

Date: 2/9/2022

2022 Spring National Meeting

Valuation of Securities (E) Task Force

Tuesday, April 5, 2022

11:30 a.m. – 1:00 p.m. ET / 10:30 a.m. – 12:00 p.m. CT

9:30 a.m. – 11:00 a.m. MT / 8:30 a.m. – 10:00 a.m. PT

ROLL CALL

Member	Representative	State
Doug Ommen, Chair	Carrie Mears	Iowa
Scott A. White, Vice Chair	Doug Stolte	Virginia
Lori K. Wing-Heier	Wallace Thomas	Alaska
Evan G. Daniels		Arizona
Ricardo Lara	Laura Clements	California
Andrew N. Mais	Kathy Belfi	Connecticut
Trinidad Navarro	Rylynn Brown	Delaware
David Altmaier	Carolyn Morgan	Florida
Dean L. Cameron	Eric Fletcher	Idaho
Dana Popish Severinghaus	Vincent Tsang	Illinois
Vicki Schmidt	Tish Becker	Kansas
James J. Donelon	Stewart Guerin	Louisiana
Kathleen A. Birrane	Matt Kozak	Maryland
Gary D. Anderson		Massachusetts
Chlora Lindley-Myers	Debbie Doggett	Missouri
Eric Dunning	Lindsay Crawford	Nebraska
Marlene Caride	Nakia Reid	New Jersey
Adrienne A. Harris	James Everett	New York
Cassie Brown	Amy Garcia	Texas
Jon Pike	Jake Garn	Utah
Mike Kreidler	Tim Hays	Washington

NAIC Support Staff: Charles Therriault/Marc Perlman

AGENDA

1. Consider Adoption of the meeting minutes for the Fall National meeting
(Doc. ID: 2021-046.01)
—Carrie Mears (IA), Charles Therriault (NAIC), Marc Perlman (NAIC) Attachment One
2. Receive and Discuss Comments on a Proposed Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) to Update the Definition of Principal Protected Securities (PPS)
(Doc. ID: 2021-048.01, 2021-048.02)
—Carrie Mears (IA), Charles Therriault (NAIC), Marc Perlman (NAIC) Attachment Two
Attachment Two - A
3. Receive and Discuss Comments on a Proposed Amendment to the P&P Manual to update the definition of Other Non-Payment Risk assigned a Subscript “S”
(Doc. ID: 2021-047.01, 2021-047.02)
—Carrie Mears (IA), Charles Therriault (NAIC), Marc Perlman (NAIC) Attachment Three
Attachment Three - A

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| <p>4. Receive and Discuss a Proposed Referral to the Blanks (E) Working Group to Add Fixed Income Analytical Risk Measures to Investments Reported on Schedule D, Part One
<i>(Doc. ID: 2021-053.01)</i>
—Carrie Mears (IA), Charles Therriault (NAIC), Marc Perlman (NAIC)</p> | <p>Attachment Four</p> |
| <p>5. Receive and Discuss Comments on a Proposed Amendment to the P&P Manual to add guidance on the designation of Schedule BA assets with fixed income characteristics
<i>(Doc. ID: 2021-049.01, 2021-049.02)</i>
—Carrie Mears (IA), Charles Therriault (NAIC), Marc Perlman (NAIC)</p> | <p>Attachment Five
Attachment Five - A</p> |
| <p>6. Discuss and Consider for Adoption a Proposed Amendment to the P&P Manual to permit un-guaranteed and unrated subsidiary obligors in WCFI transactions, with SVO discretion
<i>(Doc. ID: 2021-050.01, 2021-050.02, 2021-050.03)</i>
—Carrie Mears (IA), Charles Therriault (NAIC), Marc Perlman (NAIC)</p> | <p>Attachment Six
Attachment Six - A - C</p> |
| <p>7. Receive and Discuss Comments on a Staff Report on Use of NAIC Designations by Other Jurisdictions in the Regulation of Insurers
<i>(Doc. ID: 2021-051.01, 2021-051.02)</i>
—Carrie Mears (IA), Charles Therriault (NAIC), Marc Perlman (NAIC)</p> | <p>Attachment Seven
Attachment Seven - A</p> |
| <p>8. Receive a Report from SVO on Year-end Carry-over Filings
<i>(Doc. ID: 2022-001.01)</i>
—Carrie Mears (AL), Charles Therriault (NAIC), Marc Perlman (NAIC)</p> | <p>Attachment Eight</p> |
| <p>9. Hear a Staff Report on Project of the Statutory Accounting Principles (E) Working Group
—Carrie Mears (IA), Julie Gann (NAIC)</p> | |
| <p>10. Hear a Staff Update on New RMBS/CMBS Thresholds and Price Breakpoints
—Eric Kolchinsky (NAIC)</p> | |
| <p>11. Hear a Staff Update on the Ad Hoc CRP Study Group
—Carrie Mears (AL), Charles Therriault (NAIC), Marc Perlman (NAIC)</p> | |
| <p>12. Any other matters</p> | |

Draft Pending Adoption

Draft: 12/22/21

Valuation of Securities (E) Task Force
San Diego, California
December 12, 2021

The Valuation of Securities (E) Task Force met in San Diego, CA, Dec. 12, 2021. The following Task Force members participated: Dana Popish Severinghaus, Chair, represented by Kevin Fry (IL); Doug Ommen, Vice Chair, represented by Carrie Mears (IA); Lori K. Wing-Heier represented by David Phifer (AK); Ricardo Lara represented by Laura Clements (CA); Andrew N. Mais represented by Kathy Belfi and Kenneth Cotrone (CT); Trinidad Navarro represented by Rylynn Brown (DE); David Altmaier represented by Ray Spudeck and Virginia Christy (FL); Dean L. Cameron represented by Eric Fletcher (ID); Vicki Schmidt represented by Tish Becker (KS); James J. Donelon represented by Stewart Guerin (LA); Kathleen A. Birrane represented by Matt Kozak (MD); Gary D. Anderson represented by John Turchi (MA); Chlora Lindley-Myers represented by Debbie Doggett (MO); Eric Dunning represented by Lindsay Crawford and Justin Schrader (NE); Marlene Caride represented by John Sirovetz (NJ); Russell Toal represented by Leatrice Geckler (NM); Adrienne A. Harris represented by Jim Everett (NY); Cassie Brown represented by Jamie Walker (TX); Jonathan T. Pike represented by Jake Garn (UT); Scott A. White represented by Doug Stolte and Greg Chew (VA); Mike Kreidler represented by Tim Hays (WA); and Mark Afable represented by Amy Malm (WI).

1. Adopted its Nov. 17, Sept. 30, and Summer National Meeting Minutes

Mr. Fry said the first item on the agenda is to consider adoption of the Task Force's Nov. 17, Sept. 30, and Summer National Meeting minutes.

Ms. Belfi made a motion, seconded by Ms. Walker, to adopt the Task Force's Nov. 17 (Attachment One), Sept. 30 (Attachment Two), and July 15 (*see NAIC Proceedings – Summer 2021, Valuation of Securities (E) Task Force*) minutes. The motion passed unanimously.

2. Adopted an Amendment to the P&P Manual to Remove Residual Tranches from Receiving an NAIC Designation

Mr. Fry said the next agenda item is to discuss and consider adoption of a proposed amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to remove residual tranches from receiving an NAIC Designation. Residual tranches capture securitization tranches and beneficial interests that reflect loss layers without any contractual payment of principal or interest. Instead, residual tranches are paid after contractual payments of principal or interest have been made to other tranches and are based on the remaining available funds.

Charles Therriault (NAIC) said the Statutory Accounting Principles (E) Working Group identified inconsistencies in how residual tranches and interests were being reported, with some entities reporting them on Schedule BA: Other Long Term Invested Assets and others reporting them on Schedule D-1: Long-Term Bonds with either self-assigned NAIC 5GI or NAIC 6 Designations. To prevent further inconsistency and direct appropriate reporting, on Nov. 10, the Working Group adopted an amendment to *Statement of Statutory Accounting Principles (SSAP) No. 43R—Loan-Backed and Structured Securities* to clarify that residual tranches and interests shall be reported on Schedule BA. To accommodate the timeframe needed for a Blanks (E) Working Group proposal to expand reporting lines on Schedule BA to capture residual tranches and interests, the Working Group's amendment permits residual tranches and interests currently reported on Schedule D-1 to continue to be reported on Schedule D-1 for 2021 reporting, with an ultimate effective date of Dec. 31, 2022.

The Securities Valuation Office (SVO) staff agree with the Statutory Accounting Principles (E) Working Group's recommendation that during this window when residual tranches currently reported on Schedule D-1 are permitted to stay on Schedule D-1, they should be allowed to do so only with an NAIC 6 Designation and not an NAIC 5GI Designation. This is consistent with the Working Group's adopted change. The NAIC 5GI Designation is not appropriate for residual tranches and interests because according to the P&P Manual, "an insurance company is permitted to self-assign an NAIC 5GI to an obligation if it meets all of the following criteria:

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1. Documentation necessary to permit a full credit analysis of the security by the SVO does not exist, or an NAIC CRP rating for an FE or PL security is not available.
2. The issuer or obligor is current on all contracted interest and principal payments.
3. The insurer has an actual expectation of ultimate payment of all contracted interest and principal.”

Assignment of an NAIC 5GI Designation for residual investments is an incorrect application of the guidance as there are no contracted interest and principal payments to certify as current, and the insurer cannot have an actual expectation of receiving all contractual principal and interest of the underlying collateral as these tranches absorb the losses first for the securitization structure. Although cash flows may pass through to the residual holders at periodic intervals under the waterfall, ultimate returns depend on continued performance; therefore, there can be no actual expectation that future payments will be received.

Along with the proposed P&P Manual language requiring residuals to be reported on Schedule BA, there is a proposed provision stating that for 2021 year-end reporting, residuals will be permitted on Schedule D-1 with an NAIC 6 Designation. If adopted, the SVO requests the Task Force’s permission to remove that provision from the 2022 version of the P&P Manual without further authorization.

There were other requests from the Working Group related to NAIC 5GI and 6 Designations that the SVO would like to bring up with the Task Force next year. The SVO staff recommend adoption of this amendment today.

Mr. Kozak made a motion, seconded by Mr. Chew, to adopt the amendment to the P&P Manual to clarify proper reporting and designation for residual tranches and interests. The motion passed unanimously.

3. Adopted an Amendment to the P&P Manual to Clarify 5GI Mapping to NAIC Designation Category

Mr. Fry said the next item is to discuss and consider adoption of a technical correction amendment to the P&P Manual clarifying 5GI mapping to a designation category in the recently amended Private Letter Rating section.

Marc Perlman (NAIC) said at the May 24 meeting, the Task Force adopted an amendment to the P&P Manual requiring the submission of private rating letter rationale reports with certain private rating letters filed with the SVO. In the May amendment, certain language that is currently in the printed December 2020 version of the P&P Manual, which clarifies that an NAIC 5GI Designation is the equivalent of an NAIC 5.B Designation Category, was mistakenly omitted. The SVO proposes a non-substantive technical amendment to the May amendment to reinsert the omitted language.

Ms. Doggett made a motion, seconded by Ms. Clements, to adopt the amendment to the P&P Manual to clarify the mapping of NAIC 5GI to a designation category. The motion passed unanimously.

4. Exposed an Amendment to the P&P Manual to Update the Definition of Other Non-Payment Risk Assigned a Subscript “S”

Mr. Fry said the next agenda item is to discuss and consider exposure of a proposed amendment to the P&P Manual to update the definition of “other non-payment risks” assigned a subscript “S.”

Mr. Therriault said securities that possess “other non-payment risks” are intended to be reviewed by the SVO, but these investments have not been explicitly included on the list of “Specific Populations of Securities Not Eligible for Filing Exemption” in Part Three of the P&P Manual. Securities with “other non-payment risks” are identified through assignment of the administrative symbol “S” as a subscript to the NAIC Designation. This amendment would add “Securities with Other Non-Payment Risks” to the list of securities that are ineligible for filing exemption (FE).

As noted in Part One, paragraph 90, of the P&P Manual, “[a]n objective of the VOS/TF is to assess the financial ability of an insurer to pay claims. For example, the regulatory assumption is that a fixed income instrument called debt by its originator or issuer requires that the issuer make scheduled payments of interest and fully repay the principal amount to the insurer on a date certain. A contractual modification that is inconsistent with this assumption creates a rebuttable inference that the security or instrument contains an additional or other non-payment risk created by the contract that may result in the insurer not being paid in accordance with the underlying regulatory assumption. The SVO is required to identify securities that contain such

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contractual modifications and quantify the possibility that such contracts will result in a diminution in payment to the insurer, so this can be reflected in the NAIC Designation assigned to the security through the application of the notching process.”

The proposed amendment would further clarify through additional illustrations securities what would also be considered as having “other non-payment risks.” These would include securities that:

- a) Incorporate the performance of other assets to determine their contractual payments, either directly or indirectly through reference pools, equity baskets, or indices.
- b) Receive payments as the remainder or residual cashflow after all other payment obligations have been made.
- c) Receive additional performance or bonus cashflows, or have no contractual events of payment default.

Mr. Fry said this amendment enhances the guidance around the subscript “S” and does not change policy in any way but makes it clearer with additional examples.

Mr. Fry directed the SVO to expose the proposed amendment to the P&P Manual to update the definition of “other non-payment risks” assigned a subscript “S” for a 60-day public comment period ending Feb. 11, 2022.

5. Exposed an Amendment to the P&P Manual to Update the Definition of PPS

Mr. Fry said next is to discuss and consider exposure of a proposed amendment to the P&P Manual to update the definition of principal protected securities (PPS). In May of last year, the Task Force adopted an amendment to the P&P defining PPS and making them ineligible for FE. The SVO has seen new transactions with similar risks but do not precisely fit the current definition.

Mr. Perlman said last May, the Task Force adopted an amendment to the P&P Manual to include PPS as a new security type ineligible for the FE process. At the time, the types of PPS that the SVO had seen were mixes of a traditional bond or bonds with additional assets that could possess any characteristic. These additional assets, which the SVO called “performance assets,” were intended to generate excess return. They included, among other things, derivatives, common stock, commodities, and equity indices. The performance assets often included undisclosed assets and were typically not securities that would otherwise be permitted on Schedule D-1 as a bond. In each case, the external credit rating was based solely on the component dedicated to the repayment of principal and ignored the risks and statutory prohibitions of reporting the performance asset on Schedule D-1.

Recently, the SVO received a proposal for a security that poses many of the same risks as a PPS but was structured in a way that it did not cleanly fit the definition in the P&P Manual. In this example, the security was not issued by a special purpose vehicle (SPV) holding an “underlying” principal protection bond and the performance asset. “Underlying” is a key component of the current definition. Rather, the security was the direct obligation of a large financial institution, whose obligation it was to pay principal at maturity and a premium based on the performance of referenced indices, including an equity index and an index made up of equities, fixed income instruments, futures, and other financial assets. Though the obligation was solely that of the issuing financial institution, meaning there were no underlying bonds or performance assets, the structure posed the same risk of exposure to a performance asset because the amount of the issuer’s payment obligation was directly dependent on the performance of the referenced indices. Additionally, unlike a PPS transaction with an underlying bond and performance asset, the likelihood of payment of that performance asset premium, whatever the amount might be, was linked directly to the creditworthiness of the issuer. As such, the SVO proposes amending the P&P Manual definition of PPS to account for alternate structures that pose similar risks.

Mr. Fry said the objective of this amendment is to take the PPS methodology and expand it to include these newer securities.

Mr. Fry directed the SVO to expose the proposed amendment to the P&P Manual to update the definition of PPS for a 60-day public comment period ending Feb. 11, 2022.

6. Exposed an Amendment to the P&P Manual to Assign NAIC Designations to Investments with a Fixed Income Component for Reporting on Schedule BA

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Mr. Fry said next is to discuss and consider exposure of a proposed amendment to the P&P Manual to add guidance on the designation of Schedule BA assets with fixed income characteristics. There are potentially many securities that do not qualify as bonds for the purposes of reporting on Schedule D-1 but have fixed income characteristics. If it were possible to assign a designation to these investments, they could potentially benefit from more favorable risk-based capital (RBC) treatment on Schedule BA.

Mr. Perlman said the SVO recommends updating the instructions in Part Three of the P&P Manual to include guidance related to the assignment of NAIC Designations to Schedule BA assets with underlying characteristics of bonds or fixed income instruments. Part One of the P&P Manual currently permits the SVO to assign NAIC Designations to Schedule BA assets with underlying characteristics of bonds or fixed income instruments, but there is no specific guidance for the SVO in Part Three. Including the proposed provisions would enable the SVO to assign NAIC Designations to Schedule BA assets that are not expressly covered by other sections of the P&P Manual, such as Schedule BA funds. Schedule BA assets for life and fraternal insurers would benefit from NAIC Designations because they would be eligible for more favorable RBC treatment.

The SVO's authority to assign NAIC Designations to certain Schedule BA assets already exists. Part One of the P&P Manual states, "the SVO is assigned to assess investment securities reported to state regulators on Schedule D and Schedule BA." Additionally, the P&P Manual explains that to be eligible for the assignment of an NAIC Designation, a Schedule BA asset must have underlying characteristics of a bond or fixed income instrument. This proposed amendment would potentially make various types of assets eligible for an NAIC Designation that are not. Each asset would need to be individually assessed by the SVO for bond or fixed income characteristics.

Mr. Fry said this issue has been around for a while, where on Schedule BA, a fixed income-like investment receives an NAIC Designation from the SVO for a life or fraternal insurer, but a property/casualty (P/C) insurer would not receive that same RBC treatment. There are a lot of asset classes that are not specifically designed as a bond, but the SVO could assign a designation to it. Thinking forward with the bond project, if any assets fall off Schedule D-1, this would at least give it a potential home if they can satisfy the requirements of the SVO with the designation.

Mr. Fry directed the SVO to expose this proposed amendment to the P&P Manual to add guidance on the designation of Schedule BA assets with fixed income characteristics for a 60-day public comment period ending Feb. 11, 2022.

7. Exposed an Amendment to the P&P Manual to Permit the SVO to Assign NAIC Designations to Unrated Subsidiaries in WCFI Transactions

Mr. Fry said the next item on the agenda is to discuss and consider exposure of a proposed amendment to the P&P Manual to permit the SVO to assign NAIC Designations to unrated subsidiaries in working capital finance investment (WCFI) transactions. The Task Force has gone through several iterations of this amendment over the past year. In this latest version, the SVO is reintroducing a proposal under which the Task Force would give the SVO discretion to notch down from the parent's rating in certain circumstances. It adheres very closely to an earlier version of the proposal.

Mr. Perlman said the SVO received comments from certain insurers and other interested parties that it should assign NAIC Designations to WCFIs with unguaranteed and unrated obligors based on the implied support from an obligor's NAIC CRP rated parent.

In November 2020, the Task Force exposed a proposed amendment to the P&P Manual to direct the SVO to rely upon the NAIC Designation or NAIC CRP rating equivalent of the subsidiary obligor's parent entity, with allowance for the SVO to notch down from the parent's rating or NAIC Designation due to its assessment of certain factors regarding the parent/subsidiary relationship. In response to feedback from some Task Force members and interested parties, the SVO subsequently presented a revised proposal to the Task Force at the Summer National Meeting to remove its discretion to notch because as demonstrated in the Oct. 16, 2020, memorandum to the Task Force, the SVO found no generally accepted analytical technique or methodology to support the assumption that a parent entity will necessarily support its subsidiary in times of financial distress. That revised amendment was also not adopted by the Task Force.

The SVO is now proposing a new clean amendment that is substantially similar to the original and reflects the comments from some Task Force and Statutory Accounting Principles (E) Working Group members that they would like the SVO to retain

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discretion to notch down, as it is deemed appropriate. Like the November 2020 amendment, the Task Force would direct the SVO to imply the parent's support of its subsidiary and would give the SVO discretion to assign an NAIC Designation to the subsidiary, which is lower than that of the parent based on its assessment of the parent/subsidiary relationship. However, this new proposal clarifies that if the SVO notches the NAIC Designation of a subsidiary obligor down from that of its parent, resulting in a credit assessment below an NAIC 2, the WCFI program would not be eligible for an NAIC Designation because it would no longer meet the definition of an eligible "obligor" in *SSAP No. 105R—Working Capital Finance Investments*.

Mr. Fry said one thing that is important to state insurance regulators is that the Task Force created a framework for WCFIs and put a lot of guardrails around them. This is one of the reasons why the Task Force got comfortable with this asset class. Some of these subsidiaries that issue the working capital finance notes do not have a rating but are consolidated into a larger group, and a top entity is rated. There is a lot of interconnectedness and relationships between those entities short of a full guarantee of it, but it has a place in the structure. In those cases, the Task Force could use this policy to just use the top rating. If the SVO saw something abnormal or something that was a little out of place from that what would be normally seen, the SVO could notch. If it does not pass the NAIC smell test for any reasons, the SVO can notch it down. If it falls below investment grade, it will not even be allowed to be admitted. It will make a lot of sense for the Task Force, if it decides to go with this policy, to monitor the activity and what the transaction looks like. If there is anything about them that is concerning, the policy could always be adjusted. The Financial Accounting Standards Board (FASB) and the U.S. Securities and Exchange Commission (SEC) are looking at these investments too. The FASB is looking at possibly creating new disclosure requirements.

Mr. Fry directed the SVO to expose this proposed amendment to the P&P Manual to assign NAIC Designations to unrated subsidiaries in WCFI transactions for a 60-day public comment period ending Feb. 11, 2022.

8. Heard a Staff Report on the Use of NAIC Designations by Other Jurisdictions in the Regulation of Insurers

Mr. Fry said the next item is to discuss a recent request that the SVO received related to non-U.S. jurisdictions wishing to reference NAIC Designations.

Mr. Therriault said the SVO was made aware of state insurance regulators or insurers in non-U.S. jurisdictions, such as the Bermuda Monetary Authority (BMA) and Japan's Financial Services Agency (FSA), either referencing NAIC Designations in their regulatory processes or wanting to reference them. The P&P Manual is very specific that NAIC Designations are only intended for NAIC members consisting of the chief insurance regulators of the 50 states; Washington, DC; and five U.S. territories. For example, the P&P Manual says of the intended, proper and authorized use of NAIC Designations is the following:

1. An NAIC designation for quality (NAIC Designation) of a security is produced solely for NAIC members who should interpret the designation for quality, in the context of the NAIC Financial Regulation Standards and Accreditation Program, a member's state insurance laws and regulations, and the regulatory or financial solvency profile of a specific insurance company.
2. Because an NAIC Designation, is not produced to aid the investment decision-making process, NAIC Designations are not deemed to be suitable for use by anyone but NAIC members.
3. NAIC Designations are not intended to be and should not be used as if they were the functional equivalent of the credit ratings of nationally recognized statistical rating organizations or other rating organizations whose ratings are intended to be used by investors as predictive opinions of default risk.
4. The use or adoption of NAIC Designations by anyone other than NAIC members is improper and is not authorized by the NAIC.
5. NAIC Designations and other analytical products of the SVO and SSG are produced solely for the benefit of NAIC members in their capacity as state insurance department officials for use in the NAIC Financial Regulation Standards and Accreditation Program.

If, despite the noted restrictions on the use of NAIC Designations, NAIC members consider it worthwhile to have the ability to approve the use of NAIC Designations by the state insurance regulators of certain non-member jurisdictions, the SVO would recommend certain conditions to be met. These conditions would include acknowledgement by the requesting state insurance regulator in a memorandum of understanding (MoU): 1) of the intended purposes of NAIC Designations, including that NAIC Designations are not the functional equivalent of credit ratings; and 2) that the requesting state insurance regulator's uses may deviate from the NAIC's intended purposes. Additionally, a formal process would need to be created, involving necessary

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amendments to the P&P Manual, to authorize and rescind authorization of the requesting jurisdiction. Consideration of the jurisdiction's recognition by the Mutual Recognition of Jurisdictions (E) Working Group could be another requirement of authorization. Once authorized and listed in the P&P Manual, insurers in that jurisdiction could then be given access to the SVO List of Investment Securities compiled in Automated Valuation Service+ (AVS+) and permitted to file securities with the SVO. The SVO is issuing this report just to request guidance from the Task Force on how to proceed.

Mr. Fry said as a state insurance regulator over the years, there are certain jurisdictions—i.e., Cayman—if you form an insurer or reinsurer there, it can also select the accounting methodology to use there; the U.S. RBC system is an option. In that case, state insurance regulators are very comfortable with that as the ratings are understood and how they are used. In that context, it would seem useful. It is important to acknowledge that NAIC Designations are produced for NAIC members and intended for NAIC regulatory purposes. From a legal perspective, it would be important to be upfront with the limitations of NAIC Designations. Before pursuing all that, this is letting the Task Force know it is something being considered. If there are no concerns, the SVO staff will proceed along these lines of developing some guidance that would clarify the issues. Task Force members can reach out to the SVO staff if they have any comments. No action is needed at this time other than soliciting input from the Task Force.

9. Heard a Staff Report on Rating Issues and Proposed Changes to the FE Process

Mr. Fry said the next item is to hear a report from the Investment Analysis Office (IAO) on issues it is seeing with the NAIC's use of ratings. This issue has been before the Task Force several times; most recently, it was discussed at the Task Force's Educational Session this October during a confidential session. The themes in this memo echo the findings of the former Rating Agency (E) Working Group that was formed to study the NAIC's reliance on rating agencies after the financial crisis in 2008. The Working Group's recommendation was adopted by the NAIC in 2010, and it may be time for the Task Force to refresh itself on these adopted items.

Mr. Therriault said the SVO, Structured Securities Group (SSG), and Capital Markets Bureau (CMB) staff have raised concerns about the NAIC's reliance on rating agency ratings several times. The SVO staff have twice before analyzed cross rating agency rating differences, and the results of this most recent analysis are consistent with the prior reviews. As was requested by the Task Force last year when it was discussing private letter (PL) rating rationale reports, the SVO provided the Task Force with an in-depth review into some of the specific issues and inconsistencies it is seeing. The SVO walked the Task Force through 43 different privately rated securities that had risk assessments that were materially different than the SVO staff's assessment, material being three to six plus rating notches higher or one to two full ratings categories higher. This was not intended to be an exhaustive audit of all privately rated securities, but only to highlight that there are meaningful deviations the SVO is seeing in risk assessment that can result in inappropriately low RBC for very risky assets.

The NAIC relies heavily on CRPs to assess the risk for the vast majority of insurer investments. This reliance comes with no oversight as to the analytical basis for those ratings, the applicability or strength of the methodology, or the consistency of the resulting risk assessments. The SVO is not charged with monitoring CRPs or authorized to use its judgement or discretion to determine how, when, and if a CRP rating should be used for NAIC purposes. Quoting from some of the former Rating Agency (E) Working Group's recommendations from 2010:

VOS should continue to develop independent analytical processes to assess investment risks. These mechanisms can be tailored to address unique regulatory concerns and should be developed for use either as supplements or alternatives to ratings, depending upon the specific regulatory process under consideration.

ARO (we now call them credit rating providers or CRPs) ratings have a role in regulation; however, since the ratings cannot be used to measure all the risk that a single investment or a mix of investments may represent in an insurer's portfolio, NAIC policy on the use of ARO ratings should be highly selective and incorporate both supplemental and alternative risk assessment benchmarks.

NAIC should evaluate whether to expand the use of SVO and increase regulator reliance on the SVO for evaluating credit and other risks of securities.

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Consideration should be given to modifying the filing exempt rule to adjust for securities with new additional ARO ratings and other measures (such as V Scores and Parameter Sensitivities) when deemed applicable. The need for difference RBC and/or some other and additional regulatory process should be evaluated. Such processes could include the use of market information on price direction and of yield trends in addition to ARO ratings for some or all filing exempt securities. Securities highlighted by this process can be reviewed by the SVO with the objective of adjusting the ARO rating to help ensure an accurate RBC charge.

The Working Group's recommendations are matched by NAIC staff's concerns today that CRP rating do not always reflect a reasonable assessment of a security's risk, and the validity of the resulting RBC ratio that relies upon that CRP rating to determine the factor to apply to that security may be significantly compromised.

Mr. Perlman said a common misconception about SEC oversight of rating agencies is that the SEC's recognition of a rating agency as a nationally recognized statistical ratings organization (NRSRO) means that the SEC has reviewed and approved of that rating agency's criteria and methodologies. That is not the case. NRSROs are regulated by the SEC, but under the Credit Rating Agency Reform Act of 2006, which introduced Section 15 of the Securities Exchange Act of 1934, the SEC and the states are forbidden from regulating NRSRO methodologies. The SEC cannot approve of or regulate the substance of a rating agency's methodologies. It cannot opine on the quality of a methodology. The SEC can enforce adherence to the process by which those methodologies were created and are applied.

The purpose of rating agency regulation is to improve ratings quality through transparency and competition. It is not to create uniform rating agencies with fungible methodologies and ratings, but rather to expose the differences between the agencies. Like other federal approaches to securities regulation, NRSRO regulation focuses on accurate disclosure, allowing users of ratings, like the NAIC, to choose the NRSRO that best meets their needs.

Mr. Therriault said in the attachment, there are three different types of analysis comparing rating agency ratings: 1) one looking at the absolute values of rating notch differences between CRPs that rated the same security; 2) the next cross-correlations between each CRP on securities rated by both; and 3) finally, a principal component analysis that statistically portrays how alike or dissimilar each CRP is to one another. The identity of each rating agency was concealed to maintain confidentiality, but these charts show that there are significant differences between ratings agencies. Ratings are not fungible; a AAA is not a AAA no matter which CRP generates it. Because CRP assessments of risk are different, IAO staff believe, as did the former Rating Agency (E) Working Group, that how each CRP's ratings are used in NAIC processes should also be different.

Eric Kolchinsky (NAIC) said some of the options that could be used for a better use of rating agency information are listed in the memo. The first option is to require at least two or sometimes more ratings for each security and then use the lowest of the two. If a security only has one rating, there is a process by which it is identified so that the SVO can look at the quality of that rating. Option two is a study, so this would look at the process by which the NAIC came up to the RBC analysis. Those provide specific thresholds for each performance rating, and the historical performance of each rating agency could be compared to those benchmarks; i.e., the thresholds. That is a lengthy process but quite doable. Option three is something like what the NAIC does for residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS). The rating agencies are one of the few vendors that do not go through a request for qualifications (RFQ). Under this option, they would be looked at like any other vendor, and qualifications would be set up. The NAIC could look at that process of using that information at the NAIC and create a closer contractual relationship between the NAIC and rating agencies. Option four is for the Task Force to eliminate one or more rating agencies that could be done based on criteria, based on recommendations from a state, or based on recommendations from another group such as the Financial Analysis (E) Working Group. Lastly, a combination of one or more of these options would be used; the options are not exclusive to one another.

Mr. Fry said the FE process is something the Task Force has looked at a lot over the years. In 2004, the idea about letting companies self-designate was talked about but did not come to fruition. Rating agencies have been the NAIC's best option for RBC framework, leveraging off their credit ratings to turn them into a factor that runs through RBC. The Task Force has seen some securities that draw questions. This memo that was put out is a great starting point. There are a lot of questions that will be generated from this memo, and a lot of people would like to understand the sample better and understand some of the statistics behind it. This document's best purpose will be a starting point of discussion for the Task Force. One approach could be for the Task Force to form a smaller group of state insurance regulators, industry participants, and rating agencies in a regulator only setting as it goes into the new year. This document could be used and gather everyone else's ideas because

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feedback is needed. Something needs to be done with FE; like anything else, it needs to be enhanced over time and doing what it is supposed to do. The SVO and state insurance regulators do not want to go fast and cause market turmoil and uncertainty. This must be a careful and collaborative approach.

Ms. Mears said she supports the idea of moving forward with a small study group that includes industry, and she has seen the benefits of that in other working groups and task forces. That collaboration between state insurance regulators, industry, other potential interested parties, and stakeholders can result in a proposal here that makes a lot of sense and addresses the core issues that have been seen. Ms. Mears said she appreciates the work that the SVO has done to bring these issues to light and agrees that it should be a priority next year.

Mr. Schrader said there are several different asset classes that are rated. The Task Force needs to look holistically at some rating agencies that have different methodologies and different types of classes. It is very important to ensure that the state insurance regulators who are relying upon this understand what they are relying upon. If there are issues or concerns, the states have the authority to take action within their statute. It is most important to be consistent and hold the entire industry to the same standard. As Ms. Mears and Mr. Fry mentioned, to give the industry some certainty that when they invest in an asset, they sort of know upfront and have a reasonable assumption of what the effects may be.

Mr. Fry received the report to use it as a basis for beginning discussions in 2022 and encouraged feedback.

10. Heard a Staff Report on a Project of the Statutory Accounting Principles (E) Working Group

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

Julie Gann (NAIC) said this report is just more of the coordination initiative to identify key items that the Working Group addressed to the Task Force. The Working Group met Dec. 12 with a full agenda and addressed several items.

Regarding adopted items, the first is related to credit tenant loans (CTLs). The Working Group adopted revisions to SSAP No. 43R to explicitly identify the SVO-identified CTLs in scope. It is the final step with the CTL discussions over the last couple of years. With that adoption, examples from paragraph 27 were removed, which is not a scope paragraph, from the contents of the SSAP. The Working Group also explicitly notified *Interpretation (INT) 20-10: Reporting Nonconforming Credit Tenant Loans*, which is and had already expired. The Working Group wanted to identify the revisions that were adopted by the Task Force, and the action by the Working Group was explicitly noted for historical purposes. The Working Group disposed the agenda item that had been drafted for CTLs, as it was no longer necessary.

The Working Group also adopted an agenda item indicating support for enhanced reporting of Federal Home Loan Bank (FHLB) borrowings in Exhibit 7 when they are structured as deposit-type contracts. There were no statutory accounting revisions for that item, but it is support for a blanks proposal, which is currently out there. It will be in effect for 2022, not for this year-end. There was some state insurance regulator feedback wanting to have those breakouts on Exhibit 7 as to where the FHLB borrowings were captured. These changes will have a 2022 effective date.

Regarding exposures, first, the Working Group exposed revisions to *SSAP No. 25—Affiliates and Other Related Parties* and SSAP No. 43R to improve the reporting of related party investments. This agenda item does two things. First, it clarifies the reporting of affiliated investments in accordance with the existing definition of an affiliate that is in the *Investments of Insurers Model Act (Defined Limits Version) (#280)*, SSAP No. 25, and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*. The Working Group is trying not to conflict with that existing definition, but what it also does is propose new reporting of related party investments through an electronic column in the investment schedule that would encompass all investments that are reported on the investment schedules. The goal there is to identify the involvement of related parties regarding investments held. A key element has to do with if the related party is an originator or a sponsor of an investment, but the investment may not reflect an investment in the related party per se. That is currently exposed for comment. It is also going to have a blanks proposal with an anticipated effective date of 2022, and it is anticipated that the blanks proposal will be exposed by the end of the year, if not early January.

The Working Group also exposed revisions to SSAP No. 43R to reflect adopted changes from the Task Force as it pertains to the NAIC Designation and the Designation Category for RMBS/CMBS under the financial modeling procedure. This has two

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options in the exposure. The first one is to reflect the revisions that were adopted by the Task Force in SSAP No. 43R. The second option is to remove all that guidance from SSAP No. 43R and instead refer to the P&P Manual for guidance. This was the original process for those designations. In 2008, in response to the financial crisis and when the financial modeling was created, the Working Group pulled that guidance into SSAP No. 43R. The question is being asked if there is a need to continue that guidance in the SSAP or just refer to the P&P Manual. The Working Group would like feedback from the Task Force and industry regarding those two options.

Regarding the bond proposal project, two items were exposed. The first is a reporting option discussion draft that presents different options for changes on Schedule D-1. This is a sizable change that is being considered for reporting on Schedule D-1, and the full intent is to have improved granularity and transparency on the investments that are being reported in addition to reporting lines for the types of investments. It also asks questions on the current columns that are captured, such as the code column, the collateral type of column, and the bond characteristic column; and it asks questions on what information is currently being utilized, what is beneficial, and what should be added. There are a lot of questions in that discussion draft, so it is looking for feedback from state insurance regulators and industry regarding that. Also on the bond proposal project, the Working Group exposed tracked changes to the principal concepts for a credit enhancement, which is a required component for classifying an investment as an asset backed security (ABS). Originally, the terminology was for a sufficient credit enhancement, and that was revised to be a substantive credit enhancement to better reflect the principal intent of that guidance. That is reflected both in the principle-based bond definition guidance, as well as in the examples that go along with that principle-based bond definition.

The Working Group also exposed revisions to expand the information that is reported for subsidiary, controlled, and affiliated entities (SCA) on Schedule D-6-1. Those SCAs are filed with the NAIC and used to go to the New York office. Now, they come to the Kansas City office. NAIC staff have seen over time where there may be NAIC staff adjustments based on the guidance that is in SSAP No. 97, and those revisions are not reflected in the next year's report in Schedule D-6-1. It is a recurring issue regarding the adjustments not being made. These enhancements to Schedule D-6-1 are also in the electronic columns, and they just identify the NAIC adjusted value from the prior year, as well as additional information on the filing information. It is easier for the state insurance regulators to see if there is a sizable difference from what the company reported to what the NAIC adjusted value was. The comment deadline for all these exposures is Feb. 18, 2022. There were two other exposures not discussed today that had an earlier comment deadline of Jan. 14, 2022. All the adoptions and exposures are on the Working Group summary, which should be posted.

11. Discussed Other Matters

Mr. Therriault said the licensing for the AVS+ system, where the NAIC produces and publishes NAIC Designations and prices, has now moved to a full calendar year for 2022. There was a transition period in 2021 where the fee was adjusted for the 11-month period last year. The licenses used to renew in January; now, it will be for the full calendar year. The 2022 fee is a little different from 2021 because it represents a full year, whereas last year it was just the 11-month period.

Mr. Fry announced that he and Ms. Belfi are retiring in 2022.

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

<https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2022/2022-04 - Spring National Meeting/01 - Prior Meeting Minutes/VOSTF 12.12.2021 NM Minutes - FINAL.docx>



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, Managing Investment Counsel, NAIC Securities Valuation Office (SVO)

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

RE: Update the Definition of Principal Protected Securities in the Purposes and Procedures Manual of the NAIC Investment Analysis Office

DATE: November 11, 2021

Summary – In May 2020 the Task Force adopted an amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (the “P&P Manual”) to include Principal Protected Securities (“PPS”) as a new security type ineligible for the filing exempt process. At the time, the types of PPS which the SVO had seen were mixes of a traditional bond or bonds with additional assets that could possess any characteristic. These additional assets, which we called “performance assets,” were intended to generate excess return. They included, among other things, derivatives, common stock, commodities and equity indices. The performance assets generally included undisclosed assets and were typically not securities that would otherwise be permitted on Schedule D, Part 1 as a bond. In each case, the external credit rating provider (CRP) rating was based solely on the component dedicated to the repayment of principal and ignored the risks and statutory prohibitions of reporting the performance asset on Schedule D, Part 1

Recently, the SVO received a proposal for a security which posed many of the same risks as a PPS but was structured in a way that it did not cleanly fit the definition in the P&P Manual. In this example, the security was not issued by an SPV holding both the principal protection bond and the performance asset. Rather, the security was the direct obligation of a large financial institution whose obligation it was to pay principal at maturity and a premium based on the performance of a referenced equity index and an index comprised of equities, fixed-income instruments, futures and other financial assets. Though the obligation was solely that of the issuing financial institution, meaning there were no *underlying* bonds or performance assets, the structure posed the same risk of exposure to a performance asset because the amount of the issuer’s payment obligation was directly dependent on the performance of the referenced indices. Additionally, unlike a PPS transaction with an underlying bond and performance asset, the likelihood of payment of that performance asset premium, whatever the amount might be, was linked directly to the creditworthiness of the issuer.

As such, the SVO proposes amending the P&P Manual definition of Principal Protected Securities to account for alternate structures which pose similar risks.

Proposed Amendment - The proposed text changes to the definition of Principal Protected Securities is shown below with additions in red underline and deletions in ~~red strikethrough~~, as it would appear in the 2021 P&P Manual format.

PART THREE

**SVO PROCEDURES AND METHODOLOGY FOR PRODUCTION OF NAIC
DESIGNATIONS**

PRINCIPAL PROTECTED SECURITIES

Definition

312. Principal Protected Securities (PPSs) are a type of security that packages or repackages one or more investment exposures or referenced or underlying investments and for which contractually promised payments according to a fixed schedule are satisfied by proceeds from an issuer obligation or underlying bond(s) (including principal and, if applicable, interest, make whole payments and fees thereon) that if purchased by an insurance company on a stand-alone basis would be eligible for Filing Exemption, but for which:

- (i)
 - a. the ~~repackaged~~ security structure enables potential returns from the investment exposures or referenced or underlying investments in addition to the contractually promised cash flows paid to such ~~repackaged~~ security according to a fixed schedule;
- OR
- b. the contractual interest rate paid by the PPS is zero, below market or, in any case, equal to or below the comparable risk-free rate;

AND

- (ii) the insurer would obtain a more favorable Risk Based Capital charge or regulatory treatment for the PPS through Filing Exemption than it would were it to separately file the issuer obligation, investment exposures or referenced or underlying investments in accordance with the policies in this Manual.



Mike Monahan
Senior Director, Accounting Policy
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February 10, 2022

Ms. Carrie Mears, Chair
Valuation of Securities Task Force
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Re: Amendment to the P&P Manual to update the definition of Principal Protected Securities (PPS)

Dear Ms. Mears,

The American Council of Life Insurers (“ACLI”), Private Placement Investors Association (“PPIA”), and North American Securities Valuation Association (“NASVA”) (“the undersigned”) appreciate the opportunity to engage with state regulators and the NAIC on the SVO’s proposed Amendment to the P&P Manual to update the definition of Principal Protected Securities (PPS).

The undersigned support the efforts to the SVO to continue to update the P&P Manual for new developments. The complete reorganization of the P&P Manual, several years ago, was a welcome development in making it more user friendly, and therefore we support continued diligence toward providing clarity as well as minimizing operational challenges for those that need to comply with the provisions of the manual.

While the undersigned agree with the substance behind the proposed amendment, in the spirit of the preceding paragraph, we propose rolling this proposed amendment into the proposed amendment entitled, “Amendment to the P&P Manual to update the definition of Other Non-Payment Risk assigned a Subscript “S” for the following two reasons:

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The American Council of Life Insurers (ACLI) is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI’s member companies are dedicated to protecting consumers’ financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI’s 280 member companies represent 94 percent of industry assets in the United States.

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PPIA is a business association of insurance companies, other institutional investors, and affiliates thereof, that are active investors in the primary market for privately placed debt instruments. The association exists to provide a discussion forum for private debt investors; to facilitate the development of industry best practices; to promote interest in the primary market for privately placed debt instruments; and to increase accessibility to capital for issuers of privately placed debt instruments. The PPIA serves 63 member companies and works with regulators, NASVA, the American College of Investors Counsel, and the investment banking community to efficiently implement changes within the private placement marketplace.

NASVA is an association of insurance company representatives who interact with the NAIC Securities Valuation Office (“SVO”) to provide important input, and to exchange information, in order to improve the interaction between the SVO and its users. In the past, NASVA committees have worked on issues such as improving filing procedures, suggesting enhancements to the NAIC’s ISIS electronic security filing system, and commenting on year-end processes.

- 1) PPS securities are a type of Subscript S security. Subscript S securities are already not eligible for filing exemption, and the Subscript S proposed amendment, recommends collectively adding Subscript S securities to the list of non-filing exempt securities (because they were inadvertently left off the list due to a historical oversight). Therefore, we recommend including PPS, as one the illustrations listed under Subscript S, and removing it as a stand-alone example on the list of non-filing exempt securities in a similar manner as with other Subscript S illustrations. Such consistency will improve the clarity and usability of the P&P Manual.
- 2) While the undersigned supported the SVO's effort to included PPS as a non-filing exempt security, it took several iterations and meetings with the SVO to arrive at a definition that proved workable. By trying to layer in this additional concern, to the PPS definition, we believe a similar effort and dialogue would be needed. Further, it appears some of the additional recommended illustrations in the Subscript S proposed amendment, appear to be attempting to address the same concern. Including that concern in one spot will improve the clarity and usability of the P&P Manual.

We discussed these concepts with Charles Therriault, and his team, and suggested we would like to work with the SVO to address this matter in the most efficient way possible. Our understanding is Charles and team are amenable to this suggestion. Please see our additional letter in response to the Proposed Amendment to the P&P Manual to update the definition of Other Non-Payment Risk assigned a Subscript "S".

We look forward to working with the SVO and regulators on this issue.

Sincerely,



Mike Monahan
Senior Director, Accounting Policy

Tracey Lindsey

Tracey Lindsey
NASVA

John Petchler

John Petchler
on behalf of PPIA
Board of Directors



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, Managing Investment Counsel, NAIC Securities Valuation Office (SVO)

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

RE: Update the Definition of Other Non-Payment Risk Assigned a Subscript "S" in the P&P Manual

DATE: November 15, 2021

Summary – Securities that possess “Other Non-Payment Risks” are intended to be reviewed by the SVO but these investments have not been explicitly included on the list of Specific Populations of Securities Not Eligible For Filing Exemption in Part Three of the *Purposes Procedures Manual of the NAIC Investment Analysis Office (P&P Manual)*. Securities with other non-payment risks are identified through assignment of the Administrative Symbol “S” as a subscript to the NAIC Designation. This amendment adds “Securities with Other Non-Payment Risks” to the list of securities that are ineligible for filing exemption.

As noted in Part One, paragraph 90, of the P&P Manual, “*An objective of the VOS/TF is to assess the financial ability of an insurer to pay claims. For example, the regulatory assumption is that a fixed income instrument called debt by its originator or issuer requires that the issuer make scheduled payments of interest and fully repay the principal amount to the insurer on a date certain. A contractual modification that is inconsistent with this assumption creates a rebuttable inference that the security or instrument contains an additional or other non-payment risk created by the contract that may result in the insurer not being paid in accordance with the underlying regulatory assumption. The SVO is required to identify securities that contain such contractual modifications and quantify the possibility that such contracts will result in a diminution in payment to the insurer, so this can be reflected in the NAIC Designation assigned to the security through the application of the notching process.*”

The proposed amendment further clarifies through additional illustrations that securities that:

- a) incorporate the performance of other assets to determine their contractual payments, either directly or indirectly through reference pools, equity baskets, or indices;
- b) receive payments as the remainder or residual cashflow after all other payment obligations have been made;
- c) receive additional performance or bonus cashflows; or
- d) have no contractual events of payment default;

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would also be considered as having “Other Non-Payment Risks”.

Proposed Amendment - The text changes to update the definition of “Other Non-Payment Risks” and include Securities with Other Non-Payment Risk as a security type ineligible for filing exemption is shown below with additions in red underline and deletions in ~~red strikethrough~~, as it would appear in the 2021 P&P Manual format.

PART TWO
OPERATIONAL AND ADMINISTRATIVE INSTRUCTIONS
APPLICABLE TO THE SVO

NAIC DESIGNATION SUBSCRIPT S

Description of Other Non-Payment Risk

32. It may not be practical, desirable or possible to specifically define other non-payment risk given the assumption that it originates as a result of a contractual agreement or the presence of a structural element of a transaction that is agreed upon between the issuer and the insurer. Accordingly, what follows is intended as general guidance to insurers and others.
33. Most typically, other non-payment risk has been associated with contractual agreements between the insurer and the issuer in which the issuer is given some measure of financial flexibility not to make payments that otherwise would be assumed to be scheduled, given how the instrument has been denominated, or the insurer agrees to be exposed to a participatory risk.
34. Other non-payment risk differs from the type of issues encountered in credit risk. This is because typically, credit assessment is concerned with securities in which the parties create subordination by modifying the lender's priority of payment (e.g., senior unsecured versus junior subordinated) but in a context where the contract otherwise specifies that the failure to make payments on a schedules basis (defined in the contract) is an event of default (in the case of a bond) or triggers some other specific and identifiable lender remedy (in the case of other fixed income securities).
35. Using the broad concepts identified above, non-payment risk may be present when:
 - A reporting insurance company takes on a participatory risk in the transaction;
 - *Illustration* – The contract promised payment of a dollar denominated obligation in non-U.S. currency but does not require an exchange rate that would yield foreign currency sufficient to buy a defined principal amount of U.S. dollars. The other non-payment risk in this illustration consists of the reporting insurance company's acceptance of currency risk which may diminish the principal amount of the investment. Currency risk here is not related to the issuer's ability or willingness to pay and therefore is not appropriately reflected in the NAIC Designation of the issuer or captured by notching for credit risk.
 - The contract governing the loan provides for a degree of permanence in the borrower's capital structure that is incompatible with notions of a loan that is expected to be repaid;

- *Illustration* – A loan stated to be perpetual and giving the issuer the right to miss interest or dividend payments otherwise said to be scheduled where the missed payments are not required to be paid on a subsequent date.
- *Illustration* – An instrument denominated as a bond but lacking a maturity date, a mechanism to determine a maturity date* (e.g., a mandatory redemption) or that states a maturity equal to or exceeding 40 years.
- The governing agreements permit irregular or conditional payments that are incompatible with the notion of an issuer making scheduled payments of interest and repaying principal in full to the insurer on a date certain:
 - *Illustration* – A security that incorporates the performance of other assets to determine contractual payments, principal or interest, either directly or indirectly through references to asset pools, equity baskets, or non-interest rate indices.
 - *Illustration* – A security that receives payments as the remainder or residual cashflow after all other payment obligations have been made.
 - *Illustration* – A security that receives performance or bonus cashflows in addition to scheduled payments of principal and interest.
 - *Illustration* – A security with no contractual events of payment default.
- Agrees to an exposure that has the potential to result in a significant delay in payment of contractually promised interest and/or a return of principal in an amount less than the original investment.

Meaning of the Subscript S Symbol

36. An SVO determination that a specific security contains other non-payment risk is communicated by assigning the NAIC Designation subscript S to the specific CUSIP and applying the notching procedure described below. The subscript follows the NAIC Designation as follows: **NAIC 2S**.
37. The SVO shall assess securities for other non-payment risk:
 - Routinely, for any security or financial product filed with the SVO.
 - As part of the analysis of a security or financial product submitted to the SVO under the RTAS – Emerging Investment Vehicle process discussed in of this Manual.
 - When requested to do so by any state insurance regulator acting pursuant to this Manual, and:

- When requested by the VOS/TF; or
- In support of any other NAIC group engaged in the analysis of investment risks in new securities.

NOTE: SEE “NAIC DESIGNATION SUBSCRIPT S” IN PART ONE.

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

Filing Exemption

3. Bonds, within the scope of SSAP No. 26R and SSAP No. 43R (excluding RMBS and CMBS subject to financial modeling) and Preferred Stock within scope of SSAP No. 32, that have been assigned an Eligible NAIC CRP Rating, as described in this Manual, are exempt from filing with the SVO (FE securities) with the exception of Bonds and/or Preferred Stock explicitly excluded below.

Specific Populations of Securities Not Eligible for Filing Exemption

4. The filing exemption procedure does not apply to:

...

- **Securities with Other Non-Payment Risks** – As noted in Parts One and Two of this Manual, the regulatory assumption of a fixed income instrument called debt by its originator or issuer requires that the issuer make scheduled payments of interest and fully repay the principal amount to the insurer on a date certain. A security that is inconsistent with this assumption contains an additional or other non-payment risk created by the contract that may result in the insurer not being paid in accordance with the underlying regulatory assumption.

<https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2022/2022-04 - Spring National Meeting/03 - Update Definition Subscript S/2021-047.01 Task Force 2021 Amend PP Other Non-Payment Risk.docx>



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February 10, 2022

Ms. Carrie Mears, Chair
Valuation of Securities Task Force
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Re: Amendment to the P&P Manual to update the definition of Other Non-Payment Risk assigned a Subscript S

Dear Ms. Mears,

The American Council of Life Insurers (“ACLI”), Private Placement Investors Association (“PPIA”), and North American Securities Valuation Association (“NASVA”) (“the undersigned”) appreciate the opportunity to engage with state regulators and the NAIC on the SVO’s proposed Amendment to the P&P Manual to update the definition of Other Non-Payment Risk assigned a Subscript S.

The Proposed Amendment proposes the following two distinct additions to the P&P Manual:

- 1) The proposed addition of Subscript S securities (collectively) to the list of securities explicitly noted to be non-eligible for filing exemption in the P&P Manual, and
- 2) The proposed addition of four illustrations to the definition of Subscript S securities with other non-payment risk.

The undersigned offer the following comments on these proposals. For the purposes of brevity, we will not repeat our comments made in our letter of the same date, on the Proposed Amendment to

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The American Council of Life Insurers (ACLI) is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI’s member companies are dedicated to protecting consumers’ financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI’s 280 member companies represent 94 percent of industry assets in the United States.

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PPIA is a business association of insurance companies, other institutional investors, and affiliates thereof, that are active investors in the primary market for privately placed debt instruments. The association exists to provide a discussion forum for private debt investors; to facilitate the development of industry best practices; to promote interest in the primary market for privately placed debt instruments; and to increase accessibility to capital for issuers of privately placed debt instruments. The PPIA serves 63 member companies and works with regulators, NASVA, the American College of Investors Counsel, and the investment banking community to efficiently implement changes within the private placement marketplace.

NASVA is an association of insurance company representatives who interact with the NAIC Securities Valuation Office (“SVO”) to provide important input, and to exchange information, in order to improve the interaction between the SVO and its users. In the past, NASVA committees have worked on issues such as improving filing procedures, suggesting enhancements to the NAIC’s ISIS electronic security filing system, and commenting on year-end processes.

the P&P Manual to update the definition of Principal Protected Securities (PPS), as we believe the two proposed amendments are highly interrelated. The undersigned respectfully request readers to read that letter first to understand the full context of our comments below.

- 1) Subscript S securities are already not eligible for filing exemption, and the Subscript S proposed amendment, recommends collectively and explicitly adding Subscript S securities to the list of non-filing exempt securities. The undersigned support this proposal, in concept, because we believe they were inadvertently left off the list due to a historical oversight. As such, collectively adding Subscript S securities to the list of securities not eligible for filing exemption will improve the clarity and usability of the P&P Manual.
- 2) Prior to adding Subscript S securities to the list of non-eligible filing exempt securities, we recommend the following four steps:
 - i. Add the PPS definition, as currently written in the P&P Manual, to the list of illustrations (i.e., examples) already included under Subscript S definition. See also our letter, referred to above, related to PPS as well as our comments included below for more context.
 - ii. Remove PPS from the list of securities not eligible for filing exemption, consistent with other examples of Subscript S securities. See also our letter, referred to above, related to PPS for more context.
 - iii. Define separately the new concern related to PPS as a separate illustration (example) within the Subscript S definition. We believe trying to layer on this concern, atop the PPS definition, will make the already current and complex PPS definition, potentially unworkable. Further, it appears at least some of proposed four new additions to the Subscript S definition are already an attempt by the SVO to do so. The concern should only be addressed in one spot to ensure as much clarity and usability in the P&P Manual as possible. See also our letter, referred to above, related to PPS.
 - iv. The proposed amendment also includes four additional illustrations to the Subscript S definition without any context for their proposed inclusion. We understand at least some of these proposed new additions are related to concerns with PPS-like securities created by means other than that illustrated within the PPS definition. There is widespread confusion among the undersigned's constituency as to what specifically the SVO is trying to address with the four examples, but more importantly, what do they all potentially capture by way of unintended consequences. We therefore propose that we jointly work with the SVO, to more fully understand the explicit concerns, so we can jointly address those concerns and importantly ensure continued clarity and usability of the P&P Manual – consistent with the other examples included within Subscript S.

We discussed these concepts with Charles Therriault, and his team, and suggested we would like to work with the SVO to address this matter in the most efficient way possible. Our understanding is Charles and team are amenable to this suggestion.

We look forward to working with the SVO and regulators on this issue.

Sincerely,



Mike Monahan
Senior Director, Accounting Policy

Tracey Lindsey

Tracey Lindsey
NASVA

John Petchler

John Petchler
on behalf of PPIA
Board of Directors

https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2022/2022-04 - Spring National Meeting/03 - Update Definition Subscript S/2021-047.02 ACLIJointComments_VOSTF_Subscript S.docx



TO: Carrie Mears, Chair, Valuation of Securities (E) Task Force
Members of the Valuation of Securities (E) Task Force

FROM: Charles A. Therriault, Director, NAIC Securities Valuation Office (SVO)
Marc Perlman, Managing Investment Counsel, NAIC Securities Valuation Office (SVO)

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

RE: Additional Market Data Fields for Bond Investments

DATE: February 25, 2022

The SVO proposes adding additional market-data fields for bond investments to the annual statement instructions based on 2010 adopted recommendations of the Rating Agency (E) Working Group (RAWG) and the IAO staff's findings regarding the discrepancies between ratings, presented in its Nov. 2021 memo.

The RAWG was formed after the Financial Crisis of 2008 and was charged with gathering and assessing information on:

1. *The problems inherent in reliance on ratings, including impact on the filing exempt ("FE") process and Risk-Based Capital ("RBC");*
2. *The reasons for recent rating shortcomings, including but not limited to structured security and municipal ratings;*
3. *The current and potential future impact of ratings on state insurance financial solvency regulation; and*
4. *The effect of the use of NRSRO ratings on public confidence and public perception of regulatory oversight of the quality of insurance.*

The RAWG made the following summary recommendations in their Apr. 28, 2010, report that was adopted by the Financial Condition (E) Committee (emphasis added):

1. **Regulators explore how reliance on ARO (Approved Ratings Organization) ratings can be reduced when evaluating new, structured, or alternative asset classes, particularly by introducing additional or alternative ways to measure risk;**
2. **Consider alternatives for regulators' assessment of insurers' investment risk, including expanding the role of the NAIC Securities Valuation Office ("SVO"); and**

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Kansas City 1100 Walnut Street NW, Suite 1500, Kansas City, MO 64106-2197 p | 816 842 3600 f | 816 783 8175

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3. *When considering continuing the use of ratings in insurance regulation, the **steps taken by the NRSROs in correcting the causes that led to recent rating shortfalls**, including the NRSROs' efforts in implementing the recommended structural reforms, should be taken into account.*

As the IAO staff demonstrated with the analysis in its Nov. 29, 2021, memo regarding ratings discrepancies, not all credit rating provider (CRP) ratings reflect a reasonable assessment of a security's risk, indicating that rating shortfalls persist today. The NAIC has not made additional progress in reducing reliance on CRPs and the IAO proposed several steps in its memo to accomplish that objective. As noted by the RAWG and reflected in the IAO's memo, there persists a situation where "... ratings are neither consistent nor uniform for individual securities, nor across different types and classes of securities..." However, the role of the SVO has not been expanded to include "... evaluating credit and other risks of securities."¹

One step towards introducing alternative ways to measure a security's risk would be to require insurers to report various analytical measures about each security including metrics such as its current market yield, interest rate sensitivity, spread relative to risk-free securities such as United States Treasuries and average remaining life. The more a security's market yield and spread differ from similarly rated securities, the more likely it is that the implied market-perceived risk of that security differs from the risk indicated by the credit rating assigned to it. The yield difference or spread in basis points can potentially help identify securities whose risk assessment warrants further review by the SVO, examiners or other regulatory groups, for example, a AAA rated security with a yield of 5%. Other fields that measure a security's price sensitivity to interest rate movements may also help to identify market-perceived risk inconsistent with the assigned credit rating. These additional market data fields would align with the RAWG's referral to the Task Force and SVO Initiatives (EX) Working Group, as noted in their following detailed recommendations (emphasis added):

1. *Referral to the NAIC Valuation of Securities (E) Task Force: VOS should continue to **develop independent analytical processes to assess investment risks**. These mechanisms can be tailored to address unique regulatory concerns and should be developed for **use either as supplements or alternatives to ratings**, depending on the specific regulatory process under consideration.*
2. *Referral to the NAIC Valuation of Securities (E) Task Force: ARO ratings have a role in regulation; however, since **ratings cannot be used to measure all the risks that a single investment or a mix of investments may represent in an insurer's portfolio**, NAIC policy on the use of ARO ratings should be **highly selective and incorporate both supplemental and alternative risk assessment benchmarks**.*
3. *Referral to the NAIC's SVO Initiatives (EX) Working Group: NAIC should evaluate whether to **expand the use of SVO and increase regulator reliance on the SVO for evaluating credit and other risks of securities**.*

Recommendation: The SVO recommends the following market data fields and related descriptions be added to all the annual statement instructions, through a referral to the Blanks (E) Working Group, for all bonds reported on Schedule D, Part 1 (those within scope of SSAP No. 26R – Bonds and SSAP No. 43R – Loan-Backed and Structured Securities). To allow sufficient time for insurers to update their systems, the SVO further recommends that the changes be implemented as electronic only fields effective beginning with the reporting year ending December 31, 2023.

- Market Yield – The Market Yield is the internal rate of return discount rate that makes the net present value (NPV) of all expected cash flows equal to zero in a discounted cash flow analysis. Therefore, Fair

¹ Evaluating the Risks Associated with NAIC Reliance on NRSRO Credit Ratings – Final Report of the RAWG to the Financial Conditions (E) Committee, April 28, 2010

Value, which is already reported, is the present value (PV) of all expected cash flows discounted at the Market Yield.

- Market Price – The Market Price per unit of Par Value, which is already reported, is reflected in the Fair Value as of the financial statement date. The Market Price, which excludes accrued interest, when multiplied by Par Value and divided by 100 will be equal to the Fair Value.
- Purchase Yield – The Purchase Yield is the internal rate of return discount rate that makes the net present value (NPV) of all expected cash flows equal to zero in a discounted cash flow analysis as of the Acquired Date. Therefore, Actual Cost is the present value (PV) of all expected cash flows discounted at the Purchase Yield as of the Acquired Date.
- Weighted Average Life – The Weighted Average Life is the average length of time that each dollar of unpaid principal remains outstanding. The time weightings used in weighted average life calculations are based on payments to the principal. The calculation is "weighted" because it considers when the payments to the principal are made—if, for example, nearly all of the principal payments are made in five years, WAL will be close to five years. Weighted average life does not consider payments to interest on the loan. This value is recalculated at each statement date for the remaining principal payments.
- Spread to Average Life UST - The spread is the difference between the interpolated U.S. Treasury bond yield that matches the reported debt security's Weighted Average Life. Spreads between interpolated U.S. Treasuries and other bond issuances are measured in basis points, with a 1% difference in yield equal to a spread of 100 basis points.
- Option Adjusted Spread - The option-adjusted spread (OAS) is the measurement of the spread of a fixed-income security rate and the risk-free rate of return (typically U.S. Treasury yield), which is then adjusted to take into account an embedded option and expressed in basis points. The spread is added to the fixed-income security price to make the risk-free bond price the same as the bond. The option-adjusted spread considers historical data such as the variability of interest rates and prepayment rates. These calculations are complex since they attempt to model future changes in interest rates, prepayment behavior of mortgage borrowers, and the probability of early redemption.
- Effective Duration - This is a duration calculation for bonds that have embedded options. This measure of duration takes into account the fact that expected cash flows will fluctuate as interest rates change and is, therefore, a measure of risk given the security's Fair Value. As a formula, Effective Duration = $(P(1) - P(2)) / (2 \times P(0) \times Y)$, where $P(0)$ = the bond's Market Price per \$100 worth of par value, $P(1)$ = the price of the bond if the yield were to decrease by Y percent, $P(2)$ = the price of the bond if the yield were to increase by Y percent, and Y = the estimated change in yield used to calculate $P(1)$ and $P(2)$.
- Convexity - This is a measure of the curvature, or the degree of the curve, in the relationship between bond prices and bond yields. Convexity demonstrates how the duration of a bond changes as the interest rate changes.
- VISION ISSUE ID: The NAIC VISION system security ID reported in AVS+.

<https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2022/2022-04 - Spring National Meeting/04 - Blanks Referral Analytical Risk Measures/2021-053.01 Blanks Market Data Disclosure v2.docx>



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, Managing Investment Counsel, NAIC Securities Valuation Office (SVO)

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

RE: Purposes and Procedures Manual amendment to add guidance on the designation of Schedule BA assets with fixed income characteristics

DATE: November 17, 2021

Summary – The SVO recommends updating the instructions in Part Three of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (the “P&P Manual”) to include guidance related to the assignment of NAIC Designations to Schedule BA assets with underlying characteristics of bonds or fixed income instruments. Part One of the P&P Manual currently permits the SVO to assign NAIC Designations to Schedule BA assets with underlying characteristics of bonds or fixed income instruments, but there is currently no specific guidance for the SVO in Part Three. Including the proposed provisions would enable the SVO to assign NAIC Designations to Schedule BA assets which are not expressly covered by other sections of the P&P Manual (e.g. Schedule BA Non-Registered Private Funds with Underlying Assets Having Characteristics of Bonds or Preferred Stock). Schedule BA assets for life and fraternal insurers benefit from NAIC Designations because they would be eligible for more favorable RBC treatment.

The SVO’s authority to assign NAIC Designations to certain Schedule BA assets already exists. Part One of P&P Manual states that, “The SVO is assigned to assess investment securities reported to state regulators on Schedule D and Schedule BA.” (Paragraph 40). Additionally, the P&P explains that to be eligible for the assignment of an NAIC Designation a Schedule BA asset must have underlying characteristics of a bond or fixed income instrument.

Insurers may file a Schedule BA asset with the SVO if they can represent that the asset has underlying characteristic of a bond or other fixed income instrument. When an insurer files a Schedule BA asset the SVO assesses the insurer’s fixed income determination and it if agrees that the asset has fixed income characteristics, conducts a credit assessment and a valuation of the asset. Upon conclusion of its analysis, the SVO provides the insurer a response setting forth its determination as to the NAIC Designation and asset classification assigned to the asset. Upon receipt of the SVO response, the insurer reports the aforementioned analytical values obtained from the SVO for the asset on the NAIC Financial Statement Blank. (P&P Manual, Part One, Paragraph 99)

This proposed amendment would potentially make various types of assets eligible for an NAIC Designation which currently are not. Each asset would need to be individually assessed by the SVO for bond or fixed income characteristics.

Proposed Amendment - The text changes to add guidance to the P&P on the designation of Schedule BA assets with fixed income characteristics is shown below with additions in red underline and deletions in ~~red strikethrough~~, as it would appear in the 2021 P&P Manual format.

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

Filing Exemption

3. Bonds, within the scope of SSAP No. 26R and SSAP No. 43R (excluding RMBS and CMBS subject to financial modeling) and Preferred Stock within scope of SSAP No. 32, that have been assigned an Eligible NAIC CRP Rating, as described in this Manual, are exempt from filing with the SVO (FE securities) with the exception of Bonds and/or Preferred Stock explicitly excluded below.

Specific Populations of Securities Not Eligible for Filing Exemption

4. The filing exemption procedure does not apply to:

...

- Schedule BA Assets – Assets eligible for reporting on Schedule BA, and not otherwise subject to the processes or procedures of another section of this Manual, are ineligible for the filing exemption procedure.

SCHEDULE BA ASSETS

NOTE: See “Policies Applicable to Specific Asset Classes” in Part One for policies governing these assets, 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 in this Part.

Definition

320. Pursuant to this section, Schedule BA Assets include any asset eligible for Schedule BA which is not otherwise subject to the processes or procedures of another section of this Manual, and which has underlying characteristics of a bond or other fixed income instrument.

Required Documentation

321. In accordance with Part One of this Manual, when filing a Schedule BA Asset with the SVO, an insurer must submit a representation that the asset has underlying characteristics of a bond or other fixed income instruments. Additionally, the insurer shall submit any other information or documentation which the SVO deems necessary for it to make a determination about the asset’s underlying characteristics and, if thereafter necessary, to perform a credit assessment. An insurer determination that an instrument has fixed income characteristics also suggests it ought to have documentation very similar in nature to what would be presented to the SVO for a Schedule D asset; for example, an Audited Financial Statement, loan documentation or legal agreement.

Legal Review

322. The SVO shall review legal agreement(s) related to the transaction (e.g. prospectus, indenture, loan agreement, note purchase agreement, partnership agreement, guarantee or equivalent legal documents) along with any amendments, waivers, compliance certifications and opinions of counsel it deems necessary for its analysis.

Analysis and Methodology

323. The SVO will first assess the insurer’s fixed income determination. Only if the SVO agrees that the asset has fixed income characteristics and determines that it has the appropriate methodology and sufficient resources with which to conduct its analysis, will the SVO then conduct a credit assessment of the asset for the assignment of an NAIC Designation Category.

Maintenance and Monitoring

323. Maintenance and monitoring of SVO determinations for Schedule BA Assets will be conducted in accordance with “Maintenance and Monitoring of SVO Determinations For Schedule BA Assets” in Part One of this Manual.

<https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2022/2022-04 - Spring National Meeting/05 - Guidance for Sch BA Assets/2021-049.01 Task Force 2021 Amend PP SchBA Fixed Income Comp v2.docx>



Mike Monahan
Senior Director, Accounting Policy
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February 10, 2022

Ms. Carrie Mears, Chair
Valuation of Securities Task Force
National Association of Insurance Commissioners 1100
Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Re: Amendment to the P&P Manual to assign NAIC Designations to investments with a Fixed Income component for reporting on Schedule BA

Dear Ms. Mears,

The American Council of Life Insurers (“ACLI”), Private Placement Investors Association (“PPIA”), and North American Securities Valuation Association (“NASVA”) (“the undersigned”) appreciate the opportunity to engage with state regulators and the NAIC on the SVO’s proposed Amendment to the P&P Manual to assign NAIC Designations to investments with a Fixed Income component for reporting on Schedule BA.

The Proposed Amendment proposes the following two distinct additions to the P&P Manual:

- 1) The addition of Schedule BA assets to the non-filing exempt list in the P&P Manual, and
- 2) The expansion of the types of securities reported on Schedule BA, with fixed income like characteristics, that the SVO can provide an NAIC designation for.

The undersigned have at least two concerns with adding Schedule BA assets to the non-filing exempt list in the P&P Manual. First, the non-filing exempt list in the P&P Manual is for Bonds within

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The American Council of Life Insurers (ACLI) is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI’s member companies are dedicated to protecting consumers’ financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI’s 280 member companies represent 94 percent of industry assets in the United States.

acli.com

PPIA is a business association of insurance companies, other institutional investors, and affiliates thereof, that are active investors in the primary market for privately placed debt instruments. The association exists to provide a discussion forum for private debt investors; to facilitate the development of industry best practices; to promote interest in the primary market for privately placed debt instruments; and to increase accessibility to capital for issuers of privately placed debt instruments. The PPIA serves 63 member companies and works with regulators, NASVA, the American College of Investors Counsel, and the investment banking community to efficiently implement changes within the private placement marketplace.

NASVA is an association of insurance company representatives who interact with the NAIC Securities Valuation Office (“SVO”) to provide important input, and to exchange information, in order to improve the interaction between the SVO and its users. In the past, NASVA committees have worked on issues such as improving filing procedures, suggesting enhancements to the NAIC’s ISIS electronic security filing system, and commenting on year-end processes.

the scope of SSAP No. 26R and SSAP No. 43R, which generally does not include Schedule BA assets. Second, there are securities that do not need an NAIC designation for bond-like reporting on Schedule BA (e.g., surplus notes). Therefore, if the impetus behind this proposal is to ensure there is clarity within the P&P Manual, we believe it is better to include in each section of the P&P Manual, that specifically address instances where NAIC provides NAIC designations, that in no instance can companies self-designate.

The undersigned has consistently supported, and continues to support, the SVO providing designations for Schedule BA assets with fixed income like characteristics. However, we are not sure how much value the proposed changes on Page 5 of the proposed changes provide. Without specific additional categories of investment types for which the SVO can designate, and CATF addressing the risk-based capital implications, we are not sure how much, if anything, these changes accomplish. Further, there may be additional securities, as a result of SAPWG's ongoing Principles- Based Bond Project, where new Schedule BA assets would benefit from an NAIC designation and bond-like risk-based capital charges.

We therefore ask the question if this proposal would benefit from a referral to CATF, while the Principles- Based Bond Project is being finalized, to ensure there is coordination between all NAIC working groups and task forces that need to come together to further enact risk-based capital for schedule BA assets that reflect fixed income like risk?

We look forward to working with the SVO and regulators on this issue.

Sincerely,



Mike Monahan
Senior Director, Accounting Policy

Tracey Lindsey

Tracey Lindsey NASVA

John Petchler

John Petchler
on behalf of PPIA
Board of Directors

https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2022/2022-04 - Spring National Meeting/05 - Guidance for Sch BA Assets/2021-049.02 ACLIJointComments_VOSTF_Schedule BA.docx



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, Managing Investment Counsel, NAIC Securities Valuation Office (SVO)

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

RE: Purposes and Procedures Manual amendment to permit un-guaranteed and unrated subsidiary obligors in WCFI transaction, with SVO discretion

DATE: November 24, 2021

Summary – The SVO has received comments from certain insurers and other interested parties that it should assign NAIC Designations to Working Capital Finance Investments (WCFI) with unguaranteed and unrated obligors, based on the implied support from an obligor’s NAIC Credit Rating Provider (CRP) rated parent.

In November 2020, the Task Force exposed a proposed amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (the “P&P Manual”) to direct the SVO to rely upon the NAIC Designation or NAIC CRP Rating equivalent of the subsidiary obligor’s parent entity, with allowance for the SVO to notch down from the parent’s rating or NAIC Designation due to its assessment of certain factors regarding the parent/subsidiary relationship. In response to feedback from some Task Force members and interested parties, the SVO subsequently presented a revised proposal to the Task Force at the Summer 2021 National Meeting to remove its discretion to notch because, as demonstrated in its memorandum to the Task Force of October 16, 2020, the SVO found no generally accepted analytical technique or methodology to support the assumption that a parent entity will necessarily support its subsidiary in times of financial distress. This revised amendment was also not adopted by the Task Force.

The SVO is now proposing a new clean amendment which is substantially similar to the original and reflects the comments from some Task Force and Statutory Accounting Principles (E) Working Group members that they would like the SVO to retain discretion to notch down, as they deem appropriate. Like the November 2020 amendment, the Task Force would direct the SVO to imply the parent’s support of its subsidiary and would give the SVO discretion to assign an NAIC Designation to the subsidiary which is lower than that of the parent based on its assessment of the parent/subsidiary relationship. However, this new proposal clarifies that if the SVO notches the NAIC Designation of a subsidiary obligor down from that of its parent resulting in a credit assessment below an NAIC 2, the WCFI program would not be eligible for an NAIC Designation because it would no longer meet the definition of an eligible “Obligor” in Statements of Statutory Accounting Principles 105R – Working Capital Finance Investments.

Proposed Amendment – The proposed text changes directing the SVO to assign NAIC Designations to WCFI programs with unguaranteed and unrated subsidiary obligors are shown below with additions in red and deletions in ~~red strikethrough~~, as it would appear in the 2021 P&P Manual format.

PART ONE

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

POLICIES APPLICABLE TO SPECIFIC ASSET CLASSES

...

WORKING CAPITAL FINANCE INVESTMENTS (WCFI)

Description

118. As described in SSAP No. 105R - Working Capital Finance Investments, WCFI represents a confirmed short-term obligation to pay a specified amount owed by one party (the obligor) to another (typically a supplier of goods), generated as a part of a working capital finance investment program for which an NAIC Designation is assigned by the SVO. Pursuant to the working capital finance investment program, this short-term obligation has been transferred by the entity entitled to payment (typically a supplier of goods) to a third-party investor.

Obligor

119. The Obligor for WCFI transactions is the party that purchases the goods or services that generates the original supplier receivable (which is the payable for that Obligor). The obligor must have an NAIC Designation of “1” or “2” or an NAIC Credit Rating Provider (CRP) Rating equivalent.

Unrated Subsidiaries

120. Many WCFI programs are structured in a way whereby unrated subsidiaries of a rated parent entity are involved as transaction participants, including as the Obligor. Such programs may have strong operational and strategic linkages between the rated parent entity and its unrated subsidiaries.

121. Given (i) the short-term (less than one year) payment terms of each of the underlying receivables arising from the sale of goods or services, (ii) WCFI investors’ option to stop funding a working capital finance program, and (iii) the necessity of working capital finance programs to obligors due to obligors’ reliance on their suppliers, the Task Force has concluded there is a low probability of default of WCFI investments. Accordingly, the Task Force deems it reasonable to establish a principle to direct the SVO, in its assessment of WCFI programs, to rely upon a parent entity’s rating for purposes of determining the NAIC Designation of the overall WCFI program.

122. Solely for purposes of WCFI transactions, the Task Force directs the SVO to rely upon the NAIC Designation or NAIC CRP Rating equivalent of the obligor, subsidiary or affiliate’s parent entity if the obligor, subsidiary or affiliate does not have an NAIC CRP Rating and the SVO cannot assign an NAIC Designation to it.
123. The Task Force authorizes the SVO, based on its analytical judgement and in its sole discretion, to notch such NAIC Designation down or decline to assign an NAIC Designation, based on factors including, but not limited to, whether:
- a) the unrated subsidiaries or affiliates that serve as key transaction participants cannot reasonably perform the functions expected of them; and/or
 - b) the rated entity does not have significant documented operational control over the performance of the unrated subsidiaries or affiliates that also serve as obligors in the program; and/or
 - c) documentary evidence in the program documents or appended thereto does not sufficiently demonstrate the importance of the inter-relationship between the rated entity and the unrated subsidiaries or affiliates; and/or
 - d) the resulting NAIC Designation would, upon application of notching, be lower than an NAIC 2 Designation.
124. For the avoidance of doubt, though the Task Force directs the SVO to use the NAIC Designation or NAIC CRP rating equivalent of the obligor’s parent entity, due to the SVO’s authority to notch such NAIC Designation or rating, the SVO, based on its analytical judgement and in its sole discretion, may assign an NAIC Designation to the obligor which differs from the correlated NAIC CRP rating equivalent of the obligor’s parent entity or choose not to assign any NAIC Designation to the working capital finance program, based on aspects of the working capital finance program which are unrelated to the relationship between the obligor, subsidiary or affiliate and its parent entity.
125. The Task Force acknowledges that reliance upon the NAIC Designation or NAIC CRP rating equivalent of the obligor’s parent entity in the absence of a binding legal obligation for the parent to assume the financial obligations of the obligor, such as a guarantee, is not a generally accepted technique or methodology (as explained in “Use of Generally Accepted Techniques or Methodologies” in Part One of this Manual) and is inconsistent with the credit substitution guidelines detailed in “Credit Substitution” in Part Three of this manual, but it is directing the SVO to so rely.

NOTE: See “Working Capital Finance Investments” in Part Three for filing instructions, documentation requirements, definitions and methodology applicable to Working Capital Finance Investments.

PART THREE

**SVO PROCEDURES AND METHODOLOGY FOR PRODUCTION OF NAIC
DESIGNATIONS**

WORKING CAPITAL FINANCE INVESTMENTS

...

122. **Obligor** – An entity that purchases the goods or services from the Supplier and thereby generates the original supplier receivable—and which Obligor has, or can be designated, **NAIC 1** or **NAIC 2** by the SVO or has been assigned an equivalent credit rating by a NAIC CRP or, if not so designated, the SVO can assign such NAIC Designation, as directed by the VOS/TF pursuant to the “Working Capital Finance Investments (WCFI)” section in Part One of this Manual.

<https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2022/2022-04 - Spring National Meeting/06 - WCFI Unrated Sub Obligors/2021-050.01 Task Force 2021 Amend PP re WCFI Unrated Subs v2.docx>



Date: August 26, 2021

To: Kevin Fry, Chair, Valuation of Securities (E) Task Force

From: Dale Bruggeman, Chair, Statutory Accounting Principles (E) Working Group

RE: Referral Response: Unrated Subsidiary Obligors in WCFI transactions

Summary – Pursuant to the referral received July 28, 2021, the Valuation of Securities (E) Task Force exposed a policy change that would direct the SVO to rely upon the NAIC designation of an unrated subsidiary obligor’s parent entity for Working Capital Finance Investments (WCFI), without notching for the subsidiary. A referral was provided to the Statutory Accounting Principles (E) Working Group, as a qualifying NAIC designation of the obligor is a required element for admittance of WCFI receivables under *SSAP No. 105R—Working Capital Financial Investments*.

The Working Group has considered this exposure and acknowledges that establishment of NAIC designations is within the purview of the Task Force. However, the provisions within SSAP No. 105R were established in accordance with the historical approaches utilized in determining NAIC designations which allowed the SVO to apply its credit substitution methodology as it does for other asset classes. The proposed policy would require the SVO to imply an NAIC designation to an unrated entity based on the parent entity’s credit quality without guarantees or other legally-binding provisions that provide assurance that the parent will be legally or contractually obligated to financially cover the obligations of the unrated entity. Although, for a given program, and not related to the parent/sub relationship, the SVO may notch or otherwise not give a rating to that program.

If the Task Force chooses to move away from the historical application of financial analysis and use of the credit substitution methodology in determining NAIC designations for WCFI programs, the Working Group may deem it necessary to incorporate additional guardrail provisions to SSAP No. 105R as the NAIC designation of the obligor may no longer provide the intended safeguard for WCFI programs. As WCFI are complex arrangements, the credit quality of the obligor – who is ultimately responsible for satisfying the debt owed to the insurance reporting entity – is of paramount importance. Furthermore, the referral and exposure documentation memo seem to understand this dilemma, as it specifically identifies that “no generally accepted analytical technique or methodology supports the assumption that a parent entity will necessarily support its subsidiary in times of financial distress.” Consideration of changes that the Working Group would deem necessary, if any, would be expected to occur after any such edits to the P&P manual are adopted.

If the Task Force chooses to move forward with the issuance of “implied” NAIC designations to unrated entities for WCFI programs, the Working Group offers the following two components for additional consideration:

1. The exposed P&P Manual language seems to contradict with SSAP No. 105R, paragraph 7. Specifically, the Task Force language identifies that the implied approach is an alternative method to obtaining an NAIC designation. If the Task Force is going to permit an implied approach to an unrated sub, then to avoid conflicts with SSAP No. 105R, this implied designation would need to be considered an “NAIC Designation.” If the guidance is adopted with the inconsistency, the guidance in SSAP No. 105R requiring an NAIC designation would be the authoritative guidance. Therefore, the Working Group would recommend coordination to address any inconsistencies.
2. Although the implied designation would need to be considered an “NAIC Designation” to satisfy the requirements of SSAP No. 105R, the Working Group recommends that NAIC designations determined under the implied methodology have a specific identifier so that WCFI programs with rated obligors and unrated obligors can be separately identifiable by state insurance regulators. This is considered necessary as without this identification, regulators could erroneously conclude that an unrated obligor has been individually determined to be of high-credit quality, or that the parent entity has guaranteed or is otherwise legally obligated to pay the obligations of the unrated entity.

The Working Group appreciates the referral from the Task Force and opportunity to provide comments. Please direct any questions or responses to the Chair of the Working Group, or NAIC SAPWG Staff.

CC: Carrie Mears, Vice-Chair, Valuation of Securities (E) Task Force
Charles A. Therriault, Director, NAIC Securities Valuation Office (SVO)
Marc Perlman, Managing Investment Counsel, NAIC Securities Valuation Office (SVO)
Julie Gann, Assistant Director, NAIC Financial Regulatory Services
Robin Marcotte, Senior Manager II, NAIC Financial Regulatory Services
James Pinegar, Manager II, NAIC Financial Regulatory Services

<https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2022/2022-04 - Spring National Meeting/06 - WCFI Unrated Sub Obligors/2021-050.02 SAPWG response to VOSTF on WCFI - Unrated Subs.docx>



Mike Monahan
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January 20, 2022

Ms. Carrie Mears, Chair
Valuation of Securities Task Force

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group

National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

RE: Supply Chain Finance also known as Working Capital Finance Investments

Dear Ms. Mears and Mr. Bruggeman:

ACLI appreciates the opportunity to comment on the Task Force's Amendment to Permit Un-Guaranteed and Unrated Subsidiary Obligors in WCFI Transactions, with SVO Discretion. We also want to thank the NAIC and staff for engagement and continuing efforts to address various investment and statutory accounting issues and we appreciate the opportunity to call your attention to pending changes to both FASB¹ and IFRS² accounting standards. Both bodies have recently issued exposure drafts for comment that cover required disclosures of balance sheet accounts regarding use of what has been termed supply chain finance that in the context of the NAIC are known as Working Capital Finance Investments (SSAP 105).

Attached to this letter is a copy of FASB's exposure draft which was placed on its agenda from a joint request from the Big 4 accounting firms. All companies preparing financial statements need comply and all disclosures are subject to audit by the filing entity auditor with the FASB exposure draft disclosure requirements summarized below:

- 405-50-50-3 An entity shall disclose all the following information about its supplier finance programs:
- a. The key terms of the program.

¹ https://www.fasb.org/jsp/FASB/FASBContent_C/ProjectUpdateExpandPage&cid=1176175475663

² <https://www.ifrs.org/projects/work-plan/supplier-finance-arrangements/exposure-draft-and-comment-letters/>

b. The following information about the amount of obligations outstanding at the end of the reporting period that the entity has confirmed as valid to the finance provider or intermediary under the program (that is, the amount of obligations confirmed under the program that remains unpaid by the entity):

1. *Where those obligations are presented in the balance sheet.* If those obligations are presented in more than one balance sheet line item, then the entity shall disclose the amount outstanding at the end of the reporting period in each line item.
2. A rollforward of those obligations showing, at a minimum, all the following:
 - i. The amount of those obligations outstanding at the beginning of the reporting period
 - ii. The amount of those obligations added to the program during the reporting period
 - iii. The amount of those obligations settled during the reporting period
 - iv. The amount of those obligations outstanding at the end of the reporting period.

We want to share several observations about the proposed disclosures and its potential impact on insurance filers as well as on the current SSAP and the remaining open issues and to make several recommendations.

In brief, SSAP 105 was approved in late 2013 with industry as the catalyst for its development. Adoption was low with industry again serving as catalyst for review beginning in 2016 with request for 10 critical revisions in 2017 of which 7 were adopted in 2020. Subsequent adoption of the 2020 revisions also remains low.

The three remaining items not adopted by the NAIC include Schedule BA reporting, restrictions to NAIC 1 and 2 equivalent ratings and limitations of issuers' unrated subsidiaries which is currently the subject of evaluation by both the VOS. Importantly, each of these items are directly addressed through the pending FASB rules:

1. In the case of insurance reporting, FASB requires the corporate entity to disclose specifically where those liabilities are reported in the financial statements likely classified either as either accounts payable or debt. Schedule D is the appropriate insurance reporting schedule for such liabilities and not Schedule BA. The continuing reporting on Schedule BA is inappropriate and is a significant obstacle to adoption by insurers as, and we cannot stress this enough, the extra scrutiny of BA assets is something that many insurance filers avoid.
2. In the case of corporate entities, all companies that utilize supply chain finance will be required to disclose the arrangements, regardless of their NRSRO credit rating. In the case of the SSAP, the restriction to NAIC 2 and higher investments, which is the only investment asset class to have such a restriction, creates a considerable challenge for investment. This restriction is inappropriate as well. As the SVO has discretion to notch a potential filing, in the case of a downward notching below NAIC 2 of a filing, the investment under the existing rules would become non-admitted. There is considerable expense and risk associated with RTAS approval and ratings equivalent assignment. Uncertainty concerning filing creates limitations on the willingness of insurance filers to invest given the increased risk associated with possible downward notching.
3. In the case of subsidiaries and affiliates as part of an organization that is utilizing supply chain finance, its obligations are subject to reporting and audit as consolidated in the accounts under the FASB rules. While this is currently being addressed by the VOS it is also worth noting that there has been significant resistance among staff and some regulators regarding

the perceived risks about unrated subsidiary obligations and suitability for investment. The SSAP restriction offers no meaningful purpose.

ACLI recommends that the remaining restrictions for Schedule BA reporting and for limitations to NAIC 2 or higher obligors be removed from the SSAP. Apt in the context of the pending disclosures is Supreme Court Justice Louis Brandeis statement that “sunlight is said to be the best of disinfectants” from his 1913 Harper’s Weekly article entitled “What Publicity Can Do”, the pending changes will lead to a significant expansion of awareness of the asset class and will also lead to broader opportunities for investment. While the insurance industry has had a head start, given the restrictiveness of the SSAP it has not benefited. Time is of the essence to complete the work and amend the SSAP to resolve the remaining investment issues and request your consideration of resolving these open matters promptly.

If you have any questions in the interim, please do not hesitate to contact me.

Attachments: FASB Exposure Draft - Liabilities—Supplier Finance Programs (Subtopic 405-50)

Sincerely,



Mike Monahan
Senior Director, Accounting Policy

Cc: Julie Gann, Charles Therriault

https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2022/2022-04 - Spring National Meeting/06 - WCFI Unrated Sub Obligors/2021-050.03 ACLICommentLetteronWCFI_v012022_v2.docx

[FASB - Proposed Accounting Standards Update](#)



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
Marc Perlman, Managing Investment Counsel, NAIC Securities Valuation Office

RE: Use of NAIC Designations by Other Regulatory Jurisdiction

DATE: December 6, 2021

Introduction – The SVO was made aware of regulators or insurers in non-U.S. jurisdictions, e.g. Bermuda Monetary Authority and Japan’s Financial Services Agency, either referencing NAIC Designations in their regulatory processes or wanting to reference them. The *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) is very specific that NAIC Designations are only intended for NAIC members consisting of the chief insurance regulators of the 50 states, the District of Columbia and five U.S. territories. Listed below are paragraphs from the P&P Manual that explain in further detail the intended, proper and authorized uses of NAIC Designations.

DISCLOSURE STATEMENT

An NAIC designation for quality (NAIC Designation) of a security is produced solely for NAIC members who should interpret the designation for quality, in the context of the NAIC Financial Regulation Standards and Accreditation Program, a member’s state insurance laws and regulations, and the regulatory or financial solvency profile of a specific insurance company.

While NAIC members are the officials responsible for state insurance regulation, and while the NAIC as an association works to express regulatory consensus on issues pertaining to insurance regulation, the NAIC SVO staff has no statutory or regulatory authority.

Because an NAIC Designation, is not produced to aid the investment decision-making process, NAIC Designations are not deemed to be suitable for use by anyone but NAIC members.

NAIC Designations are not intended to be and should not be used as if they were the functional equivalent of the credit ratings of nationally recognized statistical rating organizations or other rating organizations whose ratings are intended to be used by investors as predictive opinions of default risk.

The use or adoption of NAIC Designations by anyone other than NAIC members is improper and is not authorized by the NAIC.

PART ONE - POLICIES OF THE NAIC VALUATION OF SECURITIES (E) TASK FORCE
Expression of NAIC Standards in State Law and Regulatory Processes

6. NAIC Designations and other SVO and SSG products are standards identified in the NAIC Policy Statement and Financial Regulation Standards (SFRS) that have been incorporated into state law by the States as participants in the Accreditation Program administered by the Financial Regulation Standards and Accreditation (F) Committee. Information about the F Committee and the Accreditation Program can be accessed here: www.naic.org/cmte_f.htm.

...

8. NAIC Designations and other analytical products of the SVO and SSG are produced solely for the benefit of NAIC members in their capacity as state insurance department officials for use in the NAIC Financial Regulation Standards and Accreditation Program as described above. To ensure NAIC members have a central source from which to obtain information about insurer-owned securities (including their NAIC Designations) the VOS/TF has identified the AVS+ Products as the depository for information compiled by the SVO in the SVO List of Investment Securities.

Concerns - NAIC Designations are not intended to be a public good and "...*must be interpreted by the NAIC member in context of the NAIC Financial Regulation Standards and Accreditation Program, other characteristics of the investment, and the specific financial and regulatory status of the insurance company.*" (P&P Manual, Part One, Paragraph 37). NAIC Designations are not the functional equivalent of a credit rating and must be considered within the context of the entire NAIC regulatory framework.

Recommendation - If, despite the current restrictions on the use of NAIC Designations noted above, NAIC members consider it worthwhile to have the ability to approve the use of NAIC Designations by the insurance regulators of certain non-member jurisdictions, we would recommend certain conditions be met. These conditions would include acknowledgement by the requesting regulator in a memo of understanding (MOU) (i) of the intended purposes of NAIC Designations (including that NAIC Designations are not the functional equivalent of credit ratings), and (ii) that the requesting regulator's uses may deviate from those purposes. Additionally, a formal process would need to be created, involving necessary amendments to the P&P Manual, to authorize and rescind authorization of the requesting jurisdiction. Consideration of the jurisdiction's recognition by the Mutual Recognition of Jurisdictions (E) Working Group could be another requirement of authorization. Once authorized and listed in the P&P Manual, insurers in that jurisdiction could then be given access to the SVO List of Investment Securities compiled in AVS+ and be permitted to file securities with the SVO.

[https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2022/2022-04 - Spring National Meeting/07 - Use of NAIC Designation by Other Jurisdictions/2021-051.01 Memo to VOSTF on Use of NAIC Designations by other Jurisdictions v3.docx](https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared%20Documents/Meetings/2022/2022-04%20-%20Spring%20National%20Meeting/07%20-%20Use%20of%20NAIC%20Designation%20by%20Other%20Jurisdictions/2021-051.01%20Memo%20to%20VOSTF%20on%20Use%20of%20NAIC%20Designations%20by%20other%20Jurisdictions%20v3.docx)



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February 3, 2022

Ms. Carrie Mears, Chair
Valuation of Securities Task Force
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

RE: Use of NAIC Designations by Other Jurisdictions in the Regulations of Insurers

Dear Ms. Mears,

ACLI appreciates the opportunity to provide our thoughts on the Staff Report on the “Use of NAIC Designations by Other Jurisdictions in the Regulations of Insurers” which was presented at the recent Fall National Meeting of the Valuation of Securities Task Force (VOSTF) in San Diego. We understand that the Staff Report was initiated by the Securities Valuation Office (SVO), which was made aware of regulators in non-U.S. jurisdictions referencing NAIC Designations in their regulatory processes or wanting to reference them. The Staff Report helpfully elucidates proposed conditions for enabling NAIC Designations to be used by non-US regulators. At the Fall National Meeting, VOSTF supported moving forward with the potential usage of NAIC Designations by non-U.S. jurisdictions.

ACLI supports the NAIC taking steps to enable the use of NAIC Designations overseas. If overseas regulators do not have access to NAIC Designations, US dollar investment-grade private placement securities could be classified as “unrated” and attract statutory capital charges equivalent to junk bonds. Different legal entities of a single parent could be subject to wildly different capital charges for holding identical securities. The success of this initiative would support both the global appeal of U.S. securities as well as capital consistency across regulatory frameworks.

With the publication of the Staff Report, we wanted to take the opportunity to provide some constructive suggestions for the VOSTF to consider as it advances its work on this matter. Our recommendations are as follows:

American Council of Life Insurers | 101 Constitution Ave, NW, Suite 700 | Washington, DC 20001-2133

The American Council of Life Insurers (ACLI) is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI's member companies are dedicated to protecting consumers' financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI's 280 member companies represent 94 percent of industry assets in the United States.

- The VOSTF should work with the NAIC Legal team to confirm that no apparent limitations to the use of the NAIC Designations by non-U.S. jurisdictions exist;
- Upon confirming that no such limitations exist, the SVO staff could initiate a dialogue with each of the non-U.S. jurisdictions seeking to reference the NAIC Designations, in order to understand their specific intentions for use. This dialogue could be either direct or indirect (e.g., through insurers domiciled in the overseas jurisdiction). Another option is to initiate a discussion on this topic via existing NAIC to foreign jurisdiction Dialogue. During this Dialogue, NAIC representatives or the SVO staff could share specifics of the NAIC Designation process in order to reach a mutual understanding for future foreign use;
- The VOSTF could consider entering into an agreement or Memorandum of Understanding with each non-U.S. jurisdiction intending to reference the NAIC Designations in order to establish guardrails for their ongoing use; and
- The VOSTF could expose an amendment to the P&P Manual removing the existing limitation of use of NAIC Designations by non-U.S. jurisdictions.

As always, ACLI looks forward to being a resource to the VOSTF and the SVO Staff to help advance this work and prevent unintended consequences.

Sincerely,



Mike Monahan
Senior Director, Accounting Policy

Cc: Charles Therriault

https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2022/2022-04 - Spring National Meeting/07 - Use of NAIC Designation by Other Jurisdictions/ACLIComments_VOSTF_UseofNAICDesignations_v020322.docx



TO: Carrie Mears, Chair, Valuation of Securities (E) Task Force
Members of the Valuation of Securities (E) Task Force

FROM: Charles A. Therriault, Director, NAIC Securities Valuation Office (SVO)
Marc Perlman, Managing Investment Counsel, NAIC Securities Valuation Office (SVO)

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

RE: SVO 2021 Carry Over Filings

DATE: March 10, 2022

For 2021 the SVO reviewed 12,358 filings comprised of 3,199 initial filings, 7,932 annual updates, 208 material changes, and 13 appeals. In comparison, in 2020 the SVO reviewed 12,696 filings comprised of 3,092 initial filings, 7,866 annual updates, 299 material changes and 15 appeals. The total filing numbers included 1,953 manually processed private rating letters versus 2,027 in 2020.

TYPE	ANNUAL	INITIAL	MATERIAL CHANGE	APPEALS	RENEWAL	RENUMBERING REQUEST	SUBSEQUENT	Grand Total
Appeals				11				11
Corporate	5,302	1,080	16	2		84		6,484
Counterparty Derivative	55	7						62
Defeased Bond		1						1
ETF	5	161						166
Municipal	136	123						259
Mutual Fund	144	34						178
Private Letter		1,389					564	1,953
QUSFI		19			130			149
Regulatory Transaction		9						9
RTAS		58						58
Sovereign	32	4						36
Structured Securities	2,258	541	192			1		2,992
Grand Total	7,932	3,199	208	13	130	85	564	12,358

There were also 828 carry-over filings for year-end 2021 versus 795 in 2020, 310 of which received a “IF” for an accepted initial filing and 518 received a “YE” for an accepted annual update. This represented a carry-over rate for 2021 of 6.7% which was comparable to the 6.3% rate for 2020, well below the rate of 10% or higher that would be considered concerning and reflective of a resource constraint for the office. As of March 10th, there were 140 carry-over filings remaining.

Overall, this was a solid performance by our group, and, at this time, there are no significant SVO analyst resource constraint issues. The office continues to experience significant resource limitations regarding technology support that have impacted our ability to improve the core systems, VISION, AVS+ and STS, or fully utilize our investment data. If additional analytical tasks are assigned to the SVO, which we are always happy to take on for the Task Force, additional SVO analysts or other resources may be needed.

<https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2022/2022-04 - Spring National Meeting/08 - SVO Year-end Carry-over Filings/2022-001.01 SVO Carry Over Filings.docx>