VALUATION OF SECURITIES (E) TASK FORCE

Valuation of Securities (E) Task Force December 8, 2019, Minutes
Valuation of Securities (E) Task Force October 31, 2019, Minutes (Attachment One)
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Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) to Add Ground Lease Financing Transactions as New Asset Class (Attachment Three)
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Valuation of Securities (E) Task Force
Austin, Texas
December 8, 2019

The Valuation of Securities (E) Task Force met in Austin, TX, Dec. 8, 2019. The following Task Force members participated: Robert H. Muriel, Chair, represented by Kevin Fry (IL); James J. Donelon, Vice Chair, represented by Stewart Guerin (LA); Lori K. Wing-Heier represented David Phifer and Wally Thomas (AK); Andrew N. Mais represented by Kathy Belfi and William Arfanis (CT); Trinidad Navarro represented by Rylynn Brown (DE); David Altmair represented by Ray Spudeck and Carolyn Morgan (FL); Doug Ommen represented by Carrie Mears (IA); Vicki Schmidt represented by Tish Becker and Joe McGarry (KS); Gary Anderson represented by John Turchi (MA); Al Redmer Jr. represented by Matt Kozak (MD); Chlora Lindley-Myers represented by Debbie Doggett (MO); Bruce R. Ramge represented by Lindsay Crawford and Justin Schrader (NE); Marlene Caride represented by John Sirvovetz (NJ); John G. Franchini represented by Lea Geckler (NM); Glen Mulready represented by Eli Snowbarger (OK); Jessica Altman represented by Kimberly Rankin (PA); Kent Sullivan represented by Jamie Walker and Amy Garcia (TX); Todd E. Kiser represented by Jake Garn and Reed Stringham (UT); Scott A. White represented by Doug Stolte (VA); Mike Kreidler represented by Patrick McNaughton (WA); and Mark Afable represented by Randy Milquet (WI).

1. Adopted itsOct. 31, Sept. 5 and Summer National Meeting Minutes

Ms. Belfi made a motion, seconded by Mr. Phifer, to adopt the Task Force’s Oct. 31 (Attachment One), Sept. 5 (Attachment Two) and Aug. 4 (see NAIC Proceedings – Summer 2019, Valuation of Securities (E) Task Force) minutes. The motion passed unanimously.

2. Heard a Staff Report on Projects Before the Statutory Accounting Principles (E) Working Group

Mr. Fry said the next item on the agenda is to hear a report on projects before the Statutory Accounting Principles Working Group from Julie Gann (NAIC).

Ms. Gann said the purpose of the update aligns with the coordination efforts between the Working Group and the Task Force. She highlighted a few items to the Task Force, beginning with the adopted items:

- **Other Derivatives** – The Working Group adopted revisions to clarify that other derivatives—which are derivatives that are not used in hedging, income generation or replication transactions—shall be reported at fair value and nonadmitted.

- **Goodwill** – For subsidiary, controlled and affiliated investments (SCAs), the Working Group adopted minor revisions to clarify that goodwill from an insurance entity acquisition of an SCA is subject to the 10% adjusted capital and surplus limit, regardless if the goodwill had been “pushed down.” The Working Group re-exposed the agenda item considering pushdown to provide more time for the industry to provide examples on the application of pushdown.

- **Wash Sales** – The Working Group adopted revisions to clarify that the wash sale disclosure shall only include wash sale transactions that cross reporting periods. Insurers are currently reporting wash sales that occur inter-quarter (for example, sell in January, purchase back in February). There is no need to report that transaction in the wash sale disclosure.

Items Exposed by Working Group:

- **Preferred Stock** – The Working Group exposed a revised issue paper and proposed substantively revised Statement of Statutory Accounting Principles (SSAP) No. 32R—Preferred Stock as part of the investment classification project. The overall project proposes to revise definitions, measurement and impairment guidance for these investments. The issue paper was revised to consider a number of the industry comments received from the past exposure.

- **Related Party Transactions** – The Working Group exposed two separate agenda items focusing on related party transactions. The first agenda item proposes to data-capture existing disclosures in accordance with SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties. Affiliate transactions already captured in Schedule Y would not need to be duplicated in these disclosures, but the data-capture would collect...
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information on related party (non-affiliate) transactions. These disclosures already exist in narrative form but are not currently data-captured. The second exposure clarifies the types of entities that are included as related parties, clarification that non-controlling ownership interest greater than 10% is a related party subject to related party disclosures, and guidance for disclaimers of affiliation and control for statutory accounting. Although an entity may have a disclaim of control, the edits clarify that the entity is still a related party. These two items are being addressed separately to ensure that the data-capturing of disclosures is available for year-end 2020.

- **Working Capital Finance Investments** – The Working Group exposed substantive revisions to SSAP No. 105—Working Capital Finance Investments as directed by the Working Group at the Summer National Meeting. These revisions reflect six of the recommendations provided by the industry and referred from the Task Force.

- **Qualifying Cash Pools** – The Working Group exposed revisions to SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments to incorporate concepts to allow cash pools to be reported as cash equivalents. The proposed revisions will only allow cash pools that meet certain criteria for this reporting.

- **Rolling Short-Term Investments** – The Working Group exposed revisions to SSAP No. 2R to incorporate principle concepts in classifying investments as cash equivalents or short-term investments. This exposure intends to limit the amount of time an investment can be reported as a short-term investment. For investments that are expected to terminate after 364 days and are renewed for another 364 days, this proposal would no longer allow that to be reported as a short-term investment. There are specific exclusions to this guidance to avoid unintended consequences for short-term investments like cash pools that are expected to be regularly renewed and rolled. As such, the proposed revisions would not include any nonaffiliated SSAP No. 26R—Bonds investments. It would include affiliated SSAP No. 26R investments, all SSAP No. 43R—Loan-Backed and Structured Securities investments and anything that would be reported as a Schedule BA investment if not reported as short-term.

- **Financial Modeling** – SSAP No. 43R – The Working Group exposed revisions to eliminate the financial modeling guidance from SSAP No. 43R, noting that this exposure was contingent on the Task Force taking a similar action. The Working Group will not consider adoption action on this guidance until after the Task Force takes final action.

- **Financing Derivatives** – The Working Group exposed revisions for the reporting of derivatives with financing premiums. With the exposed revisions, the gross value of the derivative—without reflection of financing components—would be reported for the derivative on Schedule DB. The financing provisions (e.g., liability for derivative) would be reported separately.

- **Equity Instruments in SSAP No. 43R** – The Working Group did not discuss the agenda item for equity instruments in SSAP No. 43R. A conference call is scheduled for Jan. 8, 2020, for this discussion. The comment deadline is Jan. 31, 2020.

3. **Received and Exposed a Nonsubstantive Proposed P&P Manual Amendment to Reflect the SEC’s Adoption of a New Rule to Modernize Regulation of Exchange-Traded Funds**

Mr. Fry said that on Sept. 26, the U.S. Securities and Exchange Commission (SEC) adopted Rule 6c-11 under the Investment Company Act of 1940, for exchange-traded funds (ETFs). Mr. Fry asked Marc Perlman (NAIC) to give a brief update on this change and proposed amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual).

Mr. Perlman said Rule 6c-11 will permit ETFs that satisfy certain conditions to operate without first obtaining an exemptive order from the SEC under the Act. The SEC has stated that the intent of the rule is to modernize the regulatory framework for ETFs by reducing expenses and delays in creating new ETFs; promoting greater consistency, transparency and efficiency for ETFs; and facilitating greater competition among ETFs. The rule becomes effective Dec. 23, followed by a one-year transition period for compliance.

Mr. Perlman noted that ETFs contain certain features that distinguish them from the types of investment companies originally contemplated by the Act and its rules and, therefore, have needed to rely on SEC exemptive orders to operate as investment companies under the Act. The new rule will end the need for most exemptive relief. Additionally, the rule permits ETFs to use “custom baskets” that do not reflect a pro rata representation or representative sampling of the ETF’s portfolio holdings, and the SEC is rescinding current ETF marketing restrictions. In order to rely on the new rule, an ETF must satisfy a new definition of ETF and various conditions, including: updated website disclosures (such as historical net asset value (NAV), premium and

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discount, and bid-ask spread information), and adoption of policies and procedures that govern the construction and acceptance of baskets.

The new rule will rescind the exemptive orders from existing ETFs, which will be able to rely on the rule going forward. However, certain categories of ETFs will not be covered by the rule, including leveraged ETFs, inverse ETFs, ETFs organized as unit investment trusts (UITs), share class ETFs and non-transparent active ETFs. The SEC expects the “vast majority” of ETFs to be covered by the rule.

Mr. Perlman said the NAIC Securities Valuation Office (SVO) takes the position that because the new rule primarily affects SEC exemptive relief and ETF reporting and disclosure, it will not impact the quantitative and qualitative factors the SVO considers when analyzing ETFs. As such, the SVO recommends nonsubstantive P&P Manual amendments to remove references to SEC exemptive orders from descriptions of ETFs and clarification that Regulatory Treatment Analysis Service (RTAS) application filers only need to provide SEC exemptive orders to the SVO to the extent they are applicable.

Ms. Mears made a motion, seconded by Ms. Belfi, to receive this P&P Manual amendment to remove references to SEC exemptive orders from descriptions of ETFs and clarification that RTAS application filers only need to provide SEC exemptive orders to the SVO, to the extent they are applicable, and to expose this proposed amendment for a 45-day public comment period ending Jan. 23, 2020. The motion passed unanimously.

4. Adopted a Proposed P&P Manual Amendment to Add Instructions for GLF Transactions

Mr. Fry said the next item on the agenda is a substantive proposed amendment to the P&P Manual to add instructions for ground lease financing (GLF) transactions. This is a joint proposed amendment was exposed during the Task Force’s Oct. 31 conference call for a public comment period that ended Nov. 22.

Mr. Fry said the SVO became aware that certain insurance company filers were submitting credit tenant loan (CTL) transactions and transactions—which the SVO is now calling GLF transactions—through the filing exempt (FE) process. The SVO considers GLF transactions distinct from CTL transactions. The SVO studied the GLF transactions, working closely with the industry, several of whom agreed to jointly sponsor this proposed amendment. He asked Mr. Perlman to provide a summary of the proposal.

Mr. Perlman said the amendment recommends a “decision-tree” approach to analyzing GLF transactions. First, the SVO would analyze the ground lease to determine if it meets the P&P Manual CTL criteria (meaning it is “hell or high water” or “triple net”). Second, the SVO would determine if the sub-leases would similarly meet the CTL criteria and, if so, potentially review the transaction as akin to a CTL. Third, if the SVO cannot look at the whole structure as akin to a CTL, the SVO would work with the NAIC Structured Securities Group (SSG) to determine if SSG can model the sub-leases or business operation like it would a commercial mortgage-backed security (CMBS). And, lastly, if the SSG determines that it cannot model the sub-leases or business operation, and if the GLF transaction has been assigned a rating by a rating agency, the SVO can use the rating agency analysis to assist in its analysis. The SVO’s analysis will be entirely at the discretion of the SVO, and the SVO will be under no obligation to accept the rating agency analysis, conclusions or ratings. Most GLF transactions are expected to fall in this final category.

Mr. Fry said this effort is the best of what the Task Force does when it coordinates with the industry, noting that the SVO staff worked closely and had several meetings with the industry to come to an amicable solution. This all started from a spot in the P&P Manual that identifies which securities are not eligible for filing exemptions. CTLs are not eligible for filing exemption and are securities that do not fit the definition of CTLs but are still in the spirit of a CTL. It is this subset of securities for which the Task Force needed to find a solution. The solution that was found covers the ground lease, which covers the more concerning of the securities that lost the regulatory treatment. In 2020, the Task Force will need to do some work on another subset of securities and this framework may serve as a template or at least a starting point to develop that solution. Mr. Fry thanked the industry and the SVO staff for working so productively on this effort.

David Persky (TIAA), representing the American Council of Life Insurers (ACLI) and interested parties, said the industry worked closely since last August to reach this compromise, noting that it works well for everyone and the industry look forward to implementing it. There are several deals in the marketplace right now and the market is eager to see the actual implementation of this change beginning Jan. 1, 2020.

Mr. Guerin made a motion, seconded by Ms. Walker to adopt this this P&P Manual amendment to add instructions for GLF transactions and make a referral to the Statutory Accounting Principles (E) Working Group so it can assess this definition for inclusion in the Accounting Practices and Procedures Manual (Attachment Three). The motion passed unanimously.
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5. Received and Exposed a Substantive Proposed P&P Manual Amendment to Remove the Financial Modeling Instruction for RMBS/CMBS Securities and Direct IAO Staff to Produce NAIC Designation and NAIC Designation Categories for These Securities

Mr. Fry said the next agenda item is a substantive proposed amendment to the P&P Manual to add instructions to remove the financial modeling instructions for residential mortgage-backed securities (RMBS)/CMBS and direct NAIC Investment Analysis Office (IAO) staff to produce NAIC designation and NAIC designation categories for these securities.

At the Summer National Meeting, the SVO staff discussed the idea that, at some point, the NAIC should align the RMBS/CMBS modeling to provide a single NAIC designation for modeled RMBS/CMBS. This would be a change from the current practice of providing a series of book/adjusted carrying value price breakpoints to companies to determine the NAIC designation. Staff raised this issue because of the upcoming implementation of NAIC designation categories for year-end 2020; i.e., the addition of 20 levels of credit risks instead of six. This will add a lot of complexity to create 19 breakpoints instead of the five current breakpoints that being used now, and might add expense and create some inconsistency across insurers reporting on these securities.

Mr. Fry said the IAO staff is recommending that the Task Force move to a single NAIC designation and NAIC designation category for the modeled assessment of credit risk for RMBS/CMBS to simplify NAIC and insurer processes, along with improving uniformity. The Task Force has discussed this a few times and it will be wise to expose this for a public comment period to get formal comments from the industry during a longer comment period. The SSG has offered to do some impact studies during the comment period that will give the Task Force additional insights.

Joshua Bean (Transamerica), representing the ACLI, said the industry appreciates the extended comment period and asked if it is possible to make it 75 days. The financial modeling process has been occurring for almost 10 years and there is a diversity of legitimate interest across this constituency to understand the new mappings. Mr. Fry said NAIC staff are recommending a 60-day public comment period to meet the year-end deadline.

Ms. Belfi made a motion, seconded by Ms. Rankin to receive and expose for a 60-day public comment period this P&P Manual amendment to remove the financial modeling instructions for RMBS/CMBS securities and move to the production of a single NAIC designation and NAIC designation categories for these securities and to make a referral to the Statutory Accounting Principles (E) Working Group, as this would impact SSAP No. 43R. The motion passed unanimously.

6. Heard an NAIC Staff Update on the Definition of “Principal Protected Securities”

Mr. Fry said SVO staff discussed during the Task Force’s meeting at the Summer National Meeting an observation that certain classes of structured securities receive ratings that may not reflect a regulator’s view of risk. The SVO advised the Task Force that it believes the credit rating providers are following their published methodologies for these investments but those methodologies, in staff’s opinion, do not meet the NAIC’s needs. The recommendation of the IAO directors was to exclude these investments from filing exemption and permit the SVO to review them using their methodologies, in this case most likely a look-through approach. On its Oct. 31 call, the Task Force directed the IAO staff to work with the industry on refining the definition that was exposed. The is a matter that may affect some insurers, so the Task Force is trying to accurately reflect the scope of securities. Mr. Fry asked Charles Therriault (NAIC) to provide an update on that work.

Mr. Therriault said the IAO staff met with industry representatives on calls held Dec. 3, Nov. 22, Nov. 15 and Nov. 8. There have been multiple versions of this definition exchanged to address each group’s concerns. A general framework has evolved that identifies principal protected notes (PPNs) as a type of security that repackages one or more underlying investments and for which contractually promised payments according to a fixed schedule are satisfied by proceeds from an underlying bond(s) that, if purchased by an insurance company on a stand-alone basis, would be eligible for filing exemption, but for which the underlying investments could generate potential returns in addition to the contractually promised cash flows paid according to a fixed schedule or the contractual interest rate paid by the PPN is zero or below market and the insurer would obtain a more favorable risk-based capital (RBC) charge or regulatory treatment for the PPN through filing exemption than it would were it to separately file the underlying investments in accordance with the policies in the P&P Manual.

Investments meeting these criteria would need to be filed with the SVO to determine if the security possesses any other non-payment risks that the SVO must assess under its Subscript S authority. There were a few noted exclusions, such as defeased or pre-refunded securities, and broadly syndicated securitizations. IAO staff believe this criteria hits upon the core issue—i.e., restructuring an investment to receive a more favorable RBC charge—and provides the SVO with discretion to review the transaction. At the industry’s request, SVO staff is expanding the definition to include transaction examples. The goal of adding
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the examples is to provide additional clarity as to the regulatory concern and transactional structure that is a concern to the Task Force. Staff will bring this back to the Task Force for consideration in early 2020.

Mr. Fry said one of the principles is that a security—for example, a bond—usually has fixed cash flows. If a security promises additional returns in excess of those fixed cash flows, then that is a characteristic to identify that security. The second is that a lot of these are rated, and the rating agencies are rating these to achieve a below market return. The third principle—when looking underneath one of these securities—it just carries that same asset on a fixed income schedule, so it produces one set of RBC charges. It is questionable that those same securities can be packaged into a different structure to create a more favorable RBC charge, so on its surface, this causes some pause. Those are the three tenants that staff are looking at right now and working with the industry to define. Mr. Fry asked if there were any questions from the Task Force members or interested parties.

Ms. Becker said Kansas is supportive of this framework and approach, and that the Task Force is looking at this matter. She expressed appreciation for the effort and cooperation involved in coming to a consensus and helping ensure that this is moving forward appropriately and to making sure all of the regulatory issues are being addressed.

Mr. Spudeck said this is a fairly important issue for a lot of people on both sides of the aisle. He asked whether there is a target timeline for when there will be some physical documentation revised for people to look at and start digesting before the market starts creating the next generation.

Mr. Fry said he is open to suggestions and will continue working on this and finalize it early next year when the Task Force has a call, possibly as early as Feb. 15, 2020. He said he wants people to get a sense of what the Task Force is doing and asked Mr. Therriault when a draft could be ready for exposure.

Mr. Therriault said he would also expect a draft could be ready for the Task Force’s first meeting in 2020. There has been extensive work already and a draft amendment is almost ready, but another iteration is needed. Ideally, he said he would like to have this ready for consideration at the Spring National Meeting.

Mr. Andersen (Andersen Insights) said he knows that a number of people have been working on this issue and commended them. Hopefully, as the discussions are open, some of the things that were mentioned will be considered but, most important, is how these assets meet the regulatory views of risk and meet the NAIC needs. His understanding of credit instruments, in general, is a question of credit because these are debt instrument and maybe are not as complicated as they may seem. There are three things Mr. Fry listed, one as promised returns that could exceed based returns, and it is true that an asset can be structured so that the returns that are reflected on the books and records of an insurer as one thing, and an asset may offer returns that are better than that. In his opinion, as long as the returns that are reported on a financial statement are minimal returns that are governed by the credit rating, he does not see how having excess returns is necessarily a problem. The question of what is the market rate of return can be a difficult and complicated thing for staff of a limited number to look at a broad number of deals and try to determine what a market rate of return is. Even if that is done, he is not sure what the question is. If an insurer elects to invest in an asset with a relatively lower return and reports that on its books and records, then the question of solvency and creditworthiness is addressed. The third point looking “underneath the hood” as to what the asset is, he said he believes everyone should support that, and it is possible with these structures to include assets that are prohibited assets. It is possible to include assets in these structures that will fill or overfill the basket. He said he believes that through structuring, it is possible to reduce risks—and the notion that there are building blocks and the building blocks result in the same risk additively as the structure itself is not necessarily always the case. He appreciates the fact that the Task Force is willing to have a discussion and open this up.

Mr. Bean said he appreciates Mr. Therriault’s summary of the discussion thus far. It has been an excellent collaboration with a lot of different perspectives to cover. Ultimately, this has been successful in working toward truly defining in assessable terms what the actual analytical concern is and how it can be addressed in a manner that actually provides guidance and clear instruction to the filing entities and does not create unintended “scope creep.” As Mr. Therriault has outlined, there is some work that we are continuing to do and hope that some of the examples will help illustrate further exactly what is meant to be targeted by this updated guidance, noting that it legitimately does present a risk profile that should be subjected to additional review at the hands of the SVO and the SSG and that is ultimately the core objective.

Mr. Fry said people should realize that what this would create is that these securities would not be able to use rating agencies ratings through the FE process. These securities will still be able to be filed with the SVO and will likely remain on the bond schedule; they may just get a different NAIC designation because the SVO will be using a different methodology.
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7. Received an IAO Staff Report on the Infrastructure Investment Study

Mr. Fry said NAIC staff earlier this year conducted a request for information on the U.S. insurance industry’s infrastructure investments. He asked Nikki Hall (NAIC) to provide an update on this study.

Ms. Hall said the NAIC Center for Insurance Policy and Research (CIPR) and the NAIC Capital Markets Group—specifically, Michele Wong and Eric Kolchinsky—are collaborating on this study. The study will focus on infrastructure investment as an asset class and the insurance industry’s participation in the infrastructure market, including barriers and opportunities.

The study was initiated in late August shortly after the Summer National Meeting with a request for information (RFI) to gather information and input from market participants and interested parties on key topics, such as the definition of infrastructure, the market size for infrastructure assets, the historical credit performance of infrastructure investments, and the treatment of infrastructure investments by state insurance regulators.

The first deadline for the RFI was in late September, where initial comments were requested on the definition of “infrastructure.” Fourteen comment letters were received to this request and, after a thorough review and internal discussion, a proposed definition was drafted of “infrastructure,” which was discussed during an Oct. 18 conference call with interested parties.

For the purposes of the study, it was decided the definition will focus on economic infrastructure, which is defined as “long-lived, capital intensive, large physical assets that provide essential services or facilities to a country, state, municipality, or region and contributes to its economic development or prosperity.”

Some of the comments received suggested that social infrastructure should also be included in the definition; however, it was decided to exclude social infrastructure from the definition for now and do a separate analysis of social infrastructure at a later time.

Ms. Hall said the presentation, which includes the proposed definition, can be found on the CIPR website. The RFI document that was distributed in August is also available on the CIPR website.

The second deadline was Nov. 22, where a request was made for comments on the other components of the request for information, such as market size, credit performance and NAIC treatment of infrastructure. Seven comment letters have been received so far. While the comment deadline has passed, additional comments from interested parties can be submitted.

In regard to next steps for the study, the process of reviewing all the submissions received from the Nov 22 deadline has begun. The team is also following up with some that have submitted comments, and this work will continue over the next few weeks.

An issue brief is being drafted that will explain the rationale behind the proposed definition, which will be shared and posted to the NAIC website when final. Drafting of the full study will begin after that.

There are plans to hold another conference call before the 2020 Spring National Meeting to provide an update on the study drafting process.

8. Heard a Staff Update on Projects

Mr. Therriault provided updates on five projects:

- The integration of securities identifiers into the FE process. These two projects have both been deferred. The first component was the incorporation of the business entity cross-reference service (BECRS), which identifies the relationship between issuers and securities. The second component was the incorporation of the global identifier cross-reference service (GICRS) which would have added additional security identifiers. These two services can be implemented separately, but they are both complex. Given the other projects that are being worked on, coupled with the complexity of this data, the two projects had to be deferred.

- The next project is a status of the application of the Japan Credit Rating Agency, Ltd., to be a vendor of credit ratings to the NAIC. The securities rated by this credit ratings provider (CRP) require NAIC systems to have International Securities Identification Numbers (ISINs). Those identifiers are part of the GICRS data set, which is a project that is being deferred. Because of that dependency, this project is also being deferred.
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- Implementation of CRP data feeds for securities subject to the private rating letters component of filing exemption is also deferred for data feeds from Fitch Ratings, Morningstar and HR Ratings de Mexico. Priority was given to the carry-over procedure project and NAIC designation category project.

- Implement of the carry-over procedure in 2019 was released this month. This project implements the administrative symbols and process to extend an NAIC designation into the next filing year with a “YE” suffix and identify initial filing properly filed and self-designated with an “IF” suffix. The project also included the change over from administrative symbol NR (not rated) to ND (not designated) along with some operational improvements related to these processes and downstream reporting through AVS+.

- The effort to add NAIC designation categories into NAIC systems is on schedule for release in early 2020. This project will add the letter modifier to create NAIC designation categories for reporting at year-end 2020. This project was discussed in passing during the discussion on RMBS/CMBS modeling. NAIC designations will continue to be produced and reported, but this additional level of granular assessment of credit risk reporting will be available for insurer reporting for Dec. 31, 2020. There are no RBC factors associated with the NAIC designation categories, so there is no change to the RBC charges; however, this detail reporting of investment credit risk still has significant value when looking at an insurer portfolio.

9. Discussed Other Matters

Mr. Kolchinsky said the Capital Markets Group, working with the SSG, completed the collateralized loan obligation (CLO) stress test, or at least the initial batch of the CLO stress test. A special report was published Dec. 6 on the NAIC website, and an in-depth methodology for CLO stress testing was also published. He said he will be covering some of the results at the Financial Stability (EX) Task Force and will be contacting the states to talk about what was found.

Having no further business, the Valuation of Securities (E) Task Force adjourned.
The Valuation of Securities (E) Task Force met via conference call Oct. 31, 2019. The following Task Force members participated: Robert H. Muriel, Chair, represented by Kevin Fry (IL); James J. Donelon, Vice Chair, represented by Stewart Guerin (LA); Ricardo Lara represented by Kim Hudson (CA); Andrew N. Mais represented by Kathy Belfi (CT); Trinidad Navarro represented by Rycha Hudson (DE); David Altmaier represented by Ray Spudeck (FL); Doug Ommen represented by Carrie Mears (IA); Dean L. Cameron represented by Eric Fletcher (ID); Vicki Schmidt represented by Tish Becker (KS); Gary Anderson represented by John Turchi (MA); Al Redmer Jr. represented by Vincent O’Grady (MD); Chlora Lindley-Myers represented by John Rehagen (MO); Bruce R. Range represented by Lindsay Crawford and Justin Schrader (NE); Marlene Caride represented by John Sirovetz (NJ); Linda A. Lacewell represented by James Matheson and Jim Everett (NY); Kent Sullivan represented by Jamie Walker (TX); Todd E. Kiser represented by Jake Garn (UT); Scott A. White represented by Doug Stolte (VA); Mike Kreidler represented by Patrick McNaughton (WA); and Mark Afable represented by Randy Milquet (WI). Also participating were: Howard Liebers (DC); and Matt Kozak (MD).

1. **Received a Non-Substantive Proposed P&P Manual Amendment to Add Instructions for ETFs that Contain a Combination of Preferred Stocks and Bonds**

Mr. Fry said this agenda item is a proposed non-substantive amendment to add instructions for exchange-traded funds (ETFs) that contain both preferred stocks and bonds. The current instructions permit the Securities Valuation Office (SVO) to consider for inclusion on the bond or preferred stock list ETFs that predominantly only invest in one or the other security type. This amendment proposes permitting an ETF that invests in both preferred stocks and bonds to be included on the preferred stock ETF list. This leads to issues of classification in a situation in which it holds 75% preferred stock and 25% bonds. Derivatives are also permitted up to certain levels, called speculative risk, and above that level it is ineligible. Mr. Fry suggested combining these issues into an SVO paper.

Charles Therriault (NAIC) said that it was a good description of the concerns and the issues. The SVO keeps the list fairly pure, and if there is any excess outside the definition of predominantly bond or preferred stock, the ETF will be rejected.

Mr. Everett said the U.S. Securities and Exchange Committee (SEC) guidance has been as low as 65% in fund guidance of whatever the title might indicate, which is what is tied into the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual); the title of the fund should reflect what is in it. He asked what is being used now to determine what predominately is and what percentage of funds are permitted for derivatives, and how that percentage is calculated.

Mr. Therriault said that is not a hard-set limit, but the SVO looks at what the ETF strategy is, how those instruments are being used to achieve bond like performance, and if it is consistent with what the SVO considers a portfolio of bonds. Generally, there is a very minor percentage of derivatives overall; the exposure is based on market value. Funds should not have any embedded leverage.

Mr. Everett asked if it is the market value as of the date of the valuation or if the percentage of the fund that is set out in the offering is circular. Mr. Therriault said the typical process looks at multiple quarters of historical holdings, and it is the market value as of those quarter ends.

Mr. Fry said that while the SEC may have a limit of 65%, the SVO would be uncomfortable approving a fund with such a low concentration. Mr. Therriault said the SVO expects “predominant” to mean a portfolio with a very high percentage invested only in bonds.

Mr. Everett asked when speaking about derivatives, if it is limited to only the three types that are permitted in the Statements of Statutory Accounting Principles (SSAP) that are limited to income generation, hedging etc., and what kinds of derivatives are being considered in the universe of these. Mr. Therriault said that different types of derivative instruments may be used. The SVO looks at what derivative instruments are used, how they are used to achieve the fund objective, and the strategy that it performs as a portfolio bond.
Mr. Kozak said that he has seen confusion with insurers reporting a U.S. issued ETF with the underlying investments being non-U.S. based. Mr. Fry agreed and believes that a separate schedule may be needed for fund investments.

Mr. Fry directed SVO staff to prepare a memorandum working with the Statutory Accounting Principles (E) Working Group staff summarizing the issues discussed to classify an ETF.

2. Received a Non-Substantive Proposed P&P Manual Amendment to Rename the U.S. Direct Obligations/Full Faith and Credit Exempt List to the U.S. Government Fund List and Discontinue the Bond Fund List

Mr. Fry said the SVO maintains the following two fund lists: the U.S. Direct Obligations/Full Faith and Credit Exempt List and the Bond Fund List. The title of the first list is lengthy and sometimes confusing; this amendment proposes shortening it to the NAIC U.S. Government Money Market Fund List.

The second list, called the Bond Fund List, comprises funds that have only U.S. government investments and maintain the “highest market risk rating,” a rating type that is no longer assigned by any rating agency. There are only four funds on this list today, and the proposal is to merge these existing funds that were on the list for 2019 over to the new NAIC Fixed Income-Like SEC Registered Funds List when they come up for renewal in 2020.

Mr. Therriault said the first list is sometimes confusing as to the definition. The idea is to just call it the NAIC U.S. Government Money Market Fund List to make it clearer. For the Bond Fund List, the SVO analysts preparing the list report that there is no longer a “highest market risk rating” available from any of the rating agencies, and they are concerned that no fund may qualify. The Bond Fund List would fit into the NAIC Fixed Income-Like SEC Registered Funds List; and if the Task Force agrees, it can be migrated there.

Mr. Everett said the first list was prepared on an explicit backing by the U.S. government of issuances and issuances by Fannie Mae and Freddie Mac if those issuances were backed by the direct power and authority by the U.S. government. He asked if there was some way that the default risks or the weighted average default risks could be looked at for funds of the two different lists. The way the lists were broken down initially when the Task Force adopted this is that they were two fundamentally different types of securities. If the lists are going to be merged, it would seem that they should be merged only if there is a statistical identity between the two types of securities.

Mr. Fry said the U.S. Direct Obligations/Full Faith and Credit Exempt List gets no risk-based capital (RBC). The Bond Fund List would be going away, and it would be included with the other mutual funds. Mr. Therriault said that the U.S. Direct Obligations/Full Faith and Credit Exempt List is reported on the cash schedule; and the second list, the Bond Fund List, is reported on Schedule D. They do get different reporting treatment, but they are both high quality. There is no “market risk rating” being produced any longer, and the funds on the Bond Fund List would satisfy the criteria for the NAIC Fixed Income-Like SEC Registered Funds List.

Mr. Everett said that being registered with the SEC does not address the quality or default risk of the funds, only that they have made the correct representations. He asked if there was a statistical identity between the two lists that would justify them being joined. Mr. Therriault said that the intent of the proposal was not to combine the U.S. Direct Obligations/Full Faith and Credit Exempt List and the Bond Fund List. The U.S. Direct Obligations/Full Faith and Credit Exempt List would be renamed, this is a title change and the definition remains the same. The Bond Fund List would be migrated to the NAIC Fixed Income-Like SEC Registered Funds List on the stock schedule with the appropriate NAIC designation based upon its underlying investments. Once the Capital Adequacy (E) Task Force decides on the RBC factors for those funds, it would receive that treatment.

Mr. Rehagen made a motion, seconded by Mr. Milquet, to receive and expose a proposed P&P Manual to rename the U.S. Direct Obligations/Full Faith and Credit Exempt List to the U.S. Government Fund List, and discontinue the Bond Fund List and make a referral to Statutory Accounting Principles (E) Working Group for a 45-day public comment period. The motion passed with New York abstaining.

3. Received a Non-Substantive Proposed P&P Manual Amendment to Add Instructions to Limit NAIC Designations to the NAIC Assigned Sovereign Rating

Mr. Fry said item three on the agenda is a non-substantive proposed amendment to the P&P Manual to add instructions limiting all NAIC designations to the NAIC foreign sovereign designation equivalent. This change is being proposed because the current limitation could be interpreted to mean that only NAIC designations assigned by the SVO (as opposed those produced through
the filing exempt [FE] process) are capped at the NAIC Foreign Sovereign Designation Equivalent List. This amendment addresses the potential interpretation inconsistency by clarifying that all NAIC designations for foreign securities will be capped according to the NAIC Foreign Sovereign Designation Equivalent List published on the SVO’s webpage. This change would ensure consistency and uniformity regardless of how an NAIC designation is assigned and that the NAIC Foreign Sovereign Designation Equivalent List would govern over all NAIC designations.

Mr. Everett made a motion, seconded by Mr. Liebers, to receive and expose a proposed P&P Manual amendment to add instructions to limit NAIC Designations to the NAIC Foreign Sovereign Designation Equivalent List for a 45-day public comment period. The motion passed unanimously.

4. **Adopted a Non-Substantive Proposed P&P Manual Amendment to Update the Interim Instructions for Mortgage Reference Securities**

Mr. Fry said item four on the agenda is a non-substantive proposed amendment to the P&P Manual to update the interim instructions for mortgage reference securities. This is a group of securities that are residential mortgage backed securities (RMBS) and commercial mortgage backed securities (CMBS), but the SVO gets involved in designating. The amendment provides guidance to insurers on how to assign an NAIC designation to a newly issued or newly acquired mortgage reference security prior to the publication of the annual surveillance data. This change was requested by industry and discussed at the Summer National Meeting where it was exposed for a 30-day public comment period ending Sept. 4. One comment letter was received from the American Council of Life Insurers (ACLI) and the North American Securities Valuation Association (NASVA) in support of the proposal. Mr. Fry asked if anyone from the ACLI or NASVA would like to comment on their letter. Josh Bean (Transamerica, on behalf of the ACLI) submitted a comment letter in support of this clarification. It provides appropriate instructions for reporting entities and appreciation for the time and work on this exposure.

Robin Marcotte (NAIC) noted that the Statutory Accounting Principles (E) Working Group is working on a Form A that will include these securities, and she recommended a referral to the Working Group.

Ms. Mears made a motion, seconded by Mr. Fletcher, to adopt the P&P Manual amendment to update the interim instructions for mortgage reference securities and send a referral to the Statutory Accounting Principles (E) Working Group. The motion passed unanimously.

5. **Received a Substantive Proposed P&P Manual Amendment to Add Instructions for Ground Lease Transactions**

Mr. Fry said item five on the agenda is a substantive joint proposed amendment to the P&P Manual to add instructions for ground lease financing (GLF) transactions. This is an item that came up in recent credit tenant loan (CTL) discussions when the Task Force decided that CTLs were outside of FE. Certain transactions are like CTLs, but they do not qualify to be a CTL. The SVO has done some good work with industry on finding a treatment for these securities that have historically performed very well. If the Task Force would like to consider this at the Fall National Meeting, it will require a shorter than usual exposure period. Mr. Fry said he would ask Mr. Therriault and Marc Perlman (NAIC) to provide a summary of this proposal.

Mr. Therriault thanked Mr. Perlman, Daniel Favero (Mayer Brown LLP) and David Persky (Nuveen) for all the hard work they put into this proposal, along with others from the industry group. Technical methodologies like this require a lot of research, discussion and brain storming on different possible analytical and structural approaches. Through this interactive and dynamic process, which was also used to develop the power generation projects methodology, a better end-product for the Task Force, industry and SVO staff has been produced. Assuming that the Task Force and industry agree, SVO staff will continue using this approach for the other lease-based transactions. Mr. Perlman, the SVO’s new Investment Counsel, is going to provide a high-level summary of the proposal.

Mr. Perlman said the SVO considers CTL transactions to be different from ground lease transactions. First, Mr. Perlman explained why the SVO makes this distinction; and second, he outlined the SVO’s proposed approach to analyzing GLF transactions going forward.

In a CTL transaction, the loan is made, primarily in reliance on the credit standing of a highly rated tenant on a long-term lease of the property. Importantly, the SVO can rely on the credit tenant rating because CTLs are generally structured around the terms of the lease which, in its strongest form, require the tenant to perform all or most obligations related to the leased premises and continue to pay rent regardless of what occurs to the premises. These leases are typically called “hell or high water” or “triple net” leases.
GLF transactions, while sharing certain similarities with CTL transactions, differ in several crucial ways. A GLF transaction typically has two components. First, there is a ground lease for up to 99 years, between a ground lessor who owns the land and a ground lessee who leases the land for the purpose of developing it. Second, there is the subleasing of space by the ground lessee or operation of a business in an existing or to-be-constructed building to one or more subtenants under shorter subleases or a business operator under a franchise agreement or other arrangement.

In a GLF transaction, it is often the case that the terms of the ground lease itself (the first leg of the transaction) makes it a “hell or high water” or “triple net” lease. However, because the ground lessee is a special purpose entity, rather than an operating entity, there is no rating agency rating to rely on; there is no credit tenant. To determine whether the ground lessee will have sufficient funds to pay its ground lease obligations, the SVO must look to the rent payments of the subtenants or the operation of the business being conducted on the property.

The SVO, in conjunction with the NAIC Structured Securities Group (SSG), takes the position that the analysis of subleases and subtenants can be more akin to a CMBS analysis than the corporate analysis in a CTL transaction. This is because ultimate payment on the ground lease loan is dependent not on a single credit tenant, but rather on payments by multiple, possibly unrated, subtenants of differing credit profiles pursuant to multiple subleases of differing terms (which are not necessarily “hell or high water” or “triple net”). The SVO also noted that some of the rating agencies which assign ratings to GLF transactions have utilized their CMBS models in their GLF ratings process, but their methodologies and criteria vary widely.

Recognizing that there are variances in how GLF transactions are structured, the SVO proposes amending the P&P Manual to institute a multi-pronged, decision-tree approach to analyzing these transactions. The proposed P&P amendments would include adding GLF transactions as a new asset class and outline the GLF analytic process as follows.

First, the SVO would analyze the ground lease to determine if it meets the P&P Manual CTL criteria (meaning, it is “hell or high water” or “triple net”). The SVO expects most ground leases to meet this test.

Second, if the ground lease meets the CTL criteria, it would be determined whether three or fewer subtenants combined comprise 90% or more of the total sublease payment obligations, whether those subtenants are rated or can be analyzed by the SVO, and whether their subleases each meet the P&P Manual criteria for CTLs. If so, the SVO could, in its sole discretion, analyze the transaction as akin to a CTL, based on the triple-net nature of both the ground and subleases, the limited number of subleases, and the credit profiles of the subtenants. The SVO expects a small fraction of all GLF transactions to fall into this category.

Third, if the ground lease meets the P&P Manual CTL criteria and there are four or more subtenants; the SVO has determined that the transaction does not meet the criteria just explained; or there are no subtenants, but a single operator of a business, the SVO may refer the subleases or the business operation to the SSG for possible financial modeling. If the SSG determines that the subleases or business operation can be modeled, it would analyze the subleases or business operation to determine whether they will provide sufficient cash flow to pay the ground lease rent payments and any additional costs which the ground lessee would be obligated to cover pursuant to the ground lease terms.

Fourth, if the SSG determines that it is unable to model the subleases or business operation, and if the GLF transaction has been assigned a public or private rating by a rating agency, the SVO may use the rating agency analysis provided by the filer to assist the SVO in its own analysis. The SVO’s analysis will be entirely at the discretion of the SVO, and the SVO will be under no obligation to accept the rating agency analysis, conclusions or ratings. The SVO expects most GLF transactions to fall into this final category.

Mr. Perlman concluded with a summary of the proposed GLF amendment to the P&P Manual, and he recommended that this criteria should apply to all GLF securities purchased after Jan. 1, 2020.

Resh Reese (Teachers Insurance and Annuity Association of America—TIAA) and Mr. Persky said they would like to thank the Task Force and SVO staff for the continued engagement with industry on this matter. With respect to the ground lease topic, industry is very appreciative of the efforts and thorough analysis that was put forth by staff in creating and crafting a resolution for both industry and state insurance regulators, and they look forward to continuing to partner with the Task Force and the SVO on all future matters.

John Garrison (John Hancock) said that the framework that was just outlined is a well thought-out and workable solution.
Mr. Everett said that he appreciates the clarity of the materials and summary.

Benjamin Guzman (Catholic Order of Foresters) said that they appreciate all the SVO and Task Force’s hard work on this solution. It is an important asset class. Tom Sargent (Waterway Capital) said that they are also very appreciative of the work it took to develop a very palatable solution. Michael M. Monahan (ACLI) said the ACLI supports the expedited comment deadline.

Mr. Everett made a motion, seconded by Mr. Kozak, to receive and expose a proposed P&P Manual amendment to add instructions for ground lease transactions and make a referral to the Statutory Accounting Principles (E) Working Group for a 22-day public comment period. The motion passed unanimously.

6. Discussed a Substantive Proposed P&P Manual Amendment for Principal Protected Securities

Mr. Fry said that item six on the agenda is to discuss a substantive proposed amendment to the P&P Manual to update the definition and instructions for principal protected securities. The amendment may benefit from some additional work on the definition and the Task Force may direct the SVO staff to work with industry to refine it and re-expose the amendment at the Fall National Meeting. The idea is to take this class of securities called principal protected notes, sometimes Collateralized Loan Obligation (CLO) Combo Notes, and make them ineligible for FE. The SVO would apply a look-through methodology to capture the regulatory risk. Mr. Fry asked Mr. Therriault to provide an update on the proposal.

Mr. Therriault said that the Investment Analysis Office (IAO), SVO and SSG staff believe that these securities should not be FE. IAO staff also believe that the rating agencies are following their published methodologies, which focus primarily on the contractual payments, particularly the re-payment of principal, but do not believe the rating assigned using these methodologies reflects how the NAIC views risk from a financial solvency perspective.

The concerns voiced in the comment letters focused primarily on four issues. The first issue is one centered upon the resources of the SVO. The NAIC has and does assign resources where it is needed to meet the needs of its members. Mr. Therriault advised the Task Force that policy decisions should not be made based upon resource concerns. The NAIC’s Executive (EX) Committee is charged with that responsibility, and it makes those decisions based upon member needs and industry feedback. As of today, the SVO does not believe that additional resources will be required to analyze this asset class.

Second, there were concerns about assigning a specific methodology to analyze these securities. Summarizing existing P&P Manual instructions, the SVO has reasonable professional latitude to interpret how the instructions and methodologies contained in the P&P manual apply to specific securities, financial products, or differing analytical situations. Factors that may affect how the SVO interprets instructions and methodologies include, but are not limited to, the terms of individual securities, unique features or characteristics of securities, legal or regulatory issues associated with structured transactions, the issuer’s industry, the introduction of a new security type or asset class, and NAIC regulatory objectives. The SVO is expressly authorized to employ any analytical technique that is taught in standard undergraduate and graduate business school financial analysis curriculum and any analytical technique otherwise widely or commonly used by lending officers, securities professionals, or credit rating analysts, despite the lack of an express authorization to use the technique in the P&P Manual. Mr. Therriault said that these existing instructions are being mentioned because these securities can come in a number of forms, and the SVO needs the flexibility and analytical discretion to apply the methodology that it believes is appropriate to the security being reviewed.

The SVO is also authorized in the P&P manual to analyze securities for other non-payment risk and can express this by assignment of an NAIC Designation with a subscript S. SVO staff believe that these securities fall into such a category. State insurance regulators attach certain economic expectations to certain terms used to describe securities or financial instruments owned by insurers and reported as invested assets. This reflects that the regulatory objective is to assess the financial ability of an insurer to pay claims. Any contractual modification of these regulatory assumptions is deemed to create a rebuttable inference that the security or instrument contains an additional or other non-payment risk—albeit one that is sanctioned by the contract—that may result in the insurer not being paid in accordance with the underlying regulatory assumption. The SVO is granted significant discretion when assigning an NAIC designation to a security that reflects other non-payment risk.

The proposal requests that the Task Force permit the SVO to apply these existing instructions to this class of securities and reflect these other risks that, while sanctioned by the contract, may result in the insurer not being paid in accordance with the underlying regulatory assumption. Rating agencies, while they may be adhering to their methodologies, do not have these same concerns or responsibilities as the Task Force.
Nevertheless, the SVO is very likely to apply a variant of the look through weighted average rating factor (WARF) methodology because such a methodology permits the SVO to look at each source of risk. For example, in analyzing a CLO Combo Note, the SVO would look at the underlying securities based on their credit rating provider (CRP) ratings and weight the ratings factor by their balances to generate the overall NAIC designation. However, the SVO would not want to be artificially constrained to only that one methodology.

A third concern was definitional, that additional assets may be pulled in that do not possess the characteristics that are of concern. The SVO agrees that this may be an issue and would be happy to work with the ACLI to refine the definition of these securities in the amendment. There was also concern expressed about the performance assets not being eligible for Schedule D reporting. Any guidance on the admissibility of an asset falls under the NAIC’s accounting standards of the Statutory Accounting Principles (E) Working Group; and as mentioned in the memorandum, the SVO recommends a referral to the Working Group to consider the issue.

The fourth concern related to application of this amendment to only newly acquired securities. The SVO is sensitive to disrupting insurer investing; particularly, near year end. Mr. Therriault said that the SVO recommends that this amendment become effective on Jan. 1, 2020, to avoid any such disruption and provide insurers an ample transition period; however, the SVO does not recommend exempting any securities from this policy because of the potentially significant inherent risks the SVO sees in these securities. When the SVO sees a situation where it does not believe a security’s rating reflects risk from the NAIC’s perspective, the SVO is obligated to bring it to the Task Force’s attention and propose a recommendation to address that risk; the SVO recommends removing this class of securities from FE eligibility.

Mr. Fry said we received comments letters from the ACLI, NASVA, Kroll Bond Rating Agency (KBRA), Security Benefit Life Insurance, Delaware Life Insurance Company, and Guggenheim Life and Annuity Company. He asked if anyone from those organizations wants to make any brief comments.

Mr. Bean said Mr. Therriault did a nice job of outlining the concerns and has already gone down the road of alleviating or addressing some of them. Certainly Mr. Fry’s comments about directing the SVO and industry to work further on the definition and appropriately refine the scope is really the ultimate focus of the ACLI and NASVA as of this point in time. The ACLI and NASVA look forward in continuing to refine that definition and ensure that the scope is appropriate but truly supports the analytical objectives, and they appreciate the opportunity to be part of the process.

Patrick Welch (KBRA) said Principal Protected Notes (PPNs), from a credit risk analysis perspective, are not inherently or always problematic. KBRA provides thoughtful, clear, respected credit rating methodology that addresses the terms of the issue or the issuance. The credit rating addresses the downside credit risk, and the performance asset could return zero and the rating will still hold.

Joseph Wittrock (Security Benefit Life Insurance) said not all PPNs are created equal. If one looks at statutory accounting guidance, if it immediately went to zero, not only will the insurer get all their principal back plus the contractual coupon; but because the risk asset immediately goes to zero, statutory accounting guidance requires an immediate write down and impairment—a direct impact to surplus—of the diminution in value of these PPN assets because of the risk asset going to zero. Mr. Wittrock said he believes that the current accounting guidance already provides significant protection to policy holders because of their requirements to address prospective cashflow when assessing current carrying value on a statutory balance sheet. In regards to the definition, Security Benefit Life Insurance has engaged in multiple conversations with industry participants, as well as the ACLI; it was quite clear that there were many industry participants that were not engaged and elected not to get involved because the definition was not clear or they did not have any PPNs. Depending on how the definition of a PPN ultimately falls, there may be a lot more industry feedback because there may be a quite a number of insurance companies who have PPN exposures. Mr. Wittrock urged the Task Force to consider a definition which provides crystal clarity of what a PPN is versus what a PPN is not, with no qualitative assessment or ambiguity in terms of what a PPN is.

Mr. Fry said this is not being considered for adoption today, and the SVO has already offered to work with the ACLI and whomever else would like to provide input into refining the definition of these securities in the amendment. Hopefully an update will be available to review at the Fall National Meeting.

Mr. Fry said that the last two items can be deferred, having run out of time. One of those deferred items is moving from price breakpoints on RMBS/CMBS securities to assigning a single NAIC Designation independent of the carrying value, a capability that the SSG already has. The idea is to get input on this change, as it would simplify processes. The other item was an update on an SEC adoption. Both can be discussed at the Fall National Meeting.
Having no further business, the Valuation of Securities (E) Task Force adjourned.
The Valuation of Securities (E) Task Force met via conference call Sept. 5, 2019. The following Task Force members participated: Robert H. Muriel, Chair, represented by Kevin Fry (IL); James J. Donelon, Vice Chair, represented by Stewart Guerin (LA); Lori K. Wing-Heier, represented by Wally Thomas (AK); Ricardo Lara represented by Laura Clements (CA); Andrew N. Mais represented by Kathy Belfi (CT); Trinidad Navarro represented by Rylynn Brown (DE); David Altmair represented by Ray Spudeck (FL); Doug Ommen represented by Carrie Mears (IA); Dean L. Cameron represented by Eric Fletcher (ID); Vicki Schmidt represented by Tish Becker (KS); Gary Anderson represented by John Turchi (MA); Al Redmer Jr. represented by Vincent O’Grady (MD); Chlora Lindley-Myers represented by Debbie Doggett (MO); Bruce R. Ramge represented by Lindsay Crawford and Justin Schrader (NE); Marlene Caride represented by John Sirovetz (NJ); Linda A. Lacewell represented by James Matheson and Jim Everett (NY); Glen Mulready represented by Eli Snowbarger (OK); Kent Sullivan represented by Jamie Walker (TX); Todd E. Kiser represented by Jake Garn (UT); Scott A. White represented by Doug Stolte (VA); Mike Kreidler represented by Patrick McNaughton (WA); and Mark Afable represented by Randy Milquet (WI).

1. **Adopted an Updated Amendment to the P&P Manual to Add Instructions for New Administrative Fields “RTS” and “RT”**

   Mr. Fry said this agenda item is a referral from the Statutory Accounting Principles (E) Working Group requesting the Task Force add new reporting codes for investments that meet the definition of a regulatory transaction within the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual). Given the P&P Manual restrictions in reporting NAIC designations for regulatory transactions, the Working Group noted that there was no reporting mechanism to identify regulatory transactions or a Securities Valuation Office (SVO) analytical value for risk-based capital (RBC) assessment on the investment schedules.

   Charles A. Therriault (NAIC) said the Task Force discussed this referral and amendment at the Summer National Meeting on Aug. 4. At that time, industry had requested some language clarifications and inclusion of needed administrative symbols. The Task Force agreed and directed SVO staff to work with industry on these clarifications and administrative updates to the amendment and then re-expose the amendment, after those revisions were made, for a two-week public comment period ending Aug. 30.

   Mr. Therriault said that it is now in September, it is unlikely that Blanks (E) Working Group or insurers can implement these symbol changes by yearend. He said SVO staff recommend that these symbols be optional for year-end 2019 reporting but required as of Jan. 1, 2020. This would include the application of the carry-over administrative symbols “YE” and “IF” for regulatory transaction that were properly filed with the SVO. The amendment highlights in yellow the changes that were made to the amendment since the Summer National Meeting.

   Mr. Fry said the Task Force received one joint comment letter from the American Council of Life Insurers (ACLI) and the North American Securities Valuation Association (NASVA). He said they are supportive of the revised proposal and its adoption. Mr. Fry asked if anyone here from the ACLI or NASVA would like to comment on this letter. Joshua Bean (Transamerica), representing the ACLI and NASVA, said they appreciate the opportunity to comment on the proposal and support its adoption as recommended by NAIC staff.

   Mr. Everett made a motion, seconded by Ms. Belfi, to adopt the revised amendment adding the new reporting codes for investments that meet the definition of a regulatory transaction within the P&P Manual and make referrals to Blanks (E) Working Group to add these codes to the SVO Administrative Symbol list in the 2020 annual statement instructions. This amendment would be optional for Dec. 31, 2019, annual statement reporting but required effective Jan. 1, 2020. The motion passed unanimously.

2. **Adopted its 2020 Proposed Charges**

   Mr. Fry discussed the Task Force’s 2020 proposed charges. He said there was one deletion from its 2019 charges: The implementation of the NAIC designation category was removed as this project is on track and will be implemented in 2020. He also said there was an addition to: “Identify potential improvements to the filing exempt process (the use of credit rating
provider ratings to determine an NAIC designation) to ensure greater consistency, uniformity and appropriateness to achieve the NAIC’s financial solvency objectives.” This charge is consistent with recent discussions by Task Force on the use of credit ratings.

The Financial Condition (E) Committee manages the work of its various task forces by assigning time periods for any activity that is not an ongoing activity. No new deadlines were proposed in these charges.

Mr. Sirovetz made a motion, seconded by Mr. Thomas, to adopt its 2020 proposed charges and direct SVO staff to provide them to the Financial Condition (E) Committee for consideration. The motion passed unanimously.

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

TO: Kevin Fry, Chair, Valuation of Securities (E) Task Force
    Members of the Valuation of Securities (E) Task Force

FROM: Charles A. Therriault, Director, NAIC Securities Valuation Office (SVO)
    Marc Perlman, Investment Counsel, NAIC Securities Valuation Office (SVO)
    Catholic Order of Foresters
    CGA Capital
    Mesirow Financial, Inc.
    CTL Capital
    Waterway Capital

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

RE: Joint Proposed Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) to Add Ground Lease Financing Transactions as New Asset Class

DATE: October 17, 2019

1. **Introduction** – Earlier in 2019 the SVO became aware that certain insurance company filers were submitting credit tenant loan (CTL) transactions and transactions which are herein defined as ground lease financing (GLF) transactions through the Filing Exempt (FE) process. The SVO subsequently explained to the market that (i) all CTL structures must be submitted to the SVO for review pursuant to Part One, Paragraph 106 and Part Three, Paragraph 4 of the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P), (ii) the SVO considered GLF transactions distinct from CTL transactions and (iii) the SVO identified that it would need to study the GLF transactions before they could make a recommendation to the Valuation of Securities (E) Task Force on whether NAIC Designations could be assigned to these structures and if they should be eligible for Schedule D reporting given their credit and legal risks. The SVO has now completed that study and a discussion of the SVO’s evaluation of the GLF asset class, its proposed approach to analyzing GLF transactions, and its recommended related amendments to the P&P follow.

2. **Analytic Overview** –

   *Credit Tenant Loans* – CTLs are loans made to the owner of real property but made primarily in reliance on the credit standing of the tenant on a long-term lease of such property (generally highly rated by an NAIC CRP), structured with an assignment of the rental payments under such lease to the lender with such real property pledged as collateral in the form of a first lien. CTLs are generally structured around the terms of the lease which, in its strongest form, requires the tenant to perform all obligations related to the leased premises thereby obligating the tenant to continue to pay rent regardless of what occurs to the leased premises (e.g. casualty or condemnation). The leases are typically considered, with certain recognized variants in the P&P, to be “hell or high water” or “triple net” in nature. Therefore, the SVOs analytic focus is on the credit worthiness of the tenant (or its guarantor), and not the
real property characteristics of the premises. As explained in the CTL section of Part Three of the P&P, the SVO recognizes four categories of CTLs as eligible for reporting on Schedule D (Bond Lease Based CTLs, Credit Lease Based CTLs, Acceptable CTL Variants (ACVs), and Multiple Property Transactions (MPTs)), each with varying degrees of landlord obligation and real estate risk exposure and varying legal and structural complexity. Pursuant to the P&P’s CTL criteria, each enumerated permitted landlord obligation or risk must be explicitly addressed with an enumerated mitigant. (CTLs are explained extensively in the P&P, Part Three, Paragraphs 71 – 91.)

Ground Lease Financings – A GLF transaction typically has two components: (i) a ground lease for a long period (e.g. 99 years) between a ground lessor who owns the land and a ground lessee who attains a leasehold for the purpose of developing the land, and (ii) the subleasing of space or operation of a business such as a hotel, warehouse, intermodal facility, etc. in an existing or to-be-constructed building to one or more tenants (space tenants) under shorter (e.g. 5-15 year) leases (space leases) or to the operator of a business such as a hotel, warehouse, intermodal facility, etc. under a franchise agreement or other arrangement.

Both the ground lessor and ground lessee will typically finance their respective estates (i.e., the fee estate of the ground lessor and the leasehold estate of the ground lessee); (i) the ground lessor, typically, with the issuance of debt-like certificates or notes, and (ii) the ground lessee, typically, by borrowing from a financial institution or traditional mortgage lender. To secure the financing, the ground lessor will grant to the lender a mortgage on the fee property such ground lessor owns, and the ground lessee will pledge to the leasehold lender its leasehold estate and its rights under the ground lease and in the improvements which it owns and the space leases if any.

Typically, in a GLF transaction neither the ground lessor nor the ground lessee is an entity either (i) rated by an NAIC CRP or (ii) whose credit worthiness can be evaluated by the SVO. Rather, they are special purpose vehicles (SPVs) intended to be bankruptcy remote.

Comparison of CTLs and GLFs – Due to the “hell or high water” or “triple net” nature of the lease in a CTL transaction or, in the instance where there are variances, their mitigation in accordance with the P&P CTL criteria, the SVO can focus its analysis on the credit worthiness of the credit tenant and not on an analysis of the underlying property. This type of lease eliminates the investor’s exposure to property risk as all payments owed to the investor ultimately come from the tenant.

In a GLF transaction it is often the case that the terms of the ground lease itself (the first leg of the transaction) is structured with the same attributes as a lease in a CTL transaction (e.g. it is “hell or high water” or “triple net”). However, because the ground lessee is an SPV rather than an operating entity, there is no NAIC CRP credit rating or SVO credit analysis to rely on. To determine whether the ground lessee will have sufficient funds to pay its ground lease obligations the SVO must look to the rent payments of the space tenants or the operation of the business being conducted on such property. The SVO, in conjunction with the NAIC Structured Securities Group (SSG) takes the position that the analysis of space leases and space tenants can be more akin to a commercial mortgage backed security (CMBS) analysis than the corporate analysis in a CTL transaction because the space leases may not meet the CTL criteria and can consist of several space tenants of differing credit profiles and each with differing space lease terms. We note that some of the NAIC CRPs which assign ratings to GLF transactions have utilized their CMBS models in their GLF ratings process, but their methodologies and criteria vary widely. The SVO understands that in most GLF transactions the certificate holder, the insurer as the investor, is in a “last loss”, or most senior, position. However, regardless of where they stand in the waterfall, unlike a traditional CTL transaction, ultimate payment on the GLF certificates is dependent not on a single credit tenant, but rather on payments by all the space tenants (which are not necessarily NAIC CRP rated or SVO analyzed entities) pursuant to space leases (which do not necessarily meet the CTL criteria).
Proposal – Recognizing that there are variances in how GLF transactions are structured the SVO proposes amending the P&P to institute a multi-pronged approach to analyzing these transactions. The proposed P&P amendments would include adding GLF transactions as a new asset class and would outline our GLF analytic process as follows:

a. The SVO would analyze the ground lease to determine if it meets the criteria for Bond Lease Based CTLs or Credit Lease Based CTLs in the P&P. We expect most ground leases to meet this test. Ground lease inconsistency with the Bond or Credit Lease Based CTL criteria would result in ineligibility for Schedule D reporting.

b. If the ground lease meets the Bond or Credit Lease Based CTL criteria and if three or fewer space tenants, each of which either (i) are rated by an NAIC CRP or (ii) whose credit worthiness can be evaluated by the SVO, when combined comprise 90% or more of the total space lease payment obligations, the SVO would analyze the space leases to determine if they meet the CTL criteria for one of the four CTL categories in the P&P. If so, the SVO could, in its sole discretion and based on its analytic judgement, analyze the transaction as akin to a CTL, based on the CTL-like nature of both the ground and space leases, the limited number of space leases and the credit profiles of the space tenants. We expect a small fraction of all GLF transactions to fall in this category.

c. If the ground lease meets the Bond or Credit Lease Based CTL criteria and there are four or more space tenants, or the SVO has determined that the transaction does not meet the criteria set forth in clause (b.) above or if there are no space tenants but one operator of a business on the leasehold such as a hotel, warehouse, intermodal facility, etc., the SVO may refer the space leases or the business operation to the SSG for possible financial modeling. If the SSG, in conjunction with its third-party modeling vendor, determines that the space leases or business operation can be modeled, the SSG would analyze the space leases or business operation, as the case may be, to determine whether they will provide sufficient cash flow to pay the ground lease rent payments and any additional costs which the ground lessee would be obligated to cover pursuant to the ground lease terms (e.g. taxes, utilities, maintenance, insurance).

d. If the SSG, in conjunction with its third-party modeling vendor, determines that it is unable to model the space leases or business operation, as the case may be, and if the transaction has been assigned an Eligible NAIC CRP Rating, public or private, the SVO may use the NAIC CRP analysis provided by the filer to assist the SVO in its own analysis. The SVO’s analysis will be entirely at the discretion of the SVO, and the SVO will be under no obligation to accept the NAIC CRP analysis, conclusions or ratings. Furthermore, upon completion of its analysis the SVO can decline to assign an NAIC Designation, in which case the security would be ineligible for Schedule D reporting.

e. Insurers that would like the SVO to review the GLF transactions prior to purchasing them may submit them through the Regulatory Treatment Analysis Service (RTAS) process. The SVO is willing to set up new RTAS processes for each of these three paths, at the request of the submitting investor: 1) SVO credit analysis, 2) SSG modeling and 3) SVO review of NAIC CRP analysis.

f. Additionally, the SVO would look for evidence that (i) the transaction is properly insured because, unlike a credit tenant in a CTL transaction, the ground lessee SPV will not have access to extra funds to cover costs such as repairs in the event of casualty, and (ii) that satisfactory Phase I and, if necessary, Phase II environmental reports have been delivered to provide comfort that there will be no expected environmental liabilities.

3. Recommended Amendment – The recommended changes to the P&P regarding the addition of Ground Lease Financing criteria are shown below in red, showing how it will appear in the 2019 P&P format. The SVO recommends that this amendment also be referred to the Statutory Accounting Principles (E) Working Group for affirmation that these investments are eligible for Schedule D, Part 1 reporting under the criteria proposed.
2019 P&P Manual

Part One – Policies of the NAIC Valuation of Securities (E) Task Force

POLICIES APPLICABLE TO SPECIFIC ASSET CLASSES

... 

GROUND LEASE FINANCING TRANSACTIONS

GLF Overview

107. A ground lease financing transaction (GLF) typically has two components: (i) a ground lease for a long period (e.g. 99 years) between a ground lessor who owns the land and a ground lessee who attains a leasehold for the purpose of developing the land, and (ii) the subleasing of space or operation of a business such as a hotel, warehouse, intermodal facility, etc. in an existing or to-be-constructed building to one or more tenants (space tenants) under shorter (e.g. 5-15 year) leases (space leases) or to the operator of a business such as a hotel, warehouse, intermodal facility, etc. under a franchise agreement or other arrangement.

108. The ground lease itself typically meets the Credit Tenant Loan (CTL) criteria for Bond Lease Based or Credit Lease Based CTLs in this Manual. Additionally, there can be one or several space tenants or business operators (which (i) may or may not be NAIC CRP rated entities or (ii) whose credit worthiness can or cannot be evaluated by the SVO) making lease payments under separate space leases (which may or may not meet the CTL criteria) or a business operation. As such, the SVO cannot rely solely on the CTL criteria for its analysis of GLF transactions and instead must rely on a combination, as necessary and available, of the CTL criteria, the CMBS criteria, the documented analysis of NAIC CRPs, and the SVOs own analytic judgement.

109. A GLF transaction reported as a CTL on transaction on Schedule D, acquired prior to January 1, 2020, and reported with an NAIC Designation produced under filing exemption, can continue to be reported on the basis of that Eligible NAIC CRP Rating until sold or disposed of.

NOTE: See “Ground Lease Financing Transactions” in Part Three for filing instructions, documentation requirements and methodology applicable to GLFs.

Part Three – SVO Procedures and Methodology for Production of NAIC Designations

PROCEDURE APPLICABLE TO FILING EXEMPT (FE) SECURITIES AND PRIVATE LETTER (PL) RATING SECURITIES

... 

FE SECURITIES

Specific Populations of Securities Not Eligible for Filing Exemption

4. The filing exemption procedure does not apply to:

...
• **Ground Lease Financing Transactions** – A Ground Lease Financing (GLF) transaction typically has two components: (i) a ground lease for a long period (e.g. 99 years) between a ground lessor who owns the land and a ground lessee who attains a leasehold for the purpose of developing the land, and (ii) the subleasing of space or operation of a business such as a hotel, warehouse, intermodal facility, etc. in an existing or to-be-constructed building to one or more tenants (space tenants) under shorter (e.g. 5-15 year) leases (space leases) or to the operator of a business such as a hotel, warehouse, intermodal facility, etc. under a franchise agreement or other arrangement. GLF transactions are not eligible for filing exemption. The GLF section in this Part provides further guidance on how the SVO analyzes GLF transactions for purposes of determining Schedule D eligibility and whether the SVO can assign an NAIC Designation.

**Part Three – SVO Procedures and Methodology for Production of NAIC Designations**

... **Ground Lease Financing Transactions**

**NOTE:** See “Policies Applicable to Specific Asset Classes” in Part One for 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.

**Initial Filing Requirements**

305. For ground lease financing (GLF) transactions, the reporting insurance company shall submit a complete GLF Evaluation Form together with the documentation described in the GLF Evaluation Form and, if available, evidence of a current Eligible NAIC CRP Rating and related NAIC CRP analysis for (i) the GLF Transaction (including, but not limited to rating methodology used, model assumptions and stress test results) and (ii) each space lessee or its guarantor or business operator in the case of a hotel, warehouse, intermodal facility, etc. or other business operation.

**Subsequent Filing Requirements**

306. For GLF Transactions, the reporting insurance company shall submit evidence, if available, of a current Eligible NAIC CRP Rating and related NAIC CRP analysis for (i) the GLF Transaction (including, but not limited to rating methodology used, model assumptions and stress test results) and (ii) each space lessee or its guarantor or business operator. For purposes of this section, a current Eligible NAIC CRP Rating is defined as one issued or reviewed within the past 12 calendar months. If the GLF Transaction is modeled by the NAIC’s third-party modeling vendor, the reporting insurance company will submit the data required by the vendor in the form such vendor specifies. In the event a space lessee or its guarantor or business operator, as the case may be, is not rated by an NAIC CRP and a space lease or business operation is not modeled, the reporting insurance company shall file the Audited Financial Statements and other relevant credit information of the space lessee or its guarantor or business operator, as the case may require, consistent with all corporate bond filing requirements.

**SVO Procedure**
307. Upon receipt of a GLF Evaluation Form, the SVO analyst shall review the form and all documentation submitted with it and shall proceed with analysis in accordance with section “SVO Approach to GLF Transactions” below.

**Ground Lease Financing Transaction – Definition and Overview**

308. A ground lease financing (GLF) transaction typically has two components: (i) a ground lease for a long period (e.g. 99 years) between a ground lessor who owns the land and a ground lessee who attains a leasehold for the purpose of developing the land, and (ii) the subleasing of space or operation of a business such as a hotel, warehouse, intermodal facility, etc. in an existing or to-be-constructed building to one or more tenants (space tenants) under shorter (e.g. 5-15 year) leases (space leases) or to the operator of a business such as a hotel, warehouse, intermodal facility, etc. under a franchise agreement or other arrangement.

309. Both the ground lessor and ground lessee will typically finance their respective estates (i.e., the fee estate of the ground lessor and the leasehold estate of the ground lessee); (i) the ground lessor, typically, with the issuance of debt-like certificates or notes, and (ii) the ground lessee, typically, by borrowing from a financial institution or traditional mortgage lender. To secure the financing, the ground lessor will grant to the lender a mortgage on the fee property such ground lessor owns, and the ground lessee will pledge to the leasehold lender its leasehold estate and its rights under the ground lease and in the improvements which it owns and the space leases if any.

310. Typically, in a GLF transaction neither the ground lessor nor the ground lessee is an entity either (i) rated by an NAIC CRP or (ii) whose credit worthiness can be evaluated by the SVO. Rather, they are special purpose vehicles (SPVs) intended to be bankruptcy remote.

311. In a GLF transaction it is often the case that the ground lease (the first leg of the transaction) is structured with the same attributes as a lease in a CTL transaction (e.g. it is “hell or high water” or “triple net”). However, because the ground lessee is an SPV rather than a corporate entity, there is no NAIC CRP corporate credit rating or SVO corporate analysis to rely on. To determine whether the ground lessee will have sufficient funds to pay its ground lease obligations the SVO must look to the rent payments of the space tenants or the operation of the business conducted in such improvements (such as a hotel, warehouse, intermodal facility, etc.). Depending on the specifics of a GLF transaction, analysis of space leases and space tenants and business operations and business operators could be more akin to a commercial mortgage backed security (CMBS) analysis than the corporate analysis in a CTL transaction because (i) the space leases may not meet the CTL criteria and can consist of one or several space tenants of differing credit profiles and each with differing space lease terms and ultimate payment on the GLF is dependent on the space tenants making their rent payment on the space leases or (ii) in the event there is a business operation, ultimate payment on the GLF is dependent on the operation of such business to generate cashflow for ground rent and other expenses. For this reason, the SVO may refer certain GLF transaction space lease or business operations analyses to the NAIC Structured Securities Group (SSG) because of the SSG’s financial modeling capabilities and because, in accordance with this Manual, it analyzes and assigns NAIC Designations to CMBS transaction.

**SVO Approach to GLF Transactions**

312. All GLF transactions are ineligible for filing exemption and must be submitted to the SVO. The SVO will conduct GLF transaction review in the following manner:
a. The SVO will analyze the GLF transaction structure and determine whether the ground lease meets the CTL criteria for Bond Lease Based or Credit Lease Based CTLs, except for not having a credit tenant. If the SVO, in its sole discretion, determines the ground lease does not meet the Bond Lease Based or Credit Lease Based CTL criteria, except for a credit tenant, the security would be ineligible for Schedule D reporting.

b. If the ground lease meets the CTL criteria, except for a credit tenant, and if three or fewer space tenants, each of which (i) are rated by an NAIC CRP or (ii) whose credit worthiness can be evaluated by the SVO, when combined comprise ninety percent (90%) or more of the total space tenant lease obligations, the SVO will analyze the space leases to determine if they meet the CTL criteria for one of the four CTL categories in this Manual. If so, the SVO can, in its sole discretion and based on its analytical judgment, analyze the transaction as akin to a CTL, based on the CTL-like nature (e.g. “hell or high water” or “triple net” features) of both the ground and space leases, the limited number of space leases and the corporate credit profiles of the space tenants.

c. If the ground lease meets the criteria for Bond Lease Based or Credit Lease Based CTLs and there are four or more space tenants, or the SVO has determined that it cannot apply the approach in (b.) above or the transaction does not meet the criteria set forth in clause (b) above, the SVO will refer the space leases or the business operation, as the case may be, to the SSG for possible financial modeling. If the SSG, in conjunction with its third-party modeling vendor, and in its sole discretion and analytical judgment based on factors including, but not limited to, availability of data, transaction structure and other transaction specific risks, determines that the space leases or business operation can be modeled, it will analyze the space leases or business operation, as the case may be, to determine whether they will provide sufficient cash flow to pay the ground lease rent payments and any additional costs which the ground lessee is required to cover pursuant to the ground lease terms (e.g. taxes, utilities, maintenance, insurance).

d. If the SSG, in conjunction with its third-party modeling vendor, and in its sole discretion and analytical judgment, determines that it is unable to model the space leases or business operation, as the case may be, and if the transaction has been assigned a public or private Eligible NAIC CRP Rating the SVO shall proceed with an analysis of the transaction guided by the available analyses of all NAIC CRPs that provided an Eligible NAIC CRP Rating on the transaction. For the avoidance of doubt, the SVO’s analysis will be entirely at the discretion of the SVO and the SVO is not obligated to accept or follow the rating methodology of any NAIC CRP and can, in its sole discretion and based on its analytical judgement, assign an NAIC Designation which differs from the correlated Eligible NAIC CRP Rating or choose not to assign any NAIC Designation. The SVO may, in its sole discretion, upon written request from the submitting investor, disclose its rationale as to why such transaction was not given a Designation correlated to the Eligible NAIC CRP Rating.

e. Should the SVO or, if applicable, SSG determine that it cannot assign an NAIC Designation to the GLF, the GLF would be ineligible for Schedule D reporting.

GLF Specific Considerations

313. The space lease payments or business operation, as the case may be, should be sufficient to cover any recurring costs the ground lessee is obligated to pay (e.g. taxes, utilities, maintenance, insurance) pursuant to the terms of the ground lease. All such ground lessee obligations will be factored into the SSG’s financial model of the space leases or business operations, if applicable.

314. To provide comfort that there will be no environmental liabilities, the filing documents shall include a Phase I environmental report showing no environmental problems and, if the Phase I report shows a
problem or the nature and prior used of the land indicates a substantial likelihood of preexisting
environmental contamination, a Phase II environmental report.

315. Typically, a ground lease will require the ground lessee to hold the following insurance to protect the
ground lease payments from potential shortfall due to the termination or abatement of space lease payments
or reduction or termination of business operation upon the occurrence of condemnation or casualty or other
insurable condition. Any of the insurable risks below that are not insured should be otherwise mitigated and
evidence of such mitigant should be included in the filing documents.

a. Casualty insurance in an amount of coverage equal to 100% of the replacement value of the
improvements with the fee lender named as the loss payee.
b. Rent loss insurance in an amount of coverage equal to at least 12 months of ground rent with the fee
lender named as loss payee.
c. General liability insurance. The amount of coverage shall be sized appropriately, depending on the
size and type of building (e.g. office, hotel, warehouse, intermodal facility, etc.).
d. Ground Lessor would be required to purchase special risk condemnation insurance in an amount of
coverage equal to the principal amount of the GLF. This policy shall be prepaid and remain in place
for the entire term of the GLF secured by the fee mortgage.
Note: All insurance must be issued by a carrier with an NAIC Designation equivalent rating of 1.G or
better.

Part Four – The NAIC Structured Securities Group

Ground Lease Financing Transactions

Definition

36. Ground Lease Financing (GLF) transactions are defined and explained in “Ground Lease Financing
Transactions” in Part Three of this Manual.

SSG Role and Process

37. On occasion the SVO may refer a GLF transaction to the SVO for financial modeling of the GLF space
leases or business operation, as applicable, in accordance with the process set forth in “Ground Lease
Financing Transactions” in Part Three of this Manual. Following an SVO referral the SSG and SVO will
maintain open communication related to requests for additional data, analytical questions and analytical
conclusions. Any GLF transaction NAIC Designation will be assigned by the SVO.
MEMORANDUM

TO: Kevin Fry, Chair, Valuation of Securities (E) Task Force
    Members of the Valuation of Securities (E) Task Force

FROM: Charles A. Therriault, Director, NAIC Securities Valuation Office

CC: Eric Kolchinsky, Director, NAIC Structured Securities Group

DATE: July 2, 2019


1. **Introduction** – The SVO proposes a non-substantive amendment to the P&P Manual to update guidance in Part Four under the The NAIC Structured Securities Group, Mortgage Reference Securities. The Structured Securities Group (SSG) is responsible to financially model this group of securities; however, they only review them during their annual surveillance process. Insurers currently do not have instructions to assign an NAIC designation to a newly issued or newly acquired mortgage reference security prior to the publication of the annual surveillance data. This proposal would provide that interim guidance.

2. **Proposed Amendment** – The proposed amendment is shown below in red-underline.

   **Part Four The NAIC Structured Securities Group**

   **MORTGAGE REFERENCED SECURITIES**

   **Definition**

   …

   **Quarterly Reporting for Mortgage Reference Securities**

   To determine the NAIC Designation to be used for quarterly financial statement reporting for a Mortgage Reference Security purchased subsequent to the annual surveillance described in this Part, the insurer uses the prior year-end modeling data for that CUSIP (which can be obtained from the NAIC) until the annual surveillance data is published for the current year. For a Mortgage Reference Security that is not in the prior year-end modeling data for that CUSIP, the insurer may follow the instructions in Part Two of this manual for the assignment of the SVO Administrative Symbol “Z” provided the insurer owned security meets the criteria for a security that is in transition in reporting or filing status.
MEMORANDUM

TO: Kevin Fry, Chair, Valuation of Securities (E) Task Force
   Members of the Valuation of Securities (E) Task Force

FROM: Charles A. Therriault, Director, NAIC Securities Valuation Office (SVO)
       Robert Carcano, NAIC Consultant

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


DATE: April 20, 2019 (Amended August 15, 2019)

1. Introduction – The Valuation of Securities (E) Task Force has received a referral (Exhibit One) from the Statutory Accounting Principles (E) Working Group to address reporting for regulatory transactions. The P&P Manual defines the term “regulatory transactions” and provides that such transactions: 1) are not eligible for credit assessment by the SVO; 2) are not eligible for filing exemption (FE); 3) cannot be self-assigned the administrative symbol Z under the 120 rule; 4) cannot be self-assigned as 5GI securities; and 5) cannot be entered into NAIC systems maintained for the Task Force. The P&P Manual also provides that a domiciliary state insurance department may request SVO or SSG assistance in the assessment of a regulatory transaction, with the understanding that the state can adopt the SVO or SSG work product as its own, but the determination is a state determination and not an NAIC work product. Despite this specified treatment, there is no specific instruction for reporting regulatory transactions, and reporting entities do not have any available reporting options when investment schedules require an NAIC designation. The Working Group initiated a project (agenda item 2018-06) to address reporting for regulatory transactions in response to a referral from the Reinsurance (E) Task Force.

On April 6, the Working Group adopted a revised staff recommendation to add reporting codes for the investment component of regulatory transactions. Under the adopted procedure, a reporting entity would use the code “RTS” when the domiciliary state has received assistance from the SVO (or SSG) in reviewing a regulatory transaction. In those cases, the code would be reported with the “analytical value” (a new term defined below) assigned by the SVO and given to the state. The code “RT” would be used for all other regulatory transactions; i.e., those in which the domiciliary state did not ask the SVO for assistance or those where the SVO was unable to determine an analytical value for the transaction for the state. This code would be reported with an NAIC 6 designation for measurement and risk-based capital (RBC) assessments. These codes are specific to Schedule D, Part 1 reporting because those schedules require reporting a “designation” for all securities. A reporting entity may identify a regulatory transaction on other investment schedules, but such other schedules do not require that an NAIC designation be reported (e.g., Schedule BA items are not required to be reported with an NAIC designation.)

The Working Group’s referral requests that the new codes be incorporated into the P&P Manual as part of the guidance on regulatory transactions. SVO staff worked with staff in the NAIC Financial Regulatory Services (FRS) Division...
on the outline of the adopted proposal and so supports the recommended change because it aligns the reporting for regulatory transactions structured as bonds with the limitations prescribed by the P&P Manual mentioned above. Accordingly, the SVO proposes an amendment to the P&P Manual, shown below, to implement it. If the Task Force adopts the proposed amendment, the SVO recommends a further referral to the Blanks (E) Working Group to add these codes to the administrative list in the instructions.

2. **Proposed Amendments** – The proposed amendments are shown in both the 2018 P&P Manual format and in the newly adopted 2019 P&P Manual format. Please note that the Task Force adopted revisions to the text to clarify treatment for an investment security that may be a component of a regulatory transaction. That version of the text, which is on the Task Force’s/SVO page on the NAIC website, is used to show the proposed amendments in both P&P Manual formats.

The updated amendment includes instructions and Administrative Codes for newly acquired regulatory transactions, the continuation of an analytical value over year-end and clarifying updates to the definitions.
Amendments Shown in 2018 P&P Manual Format

Part One Purposes, General Policies and Instructions to the SVO

Section 2—Policies Defining the SVO Staff Function

(d) SVO Regulatory Products

(iii) Authority to Direct Insurers on Reporting

The SVO has responsibility and authority to assess securities that are reportable on Schedule D and Schedule BA of the NAIC Financial Statement Blank. It is, therefore, part of the role of the SVO to determine when financial instruments or securities are not eligible for reporting on Schedule D and Schedule BA. The SVO may, therefore, be required to inform an insurer filer to redirect a financial instrument or security reported to the SVO to another schedule. Similarly, the SVO may also be required to inform an insurer filer that an instrument filed with the SVO pursuant to Part Two, Section 2 a) of this Manual does not meet the definition of an Investment Security and cannot be assessed as such or that a financial transaction or security filed with the SVO meets the definition of a Regulatory Transaction eligible for assessment by the SVO only in accordance with the procedures discussed in under Part Three, Section 6 of this Manual. In all cases in which a situation described in this subparagraph is presented, final determination as to what statutory accounting and reporting applies to the instrument or security is made in consultation between NAIC statutory accounting staff and the SVO.

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Part Two Filing with the SVO

Section 2.—General Reporting Framework

(a) Obligation to Report

Insurance companies domiciled in any state of the United States, or any of its territories or possessions, and required by the law of their domiciliary state or territory to report NAIC Designations for their Investment Securities in the NAIC Financial Statement Blank, shall report purchases of Investment Securities to the SVO or, in the case of Investment Securities exempt from filing with the SVO, for example, pursuant to Part Three, to the NAIC, as required by this Manual.

For purposes of this Part Two, Section 2 a), an Investment Security means an instrument evidencing a lending transaction between an insurance company as lender and a non-affiliated borrower, where the borrower’s sole motivation is to borrow money and the insurance company’s sole motivation is to make a profit on the loan that the state of domicile regulates by reference to the NAIC Financial Regulation Standards and Accreditation Program.
The SVO shall have no authority to issue NAIC Designations or any other NAIC analytical product to an insurance company for a Regulatory Transaction under Section 2 a) of this Part.

Part Three, Section 6 of this Manual provides that the SVO may assist a state insurance department in the assessment of the security component of a Regulatory Transaction and may issue an SVO Analytic Value to the department at the conclusion of the assessment. Part Three, Section 6 also provides instructions to insurance companies on how to report the security component of a Regulatory Transaction on investment schedules. See Part Three, Section 6 of this Manual for the definition of Regulatory Transaction and a description of the processes governing their assessment.

**Part Three Credit Assessment**

**Section 6—Regulatory Transactions**

**a) Defined**

A 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.

**b) Status of Regulatory Transactions**

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., 5GI) and
- Inclusion in the SVO List of Investment Securities or any other NAIC electronic system or processes maintained for operations of the Valuation of Securities (E) Task Force.

**c) Intent**

This Section provides guidance to the SVO and the SSG on how to manage requests for assistance made by a state insurance department under Part Two, Section 2 b) of 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 Part One, Section 3.e) and g) – l). 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.

**d) The Security Component of a Regulatory Transaction**

However, as discussed defined above, the security component of a Regulatory Transaction may be an Investment Security that is eligible for designation under filing exemption or by the SVO on a stand-alone basis.
For example,

A. An insurance company entered into a coinsurance reinsurance transaction 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 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.

B. An IBM bond that was eligible for Filing Exemption was sold/transfered from an insurance company to an affiliated insurance company that requires regulatory approval. Such an IBM bond would still be considered eligible for Filing Exemption 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 approval, if any, would not be eligible for Filing Exemption.

Procedure—Assessment of the Investment Security Component of a Regulatory Transaction—Guidelines

The SVO or SSG is authorized to conduct an analytical assessment on behalf of any state insurance department that requests such assistance.

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.

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 determinations would may make use of include and refer to 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.

Determinations made by the SVO or SSG given to a state insurance department in connection with the assessment of the security component of a Regulatory Transaction shall be referred to as an SVO Analytic Value, (defined below) to prevent confusion in the reporting by an insurer of the Regulatory Transaction or the security component of the Regulatory Transaction to the domiciliary state insurance department and the reporting of a stand-alone Investment Security under the general procedures applicable to them.

SVO or SSG determinations given in connection with the assessment of a Regulatory Transaction may be given to the state insurance department may be and 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 of the security component of a Regulatory Transaction will not be entered into NAIC computer systems reserved for Investment Securities, as defined in Part Two, Section 2 a) of this Manual or added to the SVO List of Securities as defined in Part One, Section 3 k) of 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.
f) Reporting Regulatory Transactions on Investment Schedules

A Regulatory Transaction is reported on an investment schedule. A Regulatory Transaction reported on Schedule D, Part I, must be reported with one of the two codes described below. 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 ONLY communicate information about 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.

g) Definition of SVO Analytical Value

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. 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.

h) Codes and Their Meaning

**RTS** is reported for a Regulatory Transaction for which: 1) a state insurance department requested SVO assistance in assessing the credit quality of the security component of the Regulatory Transaction; 2) the SVO provided an SVO Analytical Value for the security to the department and 3) the department thereafter directed its insurer to report the SVO Analytical Value. For the securities components 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; i.e., 4RTS. An SVO Analytical Value is ONLY assigned by the SVO if the SVO determines the Regulatory Transaction is an Investment Security if engaged in 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 Valuation of Securities Task Force either by the SVO or anyone else.

**RT** is reported for 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 in which 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; i.e. 6RT.
Part One Policies of the NAIC Valuation of Securities Task Force

Authority to Direct Insurers on Reporting

40. The SVO is assigned to assess investment securities reported to state regulators on Schedule D and Schedule BA. To fulfill its function SVO must be able to communicate to an insurer that has filed a financial instrument or security that the financial instruments or security is not an investment security eligible for reporting on Schedule D and Schedule BA. SVO may be required to communicate to an insurer that it must refile a financial instrument or security to another schedule. SVO may also have to communicate to an insurer that an instrument the insurer has filed does not meet the definition of an Investment Security in this Manual and is therefore not eligible to be assessed or that the financial transaction or security is a Regulatory Transaction that can only be assessed by the SVO for assessment by the SVO but only in accordance with the procedures discussed in this Manual if requested by a state insurance department. When situations occur that require the SVO to communicate reporting or related statutory guidance to an insurer, SVO consults with Financial Regulatory Services Division staff to ensure the communication to the insurer is accurate.

Part One Policies of the NAIC Valuation of Securities Task Force

Filing Securities with the SVO

NOTE: See “General Filing Procedures” and “Filing Process and Required Documents” in Part Two and the various asset specific sections in Part Three for filing instructions and documentation requirements specific to the security or asset type discussed in those section.

Obligation to File Securities with the SVO

48. Insurance companies domiciled in any state of the United States, or any of its territories or possessions, that have adopted laws incorporating the standards in the NAIC Financial Regulation Standards and Accreditation Program that require the use of NAIC Designations or other analytical products for Investment Securities are required by those laws to file purchases of Investment Securities with the SVO as indicated in this Manual to obtain the NAIC Designation or other analytical product required by state law.

49. Investment Security means an instrument that documents a lending transaction between an insurance company as lender and a non-affiliated borrower, where the borrower’s sole motivation is to borrow money and the insurance company’s sole motivation is to make a profit on the loan that the state of domicile regulates by reference to the NAIC Financial Regulation Standards and Accreditation Program.

50. The SVO shall have no authority to issue NAIC Designations or any other NAIC analytical product to an insurance company for a Regulatory Transaction. This Manual provides that the SVO may assist a state insurance department in the assessment of the security component of a Regulatory Transaction and may issue an SVO Analytic Value to the department at the conclusion of the assessment. This Manual also provides instructions to insurance companies on how to report the security component of a Regulatory Transactions on investment schedules.
111. 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.[RC4]

Intent

112. This section provides guidance to the SVO and the SSG on how to manage requests for assistance made by a state insurance department made as permitted 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. 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.[RC5] See Regulatory Transactions in Part Three for guidance on the status of the security component of a Regulatory Transaction.

NOTE: See “Regulatory Transactions” in Part Three and “Compilation and Publication of the SVO List of Investment Securities” in Part Two. Regulatory Transactions are excluded from all NAIC data files used to produce the SVO List of Investment Securities, including the data file that houses information about insurer-owned filing exempt securities.

Part Three SVO Procedures and Methodology for the 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

9. 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.[RC6]

Status of Regulatory Transactions

10. 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., 5GI) and
- Inclusion in the SVO List of Investment Securities or any other NAIC electronic system or
processes maintained for operations of the Valuation of Securities (E) Task Force.
### Intent

11. This Section provides guidance to the SVO and the SSG on how to manage requests for assistance made by a state insurance department under as authorized in Part Two, Section 2 b) of 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 Part One, Section 3. e) and g) – 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. [RC7]

### The Security Component of a Regulatory Transaction

12. However[RC8], as discussed defined above, the security component of a broadly defined Regulatory Transaction - a transaction engineered to address a regulatory concern one or more insurers have or may have that should be admitted to a state insurance department for approval - may be an Investment Security that Filing Exempt or may be eligible for designation under filing exemption or by the SVO on a stand-alone basis. For example,

A. An insurance company entered into a coinsurance reinsurance transaction 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.

B. An IBM bond that was eligible for Filing Exemption 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 Exemption 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 approval, if any, would not be eligible for Filing Exemption.

### Guidelines

**Procedure – Assessment of the Security Component of a Regulatory Transaction**

10. The SVO or SSG is authorized to conduct an analytical assessment on behalf of any state insurance department that requests such assistance.

13. 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.

14. 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 SVO determinations may include and refer to 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.
Determinations made by the SVO or SSG given to a state insurance department in connection with the assessment of the security component of a Regulatory Transaction shall be referred to as an SVO Analytic Value, (defined below) to prevent confusion in the reporting by an insurer of the Regulatory Transaction or the security component of the Regulatory Transaction to the domiciliary state insurance department and the reporting of a stand-alone Investment Security under the general procedures applicable to them.

SVO or SSG determinations given in connection with the assessment of a Regulatory Transaction may be given to and 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 the security component of a Regulatory Transaction will not be entered into NAIC computer systems reserved for Investment Securities as defined in this Manual or added to the SVO List of 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

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 I, 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

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 is expressed with the numerical symbol 6 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

RTS is reported for the security component of a Regulatory Transaction for which: 1) a state insurance department requested SVO assistance in assessing the credit quality of the security component of the Regulatory Transaction; 2) the SVO provided an SVO Analytical Value for the security to the department and 3) 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; i.e., 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); i.e. 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 Valuation of Securities Task Force either by the SVO or anyone else.

20. **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 in which 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; i.e. 6RT.