 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.

...



MUNICIPAL BONDS

...

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.

...

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