

Draft date: 8/5/24

*2024 Summer National Meeting  
Chicago, Illinois*

**VALUATION OF SECURITIES (E) TASK FORCE**

Tuesday, August 13, 2024

2:00 – 3:30 p.m.

McCormick Place Convention Center—S103—Level 1

**ROLL CALL**

<b>Member</b>	<b>Representative</b>	<b>State</b>
Doug Ommen, Chair	Carrie Mears	Iowa
Andrew N. Mais, Vice Chair	Kenneth Cotrone	Connecticut
Mark Fowler	Sheila Travis	Alabama
Lori K. Wing-Heier	David Phifer	Alaska
Ricardo Lara	Laura Clements	California
Michael Yaworsky	Ray Spudeck	Florida
Dean L. Cameron	Eric Fletcher	Idaho
Ann Gillespie	Vincent Tsang	Illinois
Vicki Schmidt	Tish Becker	Kansas
Timothy J. Temple	Melissa Gibson	Louisiana
Joy Y. Hatchette	Gregory Ricci	Maryland
Kevin P. Beagan	John Turchi	Massachusetts
Grace Arnold	Fred Andersen	Minnesota
Chlora Lindley-Myers	Debbie Doggett	Missouri
Eric Dunning	Tadd Wegner	Nebraska
D.J. Bettencourt	Jennifer Li	New Hampshire
Justin Zimmerman	John Sirovetz	New Jersey
Adrienne A. Harris	Bob Kasinow	New York
Jon Godfread	Matt Fischer	North Dakota
Judith L. French	Cam Piatt	Ohio
Glen Mulready	Diane Carter	Oklahoma
Michael Humphreys	Diana Sherman	Pennsylvania
Cassie Brown	Amy Garcia	Texas
Jon Pike	Jake Garn	Utah
Scott A. White	Doug Stolte	Virginia
Mike Kreidler	Katy Bardsley	Washington
Nathan Houdek	Amy Malm	Wisconsin

NAIC Support Staff: Charles Therriault/Marc Perlman/Eric Kolchinsky

## AGENDA

### ***Discuss and Consider Adoption of:***

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| <p>1. Its June 18, May 2, and Spring National Meeting Minutes<br/>(Doc. ID: 2024-010.01, 2024-011.01, 2024.012.01)<br/>—<i>Carrie Mears (IA)</i></p>  | <p>Attachment One<br/>Attachment Two<br/>Attachment Three</p> |
| <p>2. Its 2025 Proposed Charges<br/>(Doc. ID: 2024-013.01)<br/>—<i>Carrie Mears (IA), Charles Therriault (NAIC), and Marc Perlman (NAIC)</i></p>  | <p>Attachment Four</p>  |
| <p>3. The Revised Proposed <i>Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&amp;P Manual)</i> Amendment to Update the Definition of an NAIC Designation<br/>(Doc. ID: 2022-012.12, 2022-012.12a, 2022-012.13, 2022.012.14, 2022-012.15)<br/>—<i>Carrie Mears (IA), Charles Therriault (NAIC), and Marc Perlman (NAIC)</i></p>  | <p>Attachment Five<br/>Five*, Five-A – Five-C</p>             |
| <p>4. The Revised Proposed P&amp;P Manual Amendment Authorizing the Procedures for the Securities Valuation Office’s (SVO’s) Discretion Over NAIC Designations Assigned Through the Filing Exemption (FE) Process<br/>(Doc. ID: 2023-005.16, 2023-005.16a, 2023-005.18, 2023-005.19, 2023-005.20, 2023-005.21, 2023-005.22, 2023-005.23, 2023-005.24)<br/>—<i>Carrie Mears (IA), Charles Therriault (NAIC), and Marc Perlman (NAIC)</i></p> | <p>Attachment Six<br/>Six*, Six-A – Six-G</p>                 |

### ***Receive and Consider Exposure of:***

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| <p>5. A Proposed P&amp;P Manual Amendment to Require Annual Reviews of Regulatory Transactions<br/>(Doc. ID: 2024-014.01)<br/>—<i>Carrie Mears (IA), Charles Therriault (NAIC), and Marc Perlman (NAIC)</i></p>           | <p>Attachment Seven</p> |
| <p>6. A Proposed P&amp;P Manual Amendment to Update the List of NAIC Credit Rating Providers (CRPs)<br/>(Doc. ID: 2024-015.01)<br/><br/>—<i>Carrie Mears (IA), Charles Therriault (NAIC), and Marc Perlman (NAIC)</i></p> | <p>Attachment Eight</p> |

### ***Receive NAIC Staff Reports on:***

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| <p>7. The Projects of the Statutory Accounting Principles (E) Working Group<br/>—<i>Carrie Mears (IA) and Julie Gann (NAIC)</i></p> |  |
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8. Filing with the SVO Investments Moving to Schedule BA in 2025 Due to Changes to *Statement of Statutory Accounting Principle (SSAP) No. 26—Bonds* and *SSAP No. 43R—Loan-Backed and Structured Securities*  
—*Charles Therriault (NAIC)*
  
9. The Proposed Collateralized Loan Obligation (CLO) Modeling Methodology and Ad Hoc Working Group  
—*Eric Kolchinsky (NAIC)*
  
10. Discuss Any Other Matters Brought Before the Task Force
  
11. Adjournment

## Draft Pending Adoption

Draft: 3/28/24

Valuation of Securities (E) Task Force  
Phoenix, Arizona  
March 16, 2024

The Valuation of Securities (E) Task Force met in Phoenix, AZ, March 16, 2024. The following Task Force members participated: Doug Ommen, Chair, represented by Carrie Mears (IA); Eric Dunning, Vice Chair, represented by Lindsay Crawford and Andrea Johnson (NE); Mark Fowler represented by Sheila Travis and Sanjeev Chaudhuri (AL); Lori K. Wing-Heier represented by David Phifer (AK); Ricardo Lara represented by Laura Clements (CA); Andrew N. Mais represented by Kenneth Cotrone (CT); Michael Yaworsky represented by Carolyn Morgan and Ray Spudeck (FL); Dean L. Cameron represented by Eric Fletcher (ID); Dana Popish Severinghaus represented by Vincent Tsang (IL); Vicki Schmidt represented by Tish Becker (KS); Timothy J. Temple represented by Stewart Guerin (LA); Gary D. Anderson represented by John Turchi (MA); Kathleen A. Birrane represented by Greg Ricci and Matt Kozak (MD); Grace Arnold represented by Fred Andersen (MN); Chlora Lindley-Myers represented by Debbie Doggett and Danielle Smith (MO); Jon Godfread represented by Matt Fischer (ND); D.J. Bettencourt represented by Jennifer Li (NH); Justin Zimmerman represented by John Sirovetz (NJ); Adrienne A. Harris represented by Bob Kasinow (NY); Judith L. French represented by Dale Bruggeman (OH); Glen Mulready represented by Alec Reid (OK); Michael Humphreys represented by Diana Sherman (PA); Cassie Brown represented by Amy Garcia and Rachel Hemphill (TX); Jon Pike represented by Malis Rasmussen (UT); Scott A. White represented by Doug Stolte and Greg Chew (VA); Mike Kreidler represented by Steve Drutz (WA); Nathan Houdek represented by Amy Malm (WI). Also participating was: Trinidad Navarro represented by Stephen Taylor (DE).

### 1. Adopted its 2023 Fall National Meeting Minutes

Phifer made a motion, seconded by Crawford, to adopt the Task Force's Dec. 2, 2023, minutes (*see NAIC Proceedings – Fall 2023, Valuation of Securities (E) Task Force*). The motion passed unanimously.

### 2. Discussed Comments on a Revised Proposed Amendment to the P&P Manual to Update the Definition of an NAIC Designation

Mears said the next item is to receive comments on the exposure of a revision to the proposed *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) amendment to update the definition of an NAIC Designation. After the 2023 Fall National Meeting, the Securities Valuation Office (SVO) was directed to consider the actionable comments from industry members and work with them to further update and simplify the definition. The Task Force exposed those revisions for a 53-day public comment period that ended Jan. 26. The revised proposal incorporated several of the actionable comments received. It aimed to create a concise definition of an NAIC Designation that reflected credit quality but also would reflect inconsistencies with the existing regulatory assumption that a fixed income instrument pays scheduled interest and full repayment of principal on a date certain. These nonpayment type risks for which examples were given, and, when appropriate, consider loss given default and/or "tail" risk. Additionally, references to the concept of Subscript S, the administrative symbol for other non-payment risks, were removed. This type of assessment would be a communication tool for regulators. There were questions in the comment letters about the role this Task Force plays when assessing an insurer's financial solvency, meaning its ability to pay policyholder claims. While the Task Force is not responsible for analyzing individual insurers, the assessment of investment risk is a central component of the solvency-related considerations of the NAIC.

## Draft Pending Adoption

To the extent that an insurer-owned security may impact financial solvency (e.g., the ability to pay policyholder claims), it is important that the Task Force has an important role in contributing to the assessment of that risk. This role is codified in the P&P Manual that the policies adopted by the Task Force “...reflect a decision by NAIC members to provide analytical resources to support financial solvency objectives of state insurance regulators as expressed in the NAIC Financial Regulation Standards and Accreditation Program and/or other NAIC regulatory guidance embodied in state law.” The Task Force will consider these issues in the comments, but it is important to consider them when looking at the overall definition of an NAIC designation.

The Task Force received three comment letters on this revision. The SVO staff prepared a summary of the key comments and their recommended response (Attachment One).

Marc Perlman (NAIC) said that, as mentioned at previous meetings, NAIC Designations are currently explained and defined in both Parts One and Two of the P&P Manual. The SVO proposed consolidating the explanations and definitions into Part One because what constitutes an NAIC Designation is a fundamental policy of the Task Force. The revised amendments tried to clarify the meaning of an NAIC Designation, including their use, purpose, and the risks addressed while still maintaining the core regulatory objective. The latest round of revisions considered the feedback received, and the SVO believes that with certain tailored revisions to the current proposal, it is hopefully close to a final definition.

Perlman touched briefly on one of the larger themes in the letters before allowing interested parties to summarize their comments. He said there is a concern with the long-existing regulatory assumption contained in the definition that the issuer of a fixed income instrument should, under the terms of the instrument, be required to make scheduled interest and principal payments, and any terms inconsistent with that assumption could indicate other non-payment risks, which could be reflected in the Designation. Some interested parties contend that an NAIC Designation should only reflect the contractual terms of the investment. They explain that with the implementation of the Principles-Based Bond Definition in 2025, other non-payment risks contained in the contractual terms that deviate from the principles of a bond will prevent those investments from qualifying as bonds eligible for Schedule D. However, the SVO can assess and assign NAIC Designations to investments regardless of which Schedule they are on. With the implementation of the Principles-Based Bond Definition, the SVO expects investments to move from Schedule D to Schedule BA, and the SVO needs the ability to reflect these other risks to payment in the NAIC Designation. Therefore, it is important that the definition specify that a contractual provision inconsistent with the regulatory assumption may be reflected in an NAIC Designation if it is determined to impact the likelihood of principal and/or interest default. For example, the contractual ability to pay in kind (PIK) for a long period would not impact an NAIC Designation in and of itself. Rather, using or consistently using the PIK feature could indicate credit deterioration. Additionally, the SVO will share with state insurance regulators those securities with contractual terms inconsistent with the regulatory assumption, whether the SVO adjusts a Designation to reflect the risk.

As the SVO works through a further revised amendment, it will include some of the suggestions provided by interested parties and come back with a final proposal before the Summer National Meeting.

Mears said the intent of this definition is to be a foundational component within the P&P Manual. There are no actionable items, as this is just policy providing guidance for that foundation. For example, saying that it can consider tail risk, at the point where that is appropriate, the discussions on how it works would occur, particularly when working with the risk-based capital (RBC) groups in terms of what their needs are for the NAIC designations that are utilized. As a reminder, this is that foundational piece. Any P&P Manual amendment guidance related to these policies and actions to be taken would be a different concept that would take place at some other point in time.

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The Task Force received three comment letters from interested parties.

Mike Reis (Northwestern Mutual, representing the American Council of Life Insurers [ACLI], the Private Placement Investors Association [PPIA], and the North American Securities Valuation Association [NASVA]) said that this has been worked on for quite a while and the collaborative approach is appreciated. Given some of the discussions since the letter was submitted, the Task Force and SVO have a role in the ability to assess claims and assess credit. At times, there is uncertainty commingling the ability to pay claims more broadly within an NAIC Designation, similar to PIKs, so that the Life Actuarial (A) Task Force could assess the ability to pay claims like the Financial Condition (E) Committee framework that is looking to expand the role of the SVO to assess the ability to pay claims. The concern in the letter is the commingling of those two.

John Garrison (Lease-Backed Securities Working Group) said the main point of the letter was to point out how much confusion is being caused by the term “other non-payment risk,” which is an oxymoron to the extent that anything that is spelled out in the contract should not be referred to as a non-payment. This is evidenced by the many comments addressing the concept of non-payment risk. As this progresses, it would be great to clarify by calling it payment risk or variable payment types. This is not part of a credit analysis since credit is defined as the ability of the obligor to honor the terms of the contract. The effort to simplify the definition by not having it be in various parts of the manual is supported.

Christopher Anderson (Anderson Insights) said this risk is real and has been addressed systematically and carefully over the years by the Statutory Accounting Principles (E) Working Group. There are instances (pointed out in the staff memorandum) where highly rated credits might not be paid. The question is how that is best operationalized. Specifically, there are hundreds of thousands of securities/bonds that insurers own, and 10,000–15,000 of them are designated by the SVO. The SVO will not review an overwhelming majority of securities. Putting this language in the P&P Manual to add this requirement is much less efficient than what was already done by the Working Group since the Working Group requirements apply universally. These requirements would be operationally effective for the 10,000–15,000 the SVO looks at. Regarding Perlman's comment as to why it is necessary for this to be part of consideration for items moving to Schedule BA, something that has been determined to not be a bond would be subject to its own kind of analysis. That is apart from what needs to be considered in the definition of bonds to be reviewed.

Mears said that, currently, there is not an updated definition. The intent is to take feedback from the comment letters and what was heard today and work amongst the groups to create a proposed final definition after working with interested parties, which would include some of the simplifications discussed today and address the confusion around another non-payment risk.

If the Task Force does not object, the SVO is directed to continue to work with interested parties and the Task Force on a revised draft of the amendment, incorporating certain suggestions in place. Once completed, the Task Force will expose the updated draft at a future interim meeting for a 30-day public comment period, with the goal of considering it again at the Summer National Meeting.

### 3. Discussed Comments on a Revised Proposed Amendment to the P&P Manual Authorizing the Procedures for the SVO's Discretion Over NAIC Designations Assigned Through the FE Process

Mears said the next item on the agenda is to receive and discuss comments on a revised proposed P&P Manual amendment that would authorize the procedures for the SVO's discretion over NAIC Designations assigned through the filing exemption (FE) process.

## Draft Pending Adoption

The Task Force received many comments on the SVO's initial proposal. The SVO staff took those recommendations and incorporated many of them into this revised proposal exposed at the 2023 Fall National Meeting. Several comments were received on the revised proposal, so there is no final proposal to be exposed today. The Task Force wants to ensure that the comments are fully considered and plans for further time for regulatory review of those comment letters. However, two documents include feedback on comments received to date. The first document, for items that the Task Force considered, discussed, and deliberated at prior meetings, relates to the thematic feedback seen in the letters. The second document includes SVO staff recommendations to state insurance regulators regarding comments received that will require further review, which SVO staff will also go through.

It is incredibly important to remember that NAIC Designations ultimately fall under the purview of state insurance regulators and are used solely within the insurance regulatory framework; they are not ratings. Credit rating providers (CRPs) provide an invaluable service given the number of securities and efficiencies gained by the NAIC in using rating agency ratings to assign NAIC Designations. There is no intention of displacing or competing with rating agencies. However, because of how the NAIC uses CRP ratings in its processes, this is not an unconditional usage. This proposal is specific to how state insurance regulators, as responsible consumers of rating agency ratings for regulatory purposes, choose to use them in that regulatory process. It also empowers the SVO staff to take action through a well-defined process, when necessary, as a centralized source of investment expertise supporting the state regulators in this responsibility with the NAIC regulatory oversight that is put forth in the document to date.

There were some comments received on issues the Task Force had previously deliberated that are worth addressing up front, as noted in Attachment Two.

One of the questions relevant throughout many of the comment letters is the level of transparency that the insurer would receive if they were to have a rating that was challenged.

- The insurers impacted will have full transparency into the SVO analysis and rationale. In confidential discussions with insurers who are investors in the transaction and have been authorized by the issuer and rating agency to receive confidential information and share it with state insurance regulators. The SVO will provide more specific information about the issuer and share issues or concerns with the rating agency rating. State insurance regulators strongly agree that the transparency of insurers impacted is key, and they will have that full transparency. As noted in the responses, state insurance regulators will consider comments regarding the various forms that this transparent communication can take.
- The SVO is not a rating agency and, therefore, often relies upon the methodologies of rating agencies, as permitted by the Task Force in the "Use of Generally Accepted Techniques or Methodologies." The SVO considers multiple methodologies when it reviews a security and will use the one or combinations of methodologies that it believes will produce a reasonable assessment of risk for regulatory purposes. Because the SVO relies upon the methodologies of other entities, it does not publish its own except in rare cases where defined methodologies have been put in place. It is very important to stress that the use of a particular methodology from a rating agency should not be construed as validation of one CRP over another; it is simply a starting point for analysis.
- The SVO highlighted several observable factors in the proposal that it will consider to initially identify a potential issue and the possible need for closer scrutiny. When it performs its full review, the SVO will apply the methodology or combination of methodologies that it believes will produce a

## Draft Pending Adoption

reasonable assessment of investment risk as permitted under the “Use of Generally Accepted Techniques or Methodologies.”

- State insurance regulators retain all oversight and authority, and there is an explicit step for regulatory approval, including the involvement of the domiciliary regulator. Additional clarifying language may be added to this step to remove any perception of lack of authority. Domiciliary regulators retain final rights over impact to any individual insurer, subject to broader accreditation standards, as we want to ensure that there is still consistency in the way that designations are used. The Task Force does not want to end up in an instance where two different insurers and two states that owned the same bond would have different designations. Through a well-defined process, that kind of situation can be avoided.
- The SVO has been assigned certain responsibilities pursuant to the instructions published in the P&P Manual and does not have a financial interest in the outcome of its financial risk analysis. The proposal balances the SVO’s role as the state insurance regulators’ independent investment expertise and the regulators’ ultimate oversight of domiciliary insurers. State insurance regulators will review suggestions for various approval checkpoints laid out in some of the comment letters; however, this will be balanced against additional bureaucratic steps that do not add value to this further analysis. The Task Force will discuss those issues and consider where there is value in those additional components of approval checkpoints.
- As stated during prior national meetings, it is not an objective of this proposal to address concerns with an asset class or broader investment themes. The FE discretion proposal requires the SVO to discuss any recurring patterns it sees with the Task Force chair to determine the appropriate next steps. That aligns with what has been done over the past several years. The approach that has been taken when issues have been identified that call into question a full asset class or category of investments is to discuss them, address them, and find a path forward. This discretion proposal is to ensure that an entire asset class is not tainted when there are individualized issues in place. The FE discretion amendment is not intended to address asset classes or security structures.
- The proposal is intended to cover all securities with NAIC Designations produced through the translation of a CRP rating (whether through FE or private letter ruling [PLR]) as a fundamental control supporting the use of CRPs in the production of NAIC Designations.
- The proposal explicitly provides for the identification and notification to insurers of securities under review through a new SVO analytical department symbol, “UR,” which would mean the NAIC Designation assigned pursuant to the FE process is under review by the Investment Analysis Office (IAO). This symbol will be provided to insurers through the NAIC’s AVS+ application along with all other NAIC Designations and SVO Analytical Department Symbols. Additionally, the NAIC’s VISION application will notify insurers with the subject security in their portfolio that an information request has been initiated. This component will take time to implement, and the SVO will talk through some of the timing aspects. If adopted today, it would not go into place tomorrow.
- The three-notch threshold for materiality was chosen because moving three notches across NAIC Designation categories would result in an approximately 100% change in the pre-tax RBC factor for a life insurer, with some intervals being a significantly higher percentage change. This is an adequate measure of materiality.



## Draft Pending Adoption

- The FE discretion proposal is complimentary to the holistic investment framework being discussed by the Financial Condition (E) Committee and will still be needed when it is implemented. The investment framework also highlights that the reasonable assessment of insurer investment risk is a valuable use of NAIC resources and fundamental to prudential regulation.
- The SVO has no intention of reviewing every security that uses a rating agency rating in the assignment of an NAIC Designation. Currently, when the SVO or state insurance regulator encounters a security with a rating that looks anomalous, neither the SVO nor any NAIC member has the ability under existing NAIC guidance to address it in a defined and methodical manner. The FE discretion proposal would authorize the SVO to follow the process steps outlined in the proposal and, at the conclusion of that process, potentially remove the anomalous rating from the FE process. The SVO staff have no conflicts of interest or financial interests in the outcome of this process. Its only objective is the reasonable assessment of investment risk for NAIC members.
- The SVO is not a regulator. However, the members of the NAIC are prudential insurance regulators within their respective jurisdictions. The SVO has been assigned certain responsibilities pursuant to instructions published in the P&P Manual that were adopted by the Valuation of Securities (E) Task Force, Financial Condition (E) Committee, the Plenary, the chief insurance regulators of the 50 states, DC, and five U.S. territories. If adopted by the Plenary, the recommendations become NAIC policy, reflecting national regulatory consensus and serving as guidance to state insurance departments and state legislatures.
- NAIC Designations and other analytical products of the SVO and Structured Securities Group (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.

Mears asked Charles Therriault (NAIC) to review some of the other key comments received for regulatory consideration on the updated process proposal and the SVO's recommendations.

Therriault said there was a recommendation from a Task Force member that Part One of the P&P Manual related to the "Policies Applicable to the Filing Exemption (FE) Process," in paragraph 80, titled "Determinations" be slightly modified with an insertion to identify the use of credit ratings must consider the efficient use of regulatory resources. The first sentence would be revised to read: "The VOS/TF is resolved that the benefit obtained from the use of credit ratings in state regulation of insurance [this would be the inserted text between the parenthesis, open parenthesis] (i.e., most efficient use of regulatory resources) [close parenthesis] must be balanced against the risk of blind reliance on credit ratings."

There was a question regarding the reference to more than one rating having a three or more notch difference for a given security in the proposal. The plural reference was intentional as there are eight CRPs now and 10 nationally recognized statistical rating organizations (NRSROs), with the additional two potentially becoming a CRP at sometime, and any one of them could potentially provide a rating. It is possible that the SVO could see more than one rating on a security that it believes may not reflect its risk. While this scenario is unlikely, it would be an inefficient use of NAIC resources to hold more than one review of the same security. To the extent the SVO sees the situation, it would communicate that more than one rating is being reviewed to the impacted insurers and would also notify the Task Force.

There was a question about what should happen if a CRP rating was removed near year-end. At that point in the process outlined and likely revisions, the security would have gone through a full review by the SVO and the Task Force's subgroup. If there is no alternate CRP rating for the security, the SVO recommends the

## Draft Pending Adoption

removal of the CRP rating that was under review and the use of the SVO-determined NAIC Designation for year-end reporting. Any future action that may or may not occur at the conclusion of any appeal process, if one is requested, would be taken when such a decision was made. Likewise, if an alternate CRP rating was subsequently received, it would naturally be incorporated into the FE process.

There was a request that industry be permitted to attend the Task Force's subgroup meeting when hearing the SVO senior credit committee assessment. Consistent with the existing appeal process, if insurers request it, they can present their position and analysis along with supporting information to the SVO credit committee and, in this process, the Task Force's subgroup. The impacted insurers would be involved throughout this process, and it would be up to those insurers to decide how involved they wish to be. As it occurs in the existing appeals process, the insurers could include other parties during their presentation that are permitted access to the material being presented. At the conclusion of the insurer presentation, the SVO senior credit committee and Task Force's subgroup would deliberate in private, just as the credit committee does today during an appeal. This procedural clarification can be added to the amendment. The SVO recommends changing the reference from "SVO senior credit committee" to "SVO credit committee" to be consistent with other references in the P&P Manual.

There was a suggestion to post a generic public notice about the security when the security is put under review. The amendment contemplates posting the public anonymized summary of the analytical issue or concern only after the final decision has been made. Anything prior to that decision would be inappropriate to post publicly and would likely have an unnecessary negative impact on the market before any decision had been made. The SVO does not recommend publicly publishing anything other than an anonymized summary. The anonymized summary of the analytical issue should provide insurers and others with sufficient information to understand the core issues.

One comment letter requested that the independent third party adjudicate the decision of the SVO senior credit committee and Task Force's subgroup be replaced by the option to receive an additional CRP rating that would go through the existing FE process. The SVO agrees that engaging an independent third party to adjudicate these decisions would be challenging. The SVO would welcome more ratings in the FE process, but requiring multiple ratings on a single security in the FE process is beyond the scope of this proposal. The proposal provided an alternate rating, and there should be sufficient time for an alternate rating to be submitted. Assuming the additional CRP rating(s) is less than three notches different from the SVO's assessment, the SVO would recommend proceeding with the removal of the exception rating and permitting FE to proceed as normal with the alternate rating(s). The reason for continuing with the removal of the exception rating is to avoid being in this same situation if the alternate rating(s) are withdrawn. This will be discussed further with the state insurance regulators.

There was a recommendation that a summary of ratings discretion actions be publicly reported at each national meeting. The SVO recommends the proposal's existing summary at each Spring National Meeting be maintained. The SVO already provides the Task Force with a public report at that meeting, including today's, of the filings for the prior year, as required by Part Two of the P&P Manual in the guidance for the "Year-end Carry Over Procedure" and the ratings discretion actions would be made part of that report. The SVO will already publish on a public webpage an anonymized summary of the analytical issue or concern related to a ratings discretion action, which negates the need for any additional reporting as the information will already be publicly available. There will also be identified symbols in the AVS+ platform that insurers will have access to.

There are several other procedural suggestions throughout comment letters. The SVO staff did not provide recommendations for each suggested procedural comment. The SVO will work through comments individually

## Draft Pending Adoption

with state insurance regulators to produce a final draft of the proposal. There can be a few minor adjustments to the proposed process, but overall, it is fair, reasonable, sufficiently transparent, and provides the appropriate level of due process.

Mears said that there is no updated draft. The Task Force anticipates taking the comments that have been received, along with staff's recommendations and working in a regulatory environment, to go through each of those individually and ensure the final draft proposal incorporates those that are reasonable additions to the process.

Cotrone asked if the goal of updating the draft would be for the Summer or Fall National Meeting. Mears said the Task Force has a regulator-to-regulator meeting scheduled in May for state insurance regulators to go through the comments. Shortly after that meeting, there should be a draft that can be exposed for a 30-day comment period to get feedback from interested parties, which would position this for the Summer National Meeting.

Michael Reis (Northwestern Mutual) said the collaborative process is appreciated. Many of the comments were thoughtfully discussed and reflected. Especially the ability to weigh in if two ratings were three notches below and to have the regulatory committee hear the other side of the story.

Joe Engelhard (Alternative Credit Council—ACC) said there were two principal concerns. One is about the negative market impact, as well as concerns about the due process. He said that it is very good to hear comments that this is being taken seriously and that he looks forward to being able to comment on the third round.

Christopher Anderson had two suggestions. One concerns screening, and the other concerns the decision that will need to be made about whether a rating is appropriate or inappropriate. The first thing to bear in mind is the task of identifying credit rating agencies that give unreliable ratings. That is a significant task, as there are eight of them. They rate many different ratings and asset types. If you are to conclude that a rating agency is not qualified to rate a certain type of asset, then it seems that a number of trials and tests are conducted to make that determination. The screening is important, and Anderson Insights suggests that a screening tool be implemented that will look at the history and performance of ratings from rating agencies. That is available from the U.S. Securities and Exchange Commission (SEC), and it is under the administration of the SEC, which may or may not be sufficient for the NAIC. It should identify ratings that are not durable and that go down over time. The data should be mined, and additional data should be combined with the SEC data. It may require AI and further analysis. It will streamline the process because if you cast a net looking for assets with high yields, you will find mis-rated securities, but you will also find any other securities in that net. Screening is very important, and using technology to accomplish it would be beneficial. The second recommendation is to “try before you buy” or road test the procedure before the Summer National Meeting. Is the SVO decision about what a credit rating is correct, or is the rating agency's decision, as represented by an insurance company, correct? It is possible the SVO has rating methodologies, it's been submitted for a long time. The SVO can identify some of the methodologies it would like to explore. It would be very possible, and there is precedent for state insurance regulators to require insurers to file. That kind of inquiry can occur in private, where the insurer is stating the case of the rating agency and where the SVO is stating its case, and sooner or later, someone is going to have to decide. It will be difficult, but having a dry run before the Summer National Meeting will improve the process. Regarding improving screening and testing, doing a dry run of how state insurance regulators' decide this will be completed.

Michael Consedine (Athene) stated that in Athene's letter, Athene remains very supportive of a challenge right that addresses outlier ratings. The challenge rate will help achieve the investment framework's goal of

## Draft Pending Adoption

improving due diligence over rating agencies while preserving the important role that credible rating agencies play in the process. The letter offered a few suggestions and observations. First, the SVO discretion should, as it is intended, be used only to eliminate outlier ratings and not provide commentary or perspectives on asset classes or structures. Second, emphasize the importance of transparency, which has been excellent through this process, in candor, to a healthy regulatory environment that the NAIC represents. To that end, it is recommended that the SVO develop a process to ensure consistent assessment methods and challenges and that it is transparent with participants and rating agencies. Also recommended is the continued improvement of communication protocols, as markets generally adjust to regulatory objective concerns when they are fully understood. Finally, as with any new regulatory tool, changes and improvements may be needed over time. Therefore, it is recommended that the Task Force and the SVO conduct an annual review of the challenge right to allow for further adjustments as needed. The opportunity to comment is appreciated, and Athene is committed to supporting this workstream going forward.

Eric Mandelbaum (Egan-Jones Ratings Company) said many of the comments in the letter speak for themselves and were also addressed in the comments made in the beginning and in other comment letters. Because of some of the potential unintended consequences in the market, and there have been a lot of comments about the market impact, consideration should be given to the role of the SVO and whether there must be a separation between the policymaking arm and the analytical arm to give more comfort to the market. That is one of the main proposals in the comment letter that has not been addressed.

Mears said that would be part of the investment framework discussion and important for state insurance regulators to consider.

Kathy Belfi (KB Regulatory Solutions) said KB Regulatory Solutions supports the proposal and thinks it has been a collaborative and interactive process. At the opening ceremony, Commissioner Mais talked about one of the major NAIC initiatives, which is the broader initiative for the modernization of the SVO office. The only concern is that when the NAIC goes through this process, which will go forward, there may be an overlap with that greater or broader process. There must be collaboration between the two processes.

Thomas R. Sullivan (Sullivan Strategy and Advisory Services) said robust competition amongst the CRPs needs to be encouraged: narrowing competition and favoring one or two CRPs over the others would be a concern. Domestic regulator involvement needs to be stressed, which was acknowledged. The first version of the proposal said almost nothing about domestic regulator involvement. The second version got slightly better. It is hoped that the third version would vehemently acknowledge the necessity of the domestic regulator driving the process. Secondly, there needs to be a transparent review and appeal process, as mentioned by Christopher Anderson and others. In a previous meeting, a Texas state regulator mentioned that if we hold everyone else to a transparency standard, then this institution also needs to be transparent. Sullivan said that Sullivan Strategy encourages continued transparency in everything involving this process. It is comforting that the proposal is being reviewed methodically here and now and that there is a third version.

The most significant part of the comment letter is the suggestion that there be an independent auditor or third party around the entirety of this process. Those sitting here continue to have unease about where this is headed. It is unknown how many securities will be involved and how broad this effort will be once it is expanded, and there needs to be reassurance that this does not take on a life of its own. Therefore, it is recommended that some kind of third party produce a report or give some type of attestation to let everyone know that this is a well-governed and well-managed process. The duties and rights of the state insurance regulator are understood, and this is not trying to get in the way of that. Numbers have been tossed around saying that it is only going to be a few times or rarely. These concerns can be assuaged by introducing some level of audit or independent third-party review over the process. While the stated intent and direction of the

## Draft Pending Adoption

Financial Condition (E) Committee's holistic framework is appreciated, the work of the Committee and its subcommittees continues to meander down a somewhat disconnected path at times. That is not the case here, but there should continue to be close coordination between the groups. The broader initiative of the holistic approach is supported but only if the work of the committees is linked. The Financial Condition (E) Committee chair has said that this work is not going to stop. While everything cannot just freeze, that does not mean it cannot be well-coordinated.

Garrison appreciated the initial comments about transparency leading this off, which has been the focus of the Lease-Based Securities Working Group's comments. Regarding the "anonymized" summary that has been mentioned, it might be helpful for the market, in general, to understand where the SVO or the IAO is coming from, but from the investor's point of view and the security (the holders of security), basic fairness requires that those people be able to see the full analysis produced by the SVO, hopefully in writing. Without that, they are at a disadvantage in making any presentations to either the Senior SVO Credit Committee or the Task Force's subgroup. There is no reason why that cannot be the case since any confidentiality concerns could certainly be addressed with a confidentiality agreement. As pointed out in the letter, the SVO's regulatory treatment analysis service (RTAS) already has a very fulsome application process with pages of terms and conditions. There would be no liability on the part of the SVO, which is important. If the ultimate decision is that nothing is produced in writing for the investors, language was suggested in the letter to be inserted somewhere in the process that would say, "...the IAO agrees to cooperate fully with the holders of the security and share its full analysis, including what data was examined, what assumptions were made, what methodologies were used in the analysis, and what specific flaws or omissions were found in the CRP analysis." That language should be unobjectionable.

Mears said state insurance regulators will discuss that aspect as the Task Force considers updates.

Colleen Scheele (National Association of Mutual Insurance Companies—NAMIC) said NAMIC's main concern is the level of transparency that has been provided to the insurers who were going through the proposed process, but it will review the next draft and reach out to staff with any questions or suggestions.

Helen Remeza (PineBridge Investments) said that PineBridge Investments appreciates the Task Force's open and transparent process and the opportunity to comment on important issues such as SVO FE discretion. PineBridge is keen on supporting the Task Force by offering thoughtful comments and sharing its expertise in insurance asset management. It believes the submitted comment letter is self-explanatory.

Mears said the takeaway for state insurance regulators is to work through the comments that have been provided with some initial feedback and staff recommendations. Some of the Task Force members may reach out for clarification on some of the items in the comment letter, as those issues are considered. Expect to see an updated draft sometime after the Task Force's regulator-only meeting in May. The Task Force will work together on a revised amendment incorporating key suggestions and expose it for a 30-day public comment period at a future interim meeting.

#### 4. Discussed Comments on a Proposed Amendment to the P&P Manual to Add a Practical Expedient to Determine the Issued Date for PLR Filings

Therriault said the SVO has been unable to independently source the date attribute "Issue Date" (e.g., date of legal closing), which is a necessary input to determine the requirement to provide a PLR rationale report. The SVO proposed permitting it to apply a practical expedient by assuming that any security subject to the PLR guidance acquired on or after Jan. 1, 2022, and issued on or after Jan. 1, 2022, unless documentation showing an earlier issue date is provided. The joint comment letter from the ACLI, PPIA, and NASVA offered to work

## Draft Pending Adoption

with the SVO on this missing information. The SVO would be happy to work with the ACLI, PPIA, and NASVA on an operational process to resolve the missing data and report back to the Task Force with either an updated P&P Manual amendment or a recommendation to dispose of the current amendment. The SVO has also requested that CRPs also include issue date in their private rating data feeds.

Mears directed the SVO to work with interested parties to develop an operational process to add the required information, in this case issue date (e.g., date of the legal closing) and report back to the Task Force.

### 5. Exposed a Proposed P&P Manual Amendment to Update the U.S. Government Agency and Other U.S. Government Obligation Abbreviations

Linda Phelps (NAIC) said this is a technical amendment to the P&P Manual. As part of the implementation of the principals-based bond project, there were modifications to the annual statement blanks. As such, the SVO has identified abbreviations for various U.S. government agencies and other entities that will need to be modified for insurance company statement blanks reporting purposes to accommodate space limitations and eliminate conflicting abbreviations. The SVO recommends adoption of this proposed technical amendment in advance of the Jan. 1, 2025, implementation of the new statement blanks.

Mears directed the SVO to expose the proposed amendment to update U.S. government agency and other U.S. government obligation abbreviations for a 30-day public comment period ending April 17.

### 6. Exposed a Proposed P&P Manual Technical Amendment to Update References to P&P Manual SSAP Guidance for SCAs

Mears said the next item on the agenda is to hear about a proposed P&P Manual technical amendment to update references to the SSAPs in the guidance for subsidiary, controlled, and affiliated (SCA) and related party bonds or preferred stock investments.

Perlman said that at the end of 2022, the Task Force adopted amendments to the subsidiary, controlled, and affiliated (SCA) bonds section of the P&P Manual to more clearly define those investments, including those eligible or not for FE (specifically with regard to structured deals) and to include related party investments. Within the definition of an SCA and related party bond, we made specific reference to paragraph 4.a. in *Statement of Statutory Accounting Principles (SSAP) No. 43R—Loan-backed and Structured Securities* to help define which structured or loan-backed investments would qualify as an SCA or related party bond. Subsequent to the adoption of the P&P Manual amendment, SSAP No. 43R was amended; therefore, the paragraph reference in the P&P Manual is no longer accurate. Additionally, with the implementation of the principals-based bond definition, the paragraph will be changed again, and the name of SSAP No. 43R will be changed from “Loan-backed and Structured Securities” to “Asset-Backed Securities” on Jan. 1, 2025.

To avoid the need for additional P&P Manual updates due to potential future amendments to SSAP No. 43R, the SVO is proposing a technical amendment to: 1) remove that SSAP No. 43R paragraph-specific reference; and 2) to include a note that, as of Jan. 1, 2025, all P&P Manual references to SSAP No. 43R will be updated without any further action necessary by the Task Force to reflect SSAP No. 43R’s new name, “*SSAP No. 43R—Asset-Backed Securities*.”

Mears directed the SVO to expose the proposed technical amendment to update references to the SSAPs in the guidance for SCA and related party bonds or preferred stock Investments for a 30-day public comment period ending April 17.

## Draft Pending Adoption

### 7. Received the SVO's Annual Report on Year-End Carry Over Filings

Therriault said that, as required in Part Two, Operational and Administrative Instructions Applicable to the SVO, of the P&P Manual, the SVO director must prepare a report for the Spring National Meeting identifying an acceptable annual rate of carryover filings for the year-end reporting period. These carryover filings can be identified with the administrative symbols "IF," which are initial filings with a self-assigned NAIC Designation, and "YE," which are annual update filings the SVO has not yet reviewed and the NAIC Designation from the prior review was carried forward until the current year review is complete.

For 2023, the SVO reviewed 15,549 filings comprised of 3,893 initial filings, 11,257 annual updates, 12 appeals, 366 material changes, and 21 renumbering requests (e.g., Committee on Uniform Security Identification Procedures [CUSIP] changes). In comparison, in 2022, the SVO reviewed 12,983 filings comprised of 3,562 initial filings, 9,291 annual updates, 61 material changes, and 17 appeals. The total number of filings includes 3,879 manually processed PLR-related filings comprising 2,407 private ratings, 1,305 rationale reports not billed, and 167 rejected filings. In 2022, there were 1,961 manual processed PLRs.

There were also 1,262 carry-over filings for year-end 2023 versus 1,199 in 2022 and 828 in 2021. There were 312 that received "IF" for an accepted initial filing, and 950 received "YE" for an accepted annual update. This represented a carry-over rate for 2023 of 8.1%, which is slightly lower than the carry-over rate of 9.2%, but the volume was slightly higher. Generally, a carry-over rate of 10% or higher would be an indication that there is an analytical resource constraint issue for the SVO. At this point, we are not identifying one, but there is a lot of volume going into the SVO. As of March 13, there were 163 carry-over filings, which is an excellent job for the team.

The year-end carry-over rate does not provide any insight into the technology resource needs of the SVO team. The SVO has made some progress on its technology initiatives, which were either approved by the Task Force or initiated by the SVO. The foundational work to permit multiple security identifiers like International Securities Identification Numbers (ISINs) by using the S&P Global Ratings business entity cross reference service (BECRS) and global identifier cross reference service (GICRS) has been added, but full functionality is still in progress. There is some ability to allow analysts to match private rating rationale reports, but that work is ongoing. We are in the process of implementing multi-factor authentication for SVO applications to improve data security. Other initiatives have not begun, such as improving the efficiency of handling the documents received by insurers, improving overall filing efficiency, and completing rating history.

The SVO continues to see significant growth with privately rated securities. In 2020, there were 4,270 privately rated securities, and for year-end 2023, the preliminary indication from statement filings through March 12, there are now 8,152. That is a 20% increase from 2022 to 2023, with an additional 1,360 securities rated privately. The SVO will try to prepare a report for the Task Force with additional details on these changes.

Mike Monahan (ACLI) said that the ACLI appreciates that this is a written rather than an oral report and thanked the Task Force and staff for that.

### 8. Received Updates on the Proposed CLO Modeling Methodology and Ad Hoc Group

Mears said the next item on the agenda is to hear updates on the proposed collateralized loan obligation (CLO) modeling methodology and CLO ad hoc group.

Eric Kolchinsky (NAIC) said the SSG has been working diligently on the CLO methodology. The SSG has published detailed cash flows on our six representative deals for each of the 10 scenarios and received

## Draft Pending Adoption

excellent feedback from several parties on all sides of the issues. The SSG is planning and running a set of stress rounds on those tests.

In addition, the SSG has been working closely with the Academy's C1 Working Group and plans to provide them with data and stress runs based on their projects. However, the work has been slower than anticipated, and as mentioned at the Fall National Meeting, the SSG will exercise the "option" to extend the effective date to year-end 2025. This will require a P&P Manual amendment that will need to be exposed during an interim meeting and, hopefully, approved at the Summer National Meeting.

In addition, giving the SSG more time to perfect the methodology will allow better alignment with the approach of other NAIC workstreams, including the holistic framework and that of the Academy's work on RBC.

Mears said there has not been an ad hoc meeting in a while, but work has taken place behind the scenes. Kolchinsky said the SSG has gotten a lot of detailed feedback on the methodology and hopes to have an ad hoc meeting in three to four weeks.

### 9. Received a Report on Statutory Accounting Principles (E) Working Group Projects

Julie Gann (NAIC) highlighted a few investment-related items under the Working Group and Task Force coordination initiative. These are just a few of the items that were addressed, and all adoptions and exposures will be posted on the Working Group's website. First, it adopted *SSAP No. 21R—Other Admitted Assets*. It was the last SSAP revision needed to conclude the principles-based bond project. The revisions detailed the accounting and reporting for non-bond debt securities, as well as accounting and measurement guidance for residual interests. The effective date is Jan. 1, 2025, but the residual interest measurement guidance is available for early adoption for this year.

In addition to the conclusion of the SSAP revisions, the blanks revisions to Schedule D, splitting the bonds scheduled to D1-1 and D1-2, and all the other related items have already been adopted. The only piece left is Schedule BA, which is currently exposed and planned to be adopted in May. NAIC staff are working with the NAIC Education & Training Department to put together comprehensive training for the principles-based bond project. They hope it becomes available as soon as possible in 2024. That project is concluded effective one 2025.

The Working Group adopted revisions to *SSAP No. 93—Low-Income Housing Tax Credit Property Investments* and *SSAP No. 94R—Transferable and Non-Transferable State Tax Credits* for new guidance for tax credits. Fundamentally, all investments that predominately provide tax credits or other tax benefits will now fall within SSAP No. 93, regardless of the form of debt or equity, and they will all follow the proportional amortization method. This guidance is also effective Jan. 1, 2025, and the revisions to Schedule BA to rename the reporting lines and make some revisions should be exposed shortly after this national meeting. The last adoption item to highlight is that the Working Group adopted revisions to the interest maintenance reserve (IMR)/asset valuation reserve (AVR) annual statement instructions to clarify that all perpetual preferred stocks and mandatory convertible preferred stocks, regardless of their perpetual or redeemable, will go through the AVR. Those are always reported at fair value, regardless of the reported NAIC Designation.

The Working Group had about five exposures. The first has to do with debt issued from funds. This was a proposed revision to the adopted principles-based bond definition, where guidance specifies that debt issued from SEC-registered funds is an issuer credit obligation. The proposed revision is to make that more principles-based, so the SEC registration requirement would not necessarily have to be in place if the fund was an



## Draft Pending Adoption

operating entity. The Working Group re-exposed those items due to informal comments received at the application of that guidance, which was going to be broader than anticipated and perhaps include feeder funds. During the exposure, the Working Group is asking for feedback from industry on how to make sure that guidance is specific to the intent so it cannot be more broadly applied than intended.

The Working Group also exposed the concept agenda item proposing convergence of securities lending and repurchase agreement guidance. Right now, the Working Group is looking to work with industry, and it comes from a referral from the ACLI to the Life Risk-Based Capital (E) Working Group, which then referred to the Statutory Accounting Principles (E) Working Group.

The Working Group also exposed consistency revisions to SAAP No. 21R and a variety of other SSAPs to remove the residual guidance currently in SSAP No. 43R and *SSAP No. 48—Joint Ventures, Partnerships, and Limited Liability Companies* so that they all point to SSAP No. 21R, which will then house all the accounting and reporting guidance for those residual interests.

The Working Group exposed another conceptual agenda item for a new schedule that details the funds withheld and modco assets that would assist state insurance regulators in identifying which assets are on the financial statements that reflect the modco arrangements or funds withheld. It would also assist with the direct pull to those items in the RBC formula. Lastly, one more conceptual agenda item was the exposure for *SSAP No. 56—Separate Accounts* to provide guidance on how the accounting should occur for book value assets that are in separate accounts. Separate accounts guidance focuses on those items held at fair value, and we know there has been an uptick in the guidance of assets held at book value. This is to improve consistency in how those assets are reported in the separate account. The comment deadline for the exposures is May 31.

## Draft Pending Adoption

### 10. Discussed Other Matters

Mears said an overall investment framework is being discussed in the Financial Condition (E) Committee. There will be an opportunity for verbal comments on the outstanding exposure draft that closes in April. There are components in it that would impact the work of the Task Force. The Task Force is taking that into account and looking at what responsibilities it will be assigned to work holistically together as further efforts move forward at the Financial Condition (E) Committee.

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

[https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-03-16 NAIC Spring NM/Minutes/VOSTF\\_2024-03-16\\_Spring\\_NM\\_Minutes v5 \(FINAL\).docx](https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-03-16 NAIC Spring NM/Minutes/VOSTF_2024-03-16_Spring_NM_Minutes v5 (FINAL).docx)

## Draft Pending Adoption

Draft: 6/5/2024

Valuation of Securities (E) Task Force  
Virtual Meeting  
May 2, 2024

The Valuation of Securities (E) Task Force met May 2, 2024. The following Task Force members participated: Doug Ommen, Chair, represented by Carrie Mears (IA); Eric Dunning, Vice Chair, represented by Lindsay Crawford and Andrea Johnson (NE); Mark Fowler represented by Sheila Travis and Sanjeev Chaudhuri (AL); Lori K. Wing-Heier represented by David Phifer (AK); Ricardo Lara represented by Laura Clements (CA); Andrew N. Mais represented by Kenneth Cotrone (CT); Michael Yaworsky represented by Ray Spudeck (FL); Dana Popish Severinghaus represented by Ann Gillespie and Vincent Tsang (IL); Vicki Schmidt represented by Tish Becker (KS); Timothy J. Temple represented by Stewart Guerin (LA); Kathleen A. Birrane represented by Greg Ricci (MD); Gary D. Anderson represented by Rachel M. Davison and John Turchi (MA); Chlora Lindley-Myers represented by Debbie Doggett and Danielle Smith (MO); D.J. Bettencourt represented by Jennifer Li (NH); Justin Zimmerman represented by John Sirovetz (NJ); Adrienne A. Harris represented by Bob Kasinow (NY); Jon Godfread represented by Matt Fischer (ND); Judith L. French represented by Dale Bruggeman (OH); Glen Mulready represented by Alec Reid (OK); Michael Humphreys represented by Diana Sherman (PA); Cassie Brown represented by Amy Garcia and Rachel Hemphill (TX); Jon Pike represented by Malis Rasmussen (UT); Scott A. White represented by Doug Stolte and Greg Chew (VA); and Nathan Houdek represented by Amy Malm (WI).

### 1. Adopted a P&P Manual Amendment to Update U.S. Government Agency and Other U.S. Government Obligation Abbreviations

Mears said the first item is to consider for adoption the proposed *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) amendment to update the U.S. government agency and other U.S. government obligations abbreviations.

Linda Phelps (NAIC) said this is a technical amendment to the P&P Manual. As part of the implementation of the principles-based bond project, there were modifications to the annual statement blanks. As such, the Securities Valuation Office (SVO) has identified abbreviations for the U.S. government and other entities that will need to be modified for reporting purposes of insurance company statement blanks to accommodate space limitations and to eliminate conflicting abbreviations. The SVO recommends adoption of this proposed technical amendment in advance of the Jan. 1, 2025, implementation date of the new statement blanks. This was exposed for a 30-day public comment period ending April 17, and no comment letters were received.

Botsko asked if the change in abbreviations would roll over into the risk-based capital (RBC) instructions and/or any of the annual statement pages that would have to be amended as well. Charles Therriault (NAIC) said any of the line reporting comes from the RBC side and should not impact the line instructions at all. Botsko said he would look it over to double-check and get back to the Task Force.

Malm made a motion, seconded by Crawford, to adopt the P&P Manual amendment to update the U.S. government agency and other U.S. government obligations abbreviations. The motion passed unanimously.

### 2. Adopted a P&P Manual Amendment That Updates SSAP References for SCA, Related Party Bond, or Preferred Stock Investments

Marc Perlman (NAIC) said at the end of 2022, the Task Force adopted amendments to the subsidiary, controlled, and affiliated (SCA) section of the P&P Manual to more clearly define SCA investments, including

## Draft Pending Adoption

those that were eligible for filing exemptions (FEs), specifically with regards to structured deals, and also to include related party investments. Within the definitions of an SCA and related party bond, the Task Force made a specific reference to paragraph 4(a) in *SSAP No. 43R—Loan-Backed and Structured Securities* to help define which structured or loan-backed investments would qualify as an SCA or related party bond. Subsequent to the adoption of the P&P Manual amendment, SSAP No. 43R was amended, and the paragraph reference in the P&P Manual is no longer accurate. Additionally, with the implementation of the principles-based bond definition, the name of SSAP No. 43R will be changing from “Loan-Backed and Structured Securities” to “Asset-Backed Securities” on Jan. 1, 2025.

To avoid the need for additional P&P Manual updates due to potential future amendments to SSAP No. 43R, the SVO proposes a technical amendment to (i) remove that SSAP No. 43R paragraph-specific reference and (ii) include a note that says as of Jan. 1, 2025, all P&P Manual references to SSAP No. 43R will be updated without any further action necessary by the Task Force to reflect SSAP No. 43R’s new name, *SSAP No. 43—Asset-Backed Securities*.

The amendment was exposed for a 30-day public comment period that ended April 17, and no comment letters were received.

Spudeck made a motion, seconded by Sherman, to adopt the proposed technical amendment to the P&P Manual, which updates references in the SSAPs that address guidance for SCA, related party bond, or preferred stock investments. The motion passed unanimously.

### 3. Exposed a P&P Manual Amendment to Permit NAIC Designations for Short-Term ABS

Therriault said the Statutory Accounting Principles (E) Working Group adopted revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* in the *Accounting Practices & Procedures Manual (AP&P)* on Dec. 1, 2023. The revisions, which will be effective Jan. 1, 2025, further restrict investments that are permitted for cash equivalent or short-term investment reporting. Included in those revisions is an instruction that, regardless of the maturity date, certain investments are not permitted to be reported as cash equivalents and must be reported on the investment schedule that corresponds to the SSAP for which the investment is applicable. The revisions specifically refer to asset-backed securities (ABS) captured in the scope of SSAP No. 43R. The amendment proposes permitting the assignment of an NAIC designation to these investments if they are captured within the scope of the revised SSAP No. 43 and are eligible to be reported on the new ABS schedule D, part 1, sub-part 2. This is to align with the changes to SSAP No. 43 instructions.

Mike Reis (Northwestern Mutual representing the American Council of Life Insurers—ACLI and the North American Securities Valuation Association—NASVA) asked whether the only change, pursuant to the proposed amendment, would be related to P&P Manual, part 1, paragraph 128, “Short-Term Investments,” which says short-term investment are excluded from receiving an NAIC designation by the SVO, but ABS, with a maturity of less than one year, can be assigned an NAIC designation by the SVO and would be shown as a bond.

Therriault said there are no definitional changes, as the Task Force does not define a bond. The Task Force makes exceptions for investments with maturities of less than a year. This proposed amendment will permit the SVO to assign designations to short-term ABS if it follows the guidance in SSAP No. 43.

Mears directed the SVO to expose the P&P Manual amendment to permit NAIC designations for short-term ABS for a 30-day public comment period ending June 2.

### 4. Exposed a P&P Manual Amendment to Add Spain to the List of Foreign (Non-U.S.) Jurisdictions Eligible for Netting in Schedule DB, Part D, Section 1

## Draft Pending Adoption

Perlman said Banco Bilbao Vizcaya Argentaria, S.A., (BBVA), a bank organized under the laws of Spain, has requested the addition of Spain to the P&P Manual's list of jurisdictions eligible for counterparty close-out netting.

The purpose of identifying jurisdictions eligible for close-out netting is to permit the calculation of credit risk exposures to counterparties in Schedule DB, Part D, Section 1. The netting of offsetting liabilities with a counterparty will only be permitted in that schedule if there is a master agreement that provides for such netting and if there is adequate legal certainty that closeout netting would be enforced upon default of the counterparty. The P&P Manual provides for the addition of jurisdictions to those eligible for close-out netting if, in the SVO's opinion, legal opinions or other analyses provide adequate legal certainty that, upon default of the counterparty, close-out netting would be enforced.

In support of its application, BBVA submitted a legal opinion of the law firm Clifford Chance, S.L.P., on the validity and enforceability of close-out netting provisions under Spanish law. The opinion was commissioned by the International Swaps and Derivatives Association (ISDA), a private trade organization whose mission is to foster safe and efficient derivatives markets, in part through the development of standardized documentation. ISDA netting opinions are widely accepted by regulators around the globe, specifically by banking regulators.

Each of the netting opinions commissioned by ISDA, including the Spanish opinion, spell out various parameters, specific to the laws of the relevant jurisdiction, which a master agreement must meet to be consistent with the opinion. For example, according to the Spanish opinion, there are different requirements for netting enforceability depending on whether the insolvent Spanish counterparty is or is not a Spanish bank, credit institution, investment firm, or broker-dealer. It would be impracticable to expect the SVO to review all master agreements for compliance with the parameters delineated in the netting opinion for the relevant jurisdiction. Therefore, the SVO proposed amending the netting eligibility section of the P&P Manual to include a proviso that it is assumed that each master agreement complies with the parameters delineated in the netting opinion for the relevant jurisdiction.

Upon the SVO's review of the Spanish law opinion, the SVO believes it provides adequate legal certainty that closeout netting would be enforced (assuming that master agreement provisions are consistent with the parameters explained in the netting opinion). As such, the SVO proposes adding Spain to the list of jurisdictions eligible for counterparty exposure netting.

Mears directed the SVO to expose the P&P Manual amendment to add Spain to the List of Foreign (Non-U.S.) Jurisdictions Eligible for Netting for a 30-day comment period ending June 2, 2024.

### 5. Exposed a Proposed P&P Manual Amendment to Change the Effective Date for the Implementation of CLO Modeling

Therriault said at the 2024 NAIC Spring National Meeting the Structured Securities Group (SSG) requested a change to the effective date for the financial modeling of collateralized loan obligations (CLOs) to assign NAIC designations and designation categories to year-end 2025 from year-end 2024. The additional time will permit the SSG to improve the methodology and allow better alignment with the approach of other NAIC workstreams. The Task Force agreed to this change. This proposed non-substantive amendment reflects the changes necessary to provide notice in the P&P Manual of the implementation effective date change.

Mears directed the SVO to expose the proposed P&P Manual Amendment to change the effective date for implementing CLO modeling for a 30-day comment period ending June 2, 2024.

## Draft Pending Adoption

### 6. Exposed a Proposed P&P Manual Amendment to Clarify Permitting Insurers to Self-Assign an NAIC Designation 6\*

Therriault said the SVO was requested to review the instructions for insurers' self-assignment of an NAIC 6\* designation. An NAIC 6\* can be self-assigned by an insurer in lieu of reporting the obligation with appropriate documentation during instances where this type of documentation does not exist and the requirements for an insurance company to assign a 5.B GI are not met. An NAIC 6\* can also be self-assigned when the security is deemed to possess the credit characteristics of securities that are assigned an NAIC 6, meaning the obligation is in or near default and payment of interest, principal, or both is not being made or will not be made in accordance with the contractual agreement. This non-substantive P&P Manual amendment is not a change in policy but is intended to clarify the self-assignment instructions for insurers that use the NAIC designation of 6\*.

Mears directed the SVO to expose the proposed amendment to clarify permitting insurers' self-assigning as an NAIC 6\* designation for a 30-day public comment period ending June 2.

### 7. Exposed a P&P Manual Amendment to Update the List of SVO Processes

Perlman said the P&P Manual references several processes the SVO uses to identify information, entities, or securities for various lists, which are part of the SVO's Compilation and Publication of the SVO List of Investment Securities responsibilities. The SVO proposes updating this section of the P&P Manual to remove those processes that the SVO no longer undertakes (such as the exchange rate, ex-dividend, and surplus note processes) and insert processes the SVO does perform but are either missing or mislabeled (such as the Counterparties Designated by the SVO, funds and credit ratings eligible for transactions, Sovereign Designation Equivalent, and the replication synthetic asset transactions [RSAT] processes). Additionally, the SVO proposes revising the list name, "List of Counterparties Rated by the SVO," to "List of Counterparties Designated by the SVO," since the SVO produces designations that are distinct from rating agency ratings.

Mears directed the SVO to expose the proposed amendment to update the list of SVO processes for a 30-day public comment period ending June 2.

### 8. Received Updates on the Proposed CLO Modeling Methodology and Ad Hoc Group

Eric Kolchinsky (NAIC) said the SSG had a meeting with the CLO Ad Hoc Working Group, where it reviewed proposed scenarios and comments the SSG received from interested parties. They also discussed how the SSG assisted the American Academy of Actuaries (Academy) in its analysis of the Risk-Based Capital Investment Risk and Evaluation (E) Working Group. The SSG took away several tasks to complete from the CLO Ad Hoc Working Group, including a review of the provided suggestions. There is one detailed proposal from a third party, which the SSG will review. The SSG will also redo all the scenarios in its 2023 deals and post the updates online, as well as propose the scenario probabilities. One of the biggest takeaways was that interested parties did not feel like they could give the SSG feedback without those probabilities. So, SSG will provide the probabilities as a starting point. The SSG has continued to receive comments and will likely have the next CLO Ad Hoc Working Group meeting in late June. Kolchinsky said that everything is going quite well and proceeding at a good pace.

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

SharePoint/NAIC Support Staff Hub/ Committees/E CMTE/VOSTF/2024\_Summer/VOSTF\_2024-05-02\_Interim\_Minutes.docx

**Draft Pending Adoption**

## Draft Pending Adoption

Draft: 7/10/24

Valuation of Securities (E) Task Force  
Virtual Meeting  
June 18, 2024

The Valuation of Securities (E) Task Force met June 18, 2024. The following Task Force members participated: Doug Ommen, Chair, represented by Carrie Mears (IA); Eric Dunning, Vice Chair, represented by Lindsay Crawford and Andrea Johnson (NE); Ricardo Lara represented by Laura Clements (CA); Andrew N. Mais represented by Kenneth Cotrone (CT); Michael Yaworsky represented by Carolyn Morgan and Ray Spudeck (FL); Dean L. Cameron represented by Eric Fletcher (ID); Vicki Schmidt represented by Tish Becker (KS); Timothy J. Temple represented by Stewart Guerin (LA); Kevin P. Beagan represented by John Turchi (MA); Joy Y. Hatchette represented by Greg Ricci and Matt Kozak (MD); Grace Arnold represented by Fred Andersen (MN); Chlora Lindley-Myers represented by Debbie Doggett and Danielle Smith (MO); Jon Godfread represented by Matt Fischer (ND); D.J. Bettencourt represented by Jennifer Li (NH); Justin Zimmerman represented by John Sirovetz (NJ); Adrienne A. Harris represented by Bob Kasinow (NY); Judith L. French represented by Cameron Piatt (OH); Cassie Brown represented by Amy Garcia and Rachel Hemphill (TX); Jon Pike represented by Jake Garn (UT); Scott A. White represented by Doug Stolte and Greg Chew (VA); Mike Kreidler represented by Steve Drutz (WA); and Nathan Houdek represented by Amy Malm (WI).

### 1. Adopted a P&P Manual Amendment to Permit NAIC Designations for Short-Term ABS

Mears said the first five agenda items were exposed at the last Task Force meeting. These are all non-contested, meaning that either no comment letter was received, or the letter received expressed support for the amendment. The five amendments will be summarized and considered in one motion.

The first proposed amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) is to permit NAIC designations for short-term asset-backed securities (ABS).

Charles Therriault (NAIC) said the Statutory Accounting Principles (E) Working Group adopted revisions to *Statement of Statutory Accounting Principles (SSAP) No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* in the *Accounting Practices and Procedures Manual* (AP&P). The revisions, which will be effective Jan. 1, 2025, further restrict the investments that are permitted for cash equivalent or short-term investment reporting. Included in those revisions is an instruction that, regardless of the maturity date, certain investments are not permitted to be reported as cash equivalents and must be reported on the investment schedule that corresponds to the SSAP for which the investment is applicable. The revisions specifically refer to ABS captured in the scope of SSAP No. 43R. This amendment would permit the assignment of NAIC designations to these investments if they are captured within the scope of the revised SSAP No. 43—Asset-Backed Securities and are eligible to be reported on the new Asset-Backed Security Schedule D, Part 1, Sub-Part 2.

The amendment was exposed for a 30-day public comment period that ended on June 2, 2024. One joint comment letter was received from the American Council of Life Insurers (ACLI), the Private Placement Investors Association (PPIA), and the North American Securities Valuation Association (NASVA), which supported the amendment as drafted. The Securities Valuation Office (SVO) recommends the adoption of the amendment.

### 2. Adopted a P&P Manual Amendment to Add Spain to List of Jurisdictions Eligible for Counterparty Close-Out Netting



## Draft Pending Adoption

Mears said the next proposed P&P Manual amendment is to add Spain to the List of Foreign (Non-U.S.) Jurisdictions Eligible for Netting for Purposes of Determining Exposures to Counterparties for Schedule DB, Part D, Section 1.

Marc Perlman (NAIC) said Banco Bilbao Vizcaya Argentaria S.A. (BBVA), a bank organized under Spanish law, has requested that Spain be added to the P&P Manual's list of jurisdictions eligible for counterparty close-out netting.

The purpose of identifying jurisdictions eligible for close-out netting is to permit the calculation of credit risk exposures to counterparties in Schedule DB, Part D, Section 1. The netting of offsetting liabilities with a counterparty will only be permitted in that Schedule if there is a master agreement that provides for such netting and if there is adequate legal certainty that close-out netting would be enforced upon default of the counterparty. The P&P Manual provides for additions to the list of jurisdictions eligible for close-out netting if, in the SVO's opinion, legal opinions or other analysis provide adequate legal certainty that, upon default of the counterparty, close-out netting would be enforced.

In support of its application, BBVA submitted a legal opinion of the law firm Clifford Chance S.L.P. on the validity and enforceability of close-out netting provisions under Spanish law. The opinion was commissioned by the International Swaps and Derivatives Association (ISDA), a private trade organization whose mission is to foster safe and efficient derivatives markets, in part through the development of standardized documentation. ISDA netting opinions are widely accepted by regulators around the globe, specifically by banking regulators.

Each of the netting opinions commissioned by ISDA, including the Spanish opinion, spell out various parameters, specific to the laws of the relevant jurisdiction, which a master agreement must meet to be consistent with the opinion. It would be impracticable to expect the SVO to review all master agreements for compliance with the parameters delineated in the netting opinion for the relevant jurisdiction. Therefore, the proposed amendment updates the netting eligibility section of the P&P Manual to include a provision that it is assumed that each master agreement complies with the parameters delineated in the netting opinion for the relevant jurisdiction.

Upon review of the Spanish law opinion, the SVO thinks it provides adequate legal certainty that close-out netting would be enforced, assuming that master agreement provisions are consistent with the parameters explained in the netting opinion. As such, the SVO recommends adding Spain to the list of jurisdictions eligible for counterparty exposure netting.

The amendment was exposed for a 30-day public comment period that ended June 2. One joint comment letter was received from the ACLI, PPIA, and NASVA, supporting the amendment as drafted.

### 3. Adopted a P&P Manual Amendment to Change the Effective Date for the Implementation of CLO Modeling

Mears said the next proposed P&P Manual amendment is to change the effective date for the implementation of collateralized loan obligation (CLO) modeling.

Therriault said at the 2024 Spring National Meeting that the Structured Securities Group (SSG) requested a change to the effective date for the financial modeling of CLOs to assign NAIC designations and NAIC designation categories, moving it to year-end 2025 from year-end 2024. The Task Force agreed to this change. This proposed non-substantive amendment reflects the changes necessary to provide notice in the P&P Manual of the implementation effective date change.

## Draft Pending Adoption

The amendment was exposed for a 30-day public comment period that ended on June 2, 2024. One joint comment letter was received from the ACLI, PPIA, and NASVA, supporting the amendment as drafted. The SVO recommends the adoption of the proposed amendment.

### 4. Adopted a P&P Manual Amendment to Clarify Permitting Insurers to Self-Assign an NAIC Designation 6\*

Mears said the next proposed P&P Manual amendment is to clarify how insurers are permitted to self-assign as an NAIC designation 6\*.

Therriault said the SVO was requested to review the instructions for insurer self-assignment of the NAIC 6\* designation. An NAIC 6\* can be self-assigned by an insurer in lieu of reporting the obligation with appropriate documentation in instances where appropriate documentation does not exist, but the requirements for an insurance company to assign a 5.B GI are not met. An NAIC 6\* can also be self-assigned when the security is deemed to possess the credit characteristics of securities assigned an NAIC 6, meaning the obligation is in or near default.

He said this non-substantive P&P Manual amendment is not a change in policy and is only intended to clarify the instructions that allow insurers to self-assign using the NAIC designation of 6\*. The SVO welcomes observations like this from industry. If there is something about the P&P Manual that is unclear, it is important to draft clarifying amendments, he said.

The amendment was exposed for a 30-day public comment period that ended on June 2, 2024. One joint comment letter was received from the ACLI, PPIA, and NASVA, supporting the amendment as drafted. The SVO recommends adoption of the proposed amendment.

### 5. Adopted P&P Manual Amendment to Make the List of SVO Processes Current

Mears said the last of the five proposed P&P Manual amendments is to make the list of SVO processes current.

Perlman said the P&P Manual references several processes the SVO uses to identify information, entities, or securities for inclusion in various lists published as part of its Compilation and Publication of the SVO List of Investment Securities responsibilities. This amendment proposes updates to this section of the P&P Manual to remove those processes which the SVO no longer undertakes (such as the exchange rate, ex dividend, and surplus note processes) and insert the processes that the SVO does perform but are either missing or mislabeled (processes such as Counterparties Designated by the SVO, Funds, Credit Ratings Eligible for Transaction, Sovereign Designation Equivalent, and RSAT processes). Additionally, the SVO proposes revising the name of a list related to one of the SVO processes from "List of Counterparties Rated by the SVO," to "List of Counterparties Designated by the SVO," since the SVO produces designations that are distinct from rating agency ratings.

The amendment was exposed for a 30-day public comment period that ended on June 2, 2024. One joint comment letter was received from the ACLI, PPIA, and NASVA, supporting the amendment.

Clements made a motion, second by Spudeck, to adopt the following amendments: permit NAIC designations for short-term ABS; add Spain to the List of Foreign (Non-U.S.) Jurisdictions Eligible for Netting for Purposes of Determining Exposures to Counterparties for Schedule DB, Part D, Section 1; change the effective date for the implementation of CLO modeling; clarify how insurers are permitted to self-assign an NAIC designation 6\*; and make the list of SVO processes current. The motion passed unanimously.

### 6. Exposed a Revised Proposed P&P Manual Amendment to Update the Definition of an NAIC Designation

## Draft Pending Adoption

Mears said the next item is to receive and consider for exposure a revised proposed P&P Manual amendment to update the definition of an NAIC designation.

Perlman said as mentioned at previous meetings, NAIC designations are currently explained and defined in both parts One and Two of the P&P Manual. The SVO proposed consolidating the explanations and definitions into Part One because what constitutes an NAIC designation is a fundamental policy of the Task Force. This proposal has now gone through several iterations. At the 2023 Summer National Meeting, the Task Force discussed an initial draft of a proposed amendment. The Task Force directed the SVO staff to consider the feedback from Task Force members and interested parties and update the proposal. During and following the 2024 Spring National Meeting, the Task Force received additional comments on the updated amendment. The revised amendment reflects the actionable comments received from Task Force members and interested parties during each comment period.

1. The SVO created an even more concise definition of an NAIC designation that focuses on the likelihood that an insurer will receive full and timely principal and expected interest. This change is notable because it reflects a departure from the term “credit risk” which focuses on the ability of an issuer to make payments in accordance with contractual terms. Credit risk alone may, at times, be too narrow a concept for NAIC purposes. For example, the performance component of a principal protected security (PPS) may produce no return, and therefore, the PPS could pay no interest with no event of default by the issuer. As such, focusing solely on credit risk could limit the SVO’s ability to assess the risk of the performance component of a PPS. By looking instead at the likelihood of the insurer’s receipt of principal and expected interest, the SVO can account for the performance component in the PPS example. This definition allows the SVO to account for a variety of risks that may be present in both traditional and more complex bonds and particularly have designations that may be used outside of Schedule D bonds, such as those that don’t qualify for the upcoming bond definition or funds that may receive a designation. The use of investment risk is also consistent with the language used in the E Committee framework for investments.
2. It is worth highlighting, however, that for the purposes of assigning an NAIC designation, volatility/interest rate, prepayment, extension, and liquidity risks will remain expressly excluded from the definition.
3. The SVO revised the regulatory objective to clarify that an objective of the Task Force is to support regulators in the assessment of the financial ability of an insurer to maintain financial solvency.
4. The SVO removed reference to the currently stated regulatory assumption that debt instruments pay scheduled interest and principal at maturity.
5. The SVO removed the application of Subscript S for other non-payment risks and the concept of “other non-payment risks.” It has been noted that there are lingering references to Subscript S throughout the P&P Manual. If this amendment is adopted, the SVO will remove any remaining P&P Manual references to Subscript S in a subsequent amendment.

Mears said this definition provides a foundation for the role of a designation. The amendment does not, on its own, create any new policies or procedures. Any future changes to policies or procedures would go through a deliberative process as normal, if applicable. This is a foundational definition and not a procedure that is being put into place.

## Draft Pending Adoption

Christopher Anderson (Anderson Insights) said it is important to get this brief comment in the mix before the Summer National Meeting. Something that could be added to this proposal that would make it more useful is an implementation plan. This is a new risk measure that goes beyond credit risk. Credit risk is dealt with through ratings from rating agencies that are used by the NAIC. Secondly, the bond project addresses all kinds of issues, such as principal-protected securities and others. The question is if there are over 300,000 individual bonds owned by insurance companies, the NAIC has those numbers on a quarterly basis. Anderson asked how these standards will be applied to the securities that are outstanding. According to the budget, the SVO reviews about 10,000 securities. Most of those are annual updates. Less than 2,000 securities that the SVO reviews each year are new issues rather than annual updates. The SVO has 22 analysts, according to the latest posted numbers, and five supervisors. The rating agencies have over 5,000 analysts and supervisors, and they are doing credit. The SVO has been tasked with looking at over 8,000 private rating rationales. These 22 analysts have a burden. The question is, how this standard can, which is beyond credit risk, be applied to the broadest measure of debt instruments that are presently being owned by insurance companies. Given the numbers, there needs to be an implementation plan, he said.

Mears said some of the verbiage here may help because there is nothing to implement. This is representative of the policies and procedures the Task Force has today. One of the changes, including the investment risk, is to stay coordinated with the investment framework that has been put out via the Financial Condition (E) Committee and the role of the SVO in providing designations for assets. For example, if the asset fails the bond definition, it would no longer be on Schedule D, but the asset would, at least as it stands right now, be able to receive an NAIC designation on Schedule BA. How to utilize those NAIC designations will ultimately be defined by the risk-based capital (RBC) groups. What has been discussed is the expectation that Schedule BA types of assets may still receive bond-like capital treatment but only if there is an SVO-provided NAIC designation. For a PPS, which is the example here, the SVO will provide NAIC designations for those investments if the insurer chooses. The definition itself does not change anything. There is no implementation plan because there are no actions that would be taken directly in relation to the definition change.

Alan Routhenstein (Routhenstein & Company) asked if the Task Force received input from the Life Risk-Based Capital (E) Working Group or the Risk-Based Capital Investment Risk and Evaluation (E) Working Group on this change and how it would impact how they calculate RBC factors.

Mears said it would not impact how they calculate RBC factors. The Task Force remains responsive to the RBC groups. As the various RBC groups and the Capital Adequacy (E) Task Force consider these issues, which would include bonds on Schedule BA, they also have an agenda item that covers funds, which may result in feedback to the Task Force of what it would need to consider. Their goals would then be the policies and procedures that the Task Force would need to put in place. The Task Force stands ready to be reactive to the needs of the RBC groups. There are no changes or actions that come from this definition change.

Routhenstein said the RBC has a separate factor for interest rate risk from C1 risk, which is credit risk. C1 risk is based on the NAIC designation. The C3 risk is based on an interest rate scenario modeling. If NAIC designations are based on interest rate modeling, then there is some kind of redundancy that is built in.

Mears said these types of risks are explicitly excluded. Interest rate risk, prepayment risk, extension risk, and liquidity risk are not risks that fall under the NAIC designation definition. A component notes that tail risk was in a previous iteration of this. In response to industry comments, there is a caveat that the Task Force would coordinate with the RBC groups. The Task Force remains very cognizant of what the RBC needs are. For example, if the RBC groups incorporate some measure of tail risks in a capital charge, that would mean the Task Force would need to adjust what's being represented by the NAIC designation and be responsive with the intent to not double count anything.

## Draft Pending Adoption

Husain Bootwala (Guggenheim Partners LLC) said the definition changed from credit risk to investment risk, and the filing exempt (FE) process is based on the credit rating provider (CRP) ratings, which is a credit rating and a credit risk. He asked how that would work for the FE process.

Mears said it would not change anything. NAIC designations are not credit ratings. The NAIC uses credit ratings to inform NAIC designations where appropriate. For example, PPS are not part of the FE process because they incorporate risks that would need to be otherwise reviewed by the SVO, and that needs to be reflected differently based on regulatory needs and practices. That asset type was removed from the FE process for that reason. This would not mean that the NAIC expects the CRP ratings to be different regarding credit risk but recognizing that, in our case, NAIC designations may go beyond that. The SVO can provide an NAIC designation for certain funds that are held by insurers that have credit risk, but the NAIC designation is not necessarily directly tied to credit risk, as the SVO considers multiple components and has a methodology for that, including, for example, how derivatives are used for those purposes. This recognizes that the designation may be broader than credit risks but it's not changing anything that the Task Force expects from the credit rating providers.

Bootwala asked for confirmation that this would not have implications for the FE process as it currently stands. Mears said there are no policy or procedure changes coming out of the definition amendment. The definition is meant to be basic. If the Task Force identifies a certain asset class that should no longer qualify for FE, it would go through a deliberative process as it happens.

Mears directed the SVO to expose the P&P Manual amendment to update the definition of an NAIC Designation for a 28-day comment period that would end on July 18, 2024.

### 7. Exposed a Revised Proposed P&P Manual Amendment Authorizing the Procedures for the SVO's Discretion Over NAIC Designations Assigned Through the FE Process

Mears said the next item on the agenda is to receive and consider for exposure a revised proposed P&P Manual amendment for the SVO's discretion over NAIC designations assigned through the FE process.

Therriault said the SVO has worked hard to incorporate the comments received from the Task Force members and interested parties into the amendment. It is important to remember that this amendment originated from a request by the industry for a proposal allowing the SVO to target specific ratings it was concerned with instead of a broader proposal that would have removed a whole asset class from FE eligibility. The first iteration of the amendment was exposed for comment a little over a year ago on May 15, 2023. The second version was exposed for comment at the 2023 Fall National Meeting on Dec. 2, 2023, and now we have the third version, dated June 4, 2024, being discussed at this meeting. In response to regulator and industry comments, the complexity of the process has increased in each iteration. As outlined in the memo, the revised amendment incorporates the following process steps:

1. SVO staff or an insurance regulator identifies an FE security with an NAIC designation determined by a rating that appears to be an unreasonable assessment of investment risk.
2. The SVO Credit Committee (CC) meets to determine if it agrees that the rating appears to be an unreasonable assessment of investment risk and, if so, places the security "Under Review."
3. If the SVO CC votes to put the security "Under Review," an information request will be sent through VISION to insurers that hold that security in their VISION portfolio and their statutory financial statements to indicate ownership of the security, and the SVO Administrative Symbol "UR" will be assigned to the security to identify it in VISION and AVS+.
4. If the information request does not receive a response, the SVO may reach out to the domiciliary chief financial regulator.

### Draft Pending Adoption

5. Upon receipt of all necessary documentation through the information request, the SVO will then perform a full analysis of the security. During its review, the SVO will coordinate verbally and in writing with insurer staff authorized to discuss the security to ask questions and discuss issues the SVO may have about the security and also respond to any questions the authorized insurer staff may have about the SVO's analysis. This communication is intended to be an open dialogue.
6. The SVO CC reconvenes to determine, based on its full analysis of all necessary information, whether the FE NAIC designation is three (3) or more notches different than the SVO CC's opinion and, therefore, whether the SVO should proceed in requesting the removal of the CRP rating from the FE process by the subgroup of the Task Force.
7. If the SVO CC's decision is to proceed with the CRP rating removal request, the SVO CC and a subgroup of the Task Force will meet to discuss the security. The domiciliary regulators of the authorized insurers will be invited to the Task Force subgroup meeting and will be provided with relevant documentation through a confidential website. The authorized insurer staff and other authorized parties requested by those insurers to participate will be invited to present their analysis at the joint meeting. At that meeting, the SVO CC will present its analysis, which may include any information provided to it or independently sourced. Following the presentations, the SVO CC and Task Force subgroup will deliberate privately where the Task Force subgroup will vote on whether it agrees with the SVO CC recommendation and if the CRP rating will be removed from the FE process. At the conclusion of the joint meeting, the SVO will communicate the decision to the authorized insurers.
8. At any time during this process, an alternate CRP rating may be requested. If an alternative CRP rating is received, it will be incorporated into the FE process, if applicable. If there are no alternative CRP ratings, the SVO CC's assessment will be entered into VISION if the Task Force subgroup approves the CRP rating removal.
9. For transparency, an anonymized summary of each unique issue or situation will be published on the SVO webpage or another insurer-accessible location.
10. The SVO will identify through SVO Administrative Symbols when a CRP rating(s) has been removed from the FE process for a security.
11. At the Spring National Meeting, the SVO director will summarize FE discretion actions taken during the preceding year.

Throughout the proposed amendment, the Task Force also replaced references to "credit risk" with the term "investment risk" to make this proposal consistent with the Designation Definition proposal Perlman discussed, assuming that the proposal is adopted.

Additionally, based on regulator comments, the SVO recommends the following edits which will be included in the exposure:

1. In paragraph 168, regarding the exchange between the Investment Analysis Office (IAO) and insurers holding the security at the time of the IAO review, include the words "**verbally and in writing**," so that it reads, "At any time during the information request submission period or during the IAO's subsequent analysis of the security, the insurance company holders of the security are encouraged to provide additional information to the IAO such as their internal analysis, presentations from the issuer, meetings with the issuer's management team and any other information that may be useful or persuasive in the analysis of the security. The IAO will coordinate **verbally and in writing** with the authorized insurer(s) staff to discuss any questions or issues the IAO may have about the security and answer any question that the authorized insurer(s) staff may have about the IAO's analysis."
2. Amend the first sentence of paragraph 172 to remove the language "for so long as the VOS/TF chair deems such meetings necessary" so that the Valuation of Securities (E) Task Force subgroup is not at the discretion of the Task Force Chair. The sentence would then read, "The Credit Committee shall schedule a call with a VOS/TF Sub-Group (the composition of which shall be determined by the VOS/TF

## Draft Pending Adoption

chair) to discuss and explain its analytical basis for any Eligible NAIC CRP Credit Rating being recommended for removal from Filing Exemption eligibility.”

3. Paragraph 175 would be added to answer the question of what would happen if the Chair deemed the Task Force subgroup meetings unnecessary because the SVO did not think that would cause the IAO to lose its discretion authority. The SVO proposes removing the Chair’s sole discretion to not convene the subgroup and update paragraph 175 to give the Chair the discretion to direct the Task Force to review the IAO discretion process. The paragraph would read, “At any time, the VOS/TF chair may direct the VOS/TF to review the described process to ensure it remains effective and efficient and to recommend revisions to any components.”

Because of the complexity of the proposal, the SVO may need to charge fees to cover its cost, but any such charge would need to be approved by the NAIC Executive (EX) Committee. The SVO will work through these complexities during the implementation, and any issues will be brought back before the Task Force for discussion. It will likely take one or two years to implement the proposal. Once approved, the exact timing for implementation will depend on the capacity of the technology team to take on the project.

Mears said the points just made are direct edits to the document that will be exposed. She said that those who downloaded the materials for this meeting should use the updated document if they plan to make a comment.

Mears said there were some comments made in the last exposure that are not reflected in these changes. One was recommending a review of separating policy-making and implementation within the SVO and IAO. This will be reviewed as part of the Financial Condition (E) Committee framework process that is looking holistically at how regulators utilize the centralized investment expertise within the NAIC. Interested parties should look to that committee to provide further guidance and feedback as it goes through this process. There have been comments about ensuring there is oversight on the back end of the SVO, reviews of policy and procedures put in place, and the designation output of the SVO. Regulator oversight is built into this process through the Task Force subgroup approval and the related components of this process. Separately, the Financial Condition (E) Committee process will include a request for proposal (RFP) draft, which will be forthcoming, and is meant to answer the broader due diligence process over CRPs and how to implement it using a consultant. The Financial Condition (E) Committee is contemplating the assistance from that third party and building out an assessment process for the SVO and its output of designations. The Task Force noted this verbally and in writing in the last set of comments, but that would be part of the RFP process, too, and not just part of this proposed P&P Manual amendment, which is more narrowly described for that discretion piece. There will be further deliberation and consideration at the Financial Condition (E) Committee level. This exposure is specifically for the amendment to the P&P Manual for the SVO.

Cotrone said Connecticut supports the edited comments to be included in the updated proposal and asked when the exposure would be available on the website. Therriault said he hoped the edits would be available after the meeting or the following day.

Michael Reis (Northwestern Mutual Life Insurance Company) asked if the proposed edits would be tracked and asked for the paragraph number for reference. Perlman said “verbally and in writing” was added to paragraph 168, and paragraphs 172 and 175 were the other changes. The changes will be highlighted in yellow.

Piatt said paragraph 80 says, “the risk of blind reliance.” He said it may be better to change this to something like “overreliance” or “imprudent reliance” rather than “blind reliance.” Mears said that is consistent with the language that is part of the holistic overview of the Financial Condition (E) Committee to increase informed reliance. The Task Force could use something like “informed reliance” as well or try to use consistent language

## Draft Pending Adoption

with other initiatives. Therriault suggested that once the policy process for rating agency ratings is changed, that may be the time to revise this section to be consistent.

Mears said unlike the last exposure, which was for 30 days, the Task Force would like to give additional time for the exposure based on when materials for the Summer National Meeting need to be posted. July 26 would allow some time to get through those comments and make changes to the materials in time for the Summer National Meeting.

Mears directed the SVO to expose the P&P Manual amendment that gives the SVO discretion over NAIC designations assigned through the FE process for a 38-day comment period that would end on July 26, 2024.

### 8. Received Updates on the Proposed CLO Modeling Methodology and Ad Hoc Group

Mears said the next item on the agenda is to hear updates on the proposed CLO modeling methodology and CLO ad-hoc working group.

Eric Kolchinsky (NAIC) said the SSG is almost finished with the inventory of 2023 CLOs, both reported and the SSG's additions. The next step is to run 10 scenarios on the universe starting next week. There will be a webpage with the results that everyone can look at by the Summer National Meeting, which is when the SSG will provide the probabilities. The SSG is working with the American Academy of Actuaries (Academy) on the RBC for CLOs.

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

NAIC Support Staff Hub/Committees/E CMTE/VOSTF/Summer Natl Mtg/VOSTF\_2024-06-18\_Interim\_Meeting\_Minutes\_v3.docx



Draft: 7/23/24

## 2025<sup>4</sup> Proposed Charges

### VALUATION OF SECURITIES (E) TASK FORCE

The mission of the Valuation of Securities (E) Task Force is to provide regulatory leadership and expertise to establish and maintain all aspects of the NAIC's credit assessment process for insurer-owned securities, as well as produce insightful and actionable research and analysis regarding insurer investments.

#### Ongoing Support of NAIC Programs, Products or Services

##### 1. The Valuation of Securities (E) Task Force will:

- A. Review and monitor the operations of the NAIC Securities Valuation Office (SVO) and the NAIC Structured Securities Group (SSG) to ensure they continue to reflect regulatory objectives.
- B. Maintain and revise the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to provide solutions to investment-related regulatory issues for existing or anticipated investments.
- C. Monitor changes in accounting and reporting requirements resulting from the continuing maintenance of the *Accounting Practices and Procedures Manual*, as well as financial statement blanks and instructions, to ensure that the P&P Manual continues to reflect regulatory needs and objectives.
- D. Consider whether improvements should be suggested to the measurement, reporting and evaluation of invested assets by the NAIC as the result of: 1) newly identified types of invested assets; 2) newly identified investment risks within existing invested asset types; or 3) elevated concerns regarding previously identified investment risks.
- E. Identify potential improvements to the credit filing process, including formats and electronic system enhancements.
- F. Provide effective direction to the NAIC's mortgage-backed securities modeling firms and consultants.
- G. Coordinate with other NAIC working groups and task forces—including, but not limited to, the Capital Adequacy (E) Task Force, the Statutory Accounting Principles (E) Working Group, the Blanks (E) Working Group, **and the Risk-based Capital Investment Risk & Evaluation (E) Working Group, and the Valuation Analysis (E) Working Group**—to formulate recommendations and to make referrals to such other NAIC regulator groups to ensure expertise relative to investments, or the purpose and objective of guidance in the P&P Manual, is reflective in the guidance of such other groups and that the expertise of such other NAIC regulatory groups and the objectives of their guidance is reflected in the P&P Manual.
- H. Identify potential improvements to the filing exempt process (the use of credit rating provider ratings to determine an NAIC designation) to ensure greater consistency, uniformity and appropriateness to achieve the NAIC's financial solvency objectives.

- I. Implement policies to oversee the NAIC's staff administration of rating agency ratings used in NAIC processes, including staff's discretion over the applicability of their use in its administration of filing exemption.
- J. Establish criteria to permit staff's discretion over the assignment of NAIC designations for securities subject to the filing exempt process (the use of credit rating provider ratings to determine an NAIC designation) to ensure greater consistency, uniformity and appropriateness to achieve the NAIC's financial solvency objectives.
- K. Implement additional and alternative ways to measure and report investment risk.

NAIC Support Staff: Charles Therriault, Marc Perlman

[https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-08 Summer NM/02-Proposed 2025 Charges/2024-XXX.01 VOSTF\\_Proposed\\_2025\\_Charges.docx](https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-08 Summer NM/02-Proposed 2025 Charges/2024-XXX.01 VOSTF_Proposed_2025_Charges.docx)

SVO



**NAIC**  
NATIONAL ASSOCIATION OF  
INSURANCE COMMISSIONERS

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: Proposed Amendment to Update the Definition of an NAIC Designation in the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual)

DATE: June 4, 2024

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#### **Summary –**

NAIC Designations are currently explained and defined in both Parts One and Two of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual). The SVO proposes both consolidating these explanations and definitions in Part One only and clarifying the meaning of an NAIC Designation including their use, purpose and risks addressed.

When the new format for the P&P Manual was adopted on November 16, 2018, and published in the new format on April 7, 2019, several changes were made in an attempt to simplify the P&P Manual. It has since become apparent that some of those changes have led to the interpretation that there are two meanings of an NAIC Designation: one meaning, found in Part One, applicable to all securities, whether assigned NAIC Designations pursuant to the Filing Exemption process or by the Securities Valuation Office (“SVO”) and a second meaning, found in Part Two, applicable only to securities assigned NAIC Designations by the SVO. It is the SVO staff’s belief that there is only one definition of an NAIC Designation and that it is applicable however the NAIC Designation is assigned. To that end, the revisions proposed in this amendment have consolidated the instructions that define an NAIC Designation to make a single uniform definition and includes updates to the definition to address questions and concerns raised about the purpose of NAIC Designations versus credit rating provider ratings.

At the Summer National Meeting held on Aug. 14, 2023, the Task Force discussed an initial draft of a proposed amendment to the P&P Manual updating the definition of an NAIC Designation. The Task Force directed the SVO staff to consider the feedback from Task Force members and interested parties and update the proposal. During and following the March 16, 2024 Spring National Meeting the Task Force received additional comments on the updated amendment. The revised amendment in this

memorandum reflects the actionable comments received from Task Force members and interested parties during each comment period including:

1. Creation of a concise definition of an NAIC Designation which focuses on the likelihood that an insurer will receive full and timely principal and expected interest. This change reflects a departure from the term “credit risk” which focuses on the ability of an issuer to make payments in accordance with contractual terms. Credit risk alone may, at times, be too narrow a concept for NAIC purposes. For example, the performance component of a principal protected security (PPS) may produce no return and, therefore, the PPS could pay no interest with no event of default by the issuer. As such, focusing solely on credit risk could limit the SVO’s ability to assess the risk of the performance component of a principal protected security.
2. Revisions to the regulatory objective to clarify that an objective of the Task Force is to support regulators in the assessment of the financial ability of an insurer to maintain financial solvency.
3. Removal of the current regulatory assumption that debt instruments pay scheduled interest and principal at maturity.
4. Removal of the application of Subscript S for other non-payment risks and the concept of “other non-payment risks”. If this amendment is adopted, any remaining P&P Manual references to Subscript S would be removed in a subsequent amendment.

**Proposed Amendment** - The proposed text changes to the P&P Manual are shown below with additions in **red font color**, new text from the last presented iteration of the proposal and deletions in **red underline** and text deleted from the last presented iteration of the proposal in **red strikethrough**, as it would appear in the 2023 P&P Manual format. Editing notes have been added with [ ] to explain section moves.

**(VERSION WITH CHANGES DISPLAYED)**

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

## POLICIES PERTAINING TO SVO AND SSG OPERATIONS

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### ~~NAIC Designations~~

*[Editing note: select portions moved from Part One, paras. 37-39 to the new "NAIC Designations" section within Part One]*

~~37. The SVO's analysis of credit risk (hereafter defined), is expressed as an opinion of credit quality by assignment of an NAIC Designation that is notched to reflect the position of the specific liability in the issuer's capital structure. Collectively, NAIC Designations as defined in this Manual describe a credit quality risk gradation range from highest quality (least risk) to lowest quality (greatest risk). NAIC Designations express opinions about credit risk except when accompanied by the NAIC Designation subscript, described below.~~

- ~~▪ Credit risk is defined as the relative financial capability of an obligor to make the payments contractually promised to a lender. Credit analysis is performed solely for the purpose of designating the quality of an investment made by an insurance company so that the NAIC member's department of insurance can better identify regulatory treatment.~~
- ~~▪ Credit risk is assessed by analyzing the information and documentation provided to the SVO by the reporting insurance company and its advisors. The SVO does not audit the information submitted and assumes the information to be timely, accurate and reliable.~~
- ~~▪ The ability of an insurance company to realize payment on a financial obligation can be affected by factors not related to credit risk or by the manner in which the repayment promise has been structured.~~
- ~~▪ NAIC Designations do not measure other risks or factors that may affect repayment, such as volatility/interest rate, prepayment, extension or liquidity risk.~~
- ~~▪ An NAIC Designation 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.~~

~~38. The result of the SVO's credit analysis, expressed as an opinion of credit quality by assignment of an NAIC Designation shall be further expanded into NAIC Designation Categories as, and for the purposes, discussed in this Manual.~~

~~**NOTE:** See "Production of NAIC Designations" in Part Two.~~

### **Other Non-Payment Risk in Securities**

~~39. The result of the SVO's analysis of securities for other non-payment risk is expressed by the assignment of an NAIC Designation Subscript S and the application of the notching procedures described below.~~

~~NOTE: See "NAIC Designation Subscript S" and "SVO Notching Guidelines" in Part Two.~~

## NAIC DESIGNATIONS

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### NAIC DESIGNATIONS

#### Regulatory Objective

88. An objective of the VOS/TF is to support regulators in the assessment of the financial ability of an insurer to maintain financial solvency, pay claims through the making of policy concerning insurer investment risk and the identification and sharing of pertinent information with other relevant regulators and regulatory groups responsible for the NAIC's regulatory framework. ~~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. NAIC Designations are required to reflect such contractual modifications and quantify the possibility that such contracts will result in a diminution in payment to the insurer.~~

#### Definitions

89. NAIC Designations represent opinions of gradations credit quality of the likelihood of an insurer's timely receipt of an investment's full principal and expected interest. Where appropriate for a given investment, NAIC Designations and Designation Categories shall reflect "tail risk" and/or loss given default, ~~NAIC Designations and Designations Categories shall reflect the position of the specific liability in the issuer's capital structure, and other non-payment risks or non-payment mitigants. NAIC Designations do not measure and all other risks or factors that may affect repayment, such as, except for volatility/interest rate, prepayment, extension or liquidity risk. [Editing Note: moved from Part One, para. 37]~~ NAIC Designations shall be identified by the NAIC 1 through NAIC 6 symbols (as modified by NAIC Designation Categories) which indicate the highest quality (least risk) to the lowest quality (greatest risk), respectively, and which reflect the likelihood of timely and full payment of principal and scheduled periodic interest, in accordance with the regulatory objectives explained above, and the likelihood of principal and/or interest payment default.

#### Use and Purposes of NAIC Designations

90. **NAIC Designations** are proprietary symbols of the NAIC. The SVO, the SSG and, under certain circumstances, insurers, produce NAIC Designations for insurer-owned securities using the policies, procedures or methodologies adopted by the VOS/TF in this Manual.



*[Editing Note: Moved from Part Two, para. 18.]* The ~~credit~~ analysis is performed solely for the purpose of designating the quality of an investment made by an insurance company so that the NAIC member's department of insurance can better identify regulatory treatment. *[Editing Note: moved from Part One, para. 37]* Credit Investment risk is assessed by analyzing the information and documentation provided to the SVO by the reporting insurance company and its advisors. The SVO does not audit the information submitted and assumes the information to be timely, accurate and reliable. *[Editing Note: moved from Part One, para. 37]*

91. **NAIC Designations** are produced for statutory accounting, reporting, state investment laws and other purposes identified in the NAIC Financial Regulation Standards and Accreditation Program and/or other NAIC developed regulatory guidance embodied in state law *[Editing note: Moved from Part Two, para. 18]* 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. *[Editing note: Moved from Part One, para. 37]* ~~NAIC Designations are adjusted in accordance with the notching procedures described below so that an NAIC Designation for a given security reflects the position of that specific security in the issuer's capital structure. NAIC Designations may also be adjusted by notching to reflect the existence of other non-payment risk in the specific security in accordance with the procedures described in this Manual. *[Editing note: Deleted from Part Two, para. 18]*~~
92. **NAIC Designations** must be considered in the context of its appropriateness and consistency of use in the NAIC Policy Statement and Financial Regulation Standards (SFRS) and other NAIC guidance. For example, the NAIC Designation serves as the basis for determining the appropriate risk-based capital charge factor for a given security. NAIC Designations should consider if risks, such as tail-risk, are inconsistent with, or duplicative of, risks already captured and defined in the risk-based capital factors, as applicable.

93. ~~**NAIC Designation** — Means any one of the gradations of credit quality and credit risk identified by the **NAIC 1** through **NAIC 6** symbols further discussed and defined in this Manual and may reflect notching pursuant to one or both of the notching procedures discussed in this Manual. NAIC Designations are proprietary symbols of the NAIC to be used by the SVO and SSG or under certain circumstances by an insurer to denote a category or band of credit risk.~~

*[Editing note: Originally in Part One, para. 88]*

#### APPLICATION OF NAIC DESIGNATIONS

94. ~~**NAIC 1** is assigned to obligations exhibiting the highest quality. Credit Investment risk is at its lowest and the issuer's credit profile is stable. This means that interest, principal or both will be paid in accordance with the contractual agreement and that repayment of principal is well protected. An **NAIC 1** obligation should be eligible for the most favorable treatment provided under the NAIC Financial Regulation Standards and Accreditation Program.~~

*[Editing note: Moved from Part Two, para. 19]*

95. ~~**NAIC 2** is assigned to obligations of high quality. Credit Investment risk is low but may increase in the intermediate future and the issuer's credit profile is reasonably stable. This means that for the present, the obligation's protective elements suggest a high likelihood that interest, principal or both will be paid in accordance with the contractual agreement, but there are suggestions that an adverse change in circumstances or economic, financial or business conditions will affect the degree of protection and lead to a weakened capacity to pay. An **NAIC 2** obligation should be eligible for relatively favorable treatment under the NAIC Financial Regulation Standards and Accreditation Program.~~

*[Editing note: Moved from Part Two, para. 20]*

96. ~~**NAIC 3** is assigned to obligations of medium quality. Credit Investment risk is intermediate and the issuer's credit profile has elements of instability. These obligations exhibit speculative elements. This means that the likelihood that interest, principal or both will be paid in accordance with the contractual agreement is reasonable for the present, but an exposure to an adverse change in circumstances or economic, financial or business conditions would create an uncertainty about the issuer's capacity to make timely payments. An **NAIC 3** obligation should be eligible for less favorable treatment under the NAIC Financial Regulation Standards and Accreditation Program.~~

*[Editing note: Moved from Part Two, para. 21]*

97. **NAIC 4** is assigned to obligations of low quality. ~~Credit~~ Investment risk is high and the issuer's credit profile is volatile. These obligations are highly speculative, but currently the issuer has the capacity to meet its obligations. This means that the likelihood that interest, principal or both will be paid in accordance with the contractual agreement is low and that an adverse change in circumstances or business, financial or economic conditions would accelerate credit risk, leading to a significant impairment in the issuer's capacity to make timely payments. An **NAIC 4** obligation should be accorded stringent treatment under the NAIC Financial Regulation Standards and Accreditation Program.

*[Editing note: Moved from Part Two, para. 22]*

98. **NAIC 5** is assigned to obligations of the lowest credit quality, which are not in or near default. ~~Credit~~ Investment risk is at its highest and the issuer's credit profile is highly volatile, but currently the issuer has the capacity to meet its obligations. This means that the likelihood that interest, principal or both will be paid in accordance with the contractual agreement is significantly impaired given any adverse business, financial or economic conditions. An **NAIC 5** Designation suggests a very high probability of default. An **NAIC 5** obligation should incur more stringent treatment under the NAIC Financial Regulation Standards and Accreditation Program.

*[Editing note: Moved from Part Two, para. 23]*

99. **NAIC 6** is assigned to obligations that are in or near default. This means that payment of interest, principal or both is not being made, or will not be made, in accordance with the contractual agreement. An **NAIC 6** obligation should incur the most severe treatment under the NAIC Financial Regulation Standards and Accreditation Program. *[Editing note:*

*Moved from Part Two, para. 24]*

**NOTE:** See ~~“NAIC Designations,”~~ “Prohibition on Use of NAIC Designation in a Covenant” and “Coordination Between the Statutory Accounting Principles Working Group and the Valuation of Securities Task Force” in Part One; ~~“NAIC Designation Categories”~~ below; and “Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities” in Part Three.

#### APPLICATION OF NAIC DESIGNATION CATEGORIES

100. Upon the determination of an NAIC Designation, the SVO produces NAIC Designation Categories, ~~as described and defined in this Manual.~~

*[Editing note: Moved from Part Two, para. 25]*

101. **NAIC Designation Category** – Means and refers to 20 more granular delineations of credit investment risk in the **NAIC 1** through **NAIC 6** credit investment risk scale used by the VOS/TF to relate credit investment risk in insurer-owned securities to a risk-based capital factor assigned by the NAIC Capital Adequacy (E) Task Force. Each delineation of credit investment risk is represented by a letter (a Modifier) which modifies the NAIC Designation grade to indicate a more granular measure of credit investment risk within the NAIC Designation grade. The more granular delineations of credit investment risk are distributed as follows: 7 for the **NAIC 1** Designation grade indicated by the letters A through G; 3 delineations each for each of the NAIC Designation grades **NAIC 2**, **NAIC 3**, **NAIC 4** and **NAIC 5** indicated by the letters A, B and C and 1 delineation for NAIC Designation grade **NAIC 6**. The NAIC Designation Category framework is shown in this Manual. All Modifiers roll up into the respective NAIC Designation grade as they are a subset of them.

**NOTE:** See “~~Production of NAIC Designations~~” in Part Two.  
*[Editing Note: Moved from Part One, para. 89.]*

102. **NAIC Designation Categories** are a subset of **NAIC Designations** and are used by the VOS/TF to link the NAIC risk-based-capital (RBC) framework adopted by the NAIC Capital Adequacy (E) Task Force to the VOS/TF’s credit investment risk assessment process. The NAIC Capital Adequacy (E) Task Force assigns RBC factors to each NAIC Designation Category as shown below.

NAIC Designation	+	NAIC Designation Modifier	=	NAIC Designation Category
1		A		1.A
1		B		1.B
1		C		1.C
1		D		1.D
1		E		1.E
1		F		1.F
1		G		1.G
2		A		2.A
2		B		2.B
2		C		2.C
3		A		3.A
3		B		3.B
3		C		3.C
4		A		4.A
4		B		4.B
4		C		4.C
5		A		5.A
5		B		5.B
5		C		5.C
6				6

*[Editing note: Moved from Part Two, para. 26]*

103. NAIC Designations and Designation Categories may be adjusted in accordance with the ~~notching~~ procedures described in this Manual ~~below~~ so that an NAIC Designation and Designation Category for a given security reflects the position of that specific security in the issuer's capital structure, ~~and other non-payment risks or non-payment mitigants.~~ ~~NAIC Designations may also be adjusted by notching to reflect the existence of other non-payment risks in the specific security in accordance with the procedures described in this Manual associated with NAIC Designations Subscript S.~~  
*[Editing note: Moved from Part Two, para. 18]*

#### NAIC DESIGNATIONS RELATED TO SPECIAL REPORTING INSTRUCTION

104. An insurance company that self-assigns a 5GI must attest that securities receiving this designation meet all required qualifications by completing the appropriate general interrogatory in the statutory financial statements. If documentation necessary for the SVO to perform a full ~~credit~~ investment risk analysis for a security does not exist or if an NAIC CRP credit rating for an FE or PL security is not available, but the issuer is not current on contractual interest and principal payments, and/or if the insurer does not have an actual expectation of ultimate payment of all contracted interest and principal, the insurance company is required to self-assign this security an NAIC 6\*.  
*[Editing note: Moved from Part Two, para. 27]*
105. NAIC 6\* is assigned by an insurer to an obligation in lieu of reporting the obligation with appropriate documentation in instances in which appropriate documentation does not exist, but the requirements for an insurance company to assign a 5GI are not met.  
*[Editing note: Moved from Part Two, para. 28]*
106. Securities with NAIC 5GI Designations are deemed to possess the ~~credit~~ investment risk characteristics of securities assigned an NAIC 5 Designation. A security assigned an NAIC 5GI Designation incurs the regulatory treatment associated with an NAIC 5 Designation. *[Editing note: Moved from Part Two, para. 29]*
107. Securities an insurance company previously assigned as NAIC 5GI are permitted to subsequently receive this designation if the requirements for an NAIC 5GI designation continue to be met. *[Editing note: Moved from Part Two, para. 30]*
108. Securities with NAIC 6\* Designations are deemed to possess the credit investment risk characteristics of securities assigned an NAIC 6 Designation. Therefore, a security assigned an NAIC 6\* Designation incurs the regulatory treatment associated with an NAIC 6 Designation. *[Editing note: Moved from Part Two, para. 31]*
109. Securities that are residual tranches or interests, as defined in *SSAP 43R – Loan Backed and Structured Securities*, shall be reported on Schedule BA - Other Long-Term Invested Assets, without an NAIC Designation and are ineligible to be assigned an NAIC 5GI or NAIC 6\* Designation.

*[Editing note: Moved from Part Two, para. 32]*

~~**NOTE REGARDING RESIDUAL TRANCHES OR INTERESTS:** For 2021 year-end reporting only, residual tranches or interests previously reported on Schedule D-1: Long-Term Bonds shall be permitted to be reported on Schedule D-1 with an NAIC 6\* Designation, however an NAIC 5GI is not permitted.~~

**NOTE:** The GI after the quality indicator 5 refers to General Interrogatory and distinguishes NAIC 5GI from an NAIC 5 Designation. The asterisk (\*) after the quality indicator 6 distinguishes the NAIC 6\* Designation from an NAIC 6 Designation.

*[Editing note: Moved from Part Two, para. 32]*

### **NAIC General Interrogatory**

110. **NAIC 5GI** and NAIC Designation Category **NAIC 5.B GI** is assigned by an insurance company to certain obligations that meet all of the following criteria:

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

*[Editing note: Moved from Part One, para. 91]*

## NAIC PLGI

111. Effective July 1, 2018, insurance companies shall be responsible for providing the SVO copies of private rating letters for PL securities, where applicable, until such time as industry representatives and the SVO shall have established reliable procedures for obtaining the necessary information on credit ratings directly from the NAIC CRPs. For PL Securities issued prior to January 1, 2018, if an insurance company cannot provide a copy of the rating letter to the SVO due to confidentiality concerns and the rating is not included in a CRP credit rating feed (or other form of direct delivery from the NAIC CRP), the insurer shall report such securities on such securities' General Interrogatory to be developed for this purpose (i.e., a PLGI security).

*[Editing note: Moved from Part One, para. 92]*

## Monitoring of SVO-Designated Securities

112. The SVO shall monitor, on an ongoing basis through the information provided by insurers as required by the Material Credit Events Filing described in this Manual, improvements and deterioration of credit quality of securities that are not filing exempt.

*[Editing note: Moved from Part One, para. 93]*

**PART TWO**  
**OPERATIONAL AND ADMINISTRATIVE INSTRUCTIONS**  
**APPLICABLE TO THE SVO**



~~PRODUCTION OF NAIC DESIGNATIONS [EDITING NOTE: MOVED TO PART ONE “NAIC DESIGNATIONS”].~~

~~NAIC DESIGNATIONS~~

- ~~18. NAIC Designations are proprietary symbols of the NAIC. The SVO and sometimes the SSG produce NAIC Designations for insurer-owned securities using the policies, procedures or methodologies adopted by the VOS/TF in this Manual. NAIC Designations identify a category or band of credit risk. NAIC Designations are produced for statutory accounting, reporting, state investment laws and other purposes identified in the NAIC Financial Regulation Standards and Accreditation Program and/or other NAIC developed regulatory guidance embodied in state law. NAIC Designations are adjusted in accordance with the notching procedures described below so that an NAIC Designation for a given security reflects the position of that specific security in the issuer’s capital structure. NAIC Designations may also be adjusted by notching to reflect the existence of other non-payment risk in the specific security in accordance with the procedures described in this Manual.~~
- ~~19. **NAIC 1** is assigned to obligations exhibiting the highest quality. Credit risk is at its lowest and the issuer’s credit profile is stable. This means that interest, principal or both will be paid in accordance with the contractual agreement and that repayment of principal is well protected. An **NAIC 1** obligation should be eligible for the most favorable treatment provided under the NAIC Financial Regulation Standards and Accreditation Program.~~
- ~~20. **NAIC 2** is assigned to obligations of high quality. Credit risk is low but may increase in the intermediate future and the issuer’s credit profile is reasonably stable. This means that for the present, the obligation’s protective elements suggest a high likelihood that interest, principal or both will be paid in accordance with the contractual agreement, but there are suggestions that an adverse change in circumstances or economic, financial or business conditions will affect the degree of protection and lead to a weakened capacity to pay. An **NAIC 2** obligation should be eligible for relatively favorable treatment under the NAIC Financial Regulation Standards and Accreditation Program.~~
- ~~21. **NAIC 3** is assigned to obligations of medium quality. Credit risk is intermediate and the issuer’s credit profile has elements of instability. These obligations exhibit speculative elements. This means that the likelihood that interest, principal or both will be paid in accordance with the contractual agreement is reasonable for the present, but an exposure to an adverse change in circumstances or economic, financial or business conditions would create an uncertainty about the issuer’s capacity to make timely payments. An **NAIC 3** obligation should be eligible for less favorable treatment under the NAIC Financial Regulation Standards and Accreditation Program.~~

- ~~22. **NAIC 4** is assigned to obligations of low quality. Credit risk is high and the issuer's credit profile is volatile. These obligations are highly speculative, but currently the issuer has the capacity to meet its obligations. This means that the likelihood that interest, principal or both will be paid in accordance with the contractual agreement is low and that an adverse change in circumstances or business, financial or economic conditions would accelerate credit risk, leading to a significant impairment in the issuer's capacity to make timely payments. An **NAIC 4** obligation should be accorded stringent treatment under the NAIC Financial Regulation Standards and Accreditation Program.~~
- ~~23. **NAIC 5** is assigned to obligations of the lowest credit quality, which are not in or near default. Credit risk is at its highest and the issuer's credit profile is highly volatile, but currently the issuer has the capacity to meet its obligations. This means that the likelihood that interest, principal or both will be paid in accordance with the contractual agreement is significantly impaired given any adverse business, financial or economic conditions. An **NAIC 5** Designation suggests a very high probability of default. An **NAIC 5** obligation should incur more stringent treatment under the NAIC Financial Regulation Standards and Accreditation Program.~~
- ~~24. **NAIC 6** is assigned to obligations that are in or near default. This means that payment of interest, principal or both is not being made, or will not be made, in accordance with the contractual agreement. An **NAIC 6** obligation should incur the most severe treatment under the NAIC Financial Regulation Standards and Accreditation Program.~~

~~**NOTE:** See "NAIC Designations," "Prohibition on Use of NAIC Designation in a Covenant" and "Coordination Between the Statutory Accounting Principles Working Group and the Valuation of Securities Task Force" in Part One; "NAIC Designation Categories" below; and "Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities" in Part Three.~~

**NAIC DESIGNATION CATEGORIES**

25. ~~Upon the determination of an NAIC Designation, the SVO produces NAIC Designation Categories, as described and defined in this Manual.~~
26. ~~NAIC Designation Categories are a subset of NAIC Designations and are used by the VOS/TF to link the NAIC risk-based capital (RBC) framework adopted by the NAIC Capital Adequacy (E) Task Force to the VOS/TF's credit assessment process. The NAIC Capital Adequacy (E) Task Force assigns RBC factors to each NAIC Designation Category as shown below.~~

NAIC Designation	+	NAIC Designation Modifier	=	NAIC Designation Category
<del>1</del>		A		<del>1.A</del>
<del>1</del>		B		<del>1.B</del>
<u>1</u>		C		<u>1.C</u>
<del>1</del>		D		<del>1.D</del>
<u>1</u>		E		1.E
<del>1</del>		F		<del>1.F</del>
<u>1</u>		G		<u>1.G</u>
<del>2</del>		A		<del>2.A</del>
<del>2</del>		B		<del>2.B</del>
<u>2</u>		C		<u>2.C</u>
<del>3</del>		A		<del>3.A</del>
<del>3</del>		B		<del>3.B</del>
<u>3</u>		C		<u>3.C</u>
<del>4</del>		A		<del>4.A</del>
<del>4</del>		B		<del>4.B</del>
<u>4</u>		C		<u>4.C</u>
<del>5</del>		A		<del>5.A</del>
<del>5</del>		B		<del>5.B</del>
5		C		5.C
6				6

**~~NAIC DESIGNATIONS RELATED TO SPECIAL REPORTING INSTRUCTION~~**

- ~~27. An insurance company that self assigns a 5GI must attest that securities receiving this designation meet all required qualifications by completing the appropriate general interrogatory in the statutory financial statements. If documentation necessary for the SVO to perform a full credit analysis for a security does not exist or if an NAIC CRP credit rating for an FE or PL security is not available, but the issuer is not current on contractual interest and principal payments, and/or if the insurer does not have an actual expectation of ultimate payment of all contracted interest and principal, the insurance company is required to self-assign this security an NAIC 6\*.~~
- ~~28. NAIC 6\* is assigned by an insurer to an obligation in lieu of reporting the obligation with appropriate documentation in instances in which appropriate documentation does not exist, but the requirements for an insurance company to assign a 5GI are not met.~~
- ~~29. Securities with NAIC 5GI Designations are deemed to possess the credit characteristics of securities assigned an NAIC 5 Designation. A security assigned an NAIC 5GI Designation incurs the regulatory treatment associated with an NAIC 5 Designation.~~
- ~~30. Securities an insurance company previously assigned as NAIC 5GI are permitted to subsequently receive this designation if the requirements for an NAIC 5GI designation continue to be met.~~
- ~~31. Securities with NAIC 6\* Designations are deemed to possess the credit characteristics of securities assigned an NAIC 6 Designation. Therefore, a security assigned an NAIC 6\* Designation incurs the regulatory treatment associated with an NAIC 6 Designation.~~
- ~~32. Securities that are residual tranches or interests, as defined in SSAP 43R—Loan Backed and Structured Securities, shall be reported on Schedule BA—Other Long-Term Invested Assets, without an NAIC Designation and are ineligible to be assigned an NAIC 5GI or NAIC 6\* Designation.———~~

**~~NOTE REGARDING RESIDUAL TRANCHES OR INTERESTS:~~** ~~For 2021 year-end reporting only, residual tranches or interests previously reported on Schedule D-1: Long-Term Bonds shall be permitted to be reported on Schedule D-1 with an NAIC 6\* Designation, however an NAIC 5GI is not permitted.~~

**NOTE:** The GI after the quality indicator 5 refers to General Interrogatory and distinguishes NAIC 5GI from an NAIC 5 Designation. The asterisk (\*) after the quality indicator 6 distinguishes the NAIC 6\* Designation from an NAIC 6 Designation.

**NAIC DESIGNATION SUBSCRIPT S**

**Description of Other Non-Payment Risk**

- ~~33. 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.~~
- ~~34. 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.~~
- ~~35. 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 scheduled 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).~~
- ~~36. 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 dates (e.g., a mandatory redemption) or that states a maturity equal to*

*or exceeding 40 years.*

~~37. 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**

~~38. 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**.~~

~~39. 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.~~





SVO



**NAIC**  
NATIONAL ASSOCIATION OF  
INSURANCE COMMISSIONERS

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: Proposed Amendment to Update the Definition of an NAIC Designation in the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual)

DATE: July 29, 2024

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### Summary –

NAIC Designations are currently explained and defined in both Parts One and Two of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual). The SVO proposes both consolidating these explanations and definitions in Part One only and clarifying the meaning of an NAIC Designation including their use, purpose and risks addressed.

This amendment has undergone several iterations. The Valuation of Securities (E) Task Force exposed the prior version of this amendment, dated June 4, 2024, for a 28-day comment period that ended on July 18, 2024. The following updates have been made to the prior version and reflect actionable recommendations received from interested parties:

1. The inclusion of a new paragraph under the heading “Regulatory Objective” to explain why the term “investment risk,” meaning the likelihood that an insurer will receive full and timely principal and expected interest, is replacing “credit risk,” which traditionally focuses on the ability of an issuer to make payments in accordance with contractual terms. While credit risk is usually the overall fundamental and predominant determinant of what an NAIC Designation represents, focusing on credit risk alone would limit the SVO’s ability to appropriately assess certain risks including, but not limited to, the performance component of a PPS or certain funds which do not pay in accordance with contractual terms.
2. More clearly define the term “investment risk” under the heading “Definitions”.

**Proposed Amendment** - The proposed changes to the current P&P Manual are shown below with

additions in red font color, and deletions in ~~red-strikethrough~~. New text added since the last presented iteration of the proposal is in highlighted red underline.

**(VERSION WITH CHANGES DISPLAYED)**

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

## POLICIES PERTAINING TO SVO AND SSG OPERATIONS

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### ~~NAIC Designations~~

*[Editing note: select portions moved from Part One, paras. 37-39 to the new "NAIC Designations" section within Part One]*

~~37. The SVO's analysis of credit risk (hereafter defined), is expressed as an opinion of credit quality by assignment of an NAIC Designation that is notched to reflect the position of the specific liability in the issuer's capital structure. Collectively, NAIC Designations as defined in this Manual describe a credit quality risk gradation range from highest quality (least risk) to lowest quality (greatest risk). NAIC Designations express opinions about credit risk except when accompanied by the NAIC Designation subscript, described below.~~

- ~~▪ Credit risk is defined as the relative financial capability of an obligor to make the payments contractually promised to a lender. Credit analysis is performed solely for the purpose of designating the quality of an investment made by an insurance company so that the NAIC member's department of insurance can better identify regulatory treatment.~~
- ~~▪ Credit risk is assessed by analyzing the information and documentation provided to the SVO by the reporting insurance company and its advisors. The SVO does not audit the information submitted and assumes the information to be timely, accurate and reliable.~~
- ~~▪ The ability of an insurance company to realize payment on a financial obligation can be affected by factors not related to credit risk or by the manner in which the repayment promise has been structured.~~
- ~~▪ NAIC Designations do not measure other risks or factors that may affect repayment, such as volatility/interest rate, prepayment, extension or liquidity risk.~~
- ~~▪ An NAIC Designation 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.~~

~~38. The result of the SVO's credit analysis, expressed as an opinion of credit quality by assignment of an NAIC Designation shall be further expanded into NAIC Designation Categories as, and for the purposes, discussed in this Manual.~~

~~**NOTE:** See "Production of NAIC Designations" in Part Two.~~

### **Other Non-Payment Risk in Securities**

~~39. The result of the SVO's analysis of securities for other non-payment risk is expressed by the assignment of an NAIC Designation Subscript S and the application of the notching procedures described below.~~

~~NOTE: See "NAIC Designation Subscript S" and "SVO Notching Guidelines" in Part Two.~~

## NAIC DESIGNATIONS

### NAIC DESIGNATIONS

#### Regulatory Objective

88. An objective of the VOS/TF is to support regulators in the assessment of the financial ability of an insurer to maintain financial solvency, through the making of policy concerning insurer investment risk and the identification and sharing of pertinent information with other relevant regulators and regulatory groups responsible for the NAIC's regulatory framework.

89. The below definition of an NAIC Designation focuses on the likelihood that an insurer will receive full and timely principal and expected interest (i.e., investment risk). The definition differs from "credit risk" which traditionally focuses on the ability of an issuer to make payments in accordance with contractual terms. Credit risk alone may, at times, be too narrow a concept for NAIC purposes. For example, the performance component of a principal protected security (PPS) may produce no return and, therefore, the PPS could pay no interest with no event of default by the issuer. Similarly, the SVO assigns NAIC Designations to certain funds using a Weighted Average Rating Factor (WARF) methodology where the fund does not pay in accordance with contractual terms. As such, while credit risk is usually the overall fundamental and predominant determinant of what an NAIC Designation represents, focusing on credit risk alone would limit the SVO's ability to appropriately assess certain risks including, but not limited to, the performance component of a PPS or certain funds for regulatory purposes.

#### Definitions

90. NAIC Designations represent opinions of gradations of the likelihood of an insurer's timely receipt of an investment's full principal and expected interest ("investment risk"). Where appropriate for a given investment, NAIC Designations and Designation Categories shall reflect "tail risk" and/or loss given default, the position of the specific liability in the issuer's capital structure, and all other risks, except for volatility/interest rate, prepayment, extension or liquidity risk. NAIC Designations shall be identified by the NAIC 1 through NAIC 6 symbols (as modified by NAIC Designation Categories) which indicate the highest quality (least risk) to the lowest quality (greatest risk), respectively.

#### Use and Purposes of NAIC Designations

91. **NAIC Designations** are proprietary symbols of the NAIC. The SVO, the SSG and, under certain circumstances, insurers, produce NAIC Designations for insurer-owned securities using the policies, procedures or methodologies adopted by the VOS/TF in this Manual. The analysis is performed solely for the purpose of designating the quality of an investment

made by an insurance company so that the NAIC member's department of insurance can better identify regulatory treatment. Investment risk is assessed by analyzing the information and documentation provided to the SVO by the reporting insurance company and its advisors. The SVO does not audit the information submitted and assumes the information to be timely, accurate and reliable.

92. **NAIC Designations** are produced for statutory accounting, reporting, state investment laws and other purposes identified in the NAIC Financial Regulation Standards and Accreditation Program and/or other NAIC developed regulatory guidance embodied in state law 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.
93. **NAIC Designations** must be considered in the context of its appropriateness and consistency of use in the NAIC Policy Statement and Financial Regulation Standards (SFRS) and other NAIC guidance. For example, the NAIC Designation serves as the basis for determining the appropriate risk-based capital factor for a given security. NAIC Designations should consider if risks, such as tail-risk, are inconsistent with, or duplicative of, risks already captured and defined in the risk-based capital factors, as applicable.

**APPLICATION OF NAIC DESIGNATIONS**

94. **NAIC 1** is assigned to obligations exhibiting the highest quality. Investment risk is at its lowest and the issuer's credit profile is stable. This means that interest, principal or both will be paid in accordance with the contractual agreement and that repayment of principal is well protected. An **NAIC 1** obligation should be eligible for the most favorable treatment provided under the NAIC Financial Regulation Standards and Accreditation Program.
95. **NAIC 2** is assigned to obligations of high quality. Investment risk is low but may increase in the intermediate future and the issuer's credit profile is reasonably stable. This means that for the present, the obligation's protective elements suggest a high likelihood that interest, principal or both will be paid in accordance with the contractual agreement, but there are suggestions that an adverse change in circumstances or economic, financial or business conditions will affect the degree of protection and lead to a weakened capacity to pay. An **NAIC 2** obligation should be eligible for relatively favorable treatment under the NAIC Financial Regulation Standards and Accreditation Program.
96. **NAIC 3** is assigned to obligations of medium quality. Investment risk is intermediate and the issuer's credit profile has elements of instability. These obligations exhibit speculative elements. This means that the likelihood that interest, principal or both will be paid in accordance with the contractual agreement is reasonable for the present, but an exposure to an adverse change in circumstances or economic, financial or business conditions would create an uncertainty about the issuer's capacity to make timely payments. An **NAIC 3** obligation should be eligible for less favorable treatment under the NAIC Financial Regulation Standards and Accreditation Program.



97. **NAIC 4** is assigned to obligations of low quality. Investment risk is high and the issuer’s credit profile is volatile. These obligations are highly speculative, but currently the issuer has the capacity to meet its obligations. This means that the likelihood that interest, principal or both will be paid in accordance with the contractual agreement is low and that an adverse change in circumstances or business, financial or economic conditions would accelerate credit risk, leading to a significant impairment in the issuer’s capacity to make timely payments. An **NAIC 4** obligation should be accorded stringent treatment under the NAIC Financial Regulation Standards and Accreditation Program.
98. **NAIC 5** is assigned to obligations of the lowest credit quality, which are not in or near default. Investment risk is at its highest and the issuer’s credit profile is highly volatile, but currently the issuer has the capacity to meet its obligations. This means that the likelihood that interest, principal or both will be paid in accordance with the contractual agreement is significantly impaired given any adverse business, financial or economic conditions. An **NAIC 5** Designation suggests a very high probability of default. An **NAIC 5** obligation should incur more stringent treatment under the NAIC Financial Regulation Standards and Accreditation Program.
99. **NAIC 6** is assigned to obligations that are in or near default. This means that payment of interest, principal or both is not being made, or will not be made, in accordance with the contractual agreement. An **NAIC 6** obligation should incur the most severe treatment under the NAIC Financial Regulation Standards and Accreditation Program.

**NOTE:** See “Prohibition on Use of NAIC Designation in a Covenant” and “Coordination Between the Statutory Accounting Principles Working Group and the Valuation of Securities Task Force” in Part One; and “Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities” in Part Three.

<b>APPLICATION OF NAIC DESIGNATION CATEGORIES</b>
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100. Upon the determination of an NAIC Designation, the SVO produces NAIC Designation Categories.
101. **NAIC Designation Category** – Means and refers to 20 more granular delineations of investment risk in the **NAIC 1** through **NAIC 6** investment risk scale used by the VOS/TF to relate investment risk in insurer-owned securities to a risk-based capital factor assigned by the NAIC Capital Adequacy (E) Task Force. Each delineation of investment risk is represented by a letter (a Modifier) which modifies the NAIC Designation grade to indicate a more granular measure of investment risk within the NAIC Designation grade. The more granular delineations of investment risk are distributed as follows: 7 for the **NAIC 1** Designation grade indicated by the letters A through G; 3 delineations each for each of the NAIC Designation grades **NAIC 2**, **NAIC 3**, **NAIC 4** and **NAIC 5** indicated by the letters A, B and C and 1 delineation for NAIC Designation grade **NAIC 6**. The NAIC Designation Category framework is shown in this Manual. All Modifiers roll up into the respective NAIC Designation grade as they are a subset of them.
102. **NAIC Designation Categories** are a subset of **NAIC Designations** and are used by the VOS/TF to link the NAIC risk-based-capital (RBC) framework adopted by the NAIC Capital Adequacy (E) Task Force to the VOS/TF's investment risk assessment process. The NAIC Capital Adequacy (E) Task Force assigns RBC factors to each NAIC Designation Category as shown below.

NAIC Designation	+	NAIC Designation Modifier	=	NAIC Designation Category
1		A		1.A
1		B		1.B
1		C		1.C
1		D		1.D
1		E		1.E
1		F		1.F
1		G		1.G
2		A		2.A
2		B		2.B
2		C		2.C
3		A		3.A
3		B		3.B
3		C		3.C
4		A		4.A
4		B		4.B
4		C		4.C
5		A		5.A
5		B		5.B
5		C		5.C
6				6

103. NAIC Designations and Designation Categories may be adjusted in accordance with the procedures described in this Manual so that an NAIC Designation and Designation Category for a given security reflects the position of that specific security in the issuer's

capital structure.

**NAIC DESIGNATIONS RELATED TO SPECIAL REPORTING INSTRUCTION**

104. An insurance company that self-assigns a 5GI must attest that securities receiving this designation meet all required qualifications by completing the appropriate general interrogatory in the statutory financial statements. If documentation necessary for the SVO to perform a full investment risk analysis for a security does not exist or if an NAIC CRP credit rating for an FE or PL security is not available, but the issuer is not current on contractual interest and principal payments, and/or if the insurer does not have an actual expectation of ultimate payment of all contracted interest and principal, the insurance company is required to self-assign this security an NAIC 6\*.
105. NAIC 6\* is assigned by an insurer to an obligation in lieu of reporting the obligation with appropriate documentation in instances in which appropriate documentation does not exist, but the requirements for an insurance company to assign a 5GI are not met.
106. Securities with NAIC 5GI Designations are deemed to possess the investment risk characteristics of securities assigned an NAIC 5 Designation. A security assigned an NAIC 5GI Designation incurs the regulatory treatment associated with an NAIC 5 Designation.
107. Securities an insurance company previously assigned as NAIC 5GI are permitted to subsequently receive this designation if the requirements for an NAIC 5GI designation continue to be met.
108. Securities with NAIC 6\* Designations are deemed to possess the credit investment risk characteristics of securities assigned an NAIC 6 Designation. Therefore, a security assigned an NAIC 6\* Designation incurs the regulatory treatment associated with an NAIC 6 Designation.
109. Securities that are residual tranches or interests, as defined in *SSAP 43R – Loan Backed and Structured Securities*, shall be reported on Schedule BA - Other Long-Term Invested Assets, without an NAIC Designation and are ineligible to be assigned an NAIC 5GI or NAIC 6\* Designation.

**NOTE:** The GI after the quality indicator 5 refers to General Interrogatory and distinguishes NAIC 5GI from an NAIC 5 Designation. The asterisk (\*) after the quality indicator 6 distinguishes the NAIC 6\* Designation from an NAIC 6 Designation.

**NAIC General Interrogatory**

110. **NAIC 5GI** and NAIC Designation Category **NAIC 5.B GI** is assigned by an

insurance company to certain obligations that meet all of the following criteria:

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

## NAIC PLGI

111. Effective July 1, 2018, insurance companies shall be responsible for providing the SVO copies of private rating letters for PL securities, where applicable, until such time as industry representatives and the SVO shall have established reliable procedures for obtaining the necessary information on credit ratings directly from the NAIC CRPs. For PL Securities issued prior to January 1, 2018, if an insurance company cannot provide a copy of the rating letter to the SVO due to confidentiality concerns and the rating is not included in a CRP credit rating feed (or other form of direct delivery from the NAIC CRP), the insurer shall report such securities on such securities' General Interrogatory to be developed for this purpose (i.e., a PLGI security).

## Monitoring of SVO-Designated Securities

112. The SVO shall monitor, on an ongoing basis through the information provided by insurers as required by the Material Credit Events Filing described in this Manual, improvements and deterioration of credit quality of securities that are not filing exempt.

**PART TWO**  
**OPERATIONAL AND ADMINISTRATIVE INSTRUCTIONS**  
**APPLICABLE TO THE SVO**

~~PRODUCTION OF NAIC DESIGNATIONS [EDITING NOTE: MOVED TO PART ONE “NAIC DESIGNATIONS”].~~

~~NAIC DESIGNATIONS~~

- ~~18. NAIC Designations are proprietary symbols of the NAIC. The SVO and sometimes the SSG produce NAIC Designations for insurer-owned securities using the policies, procedures or methodologies adopted by the VOS/TF in this Manual. NAIC Designations identify a category or band of credit risk. NAIC Designations are produced for statutory accounting, reporting, state investment laws and other purposes identified in the NAIC Financial Regulation Standards and Accreditation Program and/or other NAIC developed regulatory guidance embodied in state law. NAIC Designations are adjusted in accordance with the notching procedures described below so that an NAIC Designation for a given security reflects the position of that specific security in the issuer’s capital structure. NAIC Designations may also be adjusted by notching to reflect the existence of other non-payment risk in the specific security in accordance with the procedures described in this Manual.~~
- ~~19. **NAIC 1** is assigned to obligations exhibiting the highest quality. Credit risk is at its lowest and the issuer’s credit profile is stable. This means that interest, principal or both will be paid in accordance with the contractual agreement and that repayment of principal is well protected. An **NAIC 1** obligation should be eligible for the most favorable treatment provided under the NAIC Financial Regulation Standards and Accreditation Program.~~
- ~~20. **NAIC 2** is assigned to obligations of high quality. Credit risk is low but may increase in the intermediate future and the issuer’s credit profile is reasonably stable. This means that for the present, the obligation’s protective elements suggest a high likelihood that interest, principal or both will be paid in accordance with the contractual agreement, but there are suggestions that an adverse change in circumstances or economic, financial or business conditions will affect the degree of protection and lead to a weakened capacity to pay. An **NAIC 2** obligation should be eligible for relatively favorable treatment under the NAIC Financial Regulation Standards and Accreditation Program.~~
- ~~21. **NAIC 3** is assigned to obligations of medium quality. Credit risk is intermediate and the issuer’s credit profile has elements of instability. These obligations exhibit speculative elements. This means that the likelihood that interest, principal or both will be paid in accordance with the contractual agreement is reasonable for the present, but an exposure to an adverse change in circumstances or economic, financial or business conditions would create an uncertainty about the issuer’s capacity to make timely payments. An **NAIC 3** obligation should be eligible for less favorable treatment under the NAIC Financial Regulation Standards and Accreditation Program.~~

- ~~22. **NAIC 4** is assigned to obligations of low quality. Credit risk is high and the issuer's credit profile is volatile. These obligations are highly speculative, but currently the issuer has the capacity to meet its obligations. This means that the likelihood that interest, principal or both will be paid in accordance with the contractual agreement is low and that an adverse change in circumstances or business, financial or economic conditions would accelerate credit risk, leading to a significant impairment in the issuer's capacity to make timely payments. An **NAIC 4** obligation should be accorded stringent treatment under the NAIC Financial Regulation Standards and Accreditation Program.~~
- ~~23. **NAIC 5** is assigned to obligations of the lowest credit quality, which are not in or near default. Credit risk is at its highest and the issuer's credit profile is highly volatile, but currently the issuer has the capacity to meet its obligations. This means that the likelihood that interest, principal or both will be paid in accordance with the contractual agreement is significantly impaired given any adverse business, financial or economic conditions. An **NAIC 5** Designation suggests a very high probability of default. An **NAIC 5** obligation should incur more stringent treatment under the NAIC Financial Regulation Standards and Accreditation Program.~~
- ~~24. **NAIC 6** is assigned to obligations that are in or near default. This means that payment of interest, principal or both is not being made, or will not be made, in accordance with the contractual agreement. An **NAIC 6** obligation should incur the most severe treatment under the NAIC Financial Regulation Standards and Accreditation Program.~~

~~**NOTE:** See "NAIC Designations," "Prohibition on Use of NAIC Designation in a Covenant" and "Coordination Between the Statutory Accounting Principles Working Group and the Valuation of Securities Task Force" in Part One; "NAIC Designation Categories" below; and "Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities" in Part Three.~~



**NAIC DESIGNATION CATEGORIES**

- ~~25. Upon the determination of an NAIC Designation, the SVO produces NAIC Designation Categories, as described and defined in this Manual.~~
- ~~26. NAIC Designation Categories are a subset of NAIC Designations and are used by the VOS/TF to link the NAIC risk-based capital (RBC) framework adopted by the NAIC Capital Adequacy (E) Task Force to the VOS/TF's credit assessment process. The NAIC Capital Adequacy (E) Task Force assigns RBC factors to each NAIC Designation Category as shown below.~~

NAIC Designation	+	NAIC Designation Modifier	=	NAIC Designation Category
<del>1</del>		A		<del>1.A</del>
<del>1</del>		B		<del>1.B</del>
<u>1</u>		C		<u>1.C</u>
<del>1</del>		D		<del>1.D</del>
<u>1</u>		E		1.E
<u>1</u>		F		<del>1.F</del>
<u>1</u>		G		<del>1.G</del>
<u>2</u>		A		<u>2.A</u>
<u>2</u>		B		<u>2.B</u>
<u>2</u>		C		<u>2.C</u>
<u>3</u>		A		<u>3.A</u>
<u>3</u>		B		<u>3.B</u>
<u>3</u>		C		<u>3.C</u>
<u>4</u>		A		<u>4.A</u>
<u>4</u>		B		<u>4.B</u>
<u>4</u>		C		<u>4.C</u>
<u>5</u>		A		<u>5.A</u>
<u>5</u>		B		5.B
5		C		5.C
6				6

**~~NAIC DESIGNATIONS RELATED TO SPECIAL REPORTING INSTRUCTION~~**

- ~~27. An insurance company that self assigns a 5GI must attest that securities receiving this designation meet all required qualifications by completing the appropriate general interrogatory in the statutory financial statements. If documentation necessary for the SVO to perform a full credit analysis for a security does not exist or if an NAIC CRP credit rating for an FE or PL security is not available, but the issuer is not current on contractual interest and principal payments, and/or if the insurer does not have an actual expectation of ultimate payment of all contracted interest and principal, the insurance company is required to self assign this security an NAIC 6\*.~~
- ~~28. NAIC 6\* is assigned by an insurer to an obligation in lieu of reporting the obligation with appropriate documentation in instances in which appropriate documentation does not exist, but the requirements for an insurance company to assign a 5GI are not met.~~
- ~~29. Securities with NAIC 5GI Designations are deemed to possess the credit characteristics of securities assigned an NAIC 5 Designation. A security assigned an NAIC 5GI Designation incurs the regulatory treatment associated with an NAIC 5 Designation.~~
- ~~30. Securities an insurance company previously assigned as NAIC 5GI are permitted to subsequently receive this designation if the requirements for an NAIC 5GI designation continue to be met.~~
- ~~31. Securities with NAIC 6\* Designations are deemed to possess the credit characteristics of securities assigned an NAIC 6 Designation. Therefore, a security assigned an NAIC 6\* Designation incurs the regulatory treatment associated with an NAIC 6 Designation.~~
- ~~32. Securities that are residual tranches or interests, as defined in SSAP 43R—Loan Backed and Structured Securities, shall be reported on Schedule BA—Other Long-Term Invested Assets, without an NAIC Designation and are ineligible to be assigned an NAIC 5GI or NAIC 6\* Designation.———~~

**~~NOTE REGARDING RESIDUAL TRANCHES OR INTERESTS:~~** ~~For 2021 year-end reporting only, residual tranches or interests previously reported on Schedule D-1: Long-Term Bonds shall be permitted to be reported on Schedule D-1 with an NAIC 6\* Designation, however an NAIC 5GI is not permitted.~~

**NOTE:** The GI after the quality indicator 5 refers to General Interrogatory and distinguishes NAIC 5GI from an NAIC 5 Designation. The asterisk (\*) after the quality indicator 6 distinguishes the NAIC 6\* Designation from an NAIC 6 Designation.

**NAIC DESIGNATION SUBSCRIPT S**

**Description of Other Non-Payment Risk**

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- ~~36. 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 dates (e.g., a mandatory redemption) or that states a maturity equal to*

*or exceeding 40 years.*

~~37. 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**

~~38. 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**.~~

~~39. 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.~~





**Mike Monahan**

Senior Director, Accounting Policy  
(202) 624-2324 t  
mikemonahan@acli.com

July 18, 2024

**Ms. Carrie Mears**

Chair, Valuation of Securities (E) Task Force (VOSTF)  
National Association of Insurance Commissioners (NAIC)  
110 Walnut Street, Suite 1500  
Kansas City, MO 64106-2197

**Re: Revised Proposed P&P Manual Amendment to Update the Definition of an NAIC Designation**

Dear Ms. Mears:

The undersigned (ACLI, PPIA, and NASVA) appreciate the opportunity to comment on the exposure referred to above that was released for comment by the VOSTF on June 18, 2024. As noted in our previous letter, dated January 26, 2024, on this topic, and as often stated by both industry and regulators, the P&P Manual is often difficult to navigate, and includes conflicting and confusing language. Therefore, we agree with the premise to clearly and concisely define an NAIC Designation in a single uniform location (i.e., not in both Part 1 and Part 2 of the P&P Manual).

The undersigned are also appreciative of the VOSTF for giving serious consideration to our comments / concerns expressed in our previous letter – specifically:

- Providing appropriate clarification and addressing concerns surrounding the VOSTF’s role in assessing the ability of insurers to pay claims and the underlying related regulatory assumption, and
- Beginning cleanup work (which may continue as lingering references are identified) to remove the Subscript S language, a significant source of confusion for both regulators and industry.

The remainder of our letter will focus on the latest proposed Definition of an NAIC Designation from the exposure. The undersigned believe that in the vast majority of circumstances, the NAIC Designation represents the credit quality of the investments, with somewhat limited exceptions.

**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.

We do not believe the exceptions should drive the definition, without clear articulation of that fact. Our comments are expressed in more detail below. The exposure includes the following changes to the definition of an NAIC Designation.

*NAIC Designations represent opinions of gradations ~~credit quality~~ of the likelihood of an insurer's timely receipt of an investment's full principal and expected interest. Where appropriate for a given investment, NAIC Designations and Designation Categories shall reflect "tail risk" and/or loss given default, ~~NAIC Designations and Designation Categories shall reflect the position of the specific liability in the issuer's capital structure, and other non-payment risks or non-payment mitigants~~. ~~NAIC Designations do not measure and all other risks or factors that may affect repayment, such as, except for volatility/interest rate, prepayment, extension or liquidity risk.~~ [Editing Note: moved from Part One, para. 37] NAIC Designations shall be identified by the NAIC 1 through NAIC 6 symbols (as modified by NAIC Designation Categories) which indicate the highest quality (least risk) to the lowest quality (greatest risk), respectively, and which reflect the likelihood of timely and full payment of principal and scheduled periodic interest, in accordance with the regulatory objectives explained above, and the likelihood of principal and/or interest payment default.*

Specifically, the focus of our comments will be on the first sentence as well as subsequent references to "credit risk" in the P&P Manual being changed to "investment risk". The explanation in the exposure for this change is as follows:

*Creation of a concise definition of an NAIC Designation which focuses on the likelihood that an insurer will receive full and timely principal and expected interest. This change reflects a departure from the term "credit risk" which focuses on the ability of an issuer to make payments in accordance with contractual terms. Credit risk alone may, at times, be too narrow a concept for NAIC purposes. For example, the performance component of a principal protected security (PPS) may produce no return and, therefore, the PPS could pay no interest with no event of default by the issuer. As such, focusing solely on credit risk could limit the SVO's ability to assess the risk of the performance component of a principal protected security.*

The undersigned understand the rationale for this change, as the credit risk which focuses on the ability of an issuer to make payments in accordance with contractual terms may be too narrow for NAIC purposes in limited situations such as with Principal Projected Securities or when the NAIC applies their WARF methodology to SVO designated funds. However, credit risk assessment is still the overall fundamental and predominant determinant of what an NAIC designation represents. As the new term "investment risk" is not defined, it is imperative the P&P Manual have some explanatory language. Given the importance of this need, perhaps in a paragraph immediately following the definition of an NAIC designation, this should be codified. The undersigned suggest the following and are willing to work with the VOSTF/SVO to refine, if needed, as appropriate.

*Creation of a concise definition of an NAIC Designation focuses on the likelihood that an insurer will receive full and timely principal and expected interest (i.e., "investment risk"). This change reflects a departure from the term "credit risk" which focuses on the ability of an issuer to make payments in accordance with contractual terms. Credit risk alone may, at times, be too narrow a concept for NAIC purposes. For example, the performance*



*component of a principal protected security (PPS) may produce no return and, therefore, the PPS could pay no interest with no event of default by the issuer. Similarly, the SVO designates certain funds using its Weighted Average Rating Factor (WARF) methodology where the fund does not pay in accordance with contractual terms. As such, while credit risk is the overall fundamental and predominant determinant of what an NAIC designation represents, it would limit the SVO's ability to assess the risk of the performance component of a PPS or certain funds appropriately for regulatory purposes. While credit risk is the overall fundamental and predominant determinant of what an NAIC designation represents, for both CRP ratings used in the filing exempt process and SVO internally developed NAIC designations, the concept of credit risk has been changed to investment risk. Instances where credit risk alone is not appropriate include:*

- *Principal Protected Securities, and*
- *NAIC designated funds.*

*As part of the process of the SVO identifying other instances of investment risk outside of credit risk, including through the process of discretion over CRP ratings with a thematic occurrence (e.g., per paragraph 173 of proposed amendments to the P&P Manual authorizing the procedures for the SVO's discretion over NAIC Designations assigned through the filing exemption process), when such instances are identified, they will be added to this list.*

Sincerely,



Mike Monahan  
ACLI



Tracey Lindsey  
NASVA



John Petchler  
on behalf of PPIA Board of Directors

cc: Charles Therriault, Director, Securities Valuation Office  
Eric Kolchinsky, Director, Structured Securities Group



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July 18, 2024

The Valuation of Securities Task Force  
National Association of Insurance Commissioners  
1100 Walnut Street, Suite 1500  
Kansas City, MO 64106-2197

*Re:* Proposed Amendment to Update the Definition of an NAIC Designation in the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual)

Dear Ms. Mears and Task Force Members,

Please accept these additional comments addressing the actual implementation of this updated proposal.

It is clear that the Task Force intends to capture more than credit risk within the meaning of NAIC Designations. It is less clear, however, how it will direct the Investment Analysis Office and its constituents to accomplish this.

Nationally Recognized Statistical Rating Organizations themselves are prohibited from releasing their ratings unless each rating is explicitly supported by the public rating methodologies they have formally adopted. Notably these are credit ratings.

The IAO does not maintain a library or catalog of the methodologies it uses, instead it has stated that it borrows and uses publicly available rating agency methodologies as it sees fit. Regardless of its merits, simply following this practice should not be expected to produce anything significantly different from what the NRSROs themselves produce -- and that is credit ratings pure and simple.

As a part of the adoption process for this proposal it would seem necessary to develop specific new instructions for the Purposes and Procedures Manual for the IAO to use to quantify additional risk elements.

The questions then are what specific methodologies and procedures will this Task Force adopt for the Manual given that the NRSRO methodologies being used today address credit risk and not an expanded risk set. Secondly, how will the Task Force monitor compliance with these procedures?

A handwritten signature in blue ink that reads "Christopher Anderson".

July 18, 2024

Ms. Carrie Mears  
Chair, Valuation of Securities (E) Task Force (VOSTF)  
National Association of Insurance Commissioners (NAIC)  
110 Walnut Street, Suite 1500  
Kansas City, MO 64106-2197

**RE: Proposed Amendment to Update the Definition of an NAIC Designation in the Purposes and Procedures Manual of the NAIC Investment Analysis Office**

Dear Ms. Mears:

KBRA appreciates the opportunity to provide feedback on the VOSTF's Proposed Amendment to Update the Definition of an NAIC Designation in the Purposes and Procedures Manual of the NAIC Investment Analysis Office ("P&P Manual") (the "Proposed Designation Amendment"). As a credit rating provider ("CRP"), KBRA's core mission is to provide independent, transparent, and comprehensive credit analysis and research. We welcome policy and regulatory initiatives that are aligned with these objectives. KBRA also strives to provide insightful and constructive feedback on policy and regulatory initiatives that relate to credit risk and that impact users of credit ratings.

Consistent with these goals and objectives, we offer our observations and concerns related to the Proposed Designation Amendment. Our primary concern with the Proposed Designation Amendment is that it introduces a disconnect between the assessment of credit risk and investment risk, particularly with respect to the NAIC's separate pending proposal to authorize SVO discretion over NAIC Designations in the Filing Exempt Process (the "FE Proposal").<sup>1</sup>

The FE Proposal reflects the Proposed Designation Amendment by replacing references to "credit risk" with references to "investment risk." The FE Proposal provides that the SVO Credit Committee is empowered to determine whether an NAIC Designation determined by a credit rating is "an unreasonable assessment of investment risk," yet credit ratings are not intended to provide an assessment of "investment risk."<sup>2</sup> Because the revised definition of "investment risk" is expansive and goes well beyond credit risk, it creates a material disconnect between credit ratings, NAIC designations and the nature of the SVO's assessment under the FE Proposal. This disconnect is exacerbated by the fact that the SVO has provided limited transparency into its analysis of NAIC Designations beyond asserting that it may use "one or combinations" of CRP methodologies.<sup>3</sup> Therefore, it is also unclear how its analytical process will change to

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<sup>1</sup> Revised Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (the "P&P Manual") Authorizing the Procedures for the SVO's Discretion Over NAIC Designations Assigned Through the Filing Exemption Process, available at <https://content.naic.org/sites/default/files/inline-files/2023-005.16%20P%26P%20SVO%20Discretion%20-%20Revised%20v5.4.pdf>.

<sup>2</sup> We also note the apparent inconsistency in referencing "credit" in the Credit Committee's name given that the FE Proposal and Proposed Designation Amendment both emphasize their analysis goes beyond "credit risk" and considers a broader range of "investment risks."

<sup>3</sup> "The SVO considers multiple methodologies when it reviews a security and will use the one or combinations of methodologies that it believes will produce a reasonable assessment of risk for regulatory purposes. Because the SVO relies upon the methodologies of other entities, it does not publish those methodologies. The use of a particular methodology from a rating agency should not be construed as validation of one credit rating provider over another." Item 2, NAIC Valuation of Securities (E) Task Force Responses to Issues/Comments Previously Deliberated on the Proposed P&P Manual Amendment Authorizing the Procedures for the SVO's Discretion Over NAIC Designations Assigned Through the Filing Exemption Process (February 27,



now analyze investment risk. Much more transparency into the SVO's process, particularly around how it will evaluate investment risk is needed.

Credit ratings serve a specific purpose and are intended to measure only credit risk, specifically the probability of default and severity of loss in the event of default. Conversely, the proposed revised definition of "investment risk" would consider and reflect a wide range of risks including "the likelihood of an insurer's timely receipt of an investment's full principal and expected interest," as well "as 'tail risk' and/or loss given default," "the position of the specific liability in the issuer's capital structure," and "all other risks or factors that may affect repayment, such as, except for volatility/interest rate, prepayment, extension or liquidity risk."<sup>4</sup> The Proposed Designation Amendment is an abrupt and significant departure from a focus on credit risk.

While we understand that the Proposed Designation Amendment is intended to provide consistency across the P&P Manual with a single uniform definition of an NAIC Designation, it will produce inconsistencies in its application. Because credit ratings are by design not intended to measure anything other than credit risk, it is unclear how many credit ratings could be found to reasonably assess "investment risk" in accordance with the Proposed Designation Amendment and the FE Proposal. Merely replacing "credit risk" with "investment risk" in the P&P Manual fails to adequately clarify how NAIC designations, SVO analysis under the FE Proposal, and the use of credit ratings can be reconciled.

We would urge a clearer distinction between NAIC Designations and credit ratings for purposes of the FE Process, or alternatively, clarification on how the Proposed Designation Amendment is intended to be applied without introducing these inconsistencies.

We thank you for your consideration of our comments and look forward to continued engagement with the NAIC on these matters. KBRA remains committed to providing feedback and information to the NAIC as this process progresses and are always available when we can be of assistance.

Sincerely,

/S/ Kate Kennedy  
Senior Managing Director  
Co-Head of Business Development

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2024), available at [https://content.naic.org/sites/default/files/national\\_meeting/VOSTF%20Spring%20NM%20Materials%202024-03-16%20v3.pdf](https://content.naic.org/sites/default/files/national_meeting/VOSTF%20Spring%20NM%20Materials%202024-03-16%20v3.pdf).

<sup>4</sup> Paragraph 89 of Proposed P&P Manual Amendment to Update the Definition of an NAIC Designation.

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

**RE:** Revised Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (the “P&P Manual”) Authorizing the Procedures for the SVO’s Discretion Over NAIC Designations Assigned Through the Filing Exemption Process

**DATE:** June 4, 2024

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**Summary:** At the Summer National Meeting held on Aug. 14, 2023, the Task Force discussed an initial draft of a proposed amendment to the P&P Manual authorizing the procedures for the SVO’s discretion over NAIC designations assigned through the filing exemption (FE) process. The Task Force directed the SVO staff to consider the feedback from Task Force members and interested parties and update the proposal. At the subsequent Spring National Meeting held on March 16, 2024, the Task Force received additional comments on the updated amendment. The revised amendment in this memorandum reflects the recommended actionable comments received from Task Force members and interested parties during each comment period.

The revised amendment incorporates the following process steps, many of which were requested by interested parties:

- 1) SVO staff identifies a FE security with an NAIC Designation determined by a rating that appears to be an unreasonable assessment of investment risk.
- 2) SVO Credit Committee (CC) meets to determine if it agrees that the rating appears to be an unreasonable assessment of investment risk and, if so, places the security “Under Review”.
- 3) If the SVO CC votes to put the security “Under Review”, an information request will be sent through VISION to insurers that hold that security in their VISION portfolio and statutory financial statements, and the SVO Administrative Symbol “UR” will be assigned to identify them in VISION and AVS+.
- 4) If the information request is not responded to, the SVO may reach out to the domiciliary chief financial regulator.
- 5) Upon receipt of all necessary documentation through the information request, the SVO will then perform a full analysis of the security. During it’s the review the SVO will coordinate with insurer(s) authorized to discuss the security to discuss questions or issues the SVO may have about the security and to respond to any questions the

- authorized insurer(s) staff may have about the SVO's analysis. This communication is intended to be an open dialogue.
- 6) The SVO CC re-convenes to determine, based on its full analysis of all necessary information, whether the FE NAIC Designation is three (3) or more notches different than the SVO CC's opinion and, therefore, whether the SVO should proceed in requesting the removal of the CRP Rating from the FE process.
  - 7) If the SVO CC's decision is to proceed with the CRP rating removal request, the SVO CC and a Sub-group of the Task Force will meet to discuss the security. The domiciliary regulators of the authorized insurers will be invited to the Task Force Sub-group meeting and provided with relevant documentation through a confidential website. The authorized insurer(s) staff and other authorized parties requested by those insurers to participate, will be invited to present their analysis to the joint meeting. Also at that meeting, the SVO CC will present its analysis, which may include any information provided to it or independently sourced. Following the presentations, the SVO CC and Task Force Sub-group will deliberate privately and the Task Force Sub-Group will vote on whether it agrees with the SVO CC recommendation and whether the CRP rating will be removed from the FE process. At the conclusion of the joint meeting, the IAO will communicate the decision to the authorized insurer(s).
  - 8) At any time during this process an alternate CRP rating may be requested. If an alternative CRP rating is received, it will be incorporated into the FE process, if applicable. If there are no alternative CRP ratings, the SVO CC's assessment will be entered into VISION if the Task Force Sub-group approves the CRP rating removal.
  - 9) An anonymized summary of each unique issue or situation will be published on the SVO webpage or some other insurer accessible location for transparency.
  - 10) The SVO will identify through SVO Administrative Symbols when a CRP rating(s) has been removed from the Filing Exemption process for a security.
  - 11) At the Spring National Meeting, the SVO Director will summarize FE discretion actions taken during the preceding year.

**Recommendation:** It is expected that implementation of this process will require enhancements to NAIC's VISION and AVS+ applications. Additionally, given the requested revisions in this proposal to potentially share highly confidential and material non-public information, it may be necessary for the NAIC to add compliance and analytical review staff, and use specialized commercial systems to ensure confidentiality. Funding for the application enhancements, staffing and other system needs in the amendment, will need to be approved by the Executive (EX) Committee and the initiative will need to go through the NAIC's development and procurement process. It could take 1-2 years before this proposal can be fully implemented and fees will likely be needed to recover the initial and ongoing expense related to the revised proposal.

The SVO recommends adoption of this proposed amendment authorizing the procedures for the SVO's discretion over NAIC Designations assigned through the FE process with an effective date of January 1, 2026. The effective date can be amended, if needed, because of the dependency mentioned. The proposed text changes to P&P Manual are shown below with additions in red underline, and deletions in ~~red strikethrough~~ as it would appear in the 2023 P&P Manual format.



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

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<b>POLICIES APPLICABLE TO THE FILING EXEMPTION (FE) PROCESS</b>
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**NOTE:** The policies below provide the policy framework for “Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities” in Part Three and are related to “The Use of Credit Ratings of NRSROs in NAIC Processes” discussed above; “NAIC Policy on the Use of Credit Ratings of NRSROs” and the “Definition – Credit Ratings Eligible for Translation to NAIC Designations” in Part Two (“Eligible NAIC CRP Credit Ratings” excludes the use of any credit rating assigned to a security type where the NAIC has determined that the security type is not eligible to be reported on Schedule D or the it is not appropriate for NRSRO credit ratings to be used to determine the regulatory treatment of the security or asset.)

**Determinations**

80. The VOS/TF is resolved that the benefit obtained from the use of credit ratings in state regulation of insurance (i.e. conservation of limited regulatory resources) must be balanced against the risk of blind reliance on credit ratings. To ensure the Task Force properly understands the composition and risk of the filing exempt securities population; promote uniformity in the production of NAIC Designations, reduce reporting exceptions for filing exempt securities and increase the efficiency of this NAIC process, the SVO and SSG (hereafter, the IAO) is charged with administration of the filing exempt process defined in Part Three of this Manual.

**Directives**

81. The IAO shall:

- Recommend improvements to the production of NAIC Designations based on NRSRO credit ratings.
- Identify monitoring and communication procedures that enhance the possibility of regulatory intervention by the VOS/TF to respond to risks to insurer solvency posed by securities in the filing exempt population.
- Identify and develop correctives to the administrative, operational and system-based causes of reporting exemptions in the filing exempt process.
- Change the NAIC Designation equivalent calculated for filing exempt securities when necessary to correct errors or other anomaly that occur in the automated filing exempt process.



- Develop a staff-administered reporting exceptions resolution process that incorporates state insurance regulator and insurance companies' participation.
- In furtherance of the above directives, exclude specific otherwise Eligible NAIC CRP Credit Ratings from the automated filing exemption process in accordance with the administrative procedures outlined in Part Two of this Manual, if a Subgroup of the Task Force agrees with the determination of the IAO Credit Committee that the resulting NAIC Designation equivalent does not provide a reasonable assessment of investment risk for regulatory purposes.

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**PART TWO**  
**OPERATIONAL AND ADMINISTRATIVE INSTRUCTIONS**  
**APPLICABLE TO THE SVO**

## **SVO ORGANIZATION**

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...

### **SVO Administrative Symbols**

153. SVO administrative symbols convey information about a security or an administrative procedure instead of an opinion of credit quality. The administrative symbols in use by the SVO and their meanings are described below.

### **SVO Analytical Department Symbols**

154. All SVO analytical departments use the following administrative symbols:

...

- UR means the NAIC Designation assigned pursuant to the filing exemption process is under review by the NAIC's Investment Analysis Office.
- ER means that one or more otherwise Eligible NAIC CRP Credit Ratings have been excluded from the filing exemption process when determining the NAIC Designation through the Eligible NAIC CRP Rating exclusion procedures in this Manual.

## **PROCESS FOR EXCLUDING AN ELIGIBLE NAIC CRP RATING FROM FILING EXEMPTION FOR A SPECIFIC SECURITY**

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### **Overview**

164. This section outlines the process by which a state insurance regulator or IAO staff can contest an NAIC Designation Category assigned through the filing exemption process which it thinks is not a reasonable assessment of investment risk of the security for regulatory purposes. (Note: The guidance in this part is effective as of January 1, 2026, but this date may be amended if additional time is needed to implement the necessary NAIC technological enhancements to IAO systems.)

### **Request for Information**

165. The IAO staff will bring to the attention of the Credit Committee any filing exemption-eligible security assigned an NAIC Designation Category equivalent through the automated filing exemption process as being a security under review if (i) a state insurance regulator notifies the IAO staff that it has determined the NAIC Designation Category equivalent may not be a reasonable assessment of investment risk of the security for regulatory purposes, or (ii) the IAO staff, in its opinion, determines that the NAIC Designation Category equivalent may not be a reasonable assessment of investment risk of the security for regulatory purposes. State insurance regulator notification pursuant to this section does not negate the authority of state insurance regulators under “States May Require a Filing of Exempt or Other Transactions” in Part One of this Manual.
166. The Credit Committee will convene to determine if, in its opinion, the NAIC Designation Category assigned pursuant to the filing exemption process is a reasonable assessment of investment risk of the security for regulatory purposes. As part of its review, the Credit Committee may consider observable factors including, but not limited to (i) a comparison to peers rated by different CRPs, (ii) consistency of the security’s yield at issuance or current market yield to securities with equivalently calculated NAIC Designations rated by different CRPs, (iii) the IAO’s assessment of the security applying available methodologies, and (iv) any other factors it deems relevant. If the Credit Committee’s opinion is that the assigned NAIC Designation Category is likely a reasonable assessment of investment risk of the security for regulatory purposes, no further action will be taken at that time. If the Credit Committee’s opinion is that the assigned NAIC Designation Category is likely not a reasonable assessment of investment risk of the security for regulatory purposes, an information request will be initiated and the security will be put under review.

167. The IAO will notify insurance company holders of the security determined to be a Filing Exempt Security “Under Review” by issuing an information request and publishing a separate SVO Analytical Department Symbol of “UR” for under review in NAIC systems. The SVO Analytical Department Symbol of “UR” will not be reported on the statutory investment schedules. The purpose of the information request is to notify insurance company holders of the security to provide the IAO staff with sufficient information to perform a full analysis of the security. The information provided by insurers should be comparable to an Initial Filing, as described in this Manual, and must be accompanied by each insurer’s internal analysis. Consistent with the informational deficiency instructions in this Manual, security information consistent with an Initial Filing should be provided to the IAO within 45 days unless an extension has been granted to the insurance company by the IAO, not to exceed 90 days in total from the date that the IAO issues an information request. The IAO may contact the insurance company’s domiciliary chief financial regulator for assistance after the initial 45 days if there has been no meaningful response. If after 90 days additional information equivalent to an Initial Filing has not been provided to the IAO, the IAO may proceed with removal of the otherwise Eligible NAIC CRP Credit Rating(s) from the Filing Exempt process without convening the Sub-group of the Task Force, as described in this section.

### **Full Review**

168. At any time during the information request submission period or during the IAO’s subsequent analysis of the security, the insurance company holders of the security are encouraged to provide additional information to the IAO such as their internal analysis, presentations from the issuer, meetings with the issuer’s management team and any other information that may be useful or persuasive in the analysis of the security. The IAO will coordinate verbally and in writing with the authorized insurer(s) staff to discuss any questions or issues the IAO may have about the security and answer any question that the authorized insurer(s) staff may have about the IAO’s analysis.

169. Upon satisfactory receipt of the information through the information request, the IAO will perform a full analysis of the security during which time the SVO Analytical Department Symbol “UR” will remain in place but this symbol will not be reported on the statutory investment schedules.

### **IAO Determination and Materiality Threshold**

170. Upon completion of the IAO’s analysis, the Credit Committee will reconvene to determine its own opinion of the NAIC Designation Category. The Credit Committee will then determine whether the NAIC Designation Category assigned through the automated filing exemption process is materially different from its own assessment of the security’s risk.

171. The IAO will consider the materiality of the difference between the Eligible NAIC CRP Credit Rating used in the filing exempt process and the IAO's own assessment of the risk. The IAO may propose the removal of an otherwise Eligible NAIC CRP Credit Rating from the Filing Exemption process to a Task Force Sub-group only if the Credit Committee determines, based upon its review, that the Eligible NAIC CRP Credit Rating for the security is three (3) or more notches different than the IAO's assessment (e.g. NAIC Designation Category 1.G versus 2.C) (the "Materiality Threshold").

### Valuation of Securities (E) Task Force Oversight

172. The Credit Committee shall schedule a call with a VOS/TF Sub-Group (the composition of which shall be determined by the VOS/TF chair), ~~for so long as the VOS/TF chair deems such meetings necessary,~~ to discuss and explain its analytical basis for any Eligible NAIC CRP Credit Rating being recommended for removal from Filing Exemption eligibility. The Credit Committee will use communication processes that maintain confidentiality and notify domiciliary regulators of insurer holders of the security of the Sub-group meeting.

173. If the Credit Committee identifies that there is a recurring analytical pattern or concern, the IAO Director(s) will inform the VOS/TF chair and they will decide if an issue paper, referral, amendment to this Manual or some other action is needed.

174. Insurance company staff, and other parties invited by the insurer, that are authorized to discuss the security and who have agreed to confidentiality provisions required by the NAIC, may present their analytical basis to maintain the Eligible NAIC CRP Credit Rating's eligibility for Filing Exemption to the joint meeting of the VOS/TF Sub-group and the Credit Committee. Any materials shared during this meeting with the VOS/TF Sub- and Credit Committee are considered highly confidential and may not be shared beyond those participants at the meeting that have been identified as having been authorized to receive such materials and have agreed to maintain their confidentiality.

175. ~~If, at~~ At any time, the VOS/TF chair may direct the VOS/TF to review the described process to ensure it remains effective and efficient and to recommend revisions to any components ~~chooses not to convene a VOS/TF Sub-Group for this process, then the Credit Committee will conduct the meeting with insurance company staff and other invited parties without a VOS/TF Sub-Group and the Credit Committee's decision following such meeting will stand.~~

### **Assignment of NAIC Designation Category**

176. If the VOS/TF Sub-group disagrees with the Credit Committees' NAIC Designation Category opinion and determines that the NAIC Designation Category assigned pursuant to the Filing Exemption process does not meet the Materiality Threshold, the Eligible NAIC CRP Credit Rating shall remain eligible for Filing Exemption, the SVO Analytical Department Symbol "UR" will be deactivated, and no further action will be taken at that time. This determination shall not preclude the IAO from placing the same Eligible NAIC CRP Credit Rating under analytic review at a later date following a subsequent review should changing conditions warrant.
177. If the VOS/TF Sub-group agrees with the Credit Committees' NAIC Designation Category opinion and determines that the NAIC Designation Category assigned pursuant to the Filing Exemption process does meet the Materiality Threshold, the IAO is authorized to block the otherwise Eligible NAIC CRP Credit Rating in NAIC systems to prevent that otherwise Eligible NAIC CRP Credit Rating from being used in the automated Filing Exempt Securities Process.
178. If an Eligible NAIC CRP Rating has been removed from Filing Exemption eligibility for a security according to this section and the security has other Eligible NAIC CRP Rating(s) which have not been removed or the security receives an additional Eligible NAIC CRP Rating at any time during or after this process, then the security can receive its NAIC Designation Category through the Filing Exemption process based on the Eligible NAIC CRP Rating(s) that have not been removed. If there is no alternate Eligible NAIC CRP Rating in NAIC systems, the Credit Committee's NAIC Designation Category will be entered into NAIC systems to assign an NAIC Designation Category to the security.

### **Reinstatement of Filing Exemption Eligibility**

179. If an insurer would like the IAO to re-evaluate an Eligible NAIC CRP Credit Rating that was removed from Filing Exemption Eligibility for possible reinstatement in a subsequent filing year, it can follow the operational steps outlined in Appeals of SVO Determinations in this Manual to submit the request.

### **Reporting Securities Removed from Filing Exemption Eligibility**

180. The IAO Director(s) will prepare a summary of the removed from Filing Exemption Eligibility actions take over the prior calendar year.
181. The IAO will also publish an anonymized summary of each unique situation encountered for the securities subject to removal from Filing Exemption Eligibility and publish it on an insurer accessible web location.

182. To facilitate transparency as to the SVO’s application of discretion, the SVO Analytical Department Symbols “ER” will be added in NAIC Systems to securities with an excluded otherwise Eligible NAIC CRP Credit Rating(s). The SVO Analytical Department Symbols, “ER” will be reported on the insurer’s statutory investment schedules for the effected security instead of SVO Administrative Symbols “FE” for filing exemption.

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SVO Discretion - Revised v5.4.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)  
Eric Kolchinsky, Director, NAIC Structured Securities Group (SSG) and Capital Markets Bureau

**RE:** Revised Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (the “P&P Manual”) Authorizing the Procedures for the SVO’s Discretion Over NAIC Designations Assigned Through the Filing Exemption Process

**DATE:** July 30, 2024

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**Summary:** The Valuation of Securities (E) Task Force exposed the prior version of this amendment, dated June 4, 2024, for a 38-day comment period that ended on July 26, 2024. The following updates have been made to this prior version and reflect recommendations received from interested parties.

- Clarification that the process will be consistently applied to all CRPs.
- The term “authorized insurers” is defined.
- Clarification of the SVO’s written summary of its analysis during the review phase.
- Including other authorized parties to discuss the security with the SVO.
- IAO shall communicate in writing its opinion of the appropriate NAIC Designation Category.
- The annual summary will be anonymized and will not disclose information on specific securities, CRPs or impacted insurers.
- The SVO will publish within 45 days of a security being removed from the Filing Exemption process an anonymized summary (without references specific to the security or CRP, to avoid disclosing confidential information).
- Impact to issuers that have multiple securities within the same debt class.

**Recommendation:** The SVO recommends adoption of this proposed amendment authorizing the procedures for the SVO’s discretion over NAIC Designations assigned through the FE process with an effective date of January 1, 2026. The effective date can be amended, if needed, if additional time is needed to implement the applicable technological enhancements, as previously discussed. The proposed text changes to P&P Manual are shown in red-underline or ~~red-strikethrough~~ below with new text since the last exposure highlighted in yellow.

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

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**POLICIES APPLICABLE TO THE FILING EXEMPTION (FE) PROCESS**

**NOTE:** The policies below provide the policy framework for “Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities” in Part Three and are related to “The Use of Credit Ratings of NRSROs in NAIC Processes” discussed above; “NAIC Policy on the Use of Credit Ratings of NRSROs” and the “Definition – Credit Ratings Eligible for Translation to NAIC Designations” in Part Two (“Eligible NAIC CRP Credit Ratings” excludes the use of any credit rating assigned to a security type where the NAIC has determined that the security type is not eligible to be reported on Schedule D or the it is not appropriate for NRSRO credit ratings to be used to determine the regulatory treatment of the security or asset.)

**Determinations**

80. The VOS/TF is resolved that the benefit obtained from the use of credit ratings in state regulation of insurance (i.e. conservation of limited regulatory resources) must be balanced against the risk of blind reliance on credit ratings. To ensure the Task Force properly understands the composition and risk of the filing exempt securities population; promote uniformity in the production of NAIC Designations, reduce reporting exceptions for filing exempt securities and increase the efficiency of this NAIC process, the SVO and SSG (hereafter, the IAO) is charged with administration of the filing exempt process defined in Part Three of this Manual.

**Directives**

81. The IAO shall:

- Recommend improvements to the production of NAIC Designations based on NRSRO credit ratings.
- Identify monitoring and communication procedures that enhance the possibility of regulatory intervention by the VOS/TF to respond to risks to insurer solvency posed by securities in the filing exempt population.
- Identify and develop correctives to the administrative, operational and system-based causes of reporting exemptions in the filing exempt process.
- Change the NAIC Designation equivalent calculated for filing exempt securities when necessary to correct errors or other anomaly that occur in the automated filing exempt process.

- Develop a staff-administered reporting exceptions resolution process that incorporates state insurance regulator and insurance companies' participation.
- In furtherance of the above directives, exclude specific otherwise Eligible NAIC CRP Credit Ratings from the automated filing exemption process in accordance with the administrative procedures outlined in Part Two of this Manual, if a Subgroup of the Task Force agrees with the determination of the IAO Credit Committee that the resulting NAIC Designation equivalent does not provide a reasonable assessment of investment risk for regulatory purposes.

...

**PART TWO**  
**OPERATIONAL AND ADMINISTRATIVE INSTRUCTIONS**  
**APPLICABLE TO THE SVO**

## **SVO ORGANIZATION**

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### **SVO Administrative Symbols**

153. SVO administrative symbols convey information about a security or an administrative procedure instead of an opinion of credit quality. The administrative symbols in use by the SVO and their meanings are described below.

### **SVO Analytical Department Symbols**

154. All SVO analytical departments use the following administrative symbols:

...

- UR means the NAIC Designation assigned pursuant to the filing exemption process is under review by the NAIC's Investment Analysis Office.
- ER means that one or more otherwise Eligible NAIC CRP Credit Ratings have been excluded from the filing exemption process when determining the NAIC Designation through the Eligible NAIC CRP Rating exclusion procedures in this Manual.

## **PROCESS FOR EXCLUDING AN ELIGIBLE NAIC CRP RATING FROM FILING EXEMPTION FOR A SPECIFIC SECURITY**

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### **Overview**

164. This section outlines the process by which a state insurance regulator or IAO staff can contest an NAIC Designation Category assigned through the filing exemption process which it thinks is not a reasonable assessment of investment risk of the security for regulatory purposes. The process in this section will be consistently applied to all CRPs, without favor to any individual CRP or class of CRPs, and is not expected to be used often. For purposes of this section, the term “authorized insurers” is defined as: Holders of the affected securities that agree to the confidentiality provisions required by the NAIC.

(Note: The guidance in this part is effective as of January 1, 2026, but this date may be amended if additional time is needed to implement the necessary NAIC technological enhancements to IAO systems.)

### **Request for Information**

165. The IAO staff will bring to the attention of the Credit Committee any filing exemption-eligible security assigned an NAIC Designation Category equivalent through the automated filing exemption process as being a security under review if (i) a state insurance regulator notifies the IAO staff that it has determined the NAIC Designation Category equivalent may not be a reasonable assessment of investment risk of the security for regulatory purposes, or (ii) the IAO staff, in its opinion, determines that the NAIC Designation Category equivalent may not be a reasonable assessment of investment risk of the security for regulatory purposes. State insurance regulator notification pursuant to this section does not negate the authority of state insurance regulators under “States May Require a Filing of Exempt or Other Transactions” in Part One of this Manual.

166. The Credit Committee will convene to determine if, in its opinion, the NAIC Designation Category assigned pursuant to the filing exemption process is a reasonable assessment of investment risk of the security for regulatory purposes. As part of its review, the Credit Committee may consider observable factors including, but not limited to (i) a comparison to peers rated by different CRPs, (ii) consistency of the security's yield at issuance or current market yield to securities with equivalently calculated NAIC Designations rated by different CRPs, (iii) the IAO's assessment of the security applying available methodologies, and (iv) any other factors it deems relevant. If the Credit Committee's opinion is that the assigned NAIC Designation Category is likely a reasonable assessment of investment risk of the security for regulatory purposes, no further action will be taken at that time. If the Credit Committee's opinion is that the assigned NAIC Designation Category is likely not a reasonable assessment of investment risk of the security for regulatory purposes, an information request will be initiated and the security will be put under review.
167. The IAO will notify insurance company holders of the security determined to be a Filing Exempt Security "Under Review" by issuing an information request and publishing a separate SVO Analytical Department Symbol of "UR" for under review in NAIC systems. The SVO Analytical Department Symbol of "UR" will not be reported on the statutory investment schedules. The purpose of the information request is to notify insurance company holders of the security to provide the IAO staff with sufficient information to perform a full analysis of the security. The information provided by insurers should be comparable to an Initial Filing, as described in this Manual, and must be accompanied by each insurer's internal analysis. Consistent with the informational deficiency instructions in this Manual, security information consistent with an Initial Filing should be provided to the IAO within 45 days unless an extension has been granted to the insurance company by the IAO, not to exceed 90 days in total from the date that the IAO issues an information request. The IAO may contact the insurance company's domiciliary chief financial regulator for assistance after the initial 45 days if there has been no meaningful response. If after 90 days additional information equivalent to an Initial Filing has not been provided to the IAO, the IAO may proceed with removal of the otherwise Eligible NAIC CRP Credit Rating(s) from the Filing Exempt process without convening the Sub-group of the Task Force, as described in this section.

For the avoidance of doubt, if an issuer has multiple securities within the same debt class (i.e. position in the capital stack) whose ratings are placed Under Review, for purposes of this process only, insurers must only provide requested information materials once. After a final determination is made regarding the CRP ratings for the affected securities, should the IAO's proposed NAIC Designation Category prevail, insurers would then need to file all securities/identifiers individually to receive an IAO-assigned NAIC Designation upon NAIC Designation renewal.



## Full Review

168. At any time during the information request submission period or during the IAO's subsequent analysis of the security, the insurance company holders of the security are encouraged to provide additional information to the IAO such as their internal analysis, presentations from the issuer, meetings with the issuer's management team and any other information that may be useful or persuasive in the analysis of the security. The IAO will coordinate verbally and in writing with the authorized insurer(s) staff to discuss any questions or issues the IAO may have about the security and answer any question that the authorized insurer(s) staff may have about the IAO's analysis. The IAO will provide a written summary of its analysis and its view of why it believes the CRP's risk assessment is an unreasonable assessment of investment risk for regulatory purposes to authorized insurers. It will also coordinate verbally and in writing with the authorized insurer(s) staff to discuss any questions or issues the IAO may have about the security and answer any question that the authorized insurer(s) staff may have about the IAO's analysis. The authorized insurer(s) staff may invite other authorized parties that have agreed to the confidentiality provisions required by the NAIC to these discussions with the IAO.
169. Upon satisfactory receipt of the information through the information request, the IAO will perform a full analysis of the security during which time the SVO Analytical Department Symbol "UR" will remain in place but this symbol will not be reported on the statutory investment schedules.

## IAO Determination and Materiality Threshold

170. Upon completion of the IAO's analysis, the Credit Committee will reconvene to determine its own opinion of the NAIC Designation Category. The Credit Committee will then determine whether the NAIC Designation Category assigned through the automated filing exemption process is materially different from its own assessment of the security's risk.
171. The IAO will consider the materiality of the difference between the Eligible NAIC CRP Credit Rating used in the filing exempt process and the IAO's own assessment of the risk. The IAO may propose the removal of an otherwise Eligible NAIC CRP Credit Rating from the Filing Exemption process to a Task Force Sub-group only if the Credit Committee determines, based upon its review, that the Eligible NAIC CRP Credit Rating for the security is three (3) or more notches different than the IAO's assessment (e.g. NAIC Designation Category 1.G versus 2.C) (the "Materiality Threshold").

### Valuation of Securities (E) Task Force Oversight

172. The Credit Committee shall schedule a call with a VOS/TF Sub-Group (the composition of which shall be determined by the VOS/TF chair) to discuss and explain its analytical basis for any Eligible NAIC CRP Credit Rating being recommended for removal from Filing Exemption eligibility. The Credit Committee will use communication processes that maintain confidentiality and **notify invite the domiciliary regulators of insurer holders of the security of to participate in** the Sub-group meeting.
173. If the Credit Committee identifies that there is a recurring analytical pattern or concern, the IAO Director(s) will inform the VOS/TF chair and they will decide if an issue paper, referral, amendment to this Manual or some other action is needed **to be introduced into Task Force proceedings and deliberation.**
174. Insurance company staff, and other parties invited by the insurer, that are authorized to discuss the security and who have agreed to confidentiality provisions required by the NAIC, may present their analytical basis to maintain the Eligible NAIC CRP Credit Rating's eligibility for Filing Exemption to the joint meeting of the VOS/TF Sub-group and the Credit Committee. **Prior to inviting insurers to discuss the security and CRP ratings in question, the IAO shall communicate in writing what it believes the NAIC Designation Category to be, citing the main considerations that form the basis of the IAO's proposed NAIC Designation Category.** Any materials shared during, **or in advance of,** this meeting with the VOS/TF Sub-group and Credit Committee are considered highly confidential and may not be shared beyond those participants at the meeting that have been identified as having been authorized to receive such materials and have agreed to maintain their confidentiality.
175. At any time, the VOS/TF chair may direct the VOS/TF to review the described process to ensure it remains effective and efficient and to recommend revisions to any components.

### Assignment of NAIC Designation Category

176. If the VOS/TF Sub-group disagrees with the Credit Committees' NAIC Designation Category opinion and determines that the NAIC Designation Category assigned pursuant to the Filing Exemption process *does not* meet the Materiality Threshold, the Eligible NAIC CRP Credit Rating shall remain eligible for Filing Exemption, the SVO Analytical Department Symbol "UR" will be deactivated, and no further action will be taken at that time. This determination shall not preclude the IAO from placing the same Eligible NAIC CRP Credit Rating under analytic review at a later date following a subsequent review should changing conditions warrant.

177. If the VOS/TF Sub-group agrees with the Credit Committees' NAIC Designation Category opinion and determines that the NAIC Designation Category assigned pursuant to the Filing Exemption process *does* meet the Materiality Threshold, the IAO is authorized to block the otherwise Eligible NAIC CRP Credit Rating in NAIC systems to prevent that otherwise Eligible NAIC CRP Credit Rating from being used in the automated Filing Exempt Securities Process.
178. If an Eligible NAIC CRP Rating has been removed from Filing Exemption eligibility for a security according to this section and the security has other Eligible NAIC CRP Rating(s) which have not been removed or the security receives an additional Eligible NAIC CRP Rating at any time during or after this process, then the security can receive its NAIC Designation Category through the Filing Exemption process based on the Eligible NAIC CRP Rating(s) that have not been removed. If there is no alternate Eligible NAIC CRP Rating in NAIC systems, the Credit Committee's NAIC Designation Category will be entered into NAIC systems to assign an NAIC Designation Category to the security.

#### **Reinstatement of Filing Exemption Eligibility**

179. If an insurer would like the IAO to re-evaluate an Eligible NAIC CRP Credit Rating that was removed from Filing Exemption Eligibility for possible reinstatement in a subsequent filing year, it can follow the operational steps outlined in Appeals of SVO Determinations in this Manual to submit the request.

#### **Reporting Securities Removed from Filing Exemption Eligibility**

180. The IAO Director(s) will prepare an anonymized summary that does not disclose specific securities, CRPs or impacted insurers of the removed from Filing Exemption Eligibility actions taken over the prior calendar year.
181. Within 45 days of a security being removed from the Filing Exemption process, the IAO will also publish an anonymized summary (without references specific to the security, to avoid disclosing confidential information) of each unique situation encountered for the securities subject to removal from Filing Exemption Eligibility and publish it on an insurer accessible web location.
182. To facilitate transparency as to the SVO's application of discretion, the SVO Analytical Department Symbols "ER" will be added in NAIC Systems to securities with an excluded otherwise Eligible NAIC CRP Credit Rating(s). The SVO Analytical Department Symbols, "ER" *will be* reported on the insurer's statutory investment schedules for the effected security instead of SVO Administrative Symbols "FE" for filing exemption.

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<https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-08 Summer NM/04-SVO Discretion/2023-005.16a PP SVO Discretion - Revised v6.1.docx>



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Doug Ommen  
Iowa Insurance Commissioner  
Chair, Valuation of Securities (E) Task Force  
National Association of Insurance Commissioners

**Via Electronic Submission**

July 26, 2024

**Re: Revised Amendment to the NAIC IAO P&P Manual Authorizing Procedures for SVO Discretion over NAIC Designations Assigned Through the Filing Exemption Process**

Dear Commissioner Ommen and members of the Valuation of Securities Task Force (“VOSTF”),

The Alternative Credit Council (“ACC”)<sup>1</sup>, the private credit affiliate of the Alternative Investment Management Association Ltd (“AIMA”), appreciates the opportunity to comment on the revised proposal to authorize the Securities Valuation Office (“SVO”) of the National Association of Insurance Commissioners (“NAIC”) to review and potentially adjust the credit rating issued by an NAIC recognized credit rating provider (“CRP”).<sup>2</sup>

The revised proposal would amend the rule adopted by the NAIC in 2004 that exempts bonds and preferred stock that have received a current, monitored rating from an NAIC-recognized CRP from the requirement to receive an NAIC designation from the SVO. Instead, the rating provided by the

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<sup>1</sup> The Alternative Credit Council (ACC) is a global body that represents asset management firms in the private credit and direct lending space. It currently represents 250 members that manage over \$1trn of private credit assets. The ACC is an affiliate of AIMA and is governed by its own board which ultimately reports to the AIMA Council. ACC members provide an important source of funding to the economy. They provide finance to mid-market corporates, SMEs, commercial and residential real estate developments, infrastructure, and the trade and receivables business. The ACC’s core objectives are to provide guidance on policy and regulatory matters, support wider advocacy and educational efforts and generate industry research with the view to strengthening the sector’s sustainability and wider economic and financial benefits. Alternative credit, private debt or direct lending funds have grown substantially in recent years and are becoming a key segment of the asset management industry. The ACC seeks to explain the value of private credit by highlighting the sector’s wider economic and financial stability benefits.

<sup>2</sup> Amendment to the P&P Manual of the NAIC Investment Analysis Office Authorizing the Procedures for the SVO’s Discretion Over NAIC Designations Assigned Through the Filing Exemption Process (hereinafter “SVO Rating Override Proposal”), available at <https://content.naic.org/sites/default/files/inline-files/2023-005.15%20P%26P%20SVO%20Discretion%20-%20Revised%20v4.pdf>

Alternative Credit Council (ACC)





ALTERNATIVE  
CREDIT COUNCIL

CRP is converted to the NAIC designation and used by insurance supervisors for reporting, reserving and capital charge purposes. Under the revised proposal, there would be fifteen steps in the SVO process to review all filing-exempt ratings and determine which CRP ratings should be overridden and replaced by the SVO's own rating.

We appreciate the additional positive changes made by the SVO in its June 4, 2024 memo to the VOSTF to improve transparency and procedural protections, which addressed a number of concerns articulated in our January 26, 2024 letter.<sup>3</sup> The recent changes would result in a more transparent process, but we still have a conceptual concern about the market uncertainty that could easily result from any actions taken under this process. For that reason, we think it would be very helpful if the VOSTF would clearly state in the operational instructions to the SVO that this new authority should be rarely used.

In addition, we have two additional suggestions to further improve the process. Specifically, paragraph 172 references that the VOSTF chair shall determine the composition of the sub-group that will consider whether to remove a CRP rating from filing exempt status. We would recommend that the relevant domiciliary regulator(s) be included as a sub-group member in each review—even if they are not a standing member of the sub-group. This would ensure that the domiciliary regulator has a role in the review and is able to vote on a proposal that would impact an insurer in their jurisdiction.

Secondly, we are concerned that a lengthy review and appeals process could effectively make a successful appeal impossible given how market changes and competitive pressures might make an appeal impractical. For that reason, we recommend that specific timeframes should be included in paragraph 169 to ensure that once the rating has been marked as being under review, the length of the review process will not, in effect, make the private rating ineffective regardless of the eventual outcome. We have similar concerns about the lack of a timeline in the appeals process outlined in paragraph 179.

If you have any questions, please contact me or Joe Engelhard, Head of Private Credit & Asset Management Policy, Americas, at [jengelhard@aima.org](mailto:jengelhard@aima.org) or 202-304-0311.

Sincerely,

Yours sincerely,



Jiří Król

Deputy CEO, Global Head of Government Affairs

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<sup>3</sup> <https://content.naic.org/sites/default/files/inline-files/2023-005.16%20P%26P%20SVO%20Discretion%20-%20Revised%20v5.4.pdf>

**Mike Monahan**

Senior Director, Accounting Policy  
(202) 624-2324 t  
mikemonahan@acli.com

July 26, 2024

**Ms. Carrie Mears**

Chair, Valuation of Securities (E) Task Force (VOSTF)  
National Association of Insurance Commissioners (NAIC)  
110 Walnut Street, Suite 1500  
Kansas City, MO 64106-2197

**Re: Revised Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (the “P&P Manual”) Authorizing the Procedures for the SVO’s Discretion Over NAIC Designations Assigned Through the Filing Exemption Process**

Dear Ms. Mears:

The ACLI, PPIA and NASVA (collectively “the Undersigned”) appreciate the opportunity to comment on the above referenced amendment to the Purposes and Procedures Manual dated June 4, 2024.

The Undersigned propose several revisions to the proposed draft changes to the Purposes and Procedures Manual. These revisions provide greater clarity for industry without affecting the Regulators’ ability to have oversight and discretion over the FE process. Please see below for the proposed revisions/changes:

*In section 164:*

1) The term Authorized insurer(s) should be defined as: “Holders of the affected securities that agree to the confidentiality provisions required by the NAIC and contribute to the Initial Filing of the security Under Review.” Please see the mark-up in paragraph 164 of the attachment to this letter.

*In section 167:*

1) The notification process should be well defined to ensure that affected insurers provide timely responses. This may entail development of a new method (either with existing systems or via email) to “alert” the affected insurers. Rather than requiring specific language changes to the P&P Manual to address this operational issue, insurers and the IAO can work together to develop an appropriate notification process, prior to the 1/1/26 implementation date.

2) To minimize administrative burden and redundancy in the ratings review (“Review”) process, the requirement to effectively perform an Initial Filing on all securities Under Review from a common issuer (within the same debt class) should be deemed satisfied if one Initial Filing is completed for the issuer and the class of securities Under Review (as opposed to requiring each individual security/identifier to be filed as part of the Review process). Industry should be encouraged to coordinate efforts to make this process as efficient as possible. After completing



the Review process, if the Eligible CRP Rating has been removed, then each security/identifier will be required to be filed through the normal filing process. Please see the mark-up in paragraph 167 of the attachment to this letter.

In section 168:

1) At the June 18, 2024 VOS/TF meeting, Regulators agreed that, as part of the ratings review process, the IAO should provide insurers with a written rationale that explains the IAO's assessment of key risk drivers for a security and why the IAO disagrees with the CRP rating. That expectation should be expressed explicitly in the P&P Manual. It appears the proposed change "verbally and in writing" inadvertently only relates to the coordination with authorized insurers. As such, the Undersigned propose replacing the last sentence in this section with the following two sentences: "The IAO will provide a written summary of its analysis and its view of why it believes the CRP's risk assessment is an unreasonable assessment of investment risk for regulatory purposes. It will also coordinate verbally and in writing with the authorized insurer(s) staff to discuss any questions or issues the IAO may have about the security and answer any question that the authorized insurer(s) staff may have about the IAO's analysis." Please see the mark-up on paragraph 168 of the attachment to this letter.

In section 174:

1) At this point in the Review process, the security has now undergone a full review with the Credit Committee, and the IAO has finalized its proposed NAIC Designation Category. It is important that the written communication provided to authorized insurers be updated to include the proposed NAIC Designation Category, in addition to the rationale that explains the IAO's assessment of key risk drivers for the security and why the IAO disagrees with the CRP rating. This final communication step will allow authorized insurers to decide whether they wish to continue with the VOS/TF Sub-group review or accept the IAO's proposed NAIC Designation Category and end the Review process. Please see the mark-up on paragraph 174 of the attachment to this letter.

In section 181:

1) The anonymized summaries of each unique situation encountered should be communicated to industry on a timely basis. This can be achieved by inserting the language "Within 45 days of a security being removed from the Filing Exemption process," at the beginning of this section in the P&P Manual.

2) Industry also proposes adding the parenthetical language "(without references specific to the security, to avoid disclosing confidential information)" after the words "anonymized summary" in this section. Please see the mark-up on paragraph 181 of the attachment to this letter for both changes.

To aid in the process, the Undersigned have also included a mark-up of the exposed P&P Manual language. Our proposed changes are underlined. We stand ready to work constructively with the NAIC to discuss our proposed changes. Please feel free to reach out with any questions.

Sincerely,



Mike Monahan  
ACLI

*Tracey Lindsey*

Tracey Lindsey  
NASVA

*John Petchler*

John Petchler  
on behalf of PPIA Board of Directors

cc: Charles Therriault, Director, Securities Valuation Office  
Eric Kolchinsky, Director, Structured Securities Group

<sup>1</sup> 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.

<sup>2</sup> The Private Placement Investors Association ("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 66 member companies and works with regulators, NASVA, the ACLI, the American College of Investment Counsel, and the investment banking community to efficiently implement changes within the private placement marketplace. For more information, visit [www.usppia.com](http://www.usppia.com).

<sup>3</sup> The National Association of Securities Valuation Analysts ("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.

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

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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**

## PART ONE

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

#### POLICIES APPLICABLE TO THE FILING EXEMPTION (FE) PROCESS

**NOTE:** The policies below provide the policy framework for “Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities” in Part Three and are related to “The Use of Credit Ratings of NRSROs in NAIC Processes” discussed above; “NAIC Policy on the Use of Credit Ratings of NRSROs” and the “Definition – Credit Ratings Eligible for Translation to NAIC Designations” in Part Two (“Eligible NAIC CRP Credit Ratings” excludes the use of any credit rating assigned to a security type where the NAIC has determined that the security type is not eligible to be reported on Schedule D or the it is not appropriate for NRSRO credit ratings to be used to determine the regulatory treatment of the security or asset.)

#### Determinations

80. The VOS/TF is resolved that the benefit obtained from the use of credit ratings in state regulation of insurance (i.e. conservation of limited regulatory resources) must be balanced against the risk of blind reliance on credit ratings. To ensure the Task Force properly understands the composition and risk of the filing exempt securities population, promote uniformity in the production of NAIC Designations, reduce reporting exceptions for filing exempt securities and increase the efficiency of this NAIC process, the SVO and SSG (hereafter, the IAO) is charged with administration of the filing exempt process defined in Part Three of this Manual.

#### Directives

81. The IAO shall:

- Recommend improvements to the production of NAIC Designations based on NRSRO credit ratings.
- Identify monitoring and communication procedures that enhance the possibility of regulatory intervention by the VOS/TF to respond to risks to insurer solvency posed by securities in the filing exempt population.
- Identify and develop correctives to the administrative, operational and system-based causes of reporting exemptions in the filing exempt process.
- Change the NAIC Designation equivalent calculated for filing exempt securities when necessary to correct errors or other anomaly that occur in the automated filing exempt process.
- Develop a staff-administered a reporting exceptions resolution process that incorporates state insurance regulator and insurance companies’ participation.
- In furtherance of the above directives, exclude specific otherwise Eligible NAIC CRP Credit Ratings from the automated filing exemption process in accordance

with the administrative procedures outlined in Part Two of this Manual, if a Subgroup of the Task Force agrees with the determination of the IAO Credit Committee that the resulting NAIC Designation equivalent does not provide a reasonable assessment of investment risk for regulatory purposes.

## PART TWO

### OPERATIONAL AND ADMINISTRATIVE INSTRUCTIONS APPLICABLE TO THE SVO

#### SVO ORGANIZATION

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##### SVO Administrative Symbols

153. SVO administrative symbols convey information about a security or an administrative procedure instead of an opinion of credit quality. The administrative symbols in use by the SVO and their meanings are described below.

##### SVO Analytical Department Symbols

154. All SVO analytical departments use the following administrative symbols:
- **UR** means the NAIC Designation assigned pursuant to the filing exemption process is under review by the NAIC's Investment Analysis Office.
  - **ER** means that one or more otherwise Eligible NAIC CRP Credit Ratings have been excluded from the filing exemption process when determining the NAIC Designation through the Eligible NAIC CRP Rating exclusion procedures in the Manual.

#### PROCESS FOR EXCLUDING AN ELIGIBLE NAIC CRP RATING FROM FILING EXEMPTION FOR A SPECIFIC SECURITY

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##### Overview

164. This section outlines the process by which a state insurance regulator or IAO staff can contest an NAIC Designation Category assigned through the filing exemption process which it thinks is not a reasonable assessment of investment risk of the security for regulatory purposes. For purposes of this section, the term "authorized insurers" is defined as: "Holders of the affected securities that agree to the confidentiality provisions required by the NAIC. (Note: The guidance in this part is effective as of January 1, 2026, but this date may be amended if additional time is needed to implement the necessary NAIC technological enhancements to IAO systems.)

## Request for Information

165. The IAO staff will bring to the attention of the Credit Committee any filing exemption-eligible security assigned an NAIC Designation Category equivalent through the automated filing exemption process as being a security under review if (i) a state insurance regulator notifies the IAO staff that it has determined the NAIC Designation Category equivalent may not be a reasonable assessment of investment risk of the security for regulatory purposes, or (ii) the IAO staff, in its opinion, determines that the NAIC Designation Category equivalent may not be a reasonable assessment of investment risk of the security for regulatory purposes. State insurance regulator notification pursuant to this section does not negate the authority of state insurance regulators under “States May Require a Filing of Exempt or Other Transactions” in Part One of this Manual.
  
166. The Credit Committee will convene to determine if, in its opinion, the NAIC Designation Category assigned pursuant to the filing exemption process is a reasonable assessment of investment risk of the security for regulatory purposes. As part of its review, the Credit Committee may consider observable factors including, but not limited to (i) a comparison to peers rated by different CRPs, (ii) consistency of the security’s yield at issuance or current market yield to securities with equivalently calculated NAIC Designations rated by different CRPs, (iii) the IAO’s assessment of the security applying available methodologies, and (iv) any other factors it deems relevant. If the Credit Committee’s opinion is that the assigned NAIC Designation Category is likely a reasonable assessment of investment risk of the security for regulatory purposes, no further action will be taken at that time. If the Credit Committee’s opinion is that the assigned NAIC Designation Category is likely not a reasonable assessment of investment risk of the security for regulatory purposes, an information request will be initiated and the security will be put under review.
  
167. The IAO will notify insurance company holders of the security determined to be a Filing Exempt Security “Under Review” by issuing an information request and publishing a separate SVO Analytical Department Symbol of “UR” for under review in NAIC systems. The SVO Analytical Department Symbol of “UR” will not be reported on the statutory investment schedules. The purpose of the information request is to notify insurance company holders of the security to provide the IAO staff with sufficient information to perform a full analysis of the security. The information provided by insurers should be comparable to an Initial Filing, as described in this Manual, and must be accompanied by each insurer’s internal analysis. Consistent with the informational deficiency instructions in this Manual, security information consistent with an Initial Filing should be provided to the IAO within 45 days unless an extension has been granted to the insurance company by the IAO, not to exceed 90 days in total from the date that the IAO issues an information request. The IAO may contact the insurance company’s domiciliary chief financial regulator for assistance after the initial 45 days if there has been no meaningful response. If after

90 days additional information equivalent to an Initial Filing has not been provided to the IAO, the IAO may proceed with removal of the otherwise Eligible NAIC CRP Credit Rating(s) from the Filing Exempt process without convening the Sub-group of the Task Force, as described in this section.

For the avoidance of doubt, if an issuer has multiple securities within the same debt class (i.e., position in the capital stack) whose ratings are placed Under Review, for purposes of this process only, insurers must only provide requested information materials once. After a final determination is made regarding the CRP ratings for the affected securities, should the IAO's proposed NAIC Designation Category prevail, insurers would then need to file all securities/identifiers individually to receive an IAO-assigned designation upon designation renewal.

### **Full Review**

168. At any time during the information request submission period or during the IAO's subsequent analysis of the security, the insurance company holders of the security are encouraged to provide additional information to the IAO such as their internal analysis, presentations from the issuer, meetings with the issuer's management team and any other information that may be useful or persuasive in the analysis of the security. ~~The IAO will coordinate verbally and in writing with authorized insurer(s) staff to discuss any questions or issues the IAO may have about the security and answer any questions that the authorized insurers(s) staff may have about the IAO's analysis.~~ The IAO will provide a written summary of its analysis and its view of why it believes the CRP's risk assessment is an unreasonable assessment of investment risk for regulatory purposes. It will also coordinate verbally and in writing with the authorized insurer(s) staff to discuss any questions or issues the IAO may have about the security and answer any question that the authorized insurer(s) staff may have about the IAO's analysis.
169. Upon satisfactory receipt of the information through the information request, the IAO will perform a full analysis of the security during which time the SVO Analytical Department Symbol "UR" will remain in place but this symbol will not be reported on the statutory investment schedules.

### **IAO Determination and Materiality Threshold**

170. Upon completion of the IAO's analysis, the Credit Committee will reconvene to determine its own opinion of the NAIC Designation Category. The Credit Committee will then determine whether the NAIC Designation Category assigned through the automated filing exemption process is materially different from its own assessment of the security's risk.
171. The IAO will consider the materiality of the difference between the Eligible NAIC CRP Credit Rating used in the filing exempt process and the IAO's own assessment of the risk. The IAO may propose the removal of an otherwise Eligible NAIC CRP Credit Rating from the Filing Exemption process to a Task Force Sub-group only if the

Credit Committee determines, based upon its review, that the Eligible NAIC CRP Credit Rating for the security is three (3) or more notches different than the IAO's assessment (e.g. NAIC Designation Category 1.G versus 2.C) (the "Materiality Threshold").

### **Valuation of Securities (E) Task Force Oversight**

172. The Credit Committee shall schedule a call with a VOS/TF Sub-Group (the composition of which shall be determined by the VOS/TF chair) to discuss and explain its analytical basis for any Eligible NAIC CRP Credit Rating being recommended for removal from Filing Exemption eligibility. The Credit Committee will use communication processes that maintain confidentiality and notify domiciliary regulators of insurer holders of the security of the Sub-group meeting.
173. If the Credit Committee identifies that there is a recurring analytical pattern or concern, the IAO Director(s) will inform the VOS/TF chair and they will decide if an issue paper, referral, amendment to this Manual or some other action is needed.
174. Insurance company staff, and other parties invited by the insurer, that are authorized to discuss the security and who have agreed to confidentiality provisions required by the NAIC, may present their analytical basis to maintain the Eligible NAIC CRP Credit Rating's eligibility for Filing Exemption to the joint meeting of the VOS/TF Sub-group and the Credit Committee. Prior to inviting insurers to discuss the security and CRP ratings in question, the IAO shall communicate in writing what it believes the NAIC Designation Category to be, citing the main considerations that form the basis of the IAO's proposed NAIC Designation Category. Any materials shared during, or in advance of, this meeting with the VOS/TF Sub-group and Credit Committee are considered highly confidential and may not be shared beyond those participants at the meeting that have been identified as having been authorized to receive such materials and have agreed to maintain their confidentiality.
175. At any time, the VOS/TF chair may direct the VOS/TF to review the described process to ensure it remains effective and efficient and to recommend revisions to any components.

### **Assignment of NAIC Designation Category**

176. If the VOS/TF Sub-group disagrees with the Credit Committees' NAIC Designation Category opinion and determines that the NAIC Designation Category assigned pursuant to the Filing Exemption process *does not* meet the Materiality Threshold, the Eligible NAIC CRP Credit Rating shall remain eligible for Filing Exemption, the SVO Analytical Department Symbol "UR" will be deactivated, and no further action will be

taken at that time. This determination shall not preclude the IAO from placing the same Eligible NAIC CRP Credit Rating under analytic review at a later date following a subsequent review should changing conditions warrant. 8/13/24

177. If the VOS/TF Sub-group agrees with the Credit Committees' NAIC Designation Category opinion and determines that the NAIC Designation Category assigned pursuant to the Filing Exemption process *does* meet the Materiality Threshold, the IAO is authorized to block the otherwise Eligible NAIC CRP Credit Rating in NAIC systems to prevent that otherwise Eligible NAIC CRP Credit Rating from being used in the automated Filing Exempt Securities Process.
178. If an Eligible NAIC CRP Rating has been removed from Filing Exemption eligibility for a security according to this section and the security has other Eligible NAIC CRP Rating(s) which have not been removed or the security receives an additional Eligible NAIC CRP Rating at any time during or after this process, then the security can receive its NAIC Designation Category through the Filing Exemption process based on the Eligible NAIC CRP Rating(s) that have not been removed. If there is no alternate Eligible NAIC CRP Rating in NAIC systems, the Credit Committee's NAIC Designation Category will be entered into NAIC systems to assign an NAIC Designation Category to the security

### **Reinstatement of Filing Exemption Eligibility**

179. If an insurer would like the IAO to re-evaluate an Eligible NAIC CRP Credit Rating that was removed from Filing Exemption Eligibility for possible reinstatement in a subsequent filing year, it can follow the operational steps outlined in Appeals of SVO Determinations in this Manual to submit the request.

### **Reporting Securities Removed from Filing Exemption Eligibility**

180. The IAO Director(s) will prepare a summary of the removed from Filing Exemption Eligibility actions take over the prior calendar year.
181. Within 45 days of a security being removed from the Filing Exemption process, the IAO will also publish an anonymized summary (without references specific to the security, to avoid disclosing confidential information) of each unique situation encountered for the securities subject to removal from Filing Exemption Eligibility and publish it on an insurer accessible web location.
182. To facilitate transparency as to the SVO's application of discretion, the SVO Analytical Department Symbols "ER" will be added in NAIC Systems to securities with an excluded otherwise Eligible NAIC CRP Credit Rating(s). The SVO Analytical Department Symbols, "ER" *will be* reported on the insurer's statutory investment schedules for the effected security instead of SVO Administrative Symbols "FE" for filing exemption.





July 26, 2024

VIA ELECTRONIC SUBMISSION

Valuation of Securities (E) Task Force  
National Association of Insurance Commissioners  
1100 Walnut Street, Suite 1500  
Kansas City, MO 64106-2197

**Re: Revised Amendment to the NAIC IAO P&P Manual Authorizing Procedures for SVO Discretion over NAIC Designations Assigned Through the Filing Exemption Process**

Dear Members of the Valuation of Securities (E) Task Force (“Task Force”):

The American Investment Council (“AIC”)<sup>1</sup> appreciates the opportunity to comment on the proposed *Revised Amendment to the Purposes and Procedures Manual (“P&P Manual”) of the National Association of Insurance Commissioners (“NAIC”) Investment Analysis Office (“IAO”) Authorizing the Procedures for the NAIC Securities Valuation Office’s (“SVO”) Discretion Over NAIC Designations Assigned Through the Filing Exemption (“FE”) Process (“Proposed Amendment”)*<sup>2</sup> that was exposed for public comment on June 18, 2024. As noted in our January 26, 2024 letter to the Task Force,<sup>3</sup> we support a comprehensive, methodological and holistic review of the myriad of recent investment-related initiatives undertaken by various NAIC

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<sup>1</sup> The American Investment Council, based in Washington, D.C., is an advocacy, communications, and research organization established to advance access to capital, job creation, retirement security, innovation, and economic growth by promoting responsible long-term investment. In this effort, the AIC develops, analyzes, and distributes information about private equity and private credit industries and their contributions to the US and global economy. Established in 2007 and formerly known as the Private Equity Growth Capital Council, the AIC’s members include the world’s leading private equity and private credit firms which have experience with the investment needs of insurance companies. As such, our members are committed to growing and strengthening the companies in which, or on whose behalf, they invest, to helping secure the retirement of millions of pension holders and to helping ensure the protection of insurance policyholders by investing insurance company general accounts in appropriate, risk-adjusted investment strategies. For further information about the AIC and its members, please visit our website at <http://www.investmentcouncil.org>.

<sup>2</sup> The Proposed Amendment is available at: <https://content.naic.org/sites/default/files/inline-files/2023-005.16%20P%26P%20SVO%20Discretion%20-%20Revised%20v5.4.pdf>.

<sup>3</sup> Our January 26, 2024 letter is available at: <https://www.investmentcouncil.org/aic-comment-letter-to-the-naic-on-amendment-to-the-naic-iao-pp-manual-authorizing-procedures-for-svo-discretion-over-naic-designations-assigned-through-the-filing-exemption-process/>.

**AMERICAN INVESTMENT COUNCIL**

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working groups and task forces (including the Task Force), and commend state insurance regulators for recognizing the need to conduct a holistic review of those initiatives.<sup>4</sup>

In the event that the Proposed Amendment is ultimately adopted and in light of the comment in the Proposed Amendment’s cover note that the SVO will likely need to collect fees “to recover the initial and ongoing expense related to the revised proposal” we respectfully request that the NAIC make such fee assessment as transparent as possible. In addition to the issue of transparency, we also want to highlight a potential concern with respect to the use of highly confidential and proprietary data that the NAIC is privy to because of its role in the insurance regulatory process. Indeed, given that the SVO serves a regulatory rather than commercial function, we respectfully request that the P&P Manual include additional language expressly prohibiting the SVO and any third-party vendor from selling or otherwise disclosing any data (including anonymized data) or analysis that may be collected or produced through the SVO’s discretionary rating process. We request that data be maintained for strictly regulatory purposes.

Thank you for your consideration of these comments. We look forward to continuing to work with you on these important issues.

Sincerely,

/s/ Rebekah Goshorn Jurata  
General Counsel  
American Investment Council

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<sup>4</sup> See also our October 9, 2023 letter to the Financial Condition (E) Committee regarding the NAIC’s *Framework for Regulation of Insurer Investments – A Holistic Review*. The October 9 letter is available at: <https://www.investmentcouncil.org/aic-comment-letter-to-e-committee-re-holistic-framework/>.

July 25, 2024

**Via email**

Ms. Carrie Mears  
Chair, Valuation of Securities (E) Task Force  
Mr. Charles A. Therriault  
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RE: Revised Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (the "P&P Manual") Authorizing the Procedures for the SVO's Discretion Over NAIC Designations Assigned Through the Filing Exemption Process

Dear Ms. Mears:

We want to thank the Task Force and the staff at the Investment Analysis Office (IAO) for all their work on this proposal. We continue to believe that any policy which allows the IAO to potentially overturn the ratings of accredited Rating Agencies for otherwise-eligible "FE" securities will inevitably lead to uncertainty and disruption in the capital markets, will harm insurance companies, and ultimately harm consumers who are struggling with increased insurance premiums and in many cases, availability. The private-placement securities have performed well and are an essential part of insurance company portfolios and are one of the main sources of funding throughout the country.

While foregoing the effort is in our opinion the best approach, the below safeguards should reduce market disruption, limit the impact on insurer investments, limit pain for consumers/policyholders, and ultimately prevent unintended consequences. If the NAIC is going to move forward, we suggest that it do so very carefully by adding these enhancements. Regulators, regulated entities, market participants, and policyholders will all benefit with some additional safeguards and clarity. Specifically, we recommend the following:

1. "Rarely Used" and "CRP agnostic" - Paragraphs 80 and 81 of the proposal describe the intent of the proposed amendments. We suggest adding into those sections the E-Committees previous statement that it intends to "rarely use" the discretion set forth in the amendments (see also comment 5 below). To provide comfort that it would be "rarely Used," perhaps it would only be invoked in cases whereby it materially affects regulatory capital. We also think a sentence to once again clearly state that the intent is not to replace CRPs or target any one or group of CRPs would be helpful. We believe these would go a long way towards providing comfort to the markets that the intent is not to use this discretion often and would ultimately benefit the insurance companies and their policyholders while not unnecessarily restricting its available investments.

2. Timeframe for Review – Once a security is identified for review, we believe that there should be a timeframe for which the IAO is required to perform the full review under paragraph 169 of the proposal. While paragraph 167 includes specific timeframes as to when information needs to be supplied to the IAO, paragraph 169 is open-ended. For purposes of limiting market disruption, we believe that there needs to be a specific time frame for the IAO to complete its review of the security after placing the “UR” or Under Review” designation on the security. We suggest that there be a 90-day period from receipt of the requested information to complete its analysis and make a final determination otherwise similarly situated securities may be impacted inadvertently.
3. Primacy of Domiciliary Regulator – We believe the Domiciliary Regulators who oversee the insurance company investor should have the ultimate authority on whether this process to challenge a rating is initiated. We also believe that the SVO credit committee should not have the authority to take any action that directly impacts an insurer without appropriate regulator approval.
4. NRSRO/CRP Participation – The proposal in paragraph 174 provides that the insurance company investor may include additional participants in the process at its discretion. We believe that at the onset of the process, the CRP’s should be informed and provided all materials generated by the SVO and have a right to participate in any such review whether or not requested by the insurance company investor. The CRP is in the best position to explain the rationale for its analysis. In addition, the discussion may assist the CRP and/or IAO in future analysis and limit the securities subject to review going forward. The CRP participation is particularly important where the Credit Committee identifies a recurring analytical pattern or concern as described in paragraph 173 of the proposal. Lastly, the act of challenging a rating is likely to cause reputational harm and the CRP should be informed early to address any potential misunderstandings and minimize litigation risks.
5. Independent Review - We also believe that having an independent third-party review of the securities that were reviewed in the prior calendar year would provide comfort to the market that the process was being followed and appropriate safeguards in place.

Thank you for allowing us the opportunity to submit this comment letter. We welcome additional engagement with the VOSTF and appreciate your attention to these important requested changes.

Sincerely

*Eric Mandelbaum*

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July 26, 2024

Ms. Carrie Mears  
Chair, Valuation of Securities (E) Task Force (VOSTF)  
National Association of Insurance Commissioners (NAIC)  
110 Walnut Street, Suite 1500  
Kansas City, MO 64106-2197

**RE: Revised Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (the "P&P Manual") Authorizing the Procedures for the SVO's Discretion Over NAIC Designations Assigned Through the Filing Exemption Process**

Dear Ms. Mears:

KBRA appreciates the opportunity to provide feedback on the VOSTF's Revised Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (the "P&P Manual") Authorizing the Procedures for the SVO's Discretion Over NAIC Designations Assigned Through the Filing Exemption Process (the "FE Proposal"). As a credit rating provider (CRP), KBRA's core mission is to provide independent, transparent, and thorough credit analysis and research. We welcome policy and regulatory initiatives that are aligned with these objectives. We are concerned that the FE Proposal falls short of these objectives despite VOSTF's intention to enhance the Filing Exemption Process (the "FE Process"). As discussed in further detail below, our concerns fall into three categories:

- 1. Lack of Transparency in the SVO Credit Committee Review Process.** Unlike CRPs which publish their credit rating methodologies and publicly disclose detailed information about their analytical process, the FE Proposal provides few details about the SVO Credit Committee review process and the factors it will consider as part of its assessment. To the extent the SVO Credit Committee is empowered to override the credit assessments of CRPs, the FE Proposal should also require that the Credit Committee provide meaningful disclosure and transparency into its methodological and assessment process which is equivalent to the disclosure and transparency provided by CRPs.
- 2. The FE Proposal Should Consider the Role of CRPs in the Full Review Process.** The FE Proposal outlines a Full Review process through which the NAIC can remove a credit rating from Filing Exempt eligibility, yet the FE Proposal is entirely silent with respect to the role of the CRP in that process. We understand that the purpose of the Full Review and the broader FE Proposal is to determine the nature of the risk and whether the CRP rating is an appropriate measure of risk. We believe CRPs can play a limited, but constructive role in that process. At a minimum, we recommend that the Investment Analysis Office (IAO) notify the relevant CRP that the security is under review and that the IAO share the results of its assessment with the CRP at the conclusion of its review.
- 3. The FE Proposal Reflects a Disconnect between Credit Risk and Investment Risk.** The FE Proposal provides that the SVO Credit Committee is empowered to determine whether an NAIC Designation determined by a CRP credit rating is "an unreasonable assessment of investment risk," yet credit ratings are not intended to provide an assessment of "investment risk."<sup>1</sup> The FE Proposal would benefit from a clearer distinction between NAIC designations and CRP ratings, a clearer definition of "investment risk" versus "credit risk," as well as clarification on how the SVO analysis

<sup>1</sup> We also note the apparent inconsistency in referencing "credit" in the Credit Committee's name given that the FE Proposal and Proposed Designation Amendment both emphasize their analysis goes beyond "credit risk" and considers a broader range of "investment risks."



differs from that of CRPs when they use CRP methodologies that are intended to assess credit risk to derive NAIC designations.<sup>2</sup>

In sum, it is difficult to reconcile the FE Proposal with the challenges it seeks to address. In particular, it is unclear how a process that lacks transparency and disclosure can cure underlying concerns with “blind reliance” on credit ratings which are already subject to SEC oversight and comply with a range of regulatory requirements for disclosure and transparency.

In the attached Annex, we discuss these views in further detail. We thank you for your consideration of our comments and look forward to continued engagement with the NAIC on these matters. KBRA remains committed to providing feedback and information to the NAIC as this process progresses and are always available when we can be of assistance.

Sincerely,

/S/ Kate Kennedy  
Senior Managing Director  
Co-Head of Business Development

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<sup>2</sup> KBRA also submitted comments on the related proposed P&P Manual Amendment to Update the Definition of an NAIC Designation. See KBRA Letter to Ms. Carrie Mears, Chair, Valuation of Securities (E) Task Force (VOSTF), National Association of Insurance Commissioners (NAIC) dated July 18, 2024.



## ANNEX

### 1. Lack of Transparency in the Credit Committee Review Process

While we recognize that the FE Proposal is partly intended to address concerns about NAIC “blind reliance” on credit ratings, the amendments themselves counterintuitively provide little transparency into the methodological process the SVO will apply when exercising its discretion over NAIC designations.<sup>3</sup> We do appreciate that over time revisions to the FE Proposal have increased transparency into the SVO process, but this transparency is limited only to the insurer who holds the security in question. We find it concerning that the market at large will still not have any insight into the methodologies the SVO uses, or the type of information it gathers to perform its analysis and derive NAIC designations. We strongly recommend much more transparency into the IAO’s process, methodology used, and analysis performed so that the market understands the inputs it will use to determine its NAIC designations.

The FE Proposal indicates that the Credit Committee will “convene to determine if, in its opinion, the NAIC Designation Category assigned pursuant to the filing exemption process is a reasonable assessment of investment risk of the security for regulatory purposes.”<sup>4</sup> As part of its review, the Credit Committee “may consider observable factors, including, but not limited to:

- (i) a comparison to peers rated by different CRPs,
- (ii) consistency of the security’s yield at issuance or current market yield to securities with equivalently calculated NAIC Designations rated by different CRPs,
- (iii) the IAO’s assessment of the security applying available methodologies, and
- (iv) any other factors it deems relevant.”<sup>5</sup>

With respect to proposed comparisons to peers rated by different CRPs, we are troubled that the SVO may perceive credit ratings as interchangeable commodities and will seek to draw unsupported conclusions by comparing the credit ratings of similar types of securities or “peers.” Most critically, there are no clear or meaningful comparisons to be applied between similar types of securities or peers rated by different CRPs. Individual credit ratings reflect discrete assessment of risk through the application of CRP methodologies. Every individual transaction or issuance has a distinct set of associated risks, and these differences should not be disregarded in order to expedite the IAO’s analysis.

It is also unclear how the Credit Committee intends to consider the “consistency of the security’s yield at issuance or current market yield to securities with equivalently calculated NAIC Designations rated by different CRPs.” The relevant securities for the purposes of the FE Process are often private securities that do not have market yield or comparable market yields. The FE Proposal appears to reflect an assumption that a high yielding note should equate to equivalent high yielding public bond. This assumption fails to consider the variables inherent to private markets that drive yield. Because the FE Proposal does not provide the rationale for incorporating this factor, it is unclear how it might be applied to overcome these challenges and the role it will play in the Credit Committee’s review.

We are also concerned with the proposal to consider “the IAO’s assessment of the security applying available methodologies.” The FE Proposal is void of any detail regarding the methodologies that the SVO intends to apply or whether those methodologies are publicly available or subject to any degree of oversight. CRPs, on the other hand, apply publicly available credit rating methodologies to determine credit ratings. These methodologies are developed and applied in accordance with SEC regulations for Nationally Recognized Statistical Rating Organizations (“NRSROs”) and are exposed for market feedback and are accompanied by a range of disclosures to help users of credit ratings understand the analytical underpinnings of a credit

<sup>3</sup> See e.g., Paragraph 80 of the FE Proposal.

<sup>4</sup> Paragraph 166 of the FE Proposal.

<sup>5</sup> *Id.*



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rating.<sup>6</sup> It is unclear whether the same will be true of the methodologies applied by the IAO as part of its process.

We also understand that the SVO may consider applying “one or combinations” of CRP methodologies to perform their assessment.<sup>7</sup> CRP methodologies, however, are not intended to be used in combination with methodologies of different CRPs. CRP methodologies are developed and intended to be applied holistically in order to provide high quality and predictive credit analysis. The practice of applying disparate pieces of different methodologies risks inaccurate and unintended outcomes. We strongly discourage this approach to credit analysis.

Finally, the FE Proposal provides no transparency into the types of “other factors” it may deem relevant or how those factors might be applied and evaluated. Without this information, item (iv) essentially serves as a catch-all black box through which the SVO may exercise its discretion to override a credit rating that has been issued by a CRP in accordance with its ratings definitions and its publicly available methodologies, and consistent with SEC regulations for NRSROs.

Similarly, the proposal stipulates that “if the Credit Committee identifies that there is a recurring analytical pattern or concern, the IAO Director(s) will inform the VOS/TF chair and they will decide if an issue paper, referral, amendment to this Manual or some other action is needed.”<sup>8</sup> We find it concerning that the IAO is essentially authorizing itself to make any future changes to the P&P Manual. In the absence of any detail regarding the administration of this process, the relevant standards, or its oversight, we strongly recommend that this text be removed.

## **2. The FE Proposal Should Consider the Role of CRPs in the Full Review Process**

The FE Proposal outlines a Full Review process that facilitates the removal of a credit rating from Filing Exempt eligibility, yet the FE Proposal is silent with respect to the role of the CRP in that process. In particular, the process does not provide that CRPs will be notified that the CRP-rated security is under review, nor does it indicate that the IAO will share the results of its assessment with the CRP at the conclusion of its review. This apparent oversight in the FE Proposal prevents CRPs from playing a limited, but constructive role in the process.

In the initial stages of the Full Review process, insurance company holders of the CRP-rated security are notified by the IAO that the security is under review and are encouraged to provide information “that may be useful or persuasive in the analysis of the security.”<sup>9</sup> We recommend that the relevant CRP be notified in parallel. This notification would alert the CRP to the ongoing review and would enable the CRP to support the process by providing the insurance company holder with information as requested, subject to applicable legal and regulatory restrictions. This notification would also enable the CRP to participate constructively later in the process when “other parties invited by the insurer” may present their analytical basis to maintain the Eligible NAIC CRP Credit Rating’s eligibility for Filing Exemption to the joint meeting of the VOSTF Sub-

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<sup>6</sup> See U.S. Securities and Exchange Commission Final Rules for NRSROs (September 15, 2014), *available at* <https://www.govinfo.gov/content/pkg/FR-2014-09-15/pdf/2014-20890.pdf>.

<sup>7</sup> “The SVO considers multiple methodologies when it reviews a security and will use the one or combinations of methodologies that it believes will produce a reasonable assessment of risk for regulatory purposes. Because the SVO relies upon the methodologies of other entities, it does not publish those methodologies. The use of a particular methodology from a rating agency should not be construed as validation of one credit rating provider over another.” Item 2, NAIC Valuation of Securities (E) Task Force Responses to Issues/Comments Previously Deliberated on the Proposed P&P Manual Amendment Authorizing the Procedures for the SVO’s Discretion Over NAIC Designations Assigned Through the Filing Exemption Process (February 27, 2024), *available at* [https://content.naic.org/sites/default/files/national\\_meeting/VOSTF%20Spring%20NM%20Materials%202024-03-16%20v3.pdf](https://content.naic.org/sites/default/files/national_meeting/VOSTF%20Spring%20NM%20Materials%202024-03-16%20v3.pdf).

<sup>8</sup> Paragraph 173 of the FE Proposal.

<sup>9</sup> Paragraph 168 of the FE Proposal.





Group and the Credit Committee.”<sup>10</sup> We understand that the purpose of the Full Review and the broader FE Proposal is to determine the nature of the risk and whether the CRP rating is appropriate, and providing a mechanism for CRPs to play this limited, but constructive role in that process is entirely consistent with these objectives.

For similar reasons, subject to applicable confidentiality considerations, we strongly recommend that the IAO share the results of its assessment with the CRP at the conclusion of its review and prior to final determination of FE eligibility by the SVO Credit Committee and VOS/TF Sub-group. This additional step would provide transparency into the Full Review process and the IAO’s analytical basis for its recommendation. It would also enable the CRP to consider and reflect on the results of the assessment and, importantly, alert the IAO and Credit Committee of any potentially inaccurate or incomplete information that may have impacted the IAO’s analysis.

Finally, we welcome the most recent revisions to the FE Proposal related to VOSTF oversight. In particular, we support amendments that call for the Credit Committee to schedule a call with a VOS/TF Sub-Group to discuss and explain its analytical basis in recommending removal of an Eligible CRP credit rating from FE eligibility. These discussions should not be subject to the discretion of the VOS/TF chair as previous drafts of the FE Proposal indicated, but instead should be held as a matter of course and required by the P&P Manual. We also believe more detail is needed on how the members of the VOS/TF Sub-Group will be chosen. Given the nature of these discussions and their impact, we strongly urge that regulators themselves participate in these meetings rather than delegating this authority to their staff.

### **3. The FE Proposal Reflects a Disconnect between Credit Risk and Investment Risk**

The FE Proposal reflects pending proposed amendments to the P&P Manual that would revise the definition of a NAIC Designation by replacing references to “credit risk” with references to “investment risk.” As discussed in our comment letter to the NAIC addressing those specific proposed amendments, the revised definition of “investment risk” is expansive and goes well beyond credit risk.<sup>11</sup> This misalignment creates a disconnect between NAIC designations and the nature of the SVO’s assessment under the FE Proposal and is also a striking shift toward oversight of an insurer’s asset and liability management as opposed to the adequacy of its capital charge.

The FE Proposal provides that the SVO Credit Committee is empowered to determine whether an NAIC Designation determined by a CRP credit rating is “an unreasonable assessment of investment risk,” yet credit ratings are not intended to provide an assessment of “investment risk.”<sup>12</sup> Credit ratings serve a specific purpose and are intended to measure only credit risk, specifically the probability of default and severity of loss in the event of default. Conversely, the proposed revised definition of “investment risk” would consider and reflect a wide range of risks including “the likelihood of an insurer’s timely receipt of an investment’s full principal and expected interest,” as well “as ‘tail risk’ and/or loss given default,” “the position of the specific liability in the issuer’s capital structure,” and “all other risks or factors that may affect repayment, such as, except for volatility/interest rate, prepayment, extension or liquidity risk.”<sup>13</sup>

Credit ratings are not intended to measure all the factors included in “investment risk” as defined by the proposed amendments to the P&P Manual. It is therefore unclear the standard by which credit ratings should be evaluated for “reasonably assessing investment risk.” Merely replacing “credit risk” with “investment

<sup>10</sup> Paragraph 174 of the FE Proposal.

<sup>11</sup> See KBRA Letter to Ms. Carrie Mears, Chair, Valuation of Securities (E) Task Force (VOSTF), National Association of Insurance Commissioners (NAIC) dated July 18, 2024.

<sup>12</sup> We also note the inherent inconsistency in referencing “credit” in the committee’s name given that the FE Proposal and the proposed P&P Manual Amendment to Update the Definition of an NAIC Designation emphasize that their analysis goes beyond “credit risk” and considers a broader range of “investment risks.”

<sup>13</sup> Paragraph 89 of Proposed P&P Manual Amendment to Update the Definition of an NAIC Designation.



risk” in the P&P Manual as proposed fails to adequately clarify how the NAIC designations and SVO analysis under the FE Proposal differs from CRP ratings. We would urge a clearer distinction between NAIC designations and CRP ratings, a clearer definition of investment risk versus credit risk, as well as clarification on how the SVO analysis differs from that of CRPs when they use CRP methodologies that relate only to credit risk.

## **The Lease-Backed Securities Working Group**

**VIA EMAIL**  
July 25, 2024

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

Re: **Revised Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* Authorizing the Procedures for the SVO's Discretion Over NAIC Designations Assigned Through the Filing Exemption Process ("Revised Amendment")**

Dear Ms. Mears:

Our group, *The Lease-Backed Securities Working Group*, once again greatly appreciates the considerable time and effort the Task Force and the staff at the Investment Analysis Office has undertaken to revise and improve the Revised Amendment since its initial draft.

We continue to strongly believe that any policy which allows the IAO to potentially overturn the ratings of accredited Rating Agencies for otherwise-eligible "FE" securities on a case-by-case basis after they have been purchased by the investor will inevitably cause uncertainty for investors and result in disruption to the capital markets – particularly in the market for private placement debt securities which are such an essential part of Insurance company portfolios, and which provide one of the main sources of funding for mission-critical infrastructure, corporate, and government projects throughout the country.

However, we also believe that with the addition of a few small changes, the Revised Amendment can be implemented in a way that would at least partially mitigate this inevitable market disruption and further increase transparency and fairness to all participants, as follows:

- (1) The final proposal should include the language that was incorporated in the E-Committee Memo "Framework for Regulation of Insurer Investments - A Holistic Review": specifically, that any discretion by the SVO or IAO over CRP ratings would be "*rarely used*".
- (2) Before any CRP rating is ultimately "overruled" by the appropriate NAIC committees, the CRP should have the right to defend their rating in front of those committees. This right should be independent of whether or not they have been invited by the insurer -- or even whether or not the insurer opts to contest the decision of the NAIC. To do otherwise would have the result of irreparably harming the reputation and market acceptance of the affected CRP without giving them their "day in court".

**The Lease-Backed Securities Working Group**

**July 25, 2024**

Re: **Revised Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* Authorizing the Procedures for the SVO's Discretion Over NAIC Designations Assigned Through the Filing Exemption Process ("Revised Amendment")**

- (3) The Revised Amendment should clear indicate that (x) the domiciliary regulator of the affected insurer is included in the final decision-making process, and (y) no action by the NAIC is to be taken without the approval of the appropriate State regulator or in a manner that denies the ultimate authority of that regulator as the final arbiter.

We believe that these discrete modifications can easily be incorporated into the final document and would serve to greatly enhance the fairness and workability of the Revised Amendment.

Finally, we believe that it is essential that any policy that is ultimately approved be automatically re-examined no later than six months to a year after implementation to assess its effectiveness, its impact on the insurance industry and the capital markets, and its cost vs. benefit before making it a permanent policy.

Sincerely,

John Garrison  
On behalf of **The Lease-Backed Securities Working Group**

cc: Charles Therriault  
Denise Genao-Rosado



1776 I Street NW., Suite 501  
Washington, DC 20006  
www.structuredfinance.org

July 25, 2024

Charles Therriault, Director, NAIC Securities Valuation Office  
Denise Genao, Senior Administrative Assistant, NAIC Securities Valuation Office  
National Association of Insurance Commissioners

**Re: Revised Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (the “P&P Manual”) Authorizing the Procedures for the SVO’s Discretion Over NAIC Designations Assigned Through the Filing Exemption Process**

Dear Mr. Therriault and Ms. Genao,

The Structured Finance Association (SFA) appreciates the opportunity to provide feedback to the memorandum from the NAIC Securities Valuation Office (SVO) and NAIC Structured Securities Group (SSG) regarding the above-referenced matter, dated June 4, 2024, and exposed for comment on June 18, 2024 (the “Amendment”).

In gathering feedback to respond to the Amendment, SFA engaged with various market participants, including insurance companies, asset managers, credit rating agencies, and law firms, that may be impacted by the latest proposed changes to the P&P Manual.

SFA and its membership believe the latest revisions in the Amendment are a positive development that resolve many of the questions raised by the previously exposed revisions in the memo dated November 3, 2023. We compliment the NAIC for thoughtfully considering feedback from the securitization and structured finance industry as it finalizes revisions to the P&P Manual.

One question raised by our members relates to the point at which insurers are afforded the option to invite third parties into the proposed “Process For Excluding An Eligible NAIC CRP Rating From Filing Exemption For A Specific Security” (the “Proposed Discretion Process” or “Proposal”). As currently written, third parties, including Credit Rating Providers (“CRPs”), can only present the basis for their credit ratings pursuant to paragraph 174 of the Proposed Discretion Process. As outlined in the current Proposal, introducing CRPs at this later stage does not afford an opportunity for CRPs to provide insight into their credit analysis at a point in the Proposed Discretion Process when doing so would be most beneficial to the SVO’s ultimate decision.

While the removal of credit ratings from the Filing Exemption Process would most directly impact insurers in the form of higher capital charges, CRPs also face material reputational risk should their ratings be called into question during the Proposed Discretion Process. As such, SFA and its members believe insurers should have the option to invite third parties into the Proposed Discretion Process earlier, either at the “information request” stage outlined in paragraph 167, or at the

SFA Response to "Amendment to the SVO's Discretion Over NAIC  
Designations Assigned Through the Filing Exemption Process"  
July 25, 2024  
Page 2



"additional information" stage outlined in paragraph 168. We see two additional benefits to this request:

1. Certain parties, especially CRPs whose ratings are the subject of the IAO assessment, are well positioned to provide additional insight into their credit analysis in comparison to the IAO's own credit analysis.
2. Allowing insurers to invite third parties into the Proposed Discretion Process earlier will provide the Credit Committee and Investment Analysis Office (IAO) additional time to evaluate any information they do receive and better reflect on their own credit analysis.

SFA and its members believe that the Amendment improves the Proposed Discretion Process and resolves several questions raised by the earlier proposed revisions. However, we believe it would be beneficial to provide a mechanism to allow insurers to invite third parties into the Proposed Discretion Process sooner. In particular, CRPs are best positioned to support the process by providing the insurance company holder with information as requested, subject to applicable legal and regulatory restrictions. Inviting them into the Proposed Discretion Process sooner would provide the SVO and Credit Committee with additional time to evaluate such information and enhance their own credit process.

We again thank the NAIC for the opportunity to share these views and look forward to continuing our engagement with the NAIC on this topic.

Sincerely,

A handwritten signature in blue ink, appearing to read "Frank Tallero".

**Frank Tallero, Director, Structured Finance Association**

SVO



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

FROM: Charles A. Therriault, Director, NAIC Securities Valuation Office  
 Marc Perlman, Managing Investment Counsel, NAIC Securities Valuation Office  
 Eric Kolchinsky, Director, NAIC Structured Securities Group and Capital Markets Bureau

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

DATE: July 1, 2024

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

**Recommendation:** The SVO recommends adoption of this proposed amendment to require an annual review of Regulatory Transactions by the SVO or SSG and notification when there is a material change. The SVO believes this is a non-substantive change as it is otherwise assumed throughout the P&P Manual that SVO and SSG opinions are updated at least annually and the lack of this instruction was a drafting oversight. The proposed text changes to P&P Manual are shown below with additions in red underline, and deletions in ~~red strikethrough~~ as it would appear in the 2023 P&P Manual format.



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





## REGULATORY TRANSACTIONS

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

### Defined

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

### Status of Regulatory Transactions

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



## Intent

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

## The Security Component of a Regulatory Transaction

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

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

## Procedure: Assessment of the Security Component of a Regulatory Transaction

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



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

### **Reporting Regulatory Transactions on Investment Schedules**

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



## Definition of SVO Analytical Value

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

## Codes and Their Meaning

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

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

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



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

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

### Annual Updates and Material Changes

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

SVO



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

FROM: Charles A. Therriault, Director, NAIC Securities Valuation Office  
Marc Perlman, Managing Investment Counsel, NAIC Securities Valuation Office  
Eric Kolchinsky, Director, NAIC Structured Securities Group and Capital Markets Bureau

RE: Proposed P&P Manual Amendment to Update the List of NAIC Credit Rating Providers

DATE: July 1, 2024

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

**Recommendation:** The SVO recommends adoption of this proposed amendment to update the NRSRO status review date for the P&P Manual List of NAIC Credit Rating Providers. The SVO believes this is a non-substantive change. The proposed text changes to P&P Manual are shown below with additions in red underline, and deletions in ~~red strikethrough~~ as it would appear in the 2023 P&P Manual format.

[https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-08 Summer NM/05-CRP status/PP\\_Manual\\_Amend\\_CRP\\_NRSRO\\_Status.docx](https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-08 Summer NM/05-CRP status/PP_Manual_Amend_CRP_NRSRO_Status.docx)





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





## LIST OF NAIC CREDIT RATING PROVIDERS

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

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

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

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



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