Draft date: 10/7/2024

2024 Fall National Meeting
Denver, Colorado

VALUATION OF SECURITIES (E) TASK FORCE
Sunday, November 17, 2024
2:30 p.m. - 3:30 p.m.
Gaylord Rockies Hotel—Aurora Ballroom B—Level 2

ROLL CALL

Member	Representative	State
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
Marie Grant	Greg Ricci	Maryland
Michael T. Caljouw	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	Cameron 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

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AGENDA

Discuss and Consider Adoption of:

1. Its Oct. 1 and Summer National Meeting Minutes (Doc. ID: 2024-017.01, 2024-018.01)
—Carrie Mears (IA)
Attachment One
Attachment Two

2. A Proposed Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to Require Annual Reviews of Regulatory Transactions (Doc. ID: 2024-014.01, 2024-014.02)
—Carrie Mears (IA), Charles Therriault (NAIC), and Marc Perlman (NAIC)
Attachment Three
Attachment Three-A

3. A Proposed P&P Manual Amendment to Update the List of NAIC Credit Rating Providers (CRPs) and the NAIC Use of CRP Credit Ratings (Doc. ID: 2024-015.02, 2024-015.03, 2024-015.04, 2024-015.05)
—Carrie Mears (IA), Charles Therriault (NAIC), and Marc Perlman (NAIC)
Attachment Four
Attachment Four-A
Attachment Four-B
Attachment Four-C

4. A Proposed P&P Manual Amendment to Remove References to Subscript-S and Update References to Investment Risk (Doc. ID: 2024-016.02, 2024-016.03)
—Carrie Mears (IA), Charles Therriault (NAIC), and Marc Perlman (NAIC)
Attachment Five
Attachment Five-A

Receive NAIC Staff Reports on:

5. The Projects of the Statutory Accounting Principles (E) Working Group—*Carrie Mears (IA) and Julie Gann (NAIC)*

6. The Status of Private Rating Letter Rationale Report Filings for 2024—*Charles Therriault (NAIC)*

7. The Proposed Collateralized Loan Obligation (CLO) Modeling Methodology—*Eric Kolchinsky (NAIC)*

8. Discuss Any Other Matters Brought Before the Task Force
—Carrie Mears (IA)

9. Adjournment

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Draft: 10/14/24

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

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

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

Mears said the first agenda item was to discuss and consider for exposure a proposed *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) amendment to remove references to Subscript-S and update references to investment risk. At the Summer National Meeting, the Task Force adopted an updated definition of an NAIC designation. This included changing "credit risk" to "investment risk." While credit risk is usually the predominant determinant of what an NAIC designation represents, which focuses on an issuer's ability to make payments in accordance with contractual terms, the Task Force agreed that this was too narrow a concept for NAIC purposes. Focusing solely on credit risk could limit the NAIC's ability to assess the risk of investments like principal protected securities (PPS) or funds that currently fall under the Securities Valuation Office's (SVO's) purview. By looking at what is called "investment risk," defined as the likelihood of the insurer's receipt of full principal and expected interest, the NAIC can account for the performance component of a PPS, the share of a fund, and a variety of the risks that may be present in both traditional and more complex securities, particularly those that do not qualify as bonds under the upcoming principles-based bond definition. This use of "investment risk" is also consistent with the language used in the Financial Condition (E) Committee's Investment Framework.

As the SVO mentioned at the Task Force's June 18 meeting and in its memorandum on the definition of an NAIC designation, there are a number of lingering references to Subscript-S and other non-payment risks throughout the P&P Manual. The SVO committed to identifying those references in the P&P Manual and has submitted a non-substantive technical amendment to remove the references to Subscript-S and other non-payment risks along with references to "credit risk" and the related concept of "credit quality."

Charles Therriault (NAIC) said the update to the definition of an NAIC designation included the removal of the concept of other non-payment risk and the corresponding SVO administrative symbol Subscript-S. The P&P Manual was reviewed by the SVO to identify references to the concept and symbol and propose removing them in this amendment. Additionally, with the adoption of the term "investment risk" in the definition of an NAIC designation, the P&P Manual was also reviewed to identify references to "credit risk," "credit quality,"

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

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

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

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

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

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

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

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

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

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Draft: 8/22/24

Valuation of Securities (E) Task Force
Chicago, Illinois
August 13, 2024

The Valuation of Securities (E) Task Force met in Chicago, IL, Aug. 13, 2024. The following Task Force members participated: Doug Ommen, Chair, represented by Carrie Mears and Kevin Clark (IA); Eric Dunning, Vice Chair, represented by Tadd Wegner (NE); Lori K. Wing-Heier represented by David Phifer (AK); Mark Fowler represented by Sheila Travis and Sanjeev Chaudhuri (AL); Ricardo Lara represented by Laura Clements (CA); Andrew N. Mais represented Kenneth Cotrone (CT); Michael Yaworsky represented by Nicole Crockett and Ray Spudeck (FL); Dean L. Cameron represented by Eric Fletcher (ID); Vicki Schmidt represented by Tish Becker (KS); Timothy J. Temple represented by Melissa Gibson (LA); Kevin P. Beagan represented by John Turchi (MA); Joy Y. Hatchette represented by Greg Ricci (MD); Grace Arnold represented by Fred Andersen (MN); Chlora Lindley-Myers represented by Debbie Doggett (MO); Jon Godfread represented by Matt Fischer (ND); D.J. Bettencourt represented by Jennifer Li (NH); Justin Zimmerman represented by David Wolf (NJ); Adrienne A. Harris represented by Bob Kasinow (NY); Judith L. French represented by Cameron Piatt (OH); Glen Mulready represented by Diane Carter (OK); Michael Humphreys represented by Diana Sherman (PA); Cassie Brown represented by Amy Garcia and Jamie Walker (TX); Jon Pike represented by Jake Garn (UT); Scott A. White represented by Doug Stolte and Greg Chew (VA); Mike Kreidler represented by Katy Bardsley and Steve Drutz (WA); and Nathan Houdek represented by Amy Malm (WI).

1. Adopted its June 18, May 2, and Spring National Meeting Minutes

The Task Force met June 18 and May 2. During these meetings, the Task Force took the following action: 1) adopted amendments to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to: a) permit NAIC designations for short-term, asset-backed securities (ABS); b) 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; c) change the effective date for the implementation of collateralized loan obligation (CLO) modeling to Dec. 31, 2025; d) clarify permitting insurers to self-assign an NAIC designation 6*; and e) make current the list of Securities of Valuation Office (SVO) processes; 2) exposed several P&P Manual amendments to: a) update the definition of an NAIC designation; b) authorize the procedures for the SVO's discretion over NAIC designations assigned through the filing exempt (FE) process; and c) permit NAIC designations for short-term ABS; and 3) heard an update on the proposed CLO modeling methodology.

Doggett made a motion, seconded by Bardsley, to adopt the Task Force's June 18 (Attachment One), May 2 (Attachment Two), and Spring National Meeting (*see NAIC Proceedings – Spring 2024, Valuation of Securities (E) Task Force*) minutes. The motion passed unanimously.

2. Adopted its 2025 Proposed Charges

Mears said the next item is to consider the adoption of the Task Force's proposed 2025 charges. The proposed charges are unchanged from 2024, with the addition of the Valuation of Analysis (E) Working Group as a group with which the Task Force coordinates.

Fischer made a motion, seconded by Clements, to adopt the 2025 proposed charges (Attachment Four). The motion passed unanimously.

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3. Adopted a Revised Proposed Amendment to the P&P Manual to Update the Definition of an NAIC Designation

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

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 exposed amendment is the latest iteration in an attempt to consolidate the explanations and definitions into Part One because what constitutes an NAIC designation is a fundamental Task Force policy. The NAIC received three comment letters during the last exposure.

First, the SVO proposed inserting a new paragraph under the existing "Regulatory Objective" heading to explain the reason for the proposed change from "credit risk" to the new concept of "investment risk." While credit risk is usually the overall fundamental and predominant determinant of what an NAIC designation represents, it traditionally focuses on an issuer's ability to make payments in accordance with contractual terms and, therefore, may be too narrow a concept for NAIC purposes. For example, the performance component of a principal protected security (PPS) may produce no return; therefore, the PPS could pay no interest with no event of default by the issuer. Similarly, the SVO assigns NAIC designations to funds using a Weighted Average Rating Factor (WARF) methodology where the fund does not pay in accordance with contractual terms. As such, focusing solely on credit risk could limit the SVO's ability to assess the risk of the performance component of a PPS or fund payments. Instead, by looking at what is called "investment risk," defined as the likelihood of the insurer's receipt of full principal and expected interest, the SVO can account for the performance component of a PPS, the share of a fund, and a variety of the risks that may be present in both traditional and more complex securities, particularly those that do not qualify as bonds under the upcoming principles-based bond definition. The use of "investment risk" is also consistent with language used in the Financial Condition (E) Committee's *Framework for Regulation of Insurer Investments – A Holistic Review* (Framework).

Secondly, the "Definition" paragraph would clarify that investment risk is defined as the likelihood of an insurer's timely receipt of an investment's full principal and expected interest.

Mike Reis (Northwestern Mutual), representing the American Council of Life Insurers (ACLI), Private Placement Investors Association (PPIA), and North American Securities Valuation Association (NASVA), said the Task Force has been working on this topic for multiple years. The joint trades have been involved in many meetings with Mears, other regulators, and the SVO. There has been a lot of give-and-take, good cooperation, and interaction. The Task Force has taken a lot of ACLI, PPIA, and NASVA recommendations to get the appropriate language. Reis said the Task Force took the vast majority of the comments from the ACLI, PPIA, and NASVA's last letter, but he understands why not everything they suggested was included.

Christopher Anderson (Anderson Insights) said two things need to be considered both with respect to credit ratings and NAIC designations: 1) methodologies used to arrive at those decisions; and 2) rationales explaining how those methodologies are used. Regarding credit ratings, hundreds of methodologies have been developed by credit rating providers (CRPs), and they are prohibited from releasing a rating unless they have a methodology in place to support that rating. Furthermore, for each rating, there is a rating rationale explaining how that methodology was applied and what the subsequent credit rating was. As it stands today, the SVO explains that it uses credit rating methodologies from the CRPs but does not have its own library of

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methodologies. Furthermore, it does not release rationales, which the U.S. Securities and Exchange Commission (SEC) requires of all CRPs. There is no written explanation of how an NAIC designation is determined. Compared to what the SEC requires of the rating agencies, this is less robust and not as auditable or able to be overseen as is the case with the rating agencies. Rating agencies, however, produce credit ratings. Now, the SVO proposes to measure investment risk. Anderson said it is probably workable and acceptable not to have proprietary methodologies for credit risk, which is what the SVO is doing now; however, when it comes to investment risk, Anderson explained that he does not know of any existing methodologies. It would be necessary to have the actual procedures for how investment risk is going to be determined in the P&P Manual. There are methodologies that exist in the real world for credit risk, but Anderson said that as far as he knows, there is no real methodology for investment risk. Anderson suggested that those methodologies be a part of this proposal so that they can be complete and operational.

Mears said as a reminder that this is just the definition and that there is no procedural component. As it stands, the Task Force expects the bond definition to go into place next year, which may result in some investments being filed with the SVO for analysis. She said that, when appropriate, there may be a need to build out more specific methodologies that will be addressed as they occur, as this is just the definition piece.

Bardsley made a motion, seconded by Fletcher, to adopt the P&P Manual amendment dated July 29 (Attachment Five*) to update the definition of an NAIC designation. The motion passed unanimously.

4. Adopted 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 consider for adoption a revised proposed P&P Manual amendment for the SVO's discretion over NAIC designations assigned through the filing exemption (FE) process, which is the official name of the amendment. However, as an early response to some verbal comments received, Mears reiterated that this is a regulator-driven amendment.

Seven comment letters were submitted on the revised amendment. Mears addressed some of the issues raised in the comments. First, Mears touched briefly on a few comments in letters representing items previously discussed.

One comment states that the SVO will review every FE security under this process. Mears clarified that this process is meant to represent an action plan for discrepancies or issues under the normal review process, whether that be regulatory review during analysis, examination, or SVO findings. For example, private letter (PL) rating rationales are submitted to the SVO. There is no change to the review process. This process covers the next steps that would come from that. The proposed policy provides a formal process for the NAIC to follow. The process is only applied to possible exceptions and focuses on the types of reviews and questions state insurance regulators and staff already have and bring forth. There is no special or new identification process to put in place.

There was another comment that aligns with Anderson's earlier comments about methodology transparency. As mentioned at the Spring National and other earlier meetings, the SVO is not a rating agency but often relies on rating agency methodologies as part of its assessments. The SVO considers multiple methodologies when it reviews a security and will use one or a combination of methodologies 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 these methodologies. Mears reiterated that state insurance regulators feel strongly that the SVO should consider a variety of sources to be valid for their use and be open to the various methodologies

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that are presented across the board. State insurance regulators do not desire to limit the SVO to a single methodology that would preclude the use of others. Also, the SVO's use of a particular methodology from a rating agency should not be construed as validation of one CRP over another.

A few comment letters mentioned that rating agencies are "accredited." As explained in previous meetings, the SEC's Office of Credit Ratings (OCR) is tasked with recognizing nationally recognized statistical rating organizations (NRSROs). The SEC's oversight does not include the validation or endorsement of rating agency methodologies or ratings. Such endorsement is expressly prohibited by the Credit Rating Agency Reform Act of 2006. Likewise, the NAIC and state insurance regulators, making up a state-based organization, are prohibited from regulating credit ratings and methodologies. The NAIC's interest is purely as a consumer of ratings and how it uses those ratings in its insurance regulatory processes.

There was concern that the NAIC might sell confidential data. The NAIC absolutely does not sell confidential data it receives. There is already a component in Part Two of the P&P Manual addressing this concern: "The SVO routinely receives financial information, legal documents, and other data from reporting insurance companies so that it may assess the reported investment for the NAIC. While the NAIC is not a guarantor of the confidentiality of information submitted to the SVO, the SVO does not redistribute documents obtained during its work for other than regulatory purposes or as may be required by law."

There was a note about the transparency of the SVO fees. The Task Force is not responsible for the SVO's fees. Fees are determined via the NAIC Executive (EX) Committee. The SVO fees are part of the publicly discussed and exposed annual NAIC budget, and the NAIC Executive (EX) Committee and Plenary ultimately approves the fees in the budget. The SVO publishes these fees on its web page each year, so there is transparency from that perspective.

Mears spoke in more detail about some suggestions in the comment letters incorporated into the amendment or, in some cases, why they were not. One suggestion was to reference the Financial Condition (E) Committee's Framework to note how this process would rarely be used. Some parties thought the discretion process would be used for all FE securities. In contrast, others thought that the intent was to use the process rarely and requested that the concept be incorporated into the amendment itself, which was done. The idea from the Framework is that multiple components work in conjunction with one another, one being the implementation of an overall CRP diligence and governance process. The Committee has been working diligently on setting up that process with the exposure of a request for proposal (RFP), which will occur at the upcoming meeting. Similar to implementing this discretion proposal, the CRP due diligence process will presumably take some time to implement, but it will be the cornerstone of the NAIC's use of CRPs, allowing this discretion amendment to act as a backstop, as noted in the Framework. The Task Force looks forward to everyone's support as that diligence framework is developed. Given the proposed CRP discretion process, the SVO does not foresee large numbers of FE challenges relative to the population of FE securities. The SVO added such language for clarification and consistency. There was an update for credit risk versus investment risk, which was previously discussed, and the amendment tried to be consistent and align with what is in the Committee's Framework.

Mears said that a comment that came up in multiple conversations was about the role of the domiciliary regulator. State insurance regulators retain all oversight and authority over the discretion proposal. No rating can be removed from FE without regulatory approval through the Task Force subgroup, and the proposal now makes it clear that the domiciliary regulator will always be invited to participate in the sub-group meeting. Mears reminded interested parties, however, that NAIC designations do not allow for permitted or prescribed practices, meaning they cannot be assigned by individual states or be company-specific, so discussions will be held by the subgroup.

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There was a request to add more specificity around the timeline for review. The SVO cannot be certain how long it will take for the information to be submitted, how long discussions with insurers will last as they want to be fulsome, the complexity of the investments they will be reviewing, and the availability of all the parties to meet. Given all these unknowns, setting a specific deadline for the SVO would be difficult. The SVO and overseeing state insurance regulators expect that the work will always be expeditiously done once all the information has been received.

Mears discussed the role of CRPs and the review, clarifying that the NAIC does not regulate rating agencies, as it is the SEC's role. NAIC Members regulate insurers. The discretion process is specific to the assessment of the risk of an insurer's investment and determining whether the credit rating for that investment is appropriate for the NAIC's regulatory objectives. Again, neither the NAIC nor its Members tell a rating agency how to determine a rating. Additionally, under the discretion process, the state insurance regulators' choice to remove a rating from the FE process would in no way overrule any rating agency rating. Rather, they would choose not to use a rating for regulatory purposes.

Also, CRPs are not insurance regulators, which was implied by a few comment letters. CRPs are for-profit entities that assess credit risk and sell those credit risk assessments so consumers, like the NAIC, can use them. As mentioned before, CRPs are extremely important to the NAIC, and their ratings will continue to be used. In the end, some ratings may not be appropriate for NAIC purposes. This proposal is an insurance regulatory process for the NAIC to continue acting as a consumer of ratings. If the insurer has invested in a security that is under review by this process and it wants to involve the CRP, it can invite the CRP to participate at any time. The insurers have the authority to invite external parties to be part of what would otherwise be a confidential discussion between an insurer and its state insurance regulator. This is stated in the first section of paragraph 168 of the amendment, which states that "*…to provide additional information to the IAO such as their internal analysis, presentations from the issuer, meetings with the issuer's management team and <u>any other information that may be useful or persuasive in the analysis of the security</u>.*" The SVO agrees that this point can be further emphasized in the last sentence of that paragraph that in addition to "authorized insurer(s) staff," insurers may also include other authorized parties.

Mears reiterated that while the NAIC is unable to effectively force an insurer to invite other authorized parties to discussions, it will absolutely permit and encourage the insurer to do so. There will likely be questions the NAIC may have that are best answered by the CRP, which may be made very clear to insurers. The lack of ability to force this CRP involvement in no way minimizes the role of the CRP in the processes. This is recognized by the forthcoming implementation of the overall diligence framework, which, among other things, would be predicated on an open dialog between the NAIC and CRPs. The intent from the Committee's outline is that this diligence framework is the cornerstone of the NAIC's use of CRPs, with discretion acting as a backstop. Therefore, it is entirely reasonable to expect transparent discussions with state insurance regulators between the regulators and CRPs on an ongoing basis.

Lastly, there was concern about reputational harm to CRPs. The NAIC does not disclose which CRP rating is under review. The NAIC only discloses the security and the NAIC designation. The discussions with insurers and Task Force subgroup members will all be confidential and require the parties involved to agree to confidentiality provisions. Any party that cannot maintain confidentiality will not be invited or permitted to participate. There will be no public disclosure of the rating agency involved in our review.

Charles Therriault (NAIC) said the SVO appreciates the constructive comments submitted by interested parties on the June 4, 2024, version of the amendment that was exposed for a 38-day comment period that ended July 26. The SVO incorporated comments into the additional attachment in the materials (Attachment Six*)

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dated July 30, 2024. As noted in that accompanying memorandum, the updates include the following: 1) clarification that the process will be consistently applied across all CRPs; 2) defining the term "authorized insurers;" 3) clarification regarding the SVO's written summary of its analysis during the review phase; 4) including other authorized parties to discuss the security with the SVO; 5) the Investment Analysis Office (IAO) will communicate in writing its opinion of the appropriate NAIC designation category; 6) the annual summary will be anonymized and will not disclose information on specific securities, CRPs, or impacted insurers; 7) the SVO will publish an anonymized summary within 45 days of a security being removed from the FE process, without references specific to the security or CRP, to avoid disclosing confidential information; and 8) filing impact on issuers that have multiple securities within the same debt class.

These updates are identified in yellow in the noted attachment. The SVO recommended this revised version be adopted today.

Sasha Kamper (Mutual of Omaha), representing the PPIA, ACLI, and NASVA, echoed many of Reis's comments on the prior discussion item. The organizations Kamper represents have been working closely with NAIC staff and state insurance regulators on this topic on and off for several years. When it was first brought forward, many of their members had deep reservations about the idea of rating discretion, and nobody wanted to see more regulation. Kamper credited the SVO and certain regulators for working with them over the past couple of years and helping shape and evolve the exposure to the state it is in today. Kamper said today's exposure strikes a healthy balance between giving the NAIC more transparency into the privately rated world of securities and oversight into that process but also provides transparency for the insurers and adequate due process such that her members can get comfortable having a good framework to apply ratings discretion on a fair and consistent basis. Kamper thanked all for the work and effort and for meeting them in the middle on this issue. There are still some implementation issues that must be worked through. The SVO is working on systems changes for fields and confidentiality. This was raised in the letter submitted on this issue regarding how insurers would be notified if a security was flagged for needing more information. Industry wants to make sure insurers cannot miss that notification so they can turn around those materials in a timely fashion. Some challenges are still being worked through, even with private ratings rationales (e.g., ensuring they get into the system, insurers submit them, and the system can accept and store them.) There are a lot of issues to work through, but they are operational details, and industry is committed to working with the IAO on them to get ready so that this can be implemented in the 2026/2027 timeframe that has been discussed. There is no reason to hold up the policy decision. Industry members are grateful for all the help and dialog in this and are comfortable with moving forward.

Joe Engelhard (Alternative Credit Council—ACC) said, similar to the comments of the joint trades that were just speaking, he acknowledges the many procedural improvements outlined in the July 30 memorandum, which includes several changes asked for in the July 26 comment letter. Previous comments were also taken seriously by the SVO, which is appreciated. To highlight a few of the changes of particular focus, the changes made to paragraph 164 clarify that it is not expected that this new authority would need to be used very often, which Mears mentioned in her comments. Mears's comments earlier about the governance process may help avoid the need to use this often. This is important because the biggest conceptual concern is an adverse market reaction to using this authority, which could go well beyond the affected rating. Changes in paragraph 172 are appreciated and make it clear that domiciliary regulators will be invited to participate if they want to.

Engelhard asked for a clearer timetable and the overall review and appeals process. He explained that the ACC noted there were already some timeframes in paragraph 167. Because of the joint trades letter, the NAIC added to the amendment about the end of the process in paragraph 181 that within 45 days, the SVO will issue an anonymized summary. However, between stages 169 and 181, there is still no time frame. The ACC still thinks that if this review takes a long time due to market forces, it may not matter what happens at the

end. If it takes too long, markets will move, and that rating will be outdated at that point, or markets will move on. The ACC's principal concern is the implication to the overall markets on an affected security. The wording of the anonymized summary will be important, even if there is no mention of the specific security or the CRP. Depending on how broad the language in the summary is, it might cast doubt not just on that security but also on the entire methodology for that asset class or the use of that specific rating agency's methodology for that asset class. As mentioned earlier, hopefully, this is rarely used and will not have a big impact, but the ACC would note that a lot of care should be taken in how that anonymized summary is made because it might have a much bigger impact than on that one security alone.

Mears asked if it would be feasible to get examples of various securities to share what the ACC thinks would be an appropriate way to describe those anonymously versus what might be problematic. There can be some dialogue on that topic to ensure everyone is on the same page. Engelhard said he could certainly ask his members and reply to that request.

Jason Rapert (Providence Financial Group), as a consultant on behalf of Egan-Jones Ratings Company, thanked the Task Force for all the great work and appreciated the effort that the Task Force made to get to this point. Rapert introduced himself and provided his professional background. He said he is currently president of Providence Financial Group. He served in the Arkansas State Senate from 2011–2023 as chairman of the Arkansas Senate Insurance & Commerce Committee and president of the National Council of Insurance Legislators (NCOIL). He previously served in the Compact in association with the NAIC. Rapert appreciated the vast work that state insurance regulators do in their states for the regulation of insurance in this country. He previously was a Series 7 licensee and investment advisor licensee. Rapert said he worked in this arena professionally before entering public service.

Rapert said his comments would settle on just one thing that he would like to see considered now or in the future. There are a few items to consider that he believes would significantly enhance the proposal. At the heart of the matter is the issue of whether a particular rating is an accurate reflection of credit quality. While he understands that state insurance regulators and the Task Force cannot require the relevant CRP to be included in the proceedings, there seems to be no reason for not informing the CRP that one of its ratings is being reviewed and providing it the opportunity to explain its rating and defend its work. He said he understands that the insurance company can invite the CRP to participate in the process, but there seems to be a hole in the sense that in some cases, the insurance company may decide not to go through the burden of defending a rating, particularly if it is a relatively small portion of its overall portfolio, which is often the case. In this case, the state insurance regulator would not have the benefit of the CRP's perspective, and the CRP would not be able to explain its rating, potentially to the detriment of its reputation, which Mears spoke to in her comments. This dynamic creates due process issues. It seems that more information is always better. Rapert proposed that in order for the state insurance regulators to remedy this issue, language be considered and inserted into the policy to require that the CRP be informed of the issue at the commencement of the review and be provided with the opportunity to explain its rating. He understands that it has been stated that state regulators do not have the ability to require that. In this situation, it seems that when the heart of this is questioning a rating and trying to make a fair decision, there seems, or needs to be, some best practices would be encouraged to make sure that the entity being questioned in the process truly does have a seat at the table in some way. He thanked Mears and said he knew she and Task Force members worked hard on the proposal. Rapert said this is the one thing that he would love to see addressed in some way in this proposal.

Mears said she does not want to get ahead of Commissioner Houdek leading the Financial Condition (E) Committee Aug. 15. There will be an RFP exposure at the Committee, and there is a component trying to lean into what those kinds of iterative communications between the NAIC and CRPs can look like. There is room for that to be expanded to incorporate some of Rapert's concerns. That will be open for comment for 60 days,

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and the Committee welcomes comments. Mears suggested that Rapert tie some of these issues to that RFP since those would be happening first and allow for robust discussion. State insurance regulators review investments all the time. There are multiple investments for which she asks insurers for more information, such as the rating report and certain details embedded in the regulatory process. When we put something under review, in many cases, it is just to get more information. It is contemplated, even in this process, that that could be the end of it. We would not want to create undue concern or harm with the automatic notification of that process. It would probably feel like a lot since that is a regulators job. Mears said Rapert's comments and concerns are well-heard and understood. Many of those can be addressed through what is laid out in the Committee's RFP, the Framework's diligence process, and the required communication. This discretion proposal is meant to be a backstop to the CRP due diligence process in the Framework, and the Task Force would encourage Egan-Jones Ratings Company and any of the CRPs to read through that and provide comments on how the CRP due diligence processes could be improved.

Malm said Wisconsin would like to make a motion to adopt with some friendly amendments. Malm suggested striking "joint meeting of the" from the first sentence in item 174 of Attachment Six*; striking "and the credit committee" from the first sentence of that paragraph; and striking "and credit committee" from the third sentence in that section. That would address some of the comments and ensure that there will be a look back or review process once implemented to ensure that this process is working as intended and to clarify that state insurance regulators have the ability to make changes to the procedure in order to address any issues that have been highlighted.

Cotrone thanked all interested parties for their constructive feedback during the different phases of this proposal. He thanked the state insurance regulators for being engaged in drafting these proposals to their current state.

Walker said she echoed Cotrone's comments. She remarked that when this proposal first came out, how far apart all the parties were, and the back-and-forth communication was needed to understand the issues. She said this is a solid proposal that gets us to the point where the Task Force needs to be, and the NAIC does not rely blindly on CRPs while not creating undue uncertainty in the related markets. Walker said this is a great enhancement to the regulatory oversight of that function. Walker said she anticipates, as it takes two years to get all the operational pieces on it, the Task Force will continue to get updates on it. It is a way to step into this process, but the SVO can also move forward and figure out how to operationalize it in a way that everyone intended it to work. She said the Task Force has a great work product.

Mears reiterated that the motion would make a friendly amendment to paragraph 174 to remove the reference to "joint meeting" and the two references to "and the credit committee" to demonstrate that this is a meeting of the Task Force subgroup, and the Task Force subgroup has that authority in that perspective. Also, there is a look back on the procedures once they are implemented so that the Task Force has the ability to hear feedback and make changes to it.

Malm made a motion, seconded by Stolte, to adopt the proposed P&P Manual amendment, dated July 30, 2024, for discretion over NAIC designations assigned through the FE process (Attachment Six*). The motion passed unanimously.

5. Exposed a Proposed Amendment to the P&P Manual to Require Annual Reviews of Regulatory Transactions

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Mears said the next item on the agenda is to discuss and consider for exposure a proposed P&P Manual amendment to require annual reviews for Regulatory Transactions.

Therriault said the P&P Manual has specialized instructions for the filing and reporting of Regulatory Transactions. These transactions do not receive NAIC designations but are permitted to receive SVO Analytical Values. SVO Analytical Values are identified by the SVO Analytical Department Symbol of RTS for those that are SVO assigned and RT for those that are not SVO assigned. Those with an RT receive the treatment of an NAIC 6.

The P&P Manual does not specify that an annual update is required for Regulatory Transactions, as it does for all other filings. This amendment clarifies that annual updates are required for Regulatory Transactions in order to maintain their SVO assigned SVO Analytical Value with the RTS administrative symbol; otherwise, they revert to RT (indicating that the SVO did not review it) and the treatment of an NAIC 6.

The SVO recommended exposing this amendment for a 30-day public comment period ending Sept. 13.

Mears directed the SVO to expose the P&P Manual amendment to require the annual update of regulatory transactions with an RTS for a 30-day public comment period ending Sept. 13.

6. Exposed a Proposed P&P Manual Amendment to Update the List of NAIC CRPs

Mears said the next item on the agenda is to hear about a proposed P&P Manual amendment update to the list of CRPs.

Therriault said Part Three of the P&P Manual lists the classes of securities for which each CRP is authorized by the SEC to issue credit ratings. The list was last reviewed Feb. 2, 2021. No class changes were identified, and one minor editing error was corrected in the amendment, along with an update to the review date.

The SVO recommended exposing this amendment for a 30-day public comment period ending Sept. 13.

Mears directed the SVO to expose the P&P Manual amendment to update the list of NAIC CRPs for a 30-day public comment period ending Sept. 13.

7. Received a Staff Report on the Projects of the Statutory Accounting Principles (E) Working Group

Mears said the next item on the agenda is to hear updates on Statutory Accounting Principles (E) Working Group projects.

Julie Gann (NAIC) said she would provide an update on key accounting projects under the coordination initiative. This is a summary; all exposures and adoptions are on the Working Group's web page. She began with the bond project and stated that, hopefully, everyone is aware that all accounting and reporting revisions have previously been adopted. Those are all posted on the Working Group's web page, and the bond reporting changes for the new principles-based bond definition are effective Jan. 1, 2025. The Working Group took three actions during this national meeting. First, it adopted the bond project issue paper. Issue papers are not authoritative but provide details on all the discussions and elements considered as part of the project. Second, a question-and-answer document (Q&A) was exposed for the implementation guide. This addresses key topics and how they should be considered under the bond definition, which has been exposed until Sept. 27. Three more topics are expected to be considered and hopefully included within that Q&A. These topics will be added to the exposure as soon as the small bond group can consider them. Lastly, revisions regarding debt securities

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issued by funds were exposed for a 24-day comment period ending Sept. 6. The original adopted guidance, currently in effect, limits that guidance for SEC-registered funds, but under the principles-based concept, the Working Group wanted to incorporate something more principles-based; therefore, the guidance was revised to allow debt securities issued by operating entities to also be considered issuer credit obligations. The Working Group worked with industry during the interim in establishing this guidance, and it has been exposed for a 24-day comment period ending Sept. 6 to allow industry and state insurance regulators to review it before it is incorporated into the bond definition. The key element to highlight is that the SEC guidance is still included, but it is a practical, expedient, safe harbor, and the debt issuance limits permitted for some SEC entities should not be used as a thought process for whether another debt security issued by a fund should qualify as an issuer credit obligation. Each debt must be reviewed as to the primary purpose of the issuance. If it was issued to raise debt capital, it should not be included as an issuer credit obligation and should be assessed as an asset-backed security (ABS).

Gann said that everyone should already be aware there is new free bond training being offered by the NAIC for 2024 for both state insurance regulators and industry regarding the principles-based bond project. Gann said some people were waiting for the downloadable content to be part of that training before they took it, and she received confirmation that that content is now available. She said that if anyone has been waiting for that, please sign up to take it. Moving on to a few other topics, Gann said she wants to assure everyone that the Working Group will not be boring now that the bond project is done. It still has several other items that are being discussed. The first concerns credit repacks, which the Working Group exposed a detailed agenda item addressing. A credit repack is a bond wrapped with a derivative in a special purpose vehicle (SPV) and then held by the insurer instead of holding a bond and a derivative separately. The Working Group proposed significant revisions to *Statement of Statutory Accounting Principle* (*SSAP) No. 86—Derivatives*, which is its derivative standard, to require bifurcation of those instruments. The bond piece would be held as a bond, and the derivative piece would be held as a derivative. From what the Working Group has looked at so far if this was a combined structure, it would fail the principles-based bond definition, so it would be a non-bond debt security. The Working Group has a comment letter deadline of Sept. 27 to allow for consideration of those revisions at the Fall National Meeting.

The key item of note was that the Working Group is relooking at repurchase agreements and security lending agreement guidance. This comes along in response to a Life Risk-Based Capital (E) Working Group request from the ACLI to incorporate a conforming repurchase agreement risk-based capital (RBC) factor because the Statutory Accounting Principles (E) Working Group has that for securities lending, but the accounting and reporting of repurchase agreements and securities lending is currently different. The Working Group is looking at that guidance to see if elements should be converged before it moves forward in supporting RBC changes. The Working Group exposed a memorandum during its session at the Summer National Meeting that details its current accounting, reporting, and RBC charges for repurchase agreements and securities lending, with a variety of staff comments and requests for practical application and how things are being done in practice, for a 45-day comment period ending Sept. 27.

Gann gave a reminder that because it has already been adopted, the Working Group has new guidance for tax credit investments, which will go into effect Jan. 1, 2025. With this guidance, the federal tax credit guaranteed reporting line has been removed from the reporting. With the new guidance, NAIC designations from a CRP or the SVO will not impact the accounting and reporting of tax credit investments in the scope of *SSAP No. 93—Low-Income Housing Tax Credit Property Investments*. During its session at the national meeting, the Working Group exposed some clarifying edits to the guidance for a 45-day comment period ending Sept. 27. These are a high-level summary of the key investment-related items. Please refer to the Statutory Accounting Principles (E) Working Group's web page for the full list of projects the Working Group is working on.

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8. Received a Report from the SVO on Filing Investments Moving to Schedule BA in 2025 Due to Changes to SSAP No. 26R and SSAP No. 43R

Mears said the next item on the agenda is to hear updates from the SVO on filing securities moving to Schedule BA from Schedule D because of updates to *SSAP No. 26R—Bonds* and *SSAP No. 43R—Loan-Backed and Structured Securities.*

Therriault said the Statutory Accounting Principles (E) Working Group adopted changes related to the principles-based bond definition project that impacted SSAP No. 26R and SSAP No. 43R. The changes are effective Jan. 1, 2025. For the most part, these changes do not impact the assignment of NAIC designations. The one exception will be investments moving from Schedule D to Schedule BA. Only NAIC designations assigned by the SVO receive the RBC treatment for that level of risk for life insurance companies. Schedule BA has separate reporting lines for investments with SVO-assigned NAIC designations. These lines are used in the RBC instructions.

If these investments already have an SVO-assigned NAIC designation, insurers only need to continue filing them with the SVO. No other action is needed. However, some investments moving to Schedule BA may have a CRP rating. If they have a CRP rating and a life insurer wishes to have an SVO-assigned NAIC designation, the insurer should contact the SVO to inform them that they would like to file the investment with the SVO. The insurer can use the SVO's general inquiry email address listed on the SVO's web page, SVOInquiryDesk@naic.org, or contact one of the analysts, managers, or Therriault.

Christopher Anderson (Anderson Insights) said that when something is moved to Schedule BA, the NAIC has made the determination that it is not eligible for bond treatment. Anderson asked how an RBC factor is determined if something is not a bond. He said there are two kinds of risk: bond risk, which is a promise of repayment, and price volatility risk. For unaffiliated common stock, for example, the examination was how much the prices vary. If you use a weighted average rating factor methodology and try to say something is a bit bond-like, we will use the bond factor and a bit like something else. Anderson asked how the factor for the equity element is determined in that scenario. Anderson said everyone seems to think the risk factor for unaffiliated common stock is 30%. That is true if the beta is 1. However, the factor for unaffiliated common stock can range from 22.5%–45%, depending on the price volatility compared to the other assets in the marketplace and the other shares of stock. He asked how to take something that is not purely a bond and come up with something meaningful in terms of what the RBC factors should be. Anderson said serious consideration for how this can be accomplished should be given sooner rather than later. This matters less for the Task Force than for the Capital Adequacy (E) Task Force because it sets the RBC factors. He said this apples-to-oranges comparison does not seem to be an appropriate way of coming up with a holistic level of risk. Anderson also encouraged a review of the weighted average risk factor (WARF). He asked whether weighing the multiple risk factors and putting them all together captures investment risk in a way that is appropriate for RBC. Anderson said he hopes that there will be a sense of urgency and that the Task Force will not proceed with saying that the SVO should be developing RBC factors for assets that are somewhat bond-like and others that are not quite bond-like.

Mears said that, as Anderson noted, the Task Force is not responsible for setting RBC factors. She said she would have to defer that conversation, as Anderson noted, to a more appropriate group.

Clark said there are various reasons a debt security might fail the bond definitions, not all of which relate to its inclusion of equity risk. Also, he said he fully expects there to be some non-qualifying debt securities that the SVO cannot rate because it does not have a methodology to do so. This creates an avenue for companies

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to potentially get an NAIC designation based on the risk when it is warranted, but obviously, something causes it to fail the bond definition. He said an additional review by the SVO makes sense.

Mears said the Task Force does not know what this population will look like until it is up there, which leaves room for the Task Force to identify either themes or things that can be addressed that are appropriate for the Task Force to review and bring those to its agenda for further discussion.

9. Received a Staff Report on the Proposed CLO Modeling Methodology and the CLO Ad Hoc Group

Eric Kolchinsky (NAIC) said he had two announcements to make about the collateralized loan obligation (CLO) project. First, the Structured Securities Group (SSG) has completed running the 10 scenarios for each eligible CLO owned by insurance companies. Unfortunately, an administrative issue has held up the posting. The SSG will post the results for review on the CLO page as soon as that issue is resolved. These results will also be provided to the American Academy of Actuaries (Academy) for its analysis of the RBC factors.

Kolchinsky also said the SSG has completed the analysis of the methodology adjustments suggested by an interested party. It will present those at the next CLO Ad Hoc Group call sometime in September.
Having no further business, the Valuation of Securities (E) Task Force adjourned.

https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-08 Summer NM/Minutes/VOSTF_2024-08-13_Summer_NM_Minutes v7 (Final).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 Marc Perlman, Managing Investment Counsel, NAIC Securities Valuation Office Eric Kolchinsky, Director, NAIC Structured Securities Group and Capital Markets Bureau
RE:	Proposed P&P Manual Amendment to Require Annual Reviews of Regulatory Transactions
DATE:	July 1, 2024

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

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

PART THREE
SVO PROCEDURES AND METHODOLOGY FOR PRODUCTION OF NAIC DESIGNATIONS

REGULATORY TRANSACTIONS

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

Defined

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

Status of Regulatory Transactions

302. A Regulatory Transaction is not eligible for:

- Assignment of an NAIC Designation by the SVO;
- The filing exemption process for publicly rated securities;
- The private letter rating component of the filing exemption or for use of the PLGI designation symbol;
- Self-assignment by an insurer of the administrative symbol Z under the 120-rule;
- Self-reporting by an insurer on the general interrogatory for securities eligible for filing exemption but for which no NAIC CRP credit rating is available (i.e., 5.B GI) and
- Inclusion in the SVO List of Investment Securities or any other NAIC electronic system or processes maintained for operations for the VOS/TF.

Intent

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

The Security Component of a Regulatory Transaction

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

Mike Monahan
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September 13, 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 P&P Manual Amendment to Require Annual Reviews of Regulatory Transactions

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 July 1, 2024.

We support the exposure as drafted. ACLI is very appreciative and supportive of the VOSTF. ACLI stands ready to continue working with the NAIC.

If you have any questions regarding this letter, please do not hesitate to contact us.

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

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

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 Marc Perlman, Managing Investment Counsel, NAIC Securities Valuation Office Eric Kolchinsky, Director, NAIC Structured Securities Group and Capital Markets Bureau
RE:	Proposed P&P Manual Amendment to Update the List of NAIC Credit Rating Providers (CRP) and the NAIC Use of CRP Credit Ratings
DATE:	September 27, 2024

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

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

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

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

THE USE OF CREDIT RATINGS OF NRSROS IN NAIC PROCESSES

NOTE: See "Policies Applicable to the Filing Exemption (FE) Process" below; "NAIC Policy on the Use of Credit Ratings of NRSROs" (especially "Definition – Credit Ratings Eligible for Translation to NAIC Designations") in Part Two (the definition of "Eligible NAIC CRP Credit Ratings" excludes the use of any credit rating assigned to a security type *where the NAIC has determined that the security type is not eligible to be reported on Schedule D or that it is not appropriate for NRSRO credit ratings to be used to determine the regulatory treatment of the security or asset*); and "Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities" in Part Three.

Providing Credit Rating Services to the NAIC

57. The NAIC uses credit ratings for a number of regulatory purposes, including, to administer the filing exempt rule. Any rating organization that has been designated a Nationally Recognized Statistical Rating Organization (NRSRO) by the U.S. Securities and Exchange Commission (SEC) and which continues to be subject to federal regulation, may apply to provide Credit Rating Services[1] to the NAIC. In its administration of the filing exempt rule, the NAIC only uses credit ratings from those classes of credit ratings for which the NAIC Credit Rating Provider is registered with the SEC as an NRSRO, as identified in this Manual.

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

PART THREE
SVO PROCEDURES AND METHODOLOGY FOR PRODUCTION OF NAIC DESIGNATIONS

LIST OF NAIC CREDIT RATING PROVIDERS

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

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

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

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

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

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

October 16, 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 P&P Manual Amendment to Update the List of NAIC Credit Rating Providers (CRP) and the NAIC Use of CRP Credit Ratings

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 September 27, 2024.

We support the exposure as drafted. ACLI is very appreciative and supportive of the VOSTF. ACLI stands ready to continue working with the NAIC.

If you have any questions regarding this letter, please do not hesitate to contact us.

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

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

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Egan-Jones RATINGS

Founded 1995

October 16, 2024

Via email

Ms. Carrie Mears
Chair, Valuation of Securities (E) Task Force
Mr. Charles A. Therriault
Director, NAIC Securities Valuation Office
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197
carrie.mears@iid.iowa.gov
ctherriault@naic.org
dgenaorosado@naic.org

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

Dear Ms. Mears:

We want to thank the Task Force and the staff at the Investment Analysis Office (IAO) for the draft proposal and the opportunity to comment. We appreciate the clarification as we have heard from parties that as a result of the implementation of other recent changes including the implementation of new bond principles, there is some confusion as to how those changes will affect the choice of Credit Rating Provider (CRP). Specifically, there is concern that because the definition of the term asset-backed security is different from the term as defined by the U.S. Securities and Exchange Commission (SEC), the impact of the difference is not clear and may impact the choice of which CRP an insurer may use. The proposed new language for the P&P manual reads

> *"In its administration of the filing exempt rule, the NAIC only uses credit ratings from those classes of credit ratings for which the NAIC Credit Rating Provider is registered with the SEC as an NRSRO, as identified in this Manual."*

We believe that the proposed new language is helpful but that it could be further enhanced by adding the following additional sentences:

> *For purposes of determining whether a Credit Rating Provider is registered with the SEC as an NRSRO for any particular investment or series of investments, the NAIC relies on the SEC definitions including the definition of "asset-backed securities." No additional scrutiny shall be applied to a Credit Rating Provider that is not licensed in all classes provided that it is licensed to rate the particular investment or series of investments for which the rating letter is submitted.*

We believe that this additional language would further clarify the confusion/ambiguity that may exist as to the impact of the recent changes. Specifically, we believe that the additional language would assist in any confusion insurers and third parties may have over which definition controls when determining whether a CRP is authorized to be used as part of the FE process.

Thank you again 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

Eric Mandelbaum
General Counsel
Egan-Jones Ratings Company
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New York, NY 10036
eric.mandelbaum@egan-jones.com
(212) 425 0460 ext. – 1205

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 Marc Perlman, Managing Investment Counsel, NAIC Securities Valuation Office Eric Kolchinsky, Director, NAIC Structured Securities Group and Capital Markets Bureau
RE:	Proposed P&P Manual Amendment to Update the List of NAIC Credit Rating Providers (CRP) and the NAIC Use of CRP Credit Ratings
DATE:	October 21, 2024

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

Additionally, the updated amendment includes clarification that the NAIC only uses credit ratings from those classes of credit rating for which the NAIC Credit Rating Provider is registered with the SEC as an NRSRO and that the SEC's definitions are distinct from those used for statutory accounting asset classification purposes.

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

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

THE USE OF CREDIT RATINGS OF NRSROS IN NAIC PROCESSES

NOTE: See "Policies Applicable to the Filing Exemption (FE) Process" below; "NAIC Policy on the Use of Credit Ratings of NRSROs" (especially "Definition – Credit Ratings Eligible for Translation to NAIC Designations") in Part Two (the definition of "Eligible NAIC CRP Credit Ratings" excludes the use of any credit rating assigned to a security type *where the NAIC has determined that the security type is not eligible to be reported on Schedule D or that it is not appropriate for NRSRO credit ratings to be used to determine the regulatory treatment of the security or asset*); and "Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities" in Part Three.

Providing Credit Rating Services to the NAIC

57. The NAIC uses credit ratings for a number of regulatory purposes, including, to administer the filing exempt rule. Any rating organization that has been designated a Nationally Recognized Statistical Rating Organization (NRSRO) by the U.S. Securities and Exchange Commission (SEC) and which continues to be subject to federal regulation, may apply to provide Credit Rating Services[1] to the NAIC. The NAIC only recognizes NAIC Credit Rating Provider ratings for those classes of credit ratings (each as defined by the SEC) for which an NAIC Credit Rating Provider is registered with the SEC as an NRSRO. For the avoidance of doubt, SEC definitions are distinct from those used for statutory accounting asset classification purposes in the Statements of Statutory Accounting Principles.

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

PART THREE
SVO PROCEDURES AND METHODOLOGY FOR PRODUCTION OF NAIC DESIGNATIONS

LIST OF NAIC CREDIT RATING PROVIDERS

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

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

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

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

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

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 Marc Perlman, Managing Investment Counsel, NAIC Securities Valuation Office Eric Kolchinsky, Director, NAIC Structured Securities Group and Capital Markets Bureau
RE:	Proposed P&P Manual Amendment to Remove References to Subscript-S and Update References to Investment Risk
DATE:	September 18, 2024

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

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

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

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

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

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

…

The VOS/TF and the SVO Staff

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

…

POLICIES PERTAINING TO SVO AND SSG OPERATIONS

…

NAIC Designations Do Not Communicate Statutory Accounting or Reporting

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

…

Impact on SVO Operations

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

SECURITIES VALUATION OFFICE (SVO)

Ongoing SVO Operations

36. The SVO shall conduct the following ongoing operations:

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

…

FILING SECURITIES WITH THE SVO

Filing Requirements

53. **Initial** – Insurers that file a security must provide the SVO with the information necessary to evaluate the ~~credit~~ investment risk for the security.

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

…

APPLICATION OF THE FE PROCEDURE TO SPECIFIC POPULATIONS

…

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

. . .

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

…

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

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

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

…

PRINCIPAL PROTECTED SECURITIES

Intent

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

…

PART TWO
OPERATIONAL AND ADMINISTRATIVE INSTRUCTIONS APPLICABLE TO THE SVO

…

SVO NOTCHING GUIDELINES

…

Definition and Purpose

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

…

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

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

Relevant Considerations

51. The name given to the security is not relevant to a determination whether this subparagraph should be applied. The relevant criterion is whether the risks in the security are clearly credit risks or whether they ~~are not clearly credit~~ include other investment risks.

52. Factors the SVO may deem relevant to the question of notching for ~~other non-payment~~ investment risk may include:

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

…

56. Notching differentials are expected to be wider for **NAIC 3**, **NAIC 4** and **NAIC 5** issuers because the issuer's credit or the issue's investment risk is deemed to increase the likelihood that the issuer will avail itself of contractually provided flexibility to not pay or increase the likelihood of a loss as a result of the insurer's participatory activity.

57. Deferral of dividends in a security denominated preferred stock is presumed to be subject to notching for credit risk subject to an SVO determination that the denomination is not truly reflective of the terms of the agreement in which case it may be more appropriately notched for ~~other than credit~~ investment risk.

58. In a given capital structure, the priority of payment due to an investor may be so subordinated as to require treatment under these guidelines that the insurers will not receive full and timely principal and expected interest ~~for other non-payment risk~~. This is especially true where deep subordination is combined with a right to defer interest.

…

TRANSACTIONS SUBJECT TO RSAT APPROVAL REVIEW

…

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

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

…

THE REGULATORY TREATMENT ANALYSIS SERVICE – EMERGING INVESTMENT VEHICLE

…

Definition of Probable Regulatory Treatment

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

…

Standing of EIV Application in the NAIC Financial Condition Framework

…

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

…

SVO ORGANIZATION

…

SVO Administrative Symbols

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

APPEALS OF SVO DETERMINATIONS

APPEALS OF SVO ANALYTICAL DECISIONS

…

Procedure for Filing an Appeal

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

….

MAINTENANCE AND MONITORING OF SVO DETERMINATIONS FOR SCHEDULE BA ASSETS

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

Maintaining and Publishing SVO Determinations

…

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

PART THREE
SVO PROCEDURES AND METHODOLOGY FOR PRODUCTION OF NAIC DESIGNATIONS

…

FE SECURITIES

…

Specific Populations of Securities Not Eligible for Filing Exemption

4. The filing exemption procedure does not apply to:

…

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

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

…

LIMITATIONS ON USE OF NAIC CRP RATINGS

NAIC Designation is Capped to Highest NAIC CRP Rating

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

    - Municipal bonds.
    - Military housing bonds or securities.

…

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

…

VALUATION AND ~~CREDIT~~ INVESTMENT RISK ASSESSMENT OF DEFAULTED SECURITIES AND ANALYTICAL CONVENTIONS

General Instructions

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

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Required Documents for ~~Credit~~ Investment Risk Assessment

. . .

79. If amended, then:

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

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

…

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

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

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

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

Purpose

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

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

…

Procedure for Credit Assessment of Filed SCA Transaction

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

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NAIC FUND LISTS

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REQUIRED DOCUMENTATION, ANALYTICAL PROCEDURES AND ELIGIBILITY CRITERIA

…

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

…

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

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

Methodology*

299. The SVO shall:

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

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

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

Documentation

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

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

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MUNICIPAL BONDS

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Industrial Development Revenue Bonds; Pollution Control Bonds

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

PRINCIPAL PROTECTED SECURITIES

Definition

325. Principal Protected Securities (PPSs) typically have both a principal protected component and a performance component whose payments originate from, or are determined by, non-fixed income like sources and, therefore, pose the risk of non-fixed income like cashflows. PPS do not include the exclusions listed below in this section.

326. The following transaction examples are included for demonstrative purposes only, to highlight the intent behind the principle-based PPS definition and the core regulatory concern (that there are investment risks ~~Other Non-payments Risks~~ associated with PPSs beyond the contractually promised payments that may not be reflected in a CRP rating) but are not intended to encompass all possible PPS variants. Each of these examples meets the definition of a PPS. Any design that circumvents the definition, and related examples, through technical means but which in substance achieves the same ends or poses the same risk, shall be deemed a PPS.

…

Filing Requirements

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

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

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October 31, 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 P&P Manual Amendment to Remove References to Subscript-S and Update References to Investment Risk

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 September 27, 2024.

As reflected in the exposure, we note that at the 2024 Summer National Meeting the Valuation of Securities (E) task force (VOSTF) adopted an updated definition of an NAIC Designation. The update included the removal of the concept "Other Non-Payment Risk" and the corresponding SVO administrative symbol "Subscript S", and the replacement of the term "credit risk" with the newly defined term "investment risk."

The undersigned agree with the proposed edits made in the aforementioned exposure except for the proposed changes in paragraphs 50 – 58 in Part Two, Operational and Administrative Instructions, Applicable to the SVO related to SVO Notching Guidelines that are specifically related to "Other Non-Payment Risk."

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

Per the P&P Manual, the sections related to Notching include the following:

- Definition and Purpose
- Notching NAIC Designation Categories (to Reflect Credit Risk)
- Methodology
- SVO Guidelines for Notching
- Notching Investment Grade Issuers
- Notching for Non-Investment Grade Issuers
- Notching for NAIC Designation Subscript (to Reflect Non-Payment Risk Unrelated to Credit Risk)
- Relevant Considerations

The underlined section above specifically references its applicability to Non-Payment Risk (paragraph 50) and discusses SVO discretion. This should be removed due both to what was agreed upon at the Summer National Meeting by VOSTF and the adoption elsewhere within the P&P Manual where discretion will be utilized to change CRP ratings.

Similarly, paragraphs 51 – 58 under Relevant Considerations is an extension of discussion of "Non-Payment Risk" considerations (mentioned in several of these paragraphs) and should also be deleted as agreed upon at the Summer National Meeting by VOSTF. Further, if there are any thematic issues in this section that are not related to Credit risk (see underlined above where it is noted Non-Payment or Subscript S is Unrelated to Credit Risk), the undersigned believe it is imperative these issues be addressed transparently and with due process with the VOSTF.

If you have any questions regarding this letter, please do not hesitate to contact us.

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