

2/15/2024

2024 Spring National Meeting  
Phoenix, Arizona

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

Saturday, March 16, 2024

Time: 2:00 p.m. – 3:30 p.m. MT

Location: 301 A West - Phoenix Convention Center - Level 3

**ROLL CALL**

| <b>Member</b>            | <b>Representative</b> | <b>State</b>  |
|--------------------------|-----------------------|---------------|
| Doug Ommen, Chair        | Carrie Mears          | Iowa          |
| Eric Dunning, Vice Chair | Lindsay Crawford      | Nebraska      |
| Mark Fowler              | Sheila Travis         | Alabama       |
| Lori K. Wing-Heier       | David Phifer          | Alaska        |
| Ricardo Lara             | Ricardo Lara          | California    |
|                          | Laura Clements        |               |
| Andrew N. Mais           | Ken Cotrone           | Connecticut   |
| Michael Yaworsky         | Ray Spudeck           | Florida       |
| Dean L. Cameron          | Eric Fletcher         | Idaho         |
| Dana Popish Severinghaus | Vincent Tsang         | Illinois      |
| Vicki Schmidt            | Tish Becker           | Kansas        |
| Timothy J. Temple        | Stewart Guerin        | Louisiana     |
| Kathleen A. Birrane      | Matt Kozak            | Maryland      |
| Gary D. Anderson         | John Turchi           | Massachusetts |
| Grace Arnold             | Fred Andersen         | Minnesota     |
| Chlora Lindley-Myers     | Debbie Doggett        | Missouri      |
| D.J. Bettencourt         | Jennifer Li           | New Hampshire |
| Justin Zimmerman         | Justin Zimmerman      | New Jersey    |
|                          | John Sirovets         |               |
| Adrienne A. Harris       | Robert Kasinow        | New York      |
|                          | James Everett         |               |
| Jon Godfread             | Matt Fischer          | North Dakota  |
| Judith L. French         | Tom Botsko            | 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            | Nathan Houdek         | Wisconsin     |
|                          | Amy Malm              |               |

NAIC Support Staff: Charles Therriault/Marc Perlman

## AGENDA

### ***Discuss and Consider for Adoption:***

1. Consider Adoption of its Fall National Meeting Minutes (Doc. ID 2024-001.01)  
—Carrie Mears (IA) Attachment One

### ***Receive Comments for Discussion:***

2. Revised Proposed P&P Manual Amendment to Update the Definition of an NAIC Designation (Doc. ID: 2022-012.08, 2022-012.08a, 2022-012.09, 2022-012.10, 2022-012.11)  
—Carrie Mears (IA), Charles A. Therriault (NAIC), and Marc Perlman (NAIC) Attachment Two & Two A - D
3. Revised Proposed P&P Manual Amendment Authorizing the Procedures for the SVO's Discretion Over NAIC Designations Assigned Through the Filing Exemption Process (Doc. ID: 2023-005.15, 2023-005.15a, 2023-005.15b, 2023-005.16, 2023-005.17, 2023-005.18, 2023-005.19, 2023-005.20, 2023-005.21, 2023-005.22, 2023-005.23, 2023-005.24, 2023-005.25, 2023-005.26)  
—Carrie Mears (IA), Charles A. Therriault (NAIC), and Marc Perlman (NAIC) Attachment Three & Three A - M
4. Proposed P&P Manual Amendment to Add Practical Expedient to Determine the Issue Date for PLR filings (Doc. ID: 2023-014.01, 2023-014.02)  
—Carrie Mears (IA), Charles A. Therriault (NAIC), and Marc Perlman (NAIC) Attachment Four & Four - A

### ***Receive and Consider for Exposure:***

5. Proposed P&P Manual Amendment to Update U.S. Government Agency and Other U.S. Government Obligation Abbreviations (Doc. ID: 2024-002.01)  
—Carrie Mears (IA), Linda Phelps (NAIC), Peter Kelly (NAIC) Attachment Five
6. Proposed P&P Manual Amendment to Update References to the SSAPs in Guidance for Subsidiary, Controlled and Affiliated (SCA) and Related Party Bond or Preferred Stock Investments (Doc. ID: 2024-003.01)  
—Carrie Mears (IA), Charles A. Therriault (NAIC), and Marc Perlman (NAIC) Attachment Six

**Hear Staff Reports:**

7. Receive the Annual Report from the Securities Valuation Office (SVO) on Year-End Carry-Over Filings (Doc. ID: 2024.004.01)  
—Charles Therriault (NAIC) Attachment Seven
8. Updates on the Proposed CLO Modeling Methodology and Ad-hoc Working Group  
—Eric Kolchinsky (NAIC)
9. Receive a Report on the Projects of the Statutory Accounting Principles (E) Working Group  
—Carrie Mears (IA) and Julie Gann (NAIC)
10. Discuss Any Other Matters Brought Before the Task Force
11. Adjournment

## Draft Pending Adoption

Draft: 12/12/2023

Valuation of Securities (E) Task Force  
Orlando, Florida  
December 2, 2023

The Valuation of Securities (E) Task Force met in Orlando, FL, Dec. 2, 2023. The following Task Force members participated: Doug Ommen, Chair, represented by Carrie Mears (IA); Eric Dunning, Vice Chair, represented by Lindsay Crawford and Nolan Beal (NE); Mark Fowler represented by Sheila Travis and Blase Abreo (AL); Lori K. Wing-Heier represented by David Phifer (AK); Ricardo Lara represented by Laura Clements (CA); Andrew N. Mais represented by Kenneth Cotrone (CT); Michael Yaworsky represented by Carolyn Morgan, Jane Nelson, and Ray Spudeck (FL); Dana Popish Severinghaus represented by Vincent Tsang (IL); Vicki Schmidt represented by Tish Becker (KS); James J. Donelon represented by Stewart Guerin (LA); Kathleen A. Birrane represented by Matt Kozak and Dmitriy Valekha (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 and Jim Everett (NY); Glen Mulready represented by Diane Carter and Eli Snowbarger (OK); Michael Humphreys represented by Diana Sherman (PA); Carter Lawrence represented by Trey Hancock (TN); Cassie Brown represented by Amy Garcia and Jamie Walker (TX); Jon Pike represented by Jake Garn (UT); Scott A. White represented by Doug Stolte (VA); Mike Kreidler represented by Steve Drutz (WA); and Nathan Houdek represented by Amy Malm (WI). Also participating was: John Tudino (RI).

### 1. Adopted its Summer National Meeting Minutes

Doggett made a motion, seconded by Clements, to adopt the Task Force's Aug. 14 minutes (see *NAIC Proceedings – Summer 2023, Valuation of Securities (E) Task Force*). The motion passed unanimously.

### 2. Heard a Staff Report on The History of FE

Mears said the next item is to hear a staff report on the history of filing exemption (FE), the role of the Securities Valuation Office (SVO), and the SVO's discretion. State insurance regulators heard this report during the Fall Education Seminar and found it informative since many have not been around for this entire history. It is also informative as the Task Force moves forward with the review of reliance on rating agencies.

Marc Perlman (NAIC) said at the request of the Task Force chair, the next few minutes of the meeting will be history lesson with a walk-through of the evolution of the use of third parties, rating agencies, the SVO, and FE in the assessment of insurer investments. With the significant debate around reintroducing a form of SVO discretion over ratings, Mears thought a little context might be helpful to demonstrate that this recommendation is not an aberration but rather a return to what had been the norm.

For this report, there was an extensive review of NAIC minutes and old versions of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual). The report covers a lot of ground and a lot of years, so the research is not exhaustive but, especially with those early years, it will give a sense of how centralized valuations developed, who was tasked with doing them, and the use and role of rating agencies in the process.

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In September 1907, Massachusetts first raised concerns about discrepancies in insurer valuation practices. This was prescient because a month later there was a financial panic after which the New York Department of Insurance (DOI) and the NAIC Committee on Assets revisited the topic and suggested finding an expert to value insurer investments for all departments.

By 1909, the NAIC had convened a Committee on the Valuation of Securities, which was to become the sole source of values. It decided to outsource this task to an expert in the field. In December 1909, the Committee signed a contract for \$5,000 with Marvyn Scudder, Esq. of 55 Wall Street to produce all valuations. Scudder had been called the country's foremost stock detective and was the editor of the "Marvyn Scudder Manual of Extinct and Obsolete Companies."

Scudder produced a valuations book each year through 1928, at which point the Committee on the Valuation of Securities contracted with Poor's Publishing Company (the predecessor to Standard & Poor's [S&P]), pursuant to which it would determine all values. In 1939, Moody's Investor Service (Moody's) got the contract.

In 1934, the topic was broached of the NAIC creating a Statistical Bureau of its own, available to the Insurance Commissioners of all states to appraise, value, and analyze insurance company portfolios and publish a valuations book much like Scudder and S&P had done. That would not happen for another ten years.

In the early 1930s, there were discussions that not all bonds should be reported at market value because "value" can fluctuate, often for reasons unrelated to the creditworthiness of the issuer. There was discussion that bonds that were deemed "amply secured" should be valued on an amortized—or a long-term stable basis—rather than the market value at which a security would be liquidated.

In 1941, a change was implemented to distinguish between bonds that could be amortized and those that would be valued at market value. Credit ratings were used as a test of amortization eligibility. Bonds rated by any two of Moody's, S&P, and Fitch (the only agencies at the time) in any of the first five grades, would be deemed "amply secured" and eligible for amortization.

In 1943, the Committee stopped using external consultants, as Moody's didn't extend its contract due to wartime responsibilities. The Committee undertook to perform all valuations and amortization determinations itself and leased a space at 61 Broadway. In the next two years that office was staffed and the Office of the Committee on Valuation of Securities was created, which later became the Securities Valuation Office (SVO).

It should be noted that at the time of its establishment, this precursor to today's SVO, just like Marvyn Scudder, S&P, and Moody's, was intended to be an independent, expert, and impartial source of investment values and amortization determinations.

By 1949, the volume of private placements was growing quickly. Each was reviewed by the Office, but there was discussion about expanding the office to meet the growing demand as well as the difficulties the Office faced in producing valuation and amortization determinations for private securities based on whatever financial information it was able to gather because there was no market value. To be clear, these were corporate bond private placements, not the more complex structured private placements we see today.

Two years later, this debate was ongoing and there was an interesting summary presented at the 1951 National Meeting of the analytical standards being used by the Office and critiques of those standards. Regarding the use of ratings to determine amortization eligibility, the report said, "The principal objection to this phase of

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current valuation procedure is the Committee's reliance upon the opinions of rating agencies whose approach and objectives may differ from those employed by the technical staff of the Committee." Regarding the Office's valuation of private placements, the report said, "The limitations upon this portion of the valuation method arise primarily from a lack of readily available and sufficient information concerning publicly traded bonds with which to compare the securities under review."

By 1953, the Committee adopted an analytic approach that remained relatively unchanged until 1989. Under this approach, which was refined from time to time, investments were given "Association Values." For bonds, the association value was comprised of two parts: a numerical notation and a statement as to eligibility for amortization. The amortization eligibility component could be thought of as the NAIC's quality opinion. The approach specified two analytic tests containing different standards for different entities, such as railroad, public utility, new enterprise, etc. The tests specified certain levels of standard bond analysis techniques. In Test 1, a corporate obligation would be eligible for amortization if it were rated in one of the four highest grades (i.e., investment grade) by any one of the recognized rating agencies. If it weren't, it could still be amortized if it met certain other financial ratios.

Even then, the results of the two tests were subject to further review and examination for any cases having predominant weakness or strength. In other words, the Office had discretion. As explained by the Office, "Because it is difficult to apply standardized tests to the wide variety of obligations which are purchased by insurers, the valuation procedures provide for the exercise of discretion in determining the qualitative and reserve categories for bonds not susceptible of measurement by such measures."

With the same basic analytic approach in place for 30 years, by the mid-'80s there was a move to revamp the valuation procedures. In December 1986, the Financial Condition (EX4) Subcommittee created a Bond Criteria (EX4) Subgroup of the Valuation of Securities (E) Task Force and charged it "to update and revise the financial ratio criteria and industry breakdowns" in the bond section of the SVO Procedures (precursor to the P&P Manual). Two industry advisory groups (called the A Group and the B Group) were then created to assist the Bond Criteria (EX4) Subgroup. In a 1988 report by the B Group, industry professionals from Morgan Stanley, Merrill, Moody's, S&P, Solomon Brothers, and Drexel Burnham discussed the need for a "reasonable" solution to the SVO's regulatory and analytical charge in light of its resource limitations. The Subgroup recommended the SVO take advantage of publicly available credit analysis and the results of existing financial research to screen out those debt investments that posed nominal default risk so it could focus on the issues with greater risk or where publicly available analysis did not exist. The Subgroup also said that for those investments requiring more in-depth review, the SVO should exercise significant discretionary analysis and authority utilizing all quantitative and qualitative analytical factors that it deemed necessary. It went on to say that it "wholeheartedly" agreed with the A Group, that "the SVO retain discretionary authority to review any situation warranted by specific facts and circumstances."

Finally, in 1989, revamped analytic guidelines were created in the then new P&P Manual. The guidelines said that, where appropriate, the SVO would use the Zeta Services quantitative financial model and past financial statement data to determine a preliminary measure of the relative financial soundness of the issue. The model, however, was not intended to be the sole determinant of the NAIC Designation. Rather, the SVO would review historical financial data and focus on security-specific factors, including covenants, structure, collateral, and ratings, which were just one element of the review.

The following year, the P&P Manual was changed to say that ratings of other recognized rating organizations would be translated directly into an NAIC designation. However, "The SVO staff will have discretionary

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authority to downgrade ratings of other organizations but not to upgrade.” It was also the year that “Yes” and “No” designations were replaced with the 1–6 used today.

The 1992 P&P Manual explained the relationship to nationally recognized statistical ratings organization (NRSRO) ratings, saying that NAIC guidelines and procedures promulgated by the Task Force permitted the SVO to incorporate or adopt work product of NRSROs or other reliable securities research organizations in lieu of determining an independent valuation for a security. The P&P Manual had a conversion table, but it did not imply an equivalency between NAIC designations and NRSRO ratings. However, the P&P Manual also said that the SVO retained absolute discretion to apply a lower designation.

In 1996, a distinction between public and private ratings was made with public ratings usually being granted automatic translation, with the caveat that the SVO retained discretion. Private ratings, however, were subject to full SVO review of the factors that may not be included in the NRSROs public ratings.

The following year, the P&P Manual included another qualifier regarding the use of NRSRO ratings. It said “the NAIC uses NRSRO ratings in order to conserve limited regulatory resources and to obtain publicly available high quality credit opinions. While NAIC Designations reflect the staff’s opinion about credit risk, the staff must address concerns unique to the regulatory community. Nothing in this manual should be interpreted as implying that the methodologies by which traditional or special NRSRO ratings are produced are identical to the manner in which the SVO considers credit risk for regulatory purposes, or to imply automatic equivalency of NAIC Designations with the ratings of NRSROs.”

Until this point, with certain rare exceptions (such as highly rated commercial paper), all securities needed to be filed with the SVO. Thus, even if the SVO just looked to ratings for a determination of amortization or to assign a designation, the SVO was seeing every insurance company investment and it had very few blind spots as to what insurers were investing in.

At this point, however, the movement toward what was called provisional exemption had begun. Provisional FE became effective Jan. 1, 2000, and under Provisional FE, both traditional bonds and asset-backed securities (ABS) rated by two or more NRSROs with the equivalent of an NAIC 2 Designation or one NRSRO with the equivalent of an NAIC 1 designation would not need to be filed with the SVO. There were certain other requirements to qualify for Provisional FE. For example, the security had to be issued by a U.S. entity and paid in U.S. dollars, principal had to be paid in full by a fixed maturity date and, in the case of ABS, only certain asset classes were permitted. Even with provisional FE, though, the P&P Manual cautioned that the SVO would not be able to monitor any market innovation or regulatory risk and it maintained SVO discretion. Provisional FE did not limit the SVO’s authority to require a filing that would otherwise be provisionally exempt.

The main question is why provisional FE was adopted. In 1996, there was a letter from the Joint Trades to the Task Force that focused on the SVO’s lack of resources and industry’s dissatisfaction with SVO efficiency at that time. A trade association recommended that insurers not need file non-structured securities rated investment grade by an NRSRO. Around the same time, an SVO Oversight Working Group was created to monitor SVO operations and to be a mechanism by which industry could raise concerns about the SVO. This oversight group conducted what it called the SVO Efficiency and Effectiveness Project, with the intended goal of increasing usage by the SVO of NRSRO ratings. At the same time, the NAIC hired outside consultant KPMG Peat Marwick to produce an independent report of the SVO and an SVO Subgroup of the Executive Committee conducted a study in response, which adopted and rejected some of KPMG’s recommendations. Both reports were presented in regulator-only sessions, and copies of the report have not been located. There was also a

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supposed public 8-page summary of the report, but that was also not located. However, based on subsequent minutes, it appears that the reports recommended greater reliance on ratings and provided a basis for provisional FE, likely due to the SVO's efficiency and resource problems at that time.

The Task Force, Oversight Working Group, and some in industry had concerns with reliance on NRSROs, and the joint trades addressed that in another letter. There were concerns, for instance, about private placements. The joint trades argued those were a minority of insurer investments but conceded they might require additional due diligence. There was a concern about ratings shopping or inflation with some arguing that an AAA threshold would promote the search for higher ratings. The Joint Trades did not think that should be concerned since NRSROs are judged by the quality of their ratings, presumably meaning that they would not reduce standards.

Others argued that ratings inflation would be an NRSRO accreditation problem rather than an FE problem. Moody's noted that ratings creep could become a problem if rating agencies were used for regulatory purposes, since the issuer would place more emphasis on receiving a higher rating rather than an accurate one. Moody's also said that reliance on ratings would have more impact on the less liquid markets, including private placements and structured securities. The trade associations, however, did reiterate that the provisional FE proposal did not affect the SVO's ability to request information about any security when it believed it to be necessary.

There was a lot of discussion about which ABS asset classes would be permitted. Certain state insurance regulators, industry, and staff had concerns that the change would limit the SVO's ability to fulfill its "eyes and ears" function, its role in spotting market innovation and risk. One SVO analyst warned of then-recent developments in a potentially riskier "subprime" asset class. There were also discussions about whether NRSROs should or can be differentiated. Some said the SVO could not currently differentiate between agencies because it had not been given the tools to objectively evaluate them. Others said the SVO Oversight Working Group should address NRSRO concerns directly with the NRSROs. Also, a 1994 Federal Reserve Report was cited, which said, "Differences [between rating agencies] can be highly problematic for ratings-based regulation in which ratings of any two NRSROs are substitutable."

Provisional FE was adopted for the start of 2000. In anticipation of its adoption, industry produced a frequently asked questions (FAQ) document for its roll-out. Question #3 was: "Why does the language say, 'provisionally exempt'?" The answer was that insurers have no irrevocable "right" to exemption from the filing of securities and the SVO and state insurance regulators will maintain the authority to request filings of securities that are provisionally exempt.

Soon after provisional FE became effective, attempts to expand the scope of exemption began. The SVO Oversight Working Group charged the SVO and interested parties with analyzing the feasibility of including non-NRSRO ratings, though this did not gain traction because it was argued that the Task Force was relying on U.S. Securities and Exchange Commission (SEC) recognition of NRSROs because the SVO did not have the staff to conduct an independent analysis and make those determination for each rating agency.

Then, there was a proposal for subsequent exemption, which would have exempted certain securities with optionality features from annual updates. That, too, failed to gain traction. Other state insurance regulators discussed the possibility of the SVO reviewing every security at least once but then defining classes of securities that would be FE.

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In 2003, there was the first proposal for full FE. It had three components: 1) exemption for all NAIC 1 and 2 rated equivalent securities (ignoring the several limitations imposed by provisional exemption, which, for example, only applied to U.S. issuers paying US dollars); 2) FE for NAIC 3–6 rated equivalent securities; and 3) an alternative to SVO review of unrated securities. This part of the proposal called for insurer self-designation.

Some of the rationale for full FE was that: 1) NRSRO ratings are sufficient to establish quality and the Oversight Working Group said it was comfortable with NRSRO ratings, particularly issues that were rated by multiple NRSROs; 2) the SVO was not using its discretionary authority very often and some said FE would turn an implicit reliance on ratings into an explicit one; 3) a new SVO Research Unit (created as part of the Efficiency and Effectiveness Project) could play the main “eyes and ears” function of the SVO and the SVO’s limited resources could be directed there; 4) it was argued that ratings focus on credit risk, whereas the SVO could focus on other non-credit risks affecting solvency; 5) insurer self-designation would make the SVO more efficient; and 6) it was argued that the NAIC had the power to withdraw an NRSRO from FE eligibility if it did not meet regulatory purposes.

Some argued against the full FE proposal or parts of it. Some of those arguments were that: 1) there was more volatility in below investment grade rated securities; 2) NAIC designations do not match ratings exactly; and 3) self-designation was particularly unpopular with regulators, even those who supported full FE. They said it just does not work since competitive business pressures compromise it and investors focus on risk and return while the regulators’ approach to quality may differ. Additionally, self-designation could result in different designations for the same security and would turn the process, which had been uniform for the 100 years, into a fragmented one once again.

In any event, the SVO Oversight Working Group saw little regulatory risk in relying on NRSROs. A modified version of full FE was adopted and became effective in 2004. This version scoped in NAIC 1–6 rated equivalent securities and included ABS, residential mortgage-backed securities (RMBS), and structured securities. In this version, private ratings were included while principal-only ratings were excluded.

Since then, full FE has undergone occasional adjustments. FE has been trimmed back, with several asset classes being expressly scoped out. Some, like RMBS, commercial mortgage-backed securities (CMBS), and now collateralized loan obligations (CLOs) have been handed to the Structured Securities Group (SSG). In Part Three of the P&P Manual, there is a list of other investments that are no longer eligible for FE. Credit tenant loans (CTLs) and ground leases on that list refer to the those defined in the P&P Manual as mortgage loans in the scope of *Statement of Statutory Accounting Principles (SSAP) No. 37—Mortgage Loans* and not investments in securities that are eligible for FE.

To conclude, FE has been in use for 20 years. It is what most know, is obviously quite important, and is not going away. However, there has never been an absolute right to use rating agency ratings, including today. The Task Force and its predecessors have always retained the right to use ratings as they think appropriate. For most of the Task Force’s and SVO’s existence, even when the Office relied on ratings for certain aspects of valuation or designation, the Office was considered the independent, impartial expert (and remains so today) and its discretion was permitted and viewed by state insurance regulators and many in industry as an important and necessary feature of the valuation/designation process.

Chris Anderson (Anderson Insights LLC) said it is important to distinguish when the SVO valued securities and when it began assessing risk. The SVO valued securities and published a book of association values. In 1951, there was a mandatory securities valuation reserve (MSVR), which some may remember when credit became

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an element. With the adoption of risk-based capital (RBC) in the early 90's, the role of the SVO transitioned and is now credit focused and not the valuation office that it used to be. The takeaway is that risk metrics like MSVR and RBC were important drivers of the history of the SVO.

### 3. Received a Referral from the Statutory Accounting Principles (E) Working Group on Changes Proposed for Schedule BA Investments and a Recommendation From the SVO on Those Changes

Mears said the next agenda item was to receive a referral from the Statutory Accounting Principles (E) Working Group on its proposal to report debt securities that do not qualify as bonds on Schedule BA. A key component of the notice was to highlight that the proposal uses existing Schedule BA reporting provisions for SVO-assigned NAIC Designations in determining RBC. This referral was sent to the Task Force and the Capital Adequacy (E) Task Force. The SVO staff prepared a recommendation, and Charles Therriault (NAIC) provided a summary of that recommendation. The Task Force could then consider how it would like to respond to the Working Group and Capital Adequacy (E) Task Force on this matter.

Therriault said the Task Force has an existing policy in the P&P Manual in Part One, paragraphs 40 and 99, and instructions to the SVO in Part Two, paragraphs 209–212, that permit the SVO to assign NAIC Designations to Schedule BA assets.

SVO staff strongly recommend the continuation of the long-standing existing policy of only allowing the bond RBC factors associated with NAIC Designations assigned by the SVO to investments appropriately reported by insurers on Schedule BA. The nature of the investments on this schedule can vary widely and are often highly bespoke, which demands a higher level of regulatory scrutiny before being granted this favorable treatment. The adopted revisions to the definition of a bond following the principles-based bond project likely means that more unusual investments will be moving to Schedule BA. Keeping the process as-is will also align with the Task Force's efforts to reduce blind reliance on rating agency ratings. The SVO would also recommend the recognition and treatment of SVO-assigned NAIC Designations to investments on Schedule BA be made consistent and uniform across all statement types, as only life and fraternal insurers benefit today.

Mears, hearing no objections or concerns from the Task Force on the SVO's recommendation, said the recommendation would be communicated to the Capital Adequacy (E) Task Force and eventually the Risk-Based Capital Investment Risk and Evaluation (E) Working Group.

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

Mears said the next agenda item was to receive, discuss, and consider for exposure a revision to the proposed P&P Manual amendment to update the definition of an NAIC designation. After the Summer National Meeting, the SVO was directed to consider the actionable comments from industry and to work with industry on further updating and simplifying the definition. Perlman provided an update on these changes.

Perlman said, as mentioned at previous meetings, NAIC designations are currently explained and defined in both Parts One and Two of the P&P Manual. The SVO has proposed consolidating the explanations and definitions into Part One because what constitutes an NAIC Designation is a fundamental policy of the Task Force. In the amendment, the NAIC tried to clarify the meaning of an NAIC Designation, including their use, purpose, and the risks addressed. At the Summer National Meeting, the Task Force and interested parties discussed and provided comments and feedback on that initial draft of the proposal, and the Task Force directed the SVO staff to consider that feedback in a revised version of the amendment. Several of the

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actionable comments received were incorporated into the amendment being considered for exposure. First, a more concise definition of an NAIC designation that reflects credit quality was created, which also reflects (i) any inconsistencies with the existing regulatory assumption that a fixed-income instrument pays scheduled interest and full repayment of principal on a date certain. This could result in diminution of payment and (ii) where appropriate, loss given default and/or “tail” risk. These last components would likely only be appropriate for certain structured asset classes. Additionally, all references to Subscript S and its application to securities for other non-payment risks was removed.

Mears directed the SVO to expose the updated definition of an NAIC designation for a 53-day public comment period ending Jan. 26, 2024.

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

Mears said the next agenda item was to receive, discuss, and consider for exposure a revised proposed P&P Manual amendment that would authorize the procedures for the SVO’s discretion over NAIC Designations assigned through the FE process. As mentioned during the Summer National Meeting and during the Task Force’s the May 15 meeting, the proposal stems from the Financial Condition (E) Committee’s charge to the Task Force to: Establish criteria to permit staff’s discretion over the assignment of NAIC designations for securities subject to the FE process to ensure greater consistency, uniformity, and appropriateness to achieve the NAIC’s financial solvency objectives.

The Task Force received many comments on the initial proposal put forth by the SVO. SVO staff took those recommendations to heart and worked with state insurance regulators to incorporate many of them into this revised proposal. Overall, this was a very deliberative process that state insurance regulators feel is both fair and reasonable, with appropriate levels of feedback and oversight.

It is incredibly important to remember that NAIC designations ultimately fall under the purview of state insurance regulators and are used solely within the insurance regulatory framework. Credit rating providers (CRPs) provide an invaluable service given the number of securities and efficiencies gained by the NAIC. This was demonstrated in the presentation from Perlman and there is no intention of displacing or competing with them. However, because of how the NAIC uses CRP ratings in its processes, this is not an unconditional usage. This proposal is specific to how state insurance regulators, as responsible consumers of CRP ratings for regulatory purposes, choose to use them in that regulatory process. It also empowers the SVO staff to act through a well-defined process, when necessary, in supporting state insurance regulators in this responsibility.

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

- 1) The process starts when an SVO analyst or NAIC regulator identifies as FE security with an NAIC designation assigned by a rating that appears to be an unreasonable assessment of risk.
- 2) The SVO would then convene the Senior Credit Committee (SCC), composed of the SVO director, the managing investment council, the two credit managers, and four credit supervisors, to meet with the analyst and determine if it agrees that the rating appears to possibly be an unreasonable assessment of risk and, if so, place the security “Under Review.”

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- 3) If the SVO SCC votes to put the security “Under Review,” an information request will be sent through NAIC systems, such as VISION, to the insurers that hold that security that the SVO needs information on it. If the information request is not responded to, the SVO may reach out to the domiciliary chief financial examiner.
- 4) Upon receipt of all necessary documentation through the information request, the SVO will then perform a full analysis of the security and coordinate during its analysis with interested insurer(s) on any questions or issues the SVO may have about the security or questions that the insurers may have for the SVO. Insurers are invited to have discussions with the SVO during its analysis to better understand the SVO’s analytical concerns and methodology and are able to share their own analytical perspective and methodology.
- 5) When that analysis is completed, the SVO SCC reconvenes and determines, based on its full analysis of all necessary information, whether the FE NAIC designation is three or more notches different from the SCC’s opinion.
- 6) If the SVO SCC opinion differs from the FE-produced NAIC designation category by a material three or more notches, the specific CRP rating(s) for that security will be identified for removal from FE and the SVO SCC will present its analysis to a subgroup of the Task Force to provide oversight over the FE removal process and enable the Task Force to provide feedback to the SVO.
- 7) If there are no alternative CRP ratings, the SVO SCC’s assessment will be entered into VISION. If an alternative CRP rating is subsequently received, it will be incorporated into the FE process, if applicable.
- 8) If the SVO SCC assesses the issue is part of a recurring pattern, the SVO director will inform the chair and decide if an issue paper, referral, amendment, or other action is needed.
- 9) An anonymized summary of each unique issue or situation will be published on the SVO web page or some other insurer-accessible location for transparency.
- 10) An insurer may appeal to the Task Force chair if it believes the SVO did not follow the procedures outlined in the P&P Manual. This is an existing instruction that insurers can always avail themselves of.
- 11) If an insurer(s) wishes to appeal the SVO SCC’s analytical assessment, it may request the NAIC’s Investment Analysis Office (IAO) to contract, at the insurer’s expense, with an independent third-party acceptable to the NAIC IAO to perform a blind review of the security (e.g., without knowledge of the SCC’s, insurers’, or CRP’s assessment) with the information provided through the information request. If the independent third-party review results in an NAIC designation category that is one or less notches different from the FE-produced NAIC designation category, then the SVO SCC’s opinion will be overridden by the reinstatement of the CRP rating(s). If the independent third-party review results in an NAIC designation category that is more than one notch different from the FE-produced NAIC designation category, then the SVO SCC’s opinion will remain.
- 12) The SVO will identify through SVO administrative symbols when a CRP rating(s) has been removed from the FE process for a security through its application of discretion.
- 13) At the Spring National Meeting, the SVO director will summarize FE discretion actions taken for the preceding year.

As a whole, the process outlined reflects many of the recommendations made by Task Force members and interested parties. Specifically, the SVO will have complete information before making an assessment, the Task Force will be involved and informed, the application of discretion only targets a CRP’s rating thereby permitting an alternate CRP rating to be used, insurers are invited to have discussions with the SVO during its analysis to better understand the SVO’s analytical concerns and methodology and are able to share their own analytical perspective and methodology, there is the ability for insurers to appeal the SVO’s analytical opinion to an independent third-party, and the SVO will publish an anonymized summary of issues encountered.

## Draft Pending Adoption

The SVO agrees that credit analysis is both an art and a science; therefore, differences of professional opinion are unavoidable. This proposal focuses on only material differences of opinion. There are additional checks and balances in this proposal that should provide the Task Force and industry comfort that the investment risk assessments are reasonable. Unless otherwise directed to do so by the Executive (EX) Committee and Internal Administration (EX1) Subcommittee, which have the ultimate responsibility for all NAIC fees, the SVO is not planning to propose any fees associated with the discretion analysis other than the potential expense already noted if there is an analytical appeal by insurers to an independent third-party.

Anderson asked how the SVO can determine that something is three notches off where it should be. He also stated that the tests specified presently are unproven in three instances and vague in the fourth instance, noting that the SVO has the authority under the proposal to declare if something is off three notches for any reason that it feels appropriate. He stated that he does not see in the memorandum from Nov. 3 description of the kind of interaction and information available to insurers called into question. Anderson said if that can be documented with the information available to insurers, it would be very helpful. Anderson's third point was in regard to the appeal process that is new. He said he appreciates the fact that it is being considered and incorporated into this proposal. However, as it is written, it is fraught with problems. First, an appeal can only be mounted if an insurer feels that the SVO has not followed the P&P Manual. Anderson said what is being discussed is whether a rating agency has done a creditable job in rating a security, and the SVO does not necessarily do what rating agencies do.

Mears said there are two different components to making an appeal to the chair or Task Force if any party feels a policy was not followed. Separately, insurers can use the third-party appeal if they do not agree with the analytical assessment, which does not have to be a process-driven appeal.

Anderson said what he was addressing was the third party. The issues with the third party regard confidentiality. He stated that lot of these issues are intended to be private placements. In private placements, the banker, rating agency, and others form deal teams and have confidential information/insiders. Anderson asked how you can find a third party that is eligible and entitled to receive material nonpublic information. A larger problem is that the third party is supposed to act blindly and cannot have access to the other information. Specifically, it cannot have access to the rating agency materials that detail what the rating agency has done. The rational can run from 20–30 pages, and the rating agency is required by the SEC to disclose which of its private methodologies it uses. The third party cannot have access under this proposal. The SVO would have performed its own credit that the third party would not have access to. Under this proposal, the third party will essentially get a stack of virtual documents and will have to figure out the deal all by itself. The SVO will have the benefit of looking at rating agency work but will be coming up with a rating from scratch. Anderson stated that there is a better way of doing this and he hopes the Task Force will consider it. Instead of trying to do a rating from scratch, which would have been done by the rating agency and SVO with guidance from other sources, the third party could evaluate the work of the rating agency, if the confidentiality concerns can be overcome, compare it to the work of the SVO looking at the credit files correspondence, and decide. That would be more likely possible than the idea of coming up with a full-blown rating that will require tremendous research.

John Garrison (Lease-Backed Securities Working Group) said one thing missing from the memorandum is that nothing requires the SVO to produce a report explaining its analytical process to the investor like what is done by rating agencies. Without that, is hard to see how any appeal could be effective without knowing the steps of the analysis. A comment letter addressing that issue will be prepared.

## Draft Pending Adoption

Mears said that has come up in some discussions and that Garrison should absolutely put that in his letter. To provide some initial feedback, Mears said she was initially neutral on the request to have the SVO publish its analysis. However, hearing more about how there was an expectation that insurers would want to use it to distribute amongst themselves made Mears think it would be incredibly problematic to have a written report out there when the NAIC does not have the same engagement letter and provisions that exist for those insurers to demand confidentiality of the process, especially when there are multiple insurers that are invested in a deal and one chooses to reveal that information when others choose not to. That is not a responsibility that the SVO (via the Task Force) can take on, it would end up being problematic.

Therriault said confidentiality is something that the SVO is very concerned about and putting this out in written form to be distributed would be something the SVO is very reluctant to do and would recommend against. Having an open discussion with insurers invested in the transaction is welcomed, and the SVO regularly invites them to have an open dialogue.

Mears said there should be no expectation that the insurer will not have full visibility into the analysis that has been done or the methodologies used, and should have a full conversation with the SVO. There is absolute transparency in that process built into this proposal.

Mears, with the permission of the Task Force, directed the SVO to expose the updated amendment authorizing the procedure for the SVO's discretion over NAIC designations assigned through the FE process for a 53-day public comment period ending Jan. 26, 2024.

### 6. Exposed a Proposed P&P Manual Amendment to Add Practical Expedient to Determine the Issue Date for PLR Filings

Mears said the next item on the agenda was to hear about a proposed P&P Manual amendment to add a practical expedient to determine the issue date of private letter rating (PLR) filings.

Therriault said the SVO has been unable to independently source the date attribute "issue date" (e.g. date of legal closing), a necessary input to determine the requirement to provide a PLR rationale report. The SVO proposes permitting it to apply a practical expedient by assuming that any security subject to PLR guidance that was acquired on or after Jan. 1, 2022, was issued on or after Jan. 1, 2022, unless documentation showing an earlier issue date is provided. This is to fill in the gap that exists in the current data.

Michael Reis (Northwestern Mutual, representing the American Council of Life Insurers [ACLI], the Private Placement Investors Association [PPiA], and the North American Securities Valuation Association [NASVA]), said there has been a back and forth with PPiA, NASVA, and ACLI companies that may relate to the same root cause of what the exposure is about or even an ancillary issue related to it. The groups are fine with the exposure date but would like to meet with the SVO to talk about some the concerns.

Therriault said the SVO is always happy to meet with industry, work through any operational details, and propose modifications if something is needed to clarify an issue.

Mears said if there are any operational questions or needed guidance on how to interpret something, it can be posted on the SVO or Task Force web page.

## Draft Pending Adoption

Mears, with permission of the Task Force, directed the SVO to expose the proposed amendment to add a practical expedient to determine the issue date of PLR filings for a 53-day public comment period ending Jan. 26, 2024.

### 7. Received a Staff Report on Updates on the Proposed CLO Modeling Methodology Ad Hoc Group

Mears said the next agenda item was to hear updates on the proposed CLO Modeling Methodology Ad Hoc Group.

Eric Kolchinsky (NAIC) said the CLO project is proceeding apace. Recently, the SSG proposed 10 scenarios, including a number in the tail of the probability distribution. The detail was posted for default rates and recoveries for each scenario on the CLO web page.

The SSG also posted cash flow results for each proxy deal. The next step is to set probabilities for each of the 10 scenarios based on these cash flows. The SSG is looking for industry feedback on these probabilities.

Kolchinsky also said based on the Risk-Based Capital Investment Risk and Evaluation (E) Working Group's work, the SSG views the current approach to be consistent with the American Academy of Actuaries (Academy) principles that were discussed. The SSG offers assistance to the Working Group or Academy on any work that may be required on CLOs or any other structured product.

Kolchinsky then said he would like to address two operational issues that have come up. First is the starting date for the project, which is 2024. To clarify, nothing operational happens Jan. 1. The first impact will occur at year-end 2024 when the results are released. Second, just in case this work gets slowed down, there is an option to extend the effective date to 2025. This possibility was anticipated at the start of the project. If the extension is required, the Task Force will be informed at the Spring National Meeting, and an amendment to the P&P Manual to replace 2024 with 2025 can be submitted for the Task Force's consideration at the Summer National Meeting.

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

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

Julie Gann (NAIC) said this is an update in accordance with the coordination initiative with the Statutory Accounting Principles (E) Working Group. The Working Group met Dec. 1, 2023. Gann said that for all actions, please refer to the full summary and the minutes, as this will just be a high-level subset of investment-related items that may be of interest to the Task Force. The Working Group adopted three items. First, regarding residual interests, in the interim, there were adopted revisions to *SSAP No. 43R—Loan-Backed and Structured Securities*, *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, and the annual statement instructions to make it clear that all in-substance residuals shall be reported on Schedule BA. At this national meeting, the Working Group incorporated revisions to *SSAP No. 30R—Unaffiliated Common Stock* and *SSAP No. 32R—Preferred Stock* to make it clear that all in-substance residuals should be recorded on Schedule BA. That is effective immediately for year-end 2023. Hopefully, it is very clear that if an investment is an in-substance residual, it needs to be on the Schedule BA reporting line as a residual.

## Draft Pending Adoption

Second, the Working Group adopted revisions to *SSAP No. 2R—Cash, Cash Equivalent, Drafts and Short-Term Investments* to further restrict the investments that are permitted for cash equivalent and short-term reporting, with an effective date of Jan. 1, 2025. As a reminder under the bond project, the Working Group adopted revisions to remove all ABS from that short-term schedule. With ABS, the items that were just restricted include mortgage loans and all Schedule BA items, including collateral loans.

Third, the Working Group adopted revisions to the annual statement instructions to address specific elements related to interest maintenance reserve (IMR) that will allow non-interest-related impacts to go to IMR instead of asset valuation reserve (AVR), with an effective date of Jan. 1, 2024. Those focus mostly on mortgage loans and debt securities with known credit events that have occurred, but the rating or designation has yet to be updated before it is sold by a company.

There are six exposures to be addressed. First is the exposed revisions to *SSAP No. 21R—Other Admitted Assets* to incorporate a new measurement method for residuals. This included comments received from industry on the incorporation of the “effective yield with a cap” method but also has a practical expedient to allow the “cost recovery” method, which was the approach exposed previously by the Working Group. This exposure also includes the guidance for non-bond debt securities and is part of the bond project exposures. However, there were no comments on that section from the last exposure so there are no revisions to it. This is exposed until Jan. 22, 2024, and will hopefully be adopted in early February so the Schedule BA revisions can be adopted in February. That will conclude all the revisions for the bond project. They are posted publicly on the Working Group web page.

The Working Group exposed reporting revisions for collateral loans on Schedule BA. There had been a lot of conversations with regard to collateral loans earlier this year clarifying the guidance for admittance. The reporting was not sufficient to identify the underline collateral for collateral loans, so that is reflected in exposure with the Jan. 22, 2024, deadline to include several more reporting lines to bucket collateral loans. It also requests comments regarding possibly consolidating some of those lines.

Also exposed were reporting revisions to Schedule BA to further expand the description of the different types of underline components for the *SSAP No. 48* items, such as fixed-income instruments, common stock, and real estate, to make sure everyone did the same descriptions for which investments were reported in each category for the Jan. 22 deadline.

There is a proposal to reject the “current expected credit loss” U.S. generally accepted accounting principles (GAAP) standard, otherwise known as current expected credit losses (CECL). The current exposure is for a full rejection of the CECL guidance.

The Working Group exposed revisions to IMR related to perpetual preferred stock reported at fair value. That measurement change was incorporated in 2021. The Working Group has not updated the current IMR guidance that refers to perpetual preferred stock. These revisions serve to correct the current disconnect in the guidance.

Lastly, the Working Group exposed significant *SSAP* revisions to *SSAP No. 93—Low-Income Housing Tax Credit Property Investments* and *SSAP No. 94—Transferable and Non-Transferable State Tax Credits* pertaining to investments that generate tax credits and acquired tax credits. This exposure expands that guidance and specifically asks for comments on impacts that should be considered for the Schedule BA reporting lines beyond the current Low-Income Housing Tax Credit (LIHTC) guidance.

## Draft Pending Adoption

### 9. Received Notification from the SVO that it Will Defer the Deactivation of PLR that Missed a Required PR Rational Report Until Year-End 2024 and Requested Insurers to Submit Their Reports

Mears said she believed that Therriault had one other matter related to the deactivation of private ratings that are missing a required rationale report for year-end.

Therriault said it is taking the NAIC longer than expected to make the necessary updates to associate PLRs to the private rating rationale reports. Additional testing is still needed, and the SVO will be deferring the deactivation of PLRs that do not have a required rationale report until year-end 2024. The SVO wants to be certain this process is working accurately and does not want to unnecessarily penalize any insurer by deactivating a private rating at year-end. If the SVO has received a private rating letter in 2023, it will be reflected in the AVS+ application for year-end. Insurers should continue to submit rationale reports to the SVO. While private ratings will not be deactivated, insurers should not use this as an opportunity to avoid filing the rationale report with the SVO. The initial assessment is that private ratings have significantly increased for 2023. Through Nov. 30, there are approximately 7,327 private ratings that translate into an NAIC Designation, which may include some 2022 PLRs. There are some 2,430-private rating rationale reports missing, and the related private rating would have been deactivated if the SVO was not deferring the deactivation process for year-end 2023. That number of missing rationale reports excludes securities that are missing an issue date, the problem discussed earlier, or those issued prior to 2018. Again, the SVO requests insurers submit complete information, including the required private rating rationale reports. The SVO will continue to test NAIC systems in 2024.

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

[https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-03-19 NAIC Spring NM/01-Fall NM Minutes/VOSTF\\_2023-12-02\\_Fall\\_NM\\_Minutes \(FINAL\).docx](https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-03-19 NAIC Spring NM/01-Fall NM Minutes/VOSTF_2023-12-02_Fall_NM_Minutes (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 (SVO)  
Marc Perlman, Managing Investment Counsel, NAIC Securities Valuation Office (SVO)

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

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

DATE: October 31, 2023

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#### **Summary –**

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

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

At the Summer National Meeting held on Aug. 14, 2023, the Task Force discussed an initial draft of a proposed amendment to the P&P Manual updating the definition of an NAIC Designation. The Task Force directed the SVO staff to consider the feedback from Task Force members and interested parties and update the proposal. The revised amendment in this memorandum reflects the actionable comments received from Task Force members and interested parties, including:

1. Creation of a concise definition of an NAIC Designation which reflects, along with credit quality:
  - a. Any inconsistencies with the existing regulatory assumption that a fixed income instrument requires scheduled payments of interest and full repayment of principal on a date certain; and
  - b. Loss given default and/or “tail” risk, where appropriate; and
2. Removal of the application of Subscript S for other non-payment risks.

**Proposed Amendment** - The proposed text changes to the P&P Manual are shown below with additions in red font color and deletions in ~~red strikethrough~~, as it would appear in the 2022 P&P Manual format. Editing notes have been added with [ ] to explain section moves. New text is highlighted in yellow.

**(VERSION WITH CHANGES DISPLAYED AND ADDITIONS HIGHLIGHTED)**

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

## POLICIES PERTAINING TO SVO AND SSG OPERATIONS

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### ~~NAIC Designations~~

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

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

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

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

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

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

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

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

## NAIC DESIGNATIONS

### NAIC DESIGNATIONS

#### Regulatory Objective

88. An objective of the VOS/TF is to assess the financial ability of an insurer to pay claims. For example, the regulatory assumption is that a fixed income instrument called debt by its originator or issuer requires that the issuer make scheduled payments of interest and fully repay the principal amount to the insurer on a date certain. A contractual modification that is inconsistent with this assumption creates a rebuttable inference that the security or instrument contains an additional or other non-payment risk created by the contract that may result in the insurer not being paid in accordance with the underlying regulatory assumption. **NAIC Designations are** The SVO is required to **reflect** ~~identify securities that contain~~ such contractual modifications and quantify the possibility that such contracts will result in a diminution in payment to the insurer.

*[Editing note: Moved from Part One, para. 90]*

**NOTE:** See “NAIC Designation Subscript S” in Part Two.

#### Definitions

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

#### Use and Purposes of NAIC Designations

90. **NAIC Designations** are proprietary symbols of the NAIC. The SVO, **the SSG and, under certain circumstances, insurers,** produce NAIC Designations for insurer-owned securities using the policies, procedures or methodologies adopted by the VOS/TF in this Manual. *[Editing Note: Moved from Part Two, para. 18.]* **The** credit analysis is performed solely for the purpose of designating the quality of an investment made by an insurance company so that the NAIC member’s department of insurance can better identify regulatory treatment. *[Editing Note: moved from Part One, para. 37]* Credit risk is assessed by analyzing the

- information and documentation provided to the SVO by the reporting insurance company and its advisors. The SVO does not audit the information submitted and assumes the information to be timely, accurate and reliable. *[Editing Note: moved from Part One, para. 37]*
91. **NAIC Designations** are produced for statutory accounting, reporting, state investment laws and other purposes identified in the NAIC Financial Regulation Standards and Accreditation Program and/or other NAIC developed regulatory guidance embodied in state law *[Editing note: Moved from Part Two, para. 18]* and must be interpreted by the NAIC member in context of the NAIC Financial Regulation Standards and Accreditation Program, other characteristics of the investment, and the specific financial and regulatory status of the insurance company. *[Editing note: Moved from Part One, para. 37]* ~~NAIC Designations are adjusted in accordance with the notching procedures described below so that an NAIC Designation for a given security reflects the position of that specific security in the issuer's capital structure. NAIC Designations may also be adjusted by notching to reflect the existence of other non-payment risk in the specific security in accordance with the procedures described in this Manual. *[Editing note: Deleted from Part Two, para. 18]*~~
92. **NAIC Designations** must be considered in the context of its appropriateness and consistency of use in the NAIC Policy Statement and Financial Regulation Standards (SFRS) and other NAIC guidance. For example, the NAIC Designation serves as the basis for determining the appropriate risk-based capital charge for a given security.

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

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

#### APPLICATION OF NAIC DESIGNATIONS

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

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

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

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

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

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

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

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

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

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

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

*[Editing note: Moved from Part Two, para. 24]*

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

|   |
|---|
| <b>APPLICATION OF NAIC DESIGNATION CATEGORIES</b> |
|---|

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

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

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

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

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

| NAIC<br>Designation | + | NAIC<br>Designation<br>Modifier | = | NAIC<br>Designation<br>Category |
|---------------------|---|---------------------------------|---|---------------------------------|
| 1                   |   | A                               |   | 1.A                             |
| 1                   |   | B                               |   | 1.B                             |
| 1                   |   | C                               |   | 1.C                             |
| 1                   |   | D                               |   | 1.D                             |
| 1                   |   | E                               |   | 1.E                             |
| 1                   |   | F                               |   | 1.F                             |
| 1                   |   | G                               |   | 1.G                             |
| 2                   |   | A                               |   | 2.A                             |
| 2                   |   | B                               |   | 2.B                             |
| 2                   |   | C                               |   | 2.C                             |
| 3                   |   | A                               |   | 3.A                             |
| 3                   |   | B                               |   | 3.B                             |
| 3                   |   | C                               |   | 3.C                             |
| 4                   |   | A                               |   | 4.A                             |
| 4                   |   | B                               |   | 4.B                             |
| 4                   |   | C                               |   | 4.C                             |
| 5                   |   | A                               |   | 5.A                             |

|                             |  |  |
|-----------------------------|--|--|
| 5                           | B  | 5.B                                      |
| <b>NAIC<br/>Designation</b> | <b>+</b>                                 | <b>NAIC<br/>Designation<br/>Modifier</b> |
| <b>=</b>                    | <b>NAIC<br/>Designation<br/>Category</b> |  |
| 5                           | C  | 5.C                                      |
| 6                           |  | 6  |

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

103. NAIC Designations and Designation Categories may be adjusted in accordance with the notching procedures described in this Manual below so that an NAIC Designation and Designation Category for a given security reflects the position of that specific security in the issuer’s capital structure, and other non-payment risks or non-payment mitigants. NAIC Designations may also be adjusted by notching to reflect the existence of other non-payment risks in the specific security in accordance with the procedures described in this Manual associated with NAIC Designations Subscript S.

*[Editing note: Moved from Part Two, para. 18]*

**NAIC DESIGNATIONS RELATED TO SPECIAL REPORTING INSTRUCTION**

104. An insurance company that self-assigns a 5GI must attest that securities receiving this designation meet all required qualifications by completing the appropriate general interrogatory in the statutory financial statements. If documentation necessary for the SVO to perform a full credit analysis for a security does not exist or if an NAIC CRP credit rating for an FE or PL security is not available, but the issuer is not current on contractual interest and principal payments, and/or if the insurer does not have an actual expectation of ultimate payment of all contracted interest and principal, the insurance company is required to self-assign this security an NAIC 6\*.

*[Editing note: Moved from Part Two, para. 27]*

105. NAIC 6\* is assigned by an insurer to an obligation in lieu of reporting the obligation with appropriate documentation in instances in which appropriate documentation does not exist, but the requirements for an insurance company to assign a 5GI are not met.

*[Editing note: Moved from Part Two, para. 28]*

106. Securities with NAIC 5GI Designations are deemed to possess the credit characteristics of securities assigned an NAIC 5 Designation. A security assigned an NAIC 5GI Designation incurs the regulatory treatment associated with an NAIC 5 Designation.

*[Editing note: Moved from Part Two, para. 29]*

107. Securities an insurance company previously assigned as NAIC 5GI are permitted to subsequently receive this designation if the requirements for an NAIC 5GI designation continue to be met.

*[Editing note: Moved from Part Two, para. 30]*

108. Securities with NAIC 6\* Designations are deemed to possess the credit characteristics of securities assigned an NAIC 6 Designation. Therefore, a security assigned an NAIC 6\* Designation incurs the regulatory treatment associated with an NAIC 6 Designation.

*[Editing note: Moved from Part Two, para. 31]*

109. Securities that are residual tranches or interests, as defined in *SSAP 43R – Loan Backed and Structured Securities*, shall be reported on Schedule BA - Other Long-Term Invested Assets, without an NAIC Designation and are ineligible to be assigned an NAIC 5GI or NAIC 6\* Designation.

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

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

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

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

### **NAIC General Interrogatory**

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

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

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

## NAIC PLGI

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

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

## Monitoring of SVO-Designated Securities

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

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

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

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

~~NAIC DESIGNATIONS~~

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

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

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

**NAIC DESIGNATION CATEGORIES**

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

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

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

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

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

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

**NAIC DESIGNATION SUBSCRIPT S**

**Description of Other Non-Payment Risk**

- ~~33. It may not be practical, desirable or possible to specifically define other non-payment risk given the assumption that it originates as a result of a contractual agreement or the presence of a structural element of a transaction that is agreed upon between the issuer and the insurer. Accordingly, what follows is intended as general guidance to insurers and others.~~
- ~~34. Most typically, other non-payment risk has been associated with contractual agreements between the insurer and the issuer in which the issuer is given some measure of financial flexibility not to make payments that otherwise would be assumed to be scheduled, given how the instrument has been denominated, or the insurer agrees to be exposed to a participatory risk.~~
- ~~35. Other non-payment risk differs from the type of issues encountered in credit risk. This is because typically, credit assessment is concerned with securities in which the parties create subordination by modifying the lender's priority of payment (e.g., senior unsecured versus junior subordinated) but in a context where the contract otherwise specifies that the failure to make payments on a scheduled basis (defined in the contract) is an event of default (in the case of a bond) or triggers some other specific and identifiable lender remedy (in the case of other fixed income securities).~~
- ~~36. Using the broad concepts identified above, non-payment risk may be present when:~~
- ~~▪ A reporting insurance company takes on a participatory risk in the transaction;~~

*Illustration — The contract promised payment of a dollar denominated obligation in non-U.S. currency but does not require an exchange rate that would yield foreign currency sufficient to buy a defined principal amount of U.S. dollars. The other non-payment risk in this illustration consists of the reporting insurance company's acceptance of currency risk which may diminish the principal amount of the investment. Currency risk here is not related to the issuer's ability or willingness to pay and therefore is not appropriately reflected in the NAIC Designation of the issuer or captured by notching for credit risk.*
  - ~~▪ The contract governing the loan provides for a degree of permanence in the borrower's capital structure that is incompatible with notions of a loan that is expected to be repaid;~~

*Illustration — A loan stated to be perpetual and giving the issuer the right to miss interest or dividend payments otherwise said to be scheduled where the missed payments are not required to be paid on a subsequent date.*

*Illustration — An instrument denominated as a bond but lacking a maturity date, a mechanism to determine a maturity dates (e.g., a mandatory redemption) or that states a maturity equal to*

*or exceeding 40 years.*

~~37. Agrees to an exposure that has the potential to result in a significant delay in payment of contractually promised interest and/or a return of principal in an amount less than the original investment.~~

### **Meaning of the Subscript S Symbol**

~~38. An SVO determination that a specific security contains other non-payment risk is communicated by assigning the NAIC Designation subscript S to the specific CUSIP and applying the notching procedure described below. The subscript follows the NAIC Designation as follows: **NAIC 2S**.~~

~~39. The SVO shall assess securities for other non-payment risk:~~

- ~~▪ Routinely, for any security or financial product filed with the SVO.~~
- ~~▪ As part of the analysis of a security or financial product submitted to the SVO under the RTAS — Emerging Investment Vehicle process discussed in of this Manual.~~
- ~~▪ When requested to do so by any state insurance regulator acting pursuant to this Manual, and:~~

~~*When requested by the VOS/TF; or*~~

~~*In support of any other NAIC group engaged in the analysis of investment risks in new securities.*~~

~~**NOTE:** See “NAIC Designation Subscript S” in Part One.~~



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

2024 Spring National Meeting

Phoenix, Arizona

February 27, 2024

Chairs: Carrie Mears (IA), Lindsay Crawford (NE)

NAIC Support Staff: Charles Therriault, Marc Perlman

**Staff Recommended Responses to Key Comments for Regulator Consideration on the Proposed Amendment to Update the Definition of an NAIC Designation in the P&P Manual**

|   | Issue Category   | Issue and Recommendation  |
|---|--|---|
| 1 | Remove the Regulatory Objective of an NAIC Designation | <p><b>Issue:</b> The Regulatory Objective paragraph 88 includes references to other non-payment risk that interested parties would like removed.</p> <p><b>Staff Response:</b> The ability to reflect investment risk other than by the agreed upon contractual terms alone has been a fundamental component of the definition of an NAIC Designation for many years. Other non-payment risks may or may not impact the assignment of an NAIC Designation. However, the NAIC should retain the ability to reflect that risk if it will impact the insurers likelihood of receiving cash payments. Two parties can come to an agreement on any manner of contractual terms including receiving payment in different securities with different terms, or receiving payment in other forms (e.g. Bitcoin, inventory, kilowatts, automobiles, or anything else agreed to in the contract). While these examples may seem farfetched, “bond” transactions have been issued and invested in by insurers based upon the value of “fine art” and other transactions have involved circular relationships that that call into question the issuers ability to make payments. With the implementation of the Principals Based Bond Definition securities could be moving from Schedule D to BA and would be out of scope of the Principals Based Bond Definition and its protections.</p> <p>Likewise, the financial ability of an insurer to pay claims is a fundamental component of prudential regulation. An objective of VOSTF is to support regulators in the assessment of insurers claims paying ability and, as such, there is a longstanding regulatory assumption that a fixed income instrument requires that the issuer make scheduled payments of interest and fully repay principal by a date certain. The existence of contractual terms that are inconsistent with the regulatory objectives (e.g. PIK, other deferrals of interest) will not alone impact an NAIC Designation but they could be reflected in an NAIC Designation if they are determined to impact the likelihood of principal and/or interest</p> |



|   | Issue Category  | Issue and Recommendation  |
|---|---|---|
|   |   | payment default. The SVO staff recommends that this core characteristic remain as part of the definition.   |
| 2 | Delete references to Subscript S in the P&P Manual  | <b>Issue:</b> Interested parties have identified other sections that reference Subscript S in the P&P Manual.   |
|   |   | <b>Staff Response:</b> The SVO is aware that there are additional references to Subscript S in the P&P Manual and had planned to propose a separate technical clean-up amendment once the definition was finalized. Given that the definition is not finalized, the SVO recommends continuing with that plan to submit a separate technical clean-up amendment after the definition is adopted.   |
| 3 | NAIC Designations should not capture risks already captured in the risk-based capital factors | <b>Issue:</b> NAIC Designations should not capture risks already captured in the risk-based capital factors determined by the Capital Adequacy (E) Task Force.  |
|   |   | <b>Staff Response:</b> The Capital Adequacy (E) Task Force uses NAIC Designations, as it deems appropriate, under its responsibility to determine the appropriate capital requirements for all types of insurers. The Valuation of Securities (E) Task Force is separately charged with establishing and maintaining all aspects of the NAIC’s credit assessment process for insurer-owned securities. The Task Force, Risk-based Capital Investment Risk and Evaluation (E) Working Group (a sub-group of the Capital Adequacy (E) Task Force), and Statutory Accounting Principles (E) Working Group all actively collaborate on issues that may impact either the assessment of risk, accounting or reporting, or the associated investment risk-based capital factors. It will be through this cross-group collaboration that any duplicative risk reporting or assessment will be addressed. |
| 4 | Insurers are unaware of the use, relevance and understanding of Subscript S non-payment risk. | <b>Issue:</b> Insurers are unaware of the use, relevance and understanding of Subscript S non-payment risk.   |
|   |   | <b>Staff Response:</b> As currently noted in the P&P Manual, in Part Two, paragraphs 33-39, and in the response above, it is not practical or possible to define every situation involving other non-payment risk because it originates as a result of the contract between the issuer and insurer. If the insurer agrees to contractual terms in which the issuer is given some measure of financial flexibility to not make payments that   |



|   | Issue Category                                     | Issue and Recommendation   |
|---|--|--|
|   |  | <p>would otherwise be assumed to be scheduled or the insurer takes on participatory risk, then there is other non-payment risk. The mere presence of these contractual provisions may not have any impact to the assignment of the NAIC Designation, but they could, if utilized, and NAIC members may want to be alerted to their presence. The proposal would eliminate the administrative symbol Subscript “S” associated with NAIC Designations published in AVS+ that identify to regulators and insurers any securities the SVO believes possess other non-payment risk, however the SVO will continue to share these themes with regulators.</p>  |
| 5 | VOSTF role in insurer financial solvency           | <p><b>Issue:</b> Does the VOSTF have a role in assessing the ability of insurer to pay claims?</p>   |
|   |  | <p><b>Staff Response:</b> The VOSTF reports to the Financial Condition (E) Committee whose mission is to be the central forum and coordinator of solvency-related considerations of the NAIC. The component of that solvency-related mission assigned to the VOSTF is to provide regulatory leadership and expertise to establish and maintain all aspects of the NAIC’s credit assessment process for insurer-owned securities. To the extent that an insurer-owned security may have an impact on the financial solvency of that insurer (e.g. its ability to pay policy holder claims), the VOSTF has an important role in assessing that risk. This role is emphasized in the P&amp;P Manual in Part One that the policies adopted by the VOSTF “... reflect a decision by NAIC members to provide analytical resources to support financial solvency objectives of state insurance regulators as expressed in the NAIC Financial Regulation Standards and Accreditation Program and/or other NAIC regulatory guidance embodied in state law.” The VOSTF has a very important role in assessing the risk of insurer-owned securities, those risks can and do have a direct impact on an insurers ability to pay claims.</p>          |
| 6 | Regulatory assumption of a fixed income investment | <p><b>Issue:</b> Is the regulatory assumption that a fixed income investment called debt requires scheduled payments of interest and repayment of principal on a date certain still a relevant objective of the VOSTF?</p>   |
|   |  | <p><b>Staff Response:</b> The assignment of an NAIC Designation to an investment does not determine if that investment is a bond under statutory accounting. However, NAIC Designations do reflect the common expectation of credit risk, meaning “... the risk that a lender (e.g. insurer) may not receive the owed principal and interest, which results in an interruption of cash flows and increased costs for collection.” (<a href="#">Investopedia</a>). The general definition of what constitutes a fixed income security or bond investment expects “... defined cash flows and a specific time line for return of principal dollars invested ...” (<a href="#">Raymond James</a>) and “... the issuer promises to pay you a specified rate of interest during the life of the bond and to repay the principal, ..., when it “matures,” or comes due after a set period of time.” (<a href="#">U.S. SEC Investor.gov</a>)</p> <p>These general market definitions align with the Task Force’s own expectation of what constitutes the characteristics of a fixed income security. That does not preclude the allowance of payment-in-kind features or PIK (the ability to make payments with additional securities or by</p> |



|   | Issue Category  | Issue and Recommendation   |
|---|---|--|
|   |   | capitalizing interest instead of paying cash), but the use of such a feature (as opposed to it being contractually permitted) may indicate that there is additional risk as to the investor being repaid. The identification of the PIK attribute in other NAIC reporting and analysis by SAWPG and VAWG does not mean that the VOSTF should ignore this risk when assigning an NAIC Designation. Instead, it highlights the importance to consider this risk and its potential to impact an insurer.  |
| 7 | Adoption of the Principals Based Bond Definition obviates the need for “other non-payment risk” | <b>Issue:</b> In the Principals based Bond Definition, SAPWG describes the specific characteristics that determine which investments are and are not eligible for bond treatment. Therefore, investments with “other non-payment risks” that are inconsistent with the definition of a bond will not be treated as bonds and, therefore, such non-payment risk would be irrelevant for an NAIC Designation definition. NAIC Designations could, therefore be simplified to reflect only credit risk, thereby aligning them with conventional risk measures as reflected by NRSRO ratings.  |
|   |   | <p><b>Staff Response:</b> The SVO has the authority to assign NAIC Designations to all investments regardless of appropriate reporting Schedule. With the implementation of the Principals Based Bond Definition it is expected that many securities could move from Schedule D to BA and would be out of scope of the Principals Based Bond Definition and its protections.</p> <p>The NAIC should retain the ability to reflect other non-payment risks if they could impact the insurer’s likelihood of receiving cash payments. For example, two parties can come to an agreement on any manner of contractual terms including receiving payment in different securities with different terms, or receiving payment in other forms (e.g. Bitcoin, inventory, kilowatts, automobiles, or anything else agreed to in the contract). While these examples may seem farfetched, “bond” transactions have been issued and invested in by insurers based upon the value of “fine art” and other transactions have involved circular relationships that that call into question the issuers ability to make payments.</p> <p>The financial ability of an insurer to pay claims is a fundamental component of prudential regulation. An objective of the VOSTF is to support regulators in the assessment of insurers claims paying ability and, as such, there is a longstanding regulatory assumption that a fixed income instrument requires that the issuer make scheduled payments of interest and fully repay principal by a date certain. The SVO staff recommends that this core characteristic of an NAIC Designation remain as part of the definition.</p> |
| 8 | The SVO should be renamed   | <b>Issue:</b> If the NAIC Designation definition is amended to reflect only credit risk, thereby aligning Designations with conventional risk measures as reflected by NRSRO ratings, the Securities Valuation Office should be renamed the Credit Ratings Office or the Office of Credit Assessment.  |
|   |   | <b>Staff Response:</b> The SVO acknowledges that the “Valuation” in its name is anachronistic and is receptive to a new name. We think Investment Analysis Office would be most appropriate because it accurately represents the functions of the office and is already widely utilized as an umbrella term for the SVO and SSG. The Credit Rating Office would be inappropriate. The NAIC is a consumer of ratings and is not itself a rating agency or producer of ratings. NAIC Designations and other analytical products of the SVO and SSG are produced solely for   |



|    | Issue Category  | Issue and Recommendation   |
|----|---|--|
|    |   | the benefit of NAIC members in their capacity as insurance department officials for use in the NAIC Financial Regulation Standards and Accreditation Program. Consideration to rename the SVO and Task Force is part of the Financial Condition (E) Committee work on the “Framework for Regulation of Insurer Investments – A Holistic Review”.   |
| 9  | Is this only related to a contract modification?          | <b>Issue:</b> Is the reference in the Regulatory Objective to contractual modification only related to subsequent changes to the agreement?  |
|    |   | <p><b>Staff Response:</b> The text related to the Regulatory Objective, when read in the context of the full paragraph*, makes it clear that the modification reference is to the regulatory assumption of what is a fixed income instrument. The sentence is not intended to be taken out of that context. The SVO would be happy to amend language to make it clear that the issue relates to contractual deviations from the regulatory assumption of what is a fixed income instrument for the assignment of an NAIC Designation. As noted earlier, that assumption is consistent with the general market characteristics of a fixed income instrument.</p> <p><i>*“An objective of the VOS/TF is to assess the financial ability of an insurer to pay claims. For example, <b>the regulatory assumption</b> is that a fixed income instrument called debt by its originator or issuer requires that the issuer make scheduled payments of interest and fully repay the principal amount to the insurer on a date certain. <b>A contractual modification that is inconsistent with this assumption</b> creates a rebuttable inference that the security or instrument contains an additional or other non-payment risk created by the contract that may result in the insurer not being paid in accordance with the underlying regulatory assumption.”</i></p> |
| 10 | The SVO has been unable to define other non-payment risk. | <b>Issue:</b> The SVO has not been able to define other non-payment risk over the last several years.  |
|    |   | <p><b>Staff Response:</b> There have been descriptions and illustrations of other non-payment risk in the P&amp;P Manual for many years. As noted in the P&amp;P Manual in Part Two, paragraph 33, “It may not be practical, desirable or possible to specifically define other non-payment risk given the assumption that it originates as a result of a contractual agreement of the presence of a structural element of a transaction that is agreed upon between the issuer and the insurer.” As the following longstanding P&amp;P Manual examples illustrate, there can be a wide range of other non-payment risk characteristics reflecting the ability of the issuer and insurer to negotiate unique contractual terms. While these characteristics are defined in the contract, they can also be inconsistent with the Task Force’s regulatory assumption “... that a fixed income instrument called debt by its originator or issuer requires that the issuer make scheduled payments of interest and fully repay the principal amount to the insurer on a date certain.”</p>  |



|  | Issue Category | Issue and Recommendation  |
|--|----------------|---|
|  |                | <ul style="list-style-type: none"> <li>• The contract promised payment of a dollar denominated obligation in non-U.S. currency but does not require an exchange rate that would yield foreign currency sufficient to buy a defined principal amount of U.S. dollars.</li> <li>• The contract governing the loan provides for a degree of permanence in the borrower’s capital structure that is incompatible with notions of a loan that is expected to be repaid.</li> <li>• The lender agrees to an exposure that has the potential to result in a significant delay in payment of contractually promised interest and/or a return of principal in an amount less than the original investment.</li> <li>• Securities that 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.</li> <li>• A financial institution issues notes pursuant to which it is obligated to make (i) fixed quarterly coupon payments which are less than the comparable risk-free rate, (ii) performance payments linked to the performance of referenced equity and futures indices and the net asset value of a basket of undisclosed securities, and (iii) a principal payment at maturity.</li> <li>• A repackaging of collateralized loan obligation (CLO) notes into a CLO Combination Note (Combo Note). The Combo Note is formed by re-packaging the Class B, C, D, and Equity / Subordinated Note tranches together.</li> </ul> <p>Some of these examples may not meet the revised SSAP No. 26R definition of a bond under the principle-based bond definition but, as noted earlier, the SVO assigns NAIC Designations to investments outside of this definition. The SVO needs to consider the risk of these contractual terms for any investment it assigns an NAIC Designation, including those on Schedule D or BA. The mere presence of these contractual provisions may not have any impact to the assignment of the NAIC Designation, but they could, if utilized, and NAIC members may want to be alerted to their presence.</p> |



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January 26, 2024

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

Dear Ms. Mears:

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

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 December 2, 2023. As noted by both industry and regulators, the P&P Manual is often difficult to navigate and often includes conflicting and confusing language. Therefore, we agree with the premise of the exposure that an NAIC Designation be defined once in a single uniform definition (i.e., not in both Part 1 and Part 2 of the P&P Manual). Additionally, this is important in light of the SVO presentation at the December 2, 2023 VOSTF national meeting on the “History of Filing Exemption”, which highlighted the significant changes of the objectives of the SVO and VOSTF since 1909, as well as the evolution of investments, reserving, business models, and NAIC roles and responsibilities.

**Summarization of Key Points**

The undersigned have several significant concerns leading to what we believe to be a fatal flaw with the definition of an NAIC Designation as proposed in the exposure. The remainder of this letter will detail these concerns.

In summary, the undersigned propose the following related to the exposure surrounding the definition of an NAIC Designation for the sake of transparency, clarity, and encompassing all risks that impact non-payment.

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

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

1. Remove paragraph 88, consistent with the proposed deletions of all other P&P Manual language related to Subscript S non-payment risk.
2. Delete the sections as proposed by the SVO that discuss Subscript S non-payment risk elsewhere throughout the P&P Manual as we agree such language ambiguous, conflicting, and/or not relevant.
3. Amend the Definition of an NAIC designation as follows:

NAIC Designations represent opinions of gradations in credit quality identified by the NAIC 1 through NAIC 6 symbols (as modified by NAIC Designation Categories) which indicate the highest quality (least risk) to the lowest quality (greatest risk), respectively, and which reflect the likelihood of timely and full payment of principal and scheduled periodic interest, in accordance with the contractual terms of the debt instrument ~~regulatory objectives explained above~~, and the likelihood of principal and/or interest payment default. Where appropriate for a given investment, NAIC Designations shall reflect “tail risk” and/or loss given default. NAIC Designations and Designations Categories shall reflect the position of the specific liability in the issuer’s capital structure, and all other risks that may impact the repayment of promised interest and principal in accordance with the contractual terms of the debt instrument ~~non-payment risks or non-payment risk mitigants~~. NAIC Designations do not measure other risks or factors that may affect repayment, such as volatility/interest rate, prepayment, extension, or liquidity risk. NAIC Designations should not capture risks (e.g., tail risk) if those risk are inconsistent with, or duplicative of, risks already captured and defined in the risk-based capital factors determined by CATF, as applicable.

In summary, the definition with the undersigned’s proposed edits:

1. Capture all risks that impact credit quality, including all risks associated with non-payment,
2. Does not capture risks, beyond credit risk, such as assessing an insurer’s ability to pay claims, and
3. Ensures risks (e.g., tail risks) are not double counted and are consistent with the risk-based capital factors under the responsibility of the CATF.

### **Detailed Concerns and Support for Key Points and Conclusions**

To support these points and our conclusions, we detail our concerns with the proposal, including potential contradictions between other aspects of the NAIC’s regulatory framework and within the definition itself.

The proposed paragraph 89 of Part 1 of the P&P Manual properly defines what an NAIC Designation represents in a single uniform definition with exception of the following:

1. Lack of transparency and relevancy surrounding Subscript S non-payment risk, and
2. The interaction with the risk-based capital factors as determined by CATF.

Both shortfalls can be addressed with the surgical edits proposed and are consistent with our many previous letters regarding needed transparency and relevancy surrounding Subscript S non-payment risk as well as with previous conclusions of the VOSTF.

On the face of it, the addition of “non-payment risk” to the definition of an NAIC Designation could seem rather innocuous. That is, consideration of any risk related to non-payment should seemingly be incorporated.

However, regulators and insurers continue to lack clarity as to the use, relevance and understanding of Subscript S non-payment risk. The concept of Subscript S non-payment risk has been included in the P&P Manual for decades, but we are unaware of its use and designation by the SVO (as incorporated within paragraph 89, prior to the SVO’s proposed changes) in any significant way, if at all.

Additionally, the SVO has not been able to succinctly define Subscript S non-payment risk over the last several years, which is coupled with the P&P Manual having many seemingly conflicting statements in relation to what it represents.

Therefore, there is insufficient transparency as to what Subscript S actually means, or how it will be used, which culminates in an inappropriate comingling of Subscript S non-payment risk within the definition of an NAIC Designation. More specifically, we note the following shortfalls:

1. Paragraph 88 is selectively moved from a P&P manual section related to notching, both for position in the capital structure and Subscript S non-payment risk, to immediately prior to the proposed new definition of an NAIC Designation.
2. Both the SVO and every rating agency we have talked to first assess the “credit quality of the issuer” and then notch that credit quality based on where the debt resides in the capital structure. Notching related to position in the capital structure is appropriate when it occurs in this manner.
3. However, incorporating Subscript S non-payment risk into a credit designation is highly ambiguous – notwithstanding the changing of “notched” to “shall reflect” in paragraph 89. This concern is further accentuated with the proposed addition of Subscript S non-payment risk via a reference to paragraph 88 referred to in point 1 above, along with the proposed deletion of all other elements of Subscript S non-payment risk from the P&P Manual.

The incorporation of Subscript S non-payment risk in the definition of an NAIC Designation and the reference to paragraph 88 merits further examination.

Paragraph 88 which was moved immediately prior to the definition of an NAIC Designation, including with the SVO’s proposed changes (highlighted), is included below:

*An objective of the VOSTF is to assess the financial ability of an insurer to pay claims. For example, the regulatory assumption is that a fixed income instrument called debt by its originator or issuer requires that the issuer make scheduled payments of interest and fully repay the principal amount to the insurer on a date certain. A contractual modification that is inconsistent with this assumption creates a rebuttable inference that the security or instrument contains an additional or other non-payment risk created by the contract that may result in the insurer not being paid in accordance with the underlying regulatory assumption. NAIC Designations are ~~The SVO is required to reflect identify securities that contain such~~*

*contractual modifications and quantify the possibility that such contracts will result in a diminution in payment to the insurers.*

The first sentence is as follows:

*An objective of the VOSTF is to assess the financial ability of an insurer to pay claims.*

This objective of the VOSTF should be examined:

The SVO's presentation highlighted the significant changing role and evolution of the SVO and VOSTF over time, therefore, is this still an appropriate objective of the VOSTF? Or is it more appropriately the VOSTF's objective to oversee the SVO's assessment of credit risk? Further, if it is "an objective" of the VOSTF, it begs the following questions:

***Question 1: Is it appropriate to selectively give prominence to this objective versus the other objectives of the VOSTF? If so, how is the VOSTF fulfilling the objective of assessing the ability of insurers to pay claims?***

If regulators believe this is an objective of the VOSTF, it would be helpful for the VOSTF to state in writing how they are fulfilling this objective and how it falls under their responsibility and relates to an NAIC designation beyond assigning credit risk.

***Question 2: Is the regulatory assumption that a fixed income investment called debt by its originator or issuer requires scheduled payments of interest and repayment of principal on a date certain still a relevant objective of the VOSTF?***

Discussions with the SVO would suggest this is to be interpreted as a bond with a fixed schedule of pre-determined coupon and principal payments allowing for no potential deferral or PIK interest, no potential prepayment ability, and no potential extension terms, as these are considered non-payment risk. However, there are many valid examples of securities in the market that would appear to not meet this interpretation, but would be considered to have non-payment risk due to their contractual payment terms. For example:

1. A US agency mortgage-backed pass-through security as it is subject to both prepayment and extension risk even though it is repaid in accordance with the contractual terms and is guaranteed by the US government.
2. A security that can defer or PIK interest even though the contractual terms will require subsequent payment via capitalization of interest.

These examples may have been relevant at some point if the VOSTF was assessing the ability of insurers to pay claims, but that no longer appears appropriate. This is evidenced by the VOSTF decision in 2023 to identify securities that defer or PIK interest so regulators/LATF can see if companies are factoring in these features in asset adequacy testing (i.e., so they can assess the ability of an insurer to pay claims).

Further, extension, prepayment, and liquidity risk (i.e., the latter related to deferring or PIK interest) being incorporated into the definition of an NAIC Designation would appear to be in direct contradiction to other language long included within what an NAIC Designation represents,

and proposed to be retained, which we believe is appropriate and support. Specifically, it states, “NAIC Designations do not measure other risks or factors that may affect repayment, such as volatility/interest rate, prepayment, extension or liquidity risk.” Shouldn’t an NAIC Designation represent the assessment of credit risk rather than have VOSTF/SVO assess the ability of an insurer to pay claims?

***Question 3: Is this only related to contract modifications (third sentence in paragraph 88)? (i.e., not related to the original contract?)***

That has been industry’s understanding in the context of paragraph 88 – i.e., a subsequently modified contract, from its original terms, that allows missed or reduced payments is considered non-payment risk. The below paragraph, from the P&P Manual, clearly states that original contractual agreements which allow the financial flexibility to not make payments or is exposed to a participatory risk is non-payment risk. We believe subsequent modifications of the original terms would similarly create similar non-payment risk but the proposal inappropriately expands upon this. It is our understanding that subsequent modifications are meant to augment the below language and put one in the same place as if those terms were in the original contract. But that is in the context of not getting paid what was expected, as opposed to repayment timing. At a minimum, the P&P Manual language is conflicting or unclear.

*Most typically, other non-payment risk has been associated with contractual agreements between the insurer and the issuer in which the issuer is given some measure of financial flexibility not to make payments that otherwise would be assumed to be scheduled, given how the instrument has been denominated, or the insurer agrees to be exposed to a participatory risk.*

**Question 4: Is it appropriate to selectively tie the Subscript S concept to the definition of an NAIC Designation given that the SVO has not been able to define this over the last several years, has not been publicly identifying Subscript S securities (see proposed deleted language in paragraph 88 which delineated that role to the SVO), and for which the P&P Manual currently has conflicting definitions to what is being inferred in this definition?**

For example, the following are proposed deleted paragraphs:

*Most typically, other non-payment risk has been associated with contractual agreements between the insurer and the issuer in which the issuer is given some measure of financial flexibility not to make payments that otherwise would be assumed to be scheduled, given how the instrument has been denominated, or the insurer agrees to be exposed to a participatory risk.*

*Other non-payment risk differs from the type of issues encountered in credit risk. This is because typically, credit assessment is concerned with securities in which the parties create subordination by modifying the lender’s priority of payment (e.g., senior unsecured versus junior subordinated) but in a context where the contract otherwise specifies that the failure to make payments on a scheduled basis (defined in the contract) is an event of default (in the case*

of a bond) or triggers some other specific and identifiable lender remedy (in the case of other fixed income securities).

*Using the broad concepts identified above, non-payment risk may be present when:*

*A reporting insurance company takes on a participatory risk in the transaction;*

*Illustration – The contract promised payment of a dollar denominated obligation in non-U.S. currency but does not require an exchange rate that would yield foreign currency sufficient to buy a defined principal amount of U.S. dollars. The other non-payment risk in this illustration consists of the reporting insurance company’s acceptance of currency risk which may diminish the principal amount of the investment. Currency risk here is not related to the issuer’s ability or willingness to pay and therefore is not appropriately reflected in the NAIC Designation of the issuer or captured by notching for credit risk.*

This language illustrates a situation where the insurer may not get repaid what they were expecting, as opposed to repayment timing, and the specific example includes an embedded derivative which would not meet the revised SSAP No 26R principle-based bond definition (PBBD) accounting guidance. It also defines participatory risk where the borrower by contractual definition may not get paid. We agree this would be non-payment risk, but the proposal greatly expands upon this.

*Illustration – A loan stated to be perpetual and giving the issuer the right to miss interest or dividend payments otherwise said to be scheduled where the missed payments are not required to be paid on a subsequent date.*

Again, this illustration is such that missed payments are not required to be paid as opposed to repayment timing. We agree this would be non-payment risk, but the proposal greatly expands upon this.

*Illustration – An instrument denominated as a bond but lacking a maturity date, a mechanism to determine a maturity dates (e.g., a mandatory redemption) or that states a maturity equal to or exceeding 40 years.*

There is no non-payment risk in this illustration, as there are no missed payments that are not required to be paid on a subsequent date. Instead, it is representative of long-duration credit risk. That risk may be related to an insurer’s ability to pay claims vis-à-vis asset/liability matching but assessing claims paying ability (vs. assessing credit risk) has not historically been under the purview of the SVO/VOSTF.

## **Conclusion**

In conclusion, our proposed definition would, for example, provide flexibility to consider risks such as with PIKs, if they impact the risk of repayment (positively or negatively), but does not expand the VOSTF/SVO’s responsibility. Specifically, it does not attempt to assess liquidity risk (which would be contradictory to other language within the definition) in the context of an insurer’s ability to pay claims. We believe that the assessment of claims paying ability extends beyond the SVO’s current mandate and is addressed elsewhere within the statutory framework and would be entity specific.

We believe our proposed definition provides needed clarity and is appropriate in light of the concerns and rationale expressed in this letter. We would be interested in hearing from the VOSTF members on any concerns not captured in our proposed amended definition, or elsewhere in the statutory framework (e.g., the PBBD, the assessment of the ability of insurers to pay claims, the risk-based capital factors, etc.).

The undersigned stand ready to assist in this process and help ensure the NAIC and the assignment of risk-based capital charges continue to appropriately evolve and be refined for changes occurring elsewhere within the NAIC framework.

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

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

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

The Private Placement Investors Association (“PPIA”) is a business association of insurance companies, other institutional investors, and affiliates thereof, that are active investors in the primary market for privately placed debt instruments. The association exists to provide a discussion forum for private debt investors; to facilitate the development of industry best practices; to promote interest in the primary market for privately placed debt instruments; and to increase accessibility to capital for issuers of privately placed debt instruments. The PPIA serves 66 member companies and works with regulators, NASVA, the ACLI, the American College of Investment Counsel, and the investment banking community to efficiently implement changes within the private placement marketplace. For more information, visit [www.usppia.com](http://www.usppia.com).

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

The Lease-backed Securities Working Group

January \_\_\_, 2024

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

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

Dear Ms. Mears

In the recent discussions regarding the proper definition of an NAIC “Designation”, the use of the term “Subscript S” to designate “other non-payment risk” has created -- and is continuing to create -- a lot of confusion.

That is for the simple reason that there can be no “non-payment” if the payment referred to is *in accord with the terms of the debt agreement*. The only type of “non-payment” is one that violates the terms of the agreement...and that is precisely the definition of “credit risk”: the inability or failure of the obligor to comply with the terms of their contract.

What Subscript S really means is “other payment risk” -- types of payment which are contractually set forth in the debt agreement, but are either variable or contingent in their nature. As the P&P Manual points out, in modern debt agreements there are many types of such payment promises which are either variable or contingent on some future event, and as such, it is difficult to delineate exactly all the various types of “payment risk”.

The problem originates with the unnecessarily narrow -- and long out of date -- definition of debt in the current P&P Manual:

*“...the regulatory assumption [emphasis added] is that a fixed income instrument called debt by its originator or issuer requires that the issuer make scheduled payments of interest and fully repay the principal amount to the insurer on a date certain.”* (Note that this very narrow definition, which requires the debt to “fully repay the principal amount to the insurer on a date certain” would not even include amortization, i.e.: scheduled partial payments of principle.)

The SVO has been unable to articulate exactly what are the “regulatory concerns” that distinguish an NAIC Designation from a pure assessment of “credit risk”, but based on the regulatory assumption above, it appears that it is precisely these types of variable or contingent payments it is referring to. This confirmed by the many sections of the Manual dealing with “other non-payment risks” (“Subscript S”) which are considered as separate from “credit risk”. (The Manual states that the many other risks which affect repayment are *not* a part of NAIC Designations: “NAIC Designations do not measure other risks or factors that may affect repayment, such as volatility/interest rate, prepayment, extension or liquidity risk.”)

We agree entirely that there may be types of variable or contingent payments which are not acceptable in bonds which receive Schedule D treatment -- and other types that are. However, this is precisely what the recent “Bond Definition Project” debated at great length and resolved

The Lease-backed Securities Working Group

in great detail. There were lengthy discussions regarding what specific types of variable payments were or weren't acceptable for Schedule D Treatment, as well as where to draw the line between securities that contained "equity-like" participation or contingent payments, and represented debt in form only, versus ones that represented debt "in substance".

We believe that re-defining the issue at hand as "other *payment* risk" or "acceptable types of payments" makes it clear that this is the job of the Statutory Accounting Principles Working Group as imbedded in the revised SSAPs -- and that this eliminates entirely the need for the confusing "Subscript S" in the Manual, as the SSAPs should govern all such decisions. The idea of the SVO "notching" a Designation, (which is still defined -- even in the revised definition -- as "an opinion...of credit quality") based on the type of legally-contracted payments seems like a form of double-counting.

It is an oxymoron to say that there is a type of "non-payment risk" which is not a part of "credit risk", as defined in the Manual:

*"Credit risk is defined as the relative financial capability of an obligor to make the payments contractually promised to a lender."* (emphasis added)

And....

*"The assessment of 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."*

We believe a great step forward in clarity would be achieved by eliminating all references to "Subscript S" and the use of the confusing term "other non-payment risk" in the P&P Manual, as all of the concerns regarding "types of acceptable payments" have been thoroughly debated and addressed as part of the recent Bond Definition Project and are incorporated in the revised SSAPs.

Additional clarity for regulators and investors could be achieved by re-naming the "Securities Valuation Office" (a function they have not provided for decades) as the NAIC "Office of Credit Assessment".

We appreciate the opportunity to offer these comments and are happy to discuss this letter and any questions you might have with the members of the Task Force.

Sincerely,

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



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January 26, 2024

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

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

Dear Ms. Mears and Task Force Members,

For many years the P&P Manual has referred to “regulatory concerns” related to “other risks of non-payment” of debt securities. Fortunately, with the completion of SAPWG’s “bond project” these risks have been identified and dealt with systematically in the SSAPs. Essentially this means that the definition of NAIC Designations can be simplified to reflect credit risk, thus aligning it with conventional risk measures such as reflected in NRSRO ratings.

“Principal Protected Notes” are an excellent example where there are risks other than credit risk. Under their terms the borrower may be willing and able to make promised payments so these may be highly rated. Even so, under the terms of the agreement, and under certain conditions, no payment may actually be required, at least not of interest. In these cases even a periodic payment of zero could completely fulfill the obligation to the lender.

Regulators have concluded that such structures should not be treated as debt instruments or “bonds”. Over the years the P&P Manual itself has addressed this kind of risk, specifically in instances where creditworthiness is high but there is still a risk the borrower will not be paid. This has been done on a case-by-case basis in an ad hoc manner as has been done for PPNs and other assets.

SAPWG dealt with the same issue but it did so from a much broader perspective in that it described the specific characteristics that would define which securities are -- and are not -- eligible for bond treatment. As the result of a very long, detailed, collaborative and transparent process regulators themselves have set new and specific standards to address their concerns. These are specified in detail in the revised SSAPs.

Defining NAIC Designations as “credit risk,” which is well understood, solves a significant operational problem for the NAIC. The insurance industry, as a whole, invests in hundreds of thousands of assets reported as bonds but the SVO only provides Designations for about 10,000 of these. It is estimated, then, that under present methods only about ½% of assets are reviewed for risks of payment not related to creditworthiness. In other words, the vast majority of insurer assets are not being reviewed for these and even then these risks are not clearly defined.

The revision of the SSAPs solves this problem. All assets will be subject to the tests in the SSAPs which were determined explicitly by regulators themselves to meet their expectations and requirements. When the terms and conditions of an investment are not sufficiently specific or encompassing then the asset will be denied treatment as a bond and rating agency ratings will be irrelevant. By their own initiative regulators themselves have addressed their concerns globally and systematically by using the SSAPs.

#### Summary

Given that insurance regulators, through SAPWG, have established specific and binding criteria with a higher priority in the regulatory structure than the P&P Manual there should be no need for the P&P Manual to attempt to accomplish what SAPWG has already done. Accordingly, NAIC Designations should be redefined simply as credit risk measures using the conventional concept used widely throughout the investment community including by the NRSROs. Regulators can then rely on the revised SSAPs to continue to deny treatment as debt instruments to assets with attributes they do not find acceptable. The SVO could even be renamed the Credit Rating Office of the Investment Analysis Office to better reflect its mission.





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

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

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

DATE: November 3, 2023

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**Summary:** At the Summer National Meeting held on Aug. 14, 2023, the Task Force discussed an initial draft of a proposed amendment to the P&P Manual authorizing the procedures for the SVO's discretion over NAIC designations assigned through the filing exemption (FE) process. The Task Force directed the SVO staff to consider the feedback from Task Force members and interested parties and update the proposal. The revised amendment in this memorandum reflects the actionable comments received from Task Force members and interested parties that align with the following charges given to the Task Force from the Financial Condition (E) Committee (emphasis added):

- Identify potential improvements to the filing exempt (FE) process (the use of credit rating provider [CRP] ratings to determine an NAIC designation) to ensure greater consistency, uniformity, and appropriateness to achieve the NAIC's financial solvency objectives.
- Implement policies to oversee the NAIC's staff administration of rating agency ratings used in NAIC processes, including staff's discretion over the applicability of their use in their administration of FE.
- Establish criteria to permit staff's discretion over the assignment of NAIC designations for securities subject to the FE process (the use of CRP ratings to determine an NAIC designation) to ensure greater consistency, uniformity, and appropriateness to achieve the NAIC's financial solvency objectives.



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

- 1) SVO staff identifies a FE security with an NAIC Designation determined by a rating that appears to be an unreasonable assessment of risk.
- 2) SVO Senior Credit Committee (SCC) meets to determine if it agrees that the rating appears an unreasonable assessment of risk and, if so, places the security "Under Review".
- 3) If the SVO SCC votes to put the security "Under Review" an information request will be sent through VISION to insurers that hold that security in their VISION portfolio and an the SVO Administrative Symbol assigned to identify them in VISION and AVS+.
- 4) If the information request is not responded to, the SVO may reach out to the domiciliary Chief Financial Examiner.
- 5) Upon receipt of all necessary documentation through the information request, the SVO will then perform a full analysis of the security and coordinate with the interested insurer(s) on any questions or issues the SVO may have about the security.
- 6) SVO SCC re-convenes and determines, based on its full analysis of all necessary information, whether the FE NAIC Designation is three (3) or more notches different than the SCC's opinion.
- 7) If the SVO SCC opinion differs from the FE produced NAIC Designation Category by a material three (3) or more notches the specific CRP rating(s) for that security will be removed from FE.
- 8) The SCC will present its analysis to a sub-group of the Task Force to provide oversight over the FE removal process and enable the Task Force to provide feedback to the SVO.
- 9) If there are no alternative CRP ratings, the SVO SCC's assessment will be entered into VISION. If an alternative CRP rating is subsequently received, it will be incorporated into the FE process, if applicable.
- 10) If the SVO SCC assesses the issue is part of a recurring pattern, the SVO Director will inform the chair and decide if an issue paper, referral or amendment is needed.
- 11) An anonymized summary of each unique issue or situation will be published on the SVO webpage or some other insurer accessible location for transparency.
- 12) An insurer may appeal to the Task Force chair if they believe the SVO did not follow the procedures outlined in the P&P Manual.
- 13) If an insurer(s) wishes to appeal the SVO SCC's analytical assessment, it may request the NAIC's IAO to contract, at the insurer(s) expense, with an independent third-party acceptable to the NAIC IAO to perform a blind review of the security (e.g. without knowledge of the SCC's, insurer's or CRP's assessment) with the information provided through the information request. If the independent third-party review results in an NAIC Designation Category that is one (1) or less notches different from the FE produced NAIC Designation Category, then the SVO SCC's opinion will be overridden by the reinstatement



of the CRP rating(s). If the independent third-party review results in an NAIC Designation Category that is more than one (1) notch different from the FE produced NAIC Designation Category, then the SVO SCC's opinion will remain.

- 14) The SVO will identify through SVO Administrative Symbols when a CRP rating(s) has been removed from the Filing Exemption process for a security.
- 15) At the Spring National Meeting, the SVO Director will summarize FE discretion actions take for the preceding year.

**Recommendation:** It is expected that implementation of this process will require enhancements to NAIC's VISION and AVS+ applications. Funding for the application enhancements in the amendment, if adopted, will need to be approved by the Executive (EX) Committee and the initiative will need to go through the NAIC's development process. It could take 1-2 years before this proposal can be fully implemented. The SVO recommends adoption of this proposed amendment authorizing the procedures for the SVO's discretion over NAIC Designations assigned through the FE process with an effective date of January 1, 2025. The effective date can be amended, if needed, because of the dependency mentioned. The proposed text changes to P&P Manual are shown below with additions in red underline, and deletions in ~~red strikethrough~~ as it would appear in the 2022 P&P Manual format.



## PART ONE

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

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

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

#### Determinations

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

#### Directives

81. The IAO shall:

- Recommend improvements to the production of NAIC Designations based on NRSRO credit ratings.
- Identify monitoring and communication procedures that enhance the possibility of regulatory intervention by the VOS/TF to respond to risks to insurer solvency posed by securities in the filing exempt population.

- Identify and develop correctives to the administrative, operational and system-based causes of reporting exemptions in the filing exempt process.
- Change the NAIC Designation equivalent calculated for filing exempt securities when necessary to correct errors or other anomaly that occur in the automated filing exempt process.
- Develop a staff-administered reporting exceptions resolution process that incorporates state insurance regulator and insurance companies' participation.
- In furtherance of the above directives, exclude specific otherwise Eligible NAIC CRP Credit Ratings from the automated filing exemption process in accordance with the administrative procedures outlined in Part Two of this Manual, if the LAO, following a self or state regulator-initiated review, determines the resulting NAIC Designation equivalent does not provide a reasonable assessment of risk for regulatory purposes.

...

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

## **SVO ORGANIZATION**

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### **SVO Administrative Symbols**

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

### **SVO Analytical Department Symbols**

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

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- UR means the NAIC Designation assigned pursuant to the filing exemption process is under review by the NAIC's Investment Analysis Office.
- DR means that one or more otherwise Eligible NAIC CRP Credit Ratings have been removed from the filing exemption process when determining the NAIC Designation through the IAO's discretion procedures.

## **PROCESS FOR PLACING A FILING EXEMPT SECURITY UNDER ANALYTICAL REVIEW FOR POSSIBLE REMOVAL FROM FILING EXEMPTION**

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### **Overview**

164. This section outlines the process by which a state insurance regulator or IAO staff can contest an NAIC Designation Category assigned through the filing exemption process which it thinks is not a reasonable assessment of risk of the security for regulatory purposes.

(Note: The guidance in this part is effective as of January 1, 2025, but this date may be amended if additional time is needed to implement the necessary NAIC technological enhancements to IAO systems.)

### **Request for Information**

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

166. The SCC will convene to determine if, in its opinion, the NAIC Designation Category assigned pursuant to the filing exemption process is a reasonable assessment of risk of the security for regulatory purposes. As part of its review, the SCC may consider observable factors, among others, such as (i) a comparison to peers rated by different CRPs, (ii) consistency of the security’s yield at issuance or current market yield to securities with equivalently calculated NAIC Designations rated by different CRPs, (iii) the IAO’s assessment of the security applying available methodologies, and (iv) any other factors it deems relevant. If the SCC’s opinion is that the assigned NAIC Designation Category is likely a reasonable assessment of risk of the security for regulatory purposes, no further action will be taken at that time. If the SCC’s opinion is that the assigned NAIC Designation Category is likely not a reasonable assessment of risk of the security for regulatory purposes, an information request will be initiated and the security will be identified as “Under Review”.

167. The IAO will notify insurance company holders of a security determined to be a Filing Exempt Security “Under Review” by issuing an information request and publishing a separate SVO Analytical Department Symbol of “UR” for Under Review in NAIC systems for that security that will not be reported on the statutory investment schedules. The purpose of the information request is to provide the IAO staff with sufficient information to perform a full analysis of the security. Consistent with the informational deficiencies instructions in this Manual, security information consistent with an Initial Filing should be provided to the IAO within 45 days unless an extension has been granted to the insurance company by the IAO, not to exceed 90 days in total from the date that the IAO issues an information request. The IAO may contact the insurance company’s domiciliary chief financial regulator for assistance after the initial 45 days if there has been no meaningful response. If after 90 days additional information equivalent to a complete filing has not been provided to the IAO, the IAO may proceed with removal of the otherwise Eligible NAIC CRP Credit Rating(s) from the Filing Exempt process.

### **Full Review**

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

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

### **Materiality Threshold for IAO Analysis**

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

171. The IAO will consider the materiality of the difference between the Eligible NAIC CRP Credit Rating used in the filing exempt process and the IAO’s own assessment of the risk. The IAO may elect to remove an otherwise Eligible NAIC CRP Credit Rating from the Filing Exemption process only if the SCC determines, based upon its review, that the Eligible NAIC CRP Credit Rating for the security is three (3) or more notches different than the IAO’s assessment (e.g. NAIC Designation Category 1.G versus 2.C) (the “Materiality Threshold”).

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

172. The SCC shall discuss and explain its analytical basis for any Eligible NAIC CRP Credit Rating being removed from Filing Exemption eligibility with a sub-group of the VOS/TF (the composition of which to be determined by the VOS/TF chair) for so long as the VOS/TF chair deems such meetings necessary.
173. If the SCC identifies that there is a recurring analytical pattern or concern, the IAO Director(s) will inform the VOS/TF chair and decide if an issue paper, referral, amendment to this Manual or some other action is needed.

### Assignment of NAIC Designation Category

174. If the IAO SCC determines that the NAIC Designation Category assigned pursuant to the Filing Exemption process *does not* meet the Materiality Threshold, the Eligible NAIC CRP Credit Rating shall remain eligible for Filing Exemption, the SVO Analytical Department Symbol “UR” will be deactivated, and no further action will be taken at that time. The IAO’s determination to maintain the filing exemption eligibility of an Eligible NAIC CRP Credit Rating shall not preclude the IAO from placing the same Eligible NAIC CRP Credit Rating under analytic review at a later date following a subsequent review should changing conditions warrant.
175. If the IAO SCC determines that the NAIC Designation Category assigned pursuant to the Filing Exemption process *does* meet the Materiality Threshold, the IAO will block the otherwise Eligible NAIC CRP Credit Rating in NAIC systems to prevent it from using the automated Filing Exempt Securities Process.
176. If an Eligible NAIC CRP Rating has been removed from Filing Exemption eligibility for a security according to this section and the security has another Eligible NAIC CRP Rating which has not been removed or one is subsequently received, then the security can receive its NAIC Designation Category through the Filing Exemption process based on the other Eligible NAIC CRP Rating(s). If there is no alternate Eligible NAIC CRP Rating in NAIC systems, the SCC’s NAIC Designation Category will be entered into NAIC systems to assign an NAIC Designation Category to the security.
177. As noted in this Manual, any insurer that owns a security for which the SVO has provided an NAIC Designation, a classification or a valuation, may request a clarification of the decision from the SVO (Requests for Clarification of SVO Decisions).

### Appeal to the VOS/TF

178. An insurer that thinks the IAO did not make its Filing Exemption determination regarding the insurer’s security in accordance with the procedures in this Manual it may request consideration of the concern by the VOS/TF pursuant to “Review of SVO Decisions by the VOS/TF” in this Manual.

### **Analytical Appeal to an Independent Third-party**

179. An insurer that disagrees with the SCC's final analytical assessment may request, at its own expense, that the NAIC's IAO contract with an independent third-party acceptable to the IAO to perform a blind analysis of the security (e.g. without knowledge of the SCC's, insurer's or CRP's assessment) based upon the information provided through the information request and consistent with the objectives and purposes of an NAIC Designation Category.
180. If the independent third-party's assessment results in an NAIC Designation Category that differs from the NAIC Designation Category assigned pursuant to the Filing Exemption process by no greater than a one (1) notch, the originally assigned NAIC Designation Category will remain in force and the Eligible NAIC CRP Credit Rating remain eligible for Filing Exemption.
181. If the independent third-party's assessment results in an NAIC Designation Category that that differs from the NAIC Designation Category assigned pursuant to the Filing Exemption process by greater than one (1) notch, the SCC's opinion will remain in-force and the Eligible NAIC CRP Credit Rating will remain ineligible for Filing Exemption.

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

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

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

183. The IAO Director(s) will prepare a summary of the removed from Filing Exemption Eligibility actions take over the prior calendar year.
184. The IAO will also publish an anonymized summary of each unique situation encountered for the securities subject to removal from Filing Exemption Eligibility and publish it on an insurer accessible web location.
185. To facilitate transparency as to the SVO's application of discretion, the SVO Analytical Department Symbols "DR" will be added in NAIC Systems to securities with a blocked otherwise Eligible NAIC CRP Credit Rating(s). The SVO Analytical Department Symbols, "DR" will be reported on the insurer's statutory investment schedules for the effected security as SVO Administrative Symbols.

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<https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2023/2023-11 Fall NM/05-SVO Discretion/2023-005.15 P&P SVO Discretion - Revised v4.docx>



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

*2024 Spring National Meeting*

Phoenix, Arizona

February 27, 2024

Chairs: Carrie Mears (IA), Lindsay Crawford (NE)

NAIC Support Staff: Charles Therriault, Marc Perlman

**Responses to Issues/Comments Previously Deliberated on the Proposed P&P Manual Amendment Authorizing the Procedures for the SVO’s Discretion Over NAIC Designations Assigned Through the Filing Exemption Process**

| Issue # | Issue Category  | Issue and Response   |
|---------|---|--|
| 1       | Transparency – SVO should publish its analysis, methodology, rationale and rating agency rating | <p><b>Issue:</b> The SVO needs to provide full transparency by publishing its analysis, methodology, rationale and the rating agency rating in question.</p>   |
|         |   | <p><b>Transparency to insurer(s) impacted:</b><br/>                     The insurer(s) impacted will have full transparency into the SVO analysis and rationale. In private confidential discussions with insurers that are investors in the transaction who have been authorized by the issuer and rating agency to receive confidential information and regulators, the SVO will provide more specific information about the issuer, and issues or concerns with the rating agency rating.</p> <p>As specified in Part Two of the P&amp;P Manual, “Any insurer that owns a security for which the SVO provided an NAIC Designation, a classification or a valuation, may request a clarification of the decision from the SVO.” The SVO welcomes these transparent discussions with the insurers that own an impacted security so that they can discuss their opinion with SVO and the SVO can share the basis for its opinion during that discussion. Regulators will consider comments regarding the various forms the transparent communication can take.</p> |



| Issue # | Issue Category                    | Issue and Response  |
|---------|-----------------------------------|---|
|         |                                   | <p><b>Publication of methodologies:</b><br/> The SVO is not a rating agency and often relies upon the methodologies of rating agencies, as permitted by the Task Force in the <i>“Use of Generally Accepted Techniques or Methodologies”</i>*. The SVO considers multiple methodologies when it reviews a security and will use the one or combinations of methodologies that it believes will produce a reasonable assessment of risk for regulatory purposes. Because the SVO relies upon the methodologies of other entities, it does not publish those methodologies. The use of a particular methodology from a rating agency should not be construed as validation of one credit rating provider over another.</p> <p>The SVO highlighted several factors in the proposal that it will consider to initially identify a potential issue, including the comparison to peers rated by different CRPs, the market yield for that CRP rating level, and applying other available methodologies. When it performs its full review, the SVO will apply the methodology or combination of methodologies that it believes will produce a reasonable assessment of investment risk as permitted under the <i>“Use of Generally Accepted Techniques or Methodologies.”</i></p> <p>*Part One of the P&amp;P Manual in the <i>“Use of Generally Accepted Techniques or Methodologies”</i>: <i>“The SVO may use any analytical technique or financial modeling approach taught in undergraduate and graduate business school financial analysis curriculum; any analytical technique otherwise widely or commonly used by lending officers, securities professionals, credit rating analysts, valuation professionals, statisticians or members of other similar professions and any special technique of modeling approach that may be appropriate in a special situation that provides a reasonable assessment of risk or valuation for regulatory purposes, despite the lack of an express authorization to use any technique or modeling approach in this Manual.”</i></p> <p><b>Transparency to market:</b><br/> The proposed amendment would require the SVO to publish an anonymized summary of the analytical issue or concern while maintaining the confidentiality of the issuer and rating agency. Comment letters provide suggestions as to the timing of this summary’s publication; those suggestions will be considered for the final proposal.</p> |
| 2       | Regulator oversight and authority | <p><b>Issue:</b> Some interested parties noted the lack of express approval from the regulator sub-group or recommended a significant increase in the scope of notifications, dissemination of materials and involvement of regulators in each procedural step.</p>   |
|         |                                   | <p>Regulators retain all oversight and authority and there is an explicit step for regulator approval, including involvement of the domiciliary regulator. Additional clarifying language may be added to this step to remove any perception of lack of authority. Domiciliary regulators retain final rights over impact to any individual insurer, subject to broader accreditation standards.</p>  |



| Issue # | Issue Category                   | Issue and Response   |
|---------|----------------------------------|--|
|         |                                  | <p>The SVO has been assigned certain responsibilities pursuant to the instructions published in the P&amp;P manual and do not have a financial interest in the outcome of their financial risk analysis. The proposal balances the SVO’s role as regulators’ independent investment expertise and the regulators’ ultimate oversight of domiciliary insurers.</p> <p>Regulators will review suggestions for various approval checkpoints; however, the introduction of additional bureaucratic steps will be balanced against the value of the further analysis.</p>   |
| 3       | Recurring patterns of concern    | <p><b>Issue:</b> The SVO should publicly disclose any recurring pattern of concern.</p>  |
|         |                                  | <p>As stated in prior National Meetings, it is <b>not</b> an objective of this proposal to address concerns with an asset class or broader investment themes. There are existing requirements in Part One of the P&amp;P Manual, “<i>Procedures to Amend this Manual</i>”, outline the steps the SVO or interested parties must follow to bring an issue before the VOSTF that address this concern. Those requirements will continue to be followed where appropriate. The intent of this proposal is to address individualized issues.</p> <p>The FE discretion proposal requires the SVO to discuss with the VOSTF chair any recurring patterns it sees to determine the appropriate next steps as the FE discretion amendment is not intended to address asset classes or security structures. Such next steps may be an issue paper, additional research, referrals to other group, proposed P&amp;P Manual amendment or some other action. Regulators anticipate the sub-group will consider whether an issue is individual or part of a recurring pattern and will make its decision on process accordingly; this clarification can be added to the proposal.</p> |
| 4       | Scope of discretion              | <p><b>Issue:</b> Interested parties request the NAIC to limit the scope of the proposal to specific types of securities.</p>   |
|         |                                  | <p>The proposal is intended to cover securities with NAIC designations produced through the translation of a CRP rating as a fundamental control supporting the use of CRPs in the production of NAIC designations</p>   |
| 5       | Lack of notification to insurers | <p><b>Issue:</b> There is no requirement for the Investment Analysis Office (IAO) to notify insurers that a security is Under Review.</p>  |
|         |                                  | <p>The proposal explicitly identifies securities Under Review to insurers through the means of the new SVO Analytical Department Symbol “<i>UR means the NAIC Designation assigned pursuant to the filing exemption process is under review by the NAIC’s Investment Analysis Office.</i>” This symbol will be provided to insurers through the NAIC’s AVS+ application along with all other NAIC Designations and SVO Analytical</p>  |



| Issue # | Issue Category  | Issue and Response  |
|---------|---|---|
|         |   | <p>Department Symbols. Additionally, the NAIC’s VISION application will be notifying insurers with the subject security in their portfolio that an information request has been initiated. Insurers that hold the security in their AVS+ portfolio will see the “UR” removed shortly after it is entered into VISION, as VISION feeds that information into AVS+.</p>   |
| 6       | Materiality threshold   | <p><b>Issue:</b> The basis for three notch difference threshold.</p>  |
|         |   | <p>Moving three notches across NAIC Designation Categories would result in an approximately a 100% change in the pre-tax risk-based capital factor for a life insurer, with some intervals being a significantly higher percentage change.</p>  |
| 7       | Defer discretion proposal until the investment framework is implemented | <p><b>Issue:</b> Some interested parties recommend deferring any action of the FE discretion proposal while the Financial Condition (E) Committee works on the <i>Framework for Regulation of Insurer Investments – A Holistic Review (Framework)</i>. Reasons suggested for deferral included: better usage of scarce NAIC resources including the time of the Task Force members, require minimal involvement by regulators, eliminate requiring insurers to justify their investment decisions, and evaluation of the full population of rated securities.</p>   |
|         |   | <p>The FE discretion proposal is complimentary to the <i>Framework</i> and will still be needed when it is implemented. The Framework also highlights that the reasonable assessment of insurer investment risk is a valuable use of NAIC resource and fundamental to prudential regulation.</p> <p>As mentioned several times by the Financial Condition (E) Committee, including the committee’s comments to interested parties in the memo it exposed on its webpage dated Feb. 14<sup>th</sup>, “As it relates to the work already occurring at the Valuation of Securities (E) Task Force (“VOSTF”) and the Risk Based Capital Investment Risk and Evaluation (E) Working Group (“RBC IRE”), the Committee would like to reinforce that there will be no delay or pause in these workstreams on the basis that the current workstreams are consistent with the beginning stages of the Framework and the Committee has full faith that these groups will develop well-reasoned conclusions on their final products.”</p> <p>It is reasonable to consider how the various components of the Framework, including the potential development of an overall due diligence process, will work in conjunction with the FE discretion proposal. Regulators recognize there may be securities whose ratings are inconsistent with regulatory expectations even with a mature due diligence program in place. The implementation of an FE discretion process will take some time (i.e. 1-2 years) and therefore will align with ongoing deliberative work on the CRP due diligence framework.</p> |



| Issue # | Issue Category   | Issue and Response  |
|---------|--|---|
| 8       | How will the SVO review all of the FE securities?                                  | <p><b>Issue:</b> Interested parties asked how the SVO will be able to review thousands of FE filings on a fair and impartial basis.</p>   |
|         |  | <p>The SVO has no intention of reviewing every security that uses a rating agency rating in the assignment of an NAIC designation. Currently, when we do encounter a security with a rating that looks anomalous, neither the SVO nor any NAIC member has the ability under existing NAIC guidance to address it in a defined and methodical manner. The FE discretion proposal would authorize the SVO to follow the process steps outlined in the proposal and at the conclusion of that process potentially remove the anomalous rating from the FE process. The SVO staff have no conflicts of interest or financial interests, in the outcome of this process. Its only objective is the reasonable assessment of investment risk for NAIC members.</p>  |
| 8       | The SVO is a regulator and NAIC Designations the functional equivalent of ratings. | <p><b>Issue:</b> The SVO is a regulator and market participant. NAIC Designations are the functional equivalent of ratings.</p>   |
|         |  | <p>The SVO is not a regulator, however the members of the NAIC are prudential insurance regulators within their respective jurisdictions. The SVO has been assigned certain responsibilities pursuant to instructions published in the <i>Purposes and Procedures Manual of the NAIC Investment Analysis (P&amp;P Manual)</i> that were adopted by Valuation of Securities (E) Task Force, Financial Condition (E) Committee and ultimately the NAIC’s Plenary, the chief insurance regulators of the 50 states, the District of Columbia and five U.S. territories. If adopted by the Plenary, the recommendations become NAIC policy, reflecting national regulatory consensus and serving as guidance to state insurance departments and state legislatures.</p> <p>NAIC Designations and other analytical products of the SVO and SSG are produced solely for the benefit of NAIC members in their capacity as state insurance department officials for use in the NAIC Financial Regulation Standards and Accreditation Program. NAIC Designations are proprietary symbols of the NAIC. The SVO and sometimes the SSG produce NAIC Designations for insurer-owned securities using the policies, procedures or methodologies adopted by the VOSTF in the P&amp;P Manual. NAIC Designations identify a category or band of credit risk. NAIC Designations are produced for statutory accounting, reporting, state investment laws and other purposes identified in the NAIC Financial Regulation Standards and Accreditation Program and/or other NAIC developed regulatory guidance embodied in state law.</p> |



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

*2024 Spring National Meeting*

Phoenix, Arizona

February 27, 2024

Chairs: Carrie Mears (IA), Lindsay Crawford (NE)

NAIC Support Staff: Charles Therriault, Marc Perlman

**Staff Recommended Responses to Key Comments for Regulator Consideration on the Proposed P&P Manual Amendment Authorizing the Procedures for the SVO's Discretion Over NAIC Designations Assigned Through the Filing Exemption Process**

| Issue # | Issue Category                  | Issue and Recommendation   |
|---------|---------------------------------|--|
| 1       | Reference to plural CRP ratings | <p><b>Issue:</b> If the SVO disagrees with a CRP rating by 3 or more notches, then the security's CRP rating(s) will be removed from the FE process. The amendment indicates that there could be more than one CRP rating for the security that could be impacted.</p> <p><b>Staff Response:</b> The plural reference was intentional as there are eight credit rating providers and ten nationally recognized statistical ratings organization. It is possible that the SVO could see more than one rating on a security that it believes may not reflect its risk. While this scenario is unlikely, it would be an inefficient use of NAIC resources to hold more than one review of the same security. The SVO would communicate such as situation to the impacted insurers and Task Force.</p> |
| 2       | Year-end processing             | <p><b>Issue:</b> What should occur when the SVO and VOSTF Sub-group decide to remove a CRP rating near year end and insurers decide to appeal?</p> <p><b>Staff Response:</b> At this point the security would have gone through a full review by the SVO and the VOSTF Sub-group. The SVO recommends the removal of the CRP rating and any future action at the conclusion of the appeal process be taken when such a decision has</p>   |



| Issue # | Issue Category                                  | Issue and Recommendation  |
|---------|---|---|
|         |   | made.   |
| 3       | Insurers present to VOSTF Sub-group             | <p><b>Issue:</b> Industry has requested being able to at end the VOSTF sub-group meeting when the SVO senior credit committee presents its concerns.</p>  |
|         |   | <p><b>Staff Response:</b> Consistent with the existing appeal process, if an insurer(s) requests it, the insurer(s) can present its position along with supporting information to the SVO senior credit committee and VOSTF sub-group. The SVO senior credit committee and VOSTF sub-group would then deliberate in private. The impacted insurers would be involved throughout this process and it would be up to those insurers how involved they wished to be. As occurs in the existing appeals process, the insurers could include other parties during their presentation that are permitted access to the material being presented. This procedural clarification can be added to the amendment.</p> <p>During the process leading up to the SVO senior credit committee and VOSTF sub-group meeting, the SVO welcomes a transparent discussions with the insurers that own the impacted security so that those insurers can discuss the basis for their opinion with SVO and the SVO can share the basis for its opinion.</p> |
| 4       | Transparency - Public notification of decision. | <p><b>Issue:</b> Update the generic public notice on the security after the SVO senior credit committee and VOSTF sub-group decision.</p>   |
|         |   | <p><b>Staff Response:</b> The amendment contemplates posting the public anonymized summary of the analytical issue or concern only after the final decision has been made. Anything prior to that decision would be inappropriate to post publicly. The SVO does not recommend publicly publishing anything other than the anonymized summary. The anonymized summary of the analytical issue should provide insurers and others with sufficient information to understand the core issues.</p>   |
| 5       | Third-party adjudication                        | <p><b>Issue:</b> The request to have an independent third-party adjudicate the decision of the SVO senior credit committee and VOSTF sub-group was rescinded in one comment letter. In its place is the option to receive an additional credit rating provider (CRP) rating that would go through the existing FE process.</p>  |



| Issue # | Issue Category                                      | Issue and Recommendation   |
|---------|---|--|
|         |   | <p><b>Staff Response:</b> The SVO agrees that engaging an independent third-party to adjudicate these decisions would be very challenging. The SVO would welcome more ratings in the FE process and believes that there should probably be a minimum number of ratings required to be eligible for FE to ensure there is a broad assessment of risk. Requiring multiple ratings is beyond the scope of this proposal.</p> <p>There should be sufficient time in the proposed process to permit additional CRP rating(s) (there could be more than one) to be issued on the security. Assuming the additional CRP rating(s) is less than three notches different from the SVO’s assessment, the SVO would proceed with removal of the exception rating and permit FE to proceed as normal with the alternate rating(s). The reason to continue with the removal of the exception rating is to avoid being in this same situation if the alternate rating(s) is withdrawn.</p> |
| 6       | Frequent publication for ratings discretion actions | <p><b>Issue:</b> Interested parties requested that the summary of ratings discretion be publicly reported at each National Meeting.</p>  |
|         |   | <p><b>Staff Response:</b> The SVO recommends the proposal’s existing summary at each Spring National Meeting be maintained. The SVO already provides the Task Force a public report at that meeting of the filings for the prior year as required by Part Two of the P&amp;P Manual in the guidance for the “Year-end Carry Over Procedure” and the ratings discretion actions would be made part of that report. The SVO will already be publishing on a public webpage an anonymized summary of the analytical issue or concern related to a ratings discretion action negating the need for any additional reports as the information will already be publicly available.</p>   |
| 7       | Other procedural suggestions in comment letters     | <p><b>Issue:</b> There are a number of other procedural suggestions throughout comment letters.</p>  |
|         |   | <p><b>Staff Response:</b> SVO Staff did not provide recommendations for each suggested comment. Regulators will work through comments individually in the production of a final draft of the proposal.</p>   |



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

**Via Electronic Submission**

January 26, 2024

**Comment letter on Revised Proposed P&P Manual Amendment Authorizing the Procedures for the SVO's Discretion Over NAIC Designations Assigned Through the Filing Exemption Process (Doc. ID: 2023-005.15)**

Dear Commissioner Ommen,

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

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

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

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

Alternative Credit Council (ACC)





CRP is converted to the NAIC designation and used by insurance supervisors for reporting, reserving and capital charge purposes. Under the revised proposal, there would be fifteen steps in the SVO process to review all filing-exempt ratings and determine which CRP ratings should be overridden and replaced by the SVO's own rating. (See Annex for a full description of these proposed steps, the related changes to the NAIC's Purposes and Procedures Manual of the NAIC Investment Analysis Office (the "P&P Manual") and AIMA's specific concerns.)

We appreciate the positive changes made by the Valuation of Securities Task Force ("VOSTF") and the SVO to the most recent, revised version as part of a dialogue with a variety of industry stakeholders. However, we still have substantial conceptual as well as procedural concerns about the revised proposal, including the effectiveness of the review and appeals process, the negative impact that the extra cost and time of the review process may have on an affected investment, and the potential ramifications of an SVO override of even a single type of investment on the entire asset class.

Given these concerns, which are detailed in the Annex below, we recommend that the VOSTF form a working group with industry representatives from issuers, CRPs, and insurers to discuss the conceptual and practical concerns outlined in the Annex and to discuss how to better mitigate potential negative impacts to both the specific investments and an entire asset class that may become subject to an SVO override.

Should the NAIC proceed with this proposal, we recommend the following key changes: 1) provide greater clarity on the methodology that will be used to identify which ratings will be identified for initial review, 2) allow affected insurers, issuers and credit rating providers earlier notice and greater access to the deliberations in Steps 3 through 8, 3) clarify the role of state insurance supervisors in Step 8 and ensure they have greater oversight and decision-making in the proposed SVO process, 4) require a comprehensive written record and enable access of all information to make the independent third party review more feasible, and 5) create a working group that would allow for a dialogue between issuers, rating agencies, investors, the SVO and VOSTF staff to jointly discuss the proposed process and its potential market implications. Please see the Annex for details on these recommendations.

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

Sincerely,

Yours sincerely,

Jiří Król

Deputy CEO, Global Head of Government Affairs

## ANNEX

The revised version of the SVO Override Proposal would establish fifteen steps in the process for the SVO to review all filing exempt securities and to determine whether the rating is unreasonable for regulatory purposes:

- 1) SVO staff identifies an FE security with an NAIC Designation determined by a rating that appears to be an unreasonable assessment of risk.
- 2) SVO Senior Credit Committee (SCC) meets to determine if it agrees that the rating appears an unreasonable assessment of risk and, if so, places the security "Under Review".
- 3) If the SVO SCC votes to put the security "Under Review" an information request will be sent through VISION to insurers that hold that security in their VISION portfolio and an the SVO Administrative Symbol assigned to identify them in VISION and AVS+.
- 4) If the information request is not responded to, the SVO may reach out to the domiciliary Chief Financial Examiner.
- 5) Upon receipt of all necessary documentation through the information request, the SVO will then perform a full analysis of the security and coordinate with the interested insurer(s) on any questions or issues the SVO may have about the security.
- 6) SVO SCC re-convenes and determines, based on its full analysis of all necessary information, whether the FE NAIC Designation is three (3) or more notches different than the SCC's opinion.
- 7) If the SVO SCC opinion differs from the FE produced NAIC Designation Category by a material three (3) or more notches the specific CRP rating(s) for that security will be removed from FE.
- 8) The SCC will present its analysis to a sub-group of the Task Force to provide oversight over the FE removal process and enable the Task Force to provide feedback to the SVO.
- 9) If there are no alternative CRP ratings, the SVO SCC's assessment will be entered into VISION. If an alternative CRP rating is subsequently received, it will be incorporated into the FE process, if applicable.
- 10) If the SVO SCC assesses the issue is part of a recurring pattern, the SVO Director will inform the chair and decide if an issue paper, referral or amendment is needed.
- 11) An anonymized summary of each unique issue or situation will be published on the SVO webpage or some other insurer accessible location for transparency.
- 12) An insurer may appeal to the Task Force chair if they believe the SVO did not follow the procedures outlined in the P&P Manual.
- 13) If an insurer(s) wishes to appeal the SVO SCC's analytical assessment, it may request the NAIC's IAO to contract, at the insurer(s) expense, with an independent third-party acceptable to the NAIC IAO to perform a blind review of the security (e.g. without knowledge of the SCC's, insurers' or CRP's assessment) with the information provided through the information request. If the independent third-party review results in an NAIC Designation Category that is one (1) or less notches different from the FE produced NAIC Designation Category, then the SVO SCC's opinion will be overridden by the reinstatement

of the CRP rating(s). If the independent third-party review results in an NAIC Designation Category that is more than one (1) notch different from the FE produced NAIC Designation Category, then the SVO SCC's opinion will remain.

14) The SVO will identify through SVO Administrative Symbols when a CRP rating(s) has been removed from the Filing Exemption process for a security.

15) At the Spring National Meeting, the SVO Director will summarize FE discretion actions taken for the preceding year.<sup>3</sup>

Regarding Step 1, we have several concerns and questions, including how will the SVO staff be able to review the thousands of FE filings on a fair and impartial basis? What criteria would they use to decide that the rating "appears to be an unreasonable assessment of risk"? We believe this step requires additional study to better determine what criteria and analytical tools the SVO staff will use to identify CRP ratings that they believe may be an unreasonable assessment of risk.

In Step 2, the SCC would meet to make its own determination that the identified CRP rating may not be reasonable for regulatory purposes and, if so, should be put "under review." Paragraph 166 of the proposed update to the P&P Manual states that the SCC can consider four factors in reviewing an initial IAO staff assessment: (i) a comparison to peers rated by different CRPs, (ii) consistency of the security's yield at issuance or current market yield to securities with equivalently calculated NAIC Designations rated by different CRPs, (iii) the IAO's assessment of the security applying available methodologies, and (iv) any other factors it deems relevant.<sup>4</sup> In the minutes of the VOSTF's meeting, the SVO indicated that it primarily uses "Moody's Investors Service (Moody's) and Standard & Poor's (S&P), when it reviews securities because the SVO generally [sic] finds those methodologies to be clear, reasonable, and widely accepted across financial markets."<sup>5</sup> We are concerned that could lead issuers to prefer to use those two rating agencies, given that would lessen the odds that the SVO would put them under review by the SCC or that the SCC would find the rating to be unreasonable.

However, that additional information does not answer the question of under what basis the IAO staff made the initial assessment in Step 1. Given that individual staff of the IAO report to SVO senior management, one or more of whom will be members of the SCC, a reasonable course of action would be for the IAO staff to use these identified factors, but how can IAO staff obtain all of this information on the thousands of filing exempt ratings, let alone adequately analyze that information to determine whether any particular rating appears to be unreasonable?

Another concern regarding Step 2 is that there is no indication of which members of the SVO would be part of the SCC, so it would be helpful for the P&P Manual to specify this.

Regarding Step 3, only insurers that hold the relevant security will be informed that it is under review and asked to provide additional information. After the additional information is received,

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<sup>3</sup> SVO Rating Override Proposal, *supra* note 2, at pages 2-3.

<sup>4</sup> *Id.* at page 8.

<sup>5</sup> Minutes of VOSTF August 14, 2023 meeting, page 6 (available at [https://content.naic.org/sites/default/files/national\\_meeting/VOSTF%20Materials%202023%20Fall%20National%20Meeting%20v7.pdf](https://content.naic.org/sites/default/files/national_meeting/VOSTF%20Materials%202023%20Fall%20National%20Meeting%20v7.pdf)).

in Steps 6 and 7, the SVO reconvenes. If the SVO determines that the appropriate rating is three or more notches below the filing exempt rating, then that rating is removed from filing exempt status.

Not until Step 8 would any information about a particular SVO filing exempt rating review be provided to a sub-group of VOSTF members, and the language of Step 8 implies that the VOSTF-subgroup would be presented with information about this decision rather than having any ability to approve or overturn that decision. Step 8 does not contemplate any affected insurer, rating agency or issuer to be present when the SVO explains its decision to the VOSTF-subgroup.

We strongly encourage adjustments be made to Steps 3 through 8 that would allow for a greater opportunity for input from affected insurers, issuers and CRPs. Additional changes should be made to allow the VOSTF-subgroup to hear from affected parties in addition to the SCC, so that they could understand the potential impact on affected insurers, rating agencies, or issuers. Providing the VOSTF-subgroup with a wider range of information and views would better enable them to provide sufficient oversight and make informed decisions. Step 8 should be modified to provide greater clarity on the role for the VOSTF-subgroup and enable it to address any concerns raised by the affected insurers, rating agency and issuer before the SCC finalizes any decision to remove filing exempt status. To achieve this goal, we believe that the VOSTF-subgroup should have the authority to prevent the SCC from finalizing any decision to remove a rating from filing exempt status until their concerns and questions have been sufficiently resolved.

Step 8 does not currently require the SCC to provide a written record of the information gathered, the analysis it undertook, or an explanation for how it determined that its rating was three notches less than the one provided by the CRP. Requiring such a written record is critical not just for the oversight of the VOSTF-subgroup, but also for any potential appeal discussed in Step 13.

In Step 9, an insurer would be allowed to use a second CRP rating if one is or later becomes available. We are concerned that this may result in a de-facto need to obtain two credit ratings for every filing-exempt security, given the market risks to an investment that becomes subject to a failed filing-exempt rating. This would significantly increase the costs of investing and, as mentioned before, pressure issuers to utilize one or both of the two major rating agencies identified as the ones that the SVO primarily uses. Instead, this step should be delayed, and an affected insurer or issuer should be allowed to obtain a second rating before any final SVO decision is made to remove filing exempt status.

In Step 11, the SVO would publish an anonymized summary of the final results of its deliberations, but that step should be clarified to include if any decision was made to remove filing exempt status from a particular security. To avoid potential negative market impact on all securities of that asset class, the summary should also provide sufficient detail for holders of the same type of security to understand if that decision might impact them.

We have serious concerns about the viability of the proposed blind appeals process outlined in Step 13. A third-party review, to be meaningful, would need access to the original documentation, rationale, and other information that can often only be fully understood over a period of dialogue with the relevant investment parties. By depriving the blind reviewer of all the information gathered by the CRP and its analysis, along with the same information and analysis of the SCC, it would be extremely difficult, time-consuming and expensive for a third party to recreate it using their own efforts. To make the appeals process fair, an extensive written record would be



necessary, along with the establishment of a process whereby confidential information can be shared between the issuer, CRPs, the SVO and the blind reviewer.

Finally, as part of the changes suggested above, we recommend that the VOSTF create a working group with market participants, including representatives from issuers, CRPs, and insurers to consider the impact of an SVO review on the market impact of overriding the CRP rating of a specific investment. This should include a discussion of how any time delays and additional costs might affect a particular investment, as well as the broader market consequences of a particular CRP rating being overridden.



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January 26, 2024

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

**Re: Exposure on Revised Proposed P&P Manual Amendment Authorizing the Procedures for the SVO's Discretion Over NAIC Designation Assigned through the Filing Exemption Process**

Dear Ms. Mears:

The ACLI, PPIA and NASVA (collectively “the Undersigned”) appreciate the opportunity to comment on the above referenced exposure and related detail, dated November 3, 2023. Generally, the exposure and the proposed P&P Manual changes reflect revisions to the ratings discretion proposal that were discussed at the 2023 NAIC Summer National Meeting and were intended to be responsive to Industry’s concerns. The Undersigned appreciate modifications made to the original exposure to address concerns. We view the current proposal as a positive step in the right direction. However, the Undersigned still have some concerns and offer suggestions to further improve the proposed ratings discretion process.

First, the Undersigned wish to acknowledge how far the Ratings Discretion proposal has evolved from the initial exposure discussed at the 2023 NAIC Summer National Meeting. We particularly appreciate that securities where the SVO has questions are no longer assumed to be inappropriately rated at the outset. We believe that the process introduced, that allows for additional information gathering and review from the SVO, sets the right tone and will facilitate a constructive dialog between the SVO and insurers on such securities. We also note that the SVO and multiple Regulators have assured Industry that the ratings discretion process will be used judiciously and will focus on those securities where the NAIC has the most significant concerns. Additionally, the (E) Committee “Framework for Regulation of Insurers’ Investments” also anticipates that such discretion will be rare. The Undersigned agree that a thoughtful and cautious approach to challenging ratings is best, as it will minimize market disruption. We hope that ratings challenges will be the exception, rather than the rule, if this takes effect. The

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

Undersigned have included below a list of suggested changes to help further improve the CRP Ratings Discretion process and stand ready to discuss any questions that Regulators or the IAO might have on these suggested changes.

**Step 2** of the revised process denotes a review by the SVO Senior Credit Committee (“SVO SCC”). The Undersigned feel it would be helpful to define in the exposure which SVO members would comprise the SVO SCC.

**Step 7** of the revised process states that, following a full review, if the SVO SCC disagrees with a CRP rating by 3 or more notches, then that security’s CRP rating(s) will be removed from the FE process. The Undersigned have a couple concerns with this step as drafted. First, it is unclear to us whether the plural in “CRP rating(s)” was intentional or a drafting oversight? Given that the procedural steps were drafted in a way to imply that only one CRP rating would be challenged at any given time, the Undersigned feel it would be inappropriate to delete multiple CRP ratings from the system. (That is, if there are two or more Eligible CRP Credit Ratings, and one is challenged and deemed inappropriate for NAIC use, then only the rating deemed inappropriate should be removed from the FE system.) We suspect that was not the intent of the exposure but wish to clarify. If we are wrong, and the IAO intends to challenge two or more Eligible CRP Credit Ratings, then the decision to challenge two or more CRP ratings should be clearly communicated at the outset of the ratings discretion process. Second, the Undersigned believe that removing a rating from the system should not occur until after the VOSTF Sub-group has heard the SVO SCC’s concerns and agreed that the process should move forward. We suggest that Step 7 be moved to follow Step 8.

Note that there was some discussion among the Undersigned as to whether Step 7 should follow Step 8, or whether it should be moved to follow Step 13 (i.e., removal of a CRP rating would only occur, once a potential appeal option has been exhausted). Ultimately, the Undersigned elected to place Step 7 behind Step 8, understanding that insurers will not always exercise the appeal option when a rating is challenged. However, one concern that was raised (and we have yet to resolve) is what will happen to a security when the VOSTF Sub-group and SVO SCC decide to remove a CRP rating near-year end? In this scenario, should insurers decide to pursue an appeal, the appeal process may not be concluded before year-end. Meanwhile, the SVO’s designation would drive risk-based capital (RBC) treatment over year-end, while a different rating may ultimately result from the appeal in the following year. The Undersigned feel that this situation could be addressed with a code providing additional disclosure and indicating that the CRP rating has been challenged by the IAO and VOSTF Sub-group, but that the final NAIC Designation is still under appeal. There may be other solutions worth discussing as well. We hope to work together with the IAO to determine an interim solution that would make sense for both parties.

The Undersigned believe that the addition of Step 8, where the SVO SCC presents an analysis of a rating that it wishes to challenge to a Sub-group of the VOSTF, is a material improvement. We believe strongly that it is important for Regulators to be part of any potential ratings challenge process. To further increase transparency and ensure due process, the Undersigned recommend the following additions to **Step 8**:

- 1) Move Step 11, where the SVO provides a genericized summary of its concerns about the security on the NAIC’s website, up in the process document to combine with Step 8. Doing so will put the market on notice that certain types of securities may raise concern for the NAIC. Absent receiving public notice earlier in the process, only those insurers who own a security

under review will be aware of the SVO's potential concerns, and such insurers will then be in possession of material non-public information.

2) At the 2023 NAIC Fall National Meeting, VOSTF stated that this summary would be detailed enough to provide full transparency, laying out the SVO's concerns in substance, without breaching confidentiality. The Undersigned wish to emphasize how important that level of detail will be to the process, as it will provide transparency for insurers, Regulators and other stakeholders, and help all understand the SVO SCC's concerns in a fulsome manner. Lack of transparency will only serve to create confusion among insurers and could disrupt capital markets more than necessary. Presumably the SVO has already identified some securities with CRP ratings where it has concerns. Regardless of whether/when the proposed exposure takes effect, the Undersigned believe it is important for the SVO to provide a few examples of the types of write-ups that it intends to share publicly. These examples would help address the question of how detailed, or how substantive, the SVO's generic summaries will be and would level set expectations across all stakeholders regarding the degree of robustness.

3) In order to allow for adequate due process, the Undersigned also believe it is important that - insurers who own a security with a rating in question be permitted, at their option, to attend the VOSTF Sub-group meeting when the SVO SCC presents its concerns about that security or rating. This will ensure that insurers fully understand the SVO SCC's concerns and will allow the lead insurance spokesperson (most typically the filer) to present its own view of the security and ratings methodology to the VOSTF Sub-group. Should members of the VOSTF Sub-group have questions, they can ask the insurer directly, rather than receiving information through the SVO SCC as an intermediary. The Undersigned understand that multiple securities may be discussed at such meetings; therefore, there may be concerns about protecting confidentiality. However, this concern can be addressed by having a meeting registration process, an agenda with set discussion times for each deal, and a rotating dial-in or WebEx process. Insurers can be admitted to the meeting when their specific security and rating are up for discussion. The SVO SCC and lead insurance spokesperson can each present, and the VOSTF Sub-group can ask questions and deliberate. Once a final decision is made, those insurers who hold the security can drop, and when the next security and rating are up for review, the next group of insurers can be admitted to the dial-in or WebEx meeting.

4) The Undersigned highlight that Step 8, as currently drafted, requires the SVO SCC to present its analysis to the VOSTF Sub-group and obtain feedback; however, there is no specific requirement for the VOSTF Sub-group to decide whether or not the ratings challenge process should proceed. The Undersigned believe that a decision to override a CRP rating would be impactful to both Industry and capital markets. Therefore, we believe that authority to override a CRP rating should ultimately rest with Regulators, and we recommend clarifying Step 8, to require a specific decision from the VOSTF Sub-group on whether to move forward with a ratings challenge. Most likely, this is in keeping of the spirit of what was proposed in Step 8, but specifically stating that a decision point is required would clarify the process.

5) Once the VOSTF Sub-group has made its decision on how to proceed, the Undersigned request that the SVO update its generic public notice on the security and ratings in question. The update should indicate the VOSTF's Sub-group's decision on whether or not to proceed with

a CRP rating override, and disclose any meaningful insights that the VOSTF Sub-group shared when making its decision. Adding this level of detail would again serve to provide transparency and certainty to the market and would help stem unneeded market disruption.

**Step 9** could be split into two separate Steps—9(a) and 9(b)—where Step 9(a) addresses the situation where there is no second CRP rating, and Step 9(b) addresses the situation where there is a second CRP rating in place (or the insurance filer undertakes an effort to obtain a second CRP rating). As described further below, the Undersigned believe that **Step 9(b)** should be combined with Step 13 to replace the previously envisioned appeal process.

The Undersigned agree conceptually with **Step 10**. When the SVO SCC identifies a recurring pattern of concern, it makes sense to consider further action in conjunction with Regulators. The Undersigned believe it would be good to clarify in Step 10 that, following consultation with the VOSTF Chair, a decision regarding the best course of action (whether issues paper, P&P Manual amendment, referral, further monitoring, etc.) be made and publicly communicated, so that all insurers and the capital markets quickly become aware of the Regulatory concern. Further, if it is a recurring pattern (such as a rating methodology that is deemed inappropriate), then it is important for the SVO to identify all securities that they are aware of that will be impacted. Otherwise, the stated objective of consistent and uniform NAIC designations will not be achieved. This also will prevent further investment in assets of concern, until the NAIC has taken the opportunity to fully vet the issue and determine a final course of action, thereby limiting potentially negative RBC impacts for insurers. The Undersigned recall an issues paper published on Principal Protected Securities and Combo Notes a few years ago that was particularly instructive in laying out Regulatory concerns and served to notify the market that these securities were receiving additional scrutiny. We feel this kind of document represents a best practice for transparency and a process for raising issues.

**Step 9** mentions the possibility of insurers obtaining a second CRP rating on a security. If a second CRP rating is obtained, the Filing Exemption (“FE”) process would effectively start over again. The second CRP rating would drive capital treatment, unless or until the SVO SCC decides to challenge that second rating. Likewise, **Step 13** envisions an appeals process, wherein the NAIC IAO would obtain (at the insurer’s expense) an independent review from a third-party acceptable to the NAIC IAO. Should the third-party rating fall within one-notch of the original CRP rating, then the original rating would prevail. Should the third-party rating be two or more notches lower than the original CRP rating, then the SVO’s designation would prevail.

The Undersigned appreciate that the appeals process laid out in Step 13 was designed to accommodate Industry’s request for due process. However, upon further consideration, the Undersigned believe that the changes we requested for Step 8 are probably more valuable in preserving due process. We recognize the difficulties in selecting an appropriate third-party to adjudicate an appeal—particularly on a “white label” basis, as has been considered in discussions related to this exposure. The proposal doesn’t specify which parties would be acceptable to adjudicate a third-party appeal, and there are concerns about whether such an appeal process may even be practical. For example, are CRPs even willing to assign a rating on a white label basis? If not, who would be? What level of information could be shared with the appeal arbiter to ensure sufficient information for the appeal party to develop an informed and objective opinion, yet still protect issuer confidentiality? Should this avenue be pursued, it would probably be necessary to see examples of the type of information that would be shared on a

white label basis, so CRPs (or any other third-party appeal arbiters), Regulators and Industry can collectively assess whether such information is sufficient for an objective, independent third-party review.

In addition, the Undersigned believe that requiring an appeal provider's rating to land within one notch of the original CRP rating, in order for the CRP rating to be deemed valid is overly restrictive. Take, for example, a situation where a CRP rates a security at an NAIC 1.F-equivalent level, but the SVO believes the security should carry an NAIC 3.B-equivalent designation. If an appeal party is brought to the process and rates a security as NAIC 2.B-equivalent, then the current exposure would require the SVO's recommended NAIC 3.B Designation to stand. This seems like an overly harsh outcome, when two separate CRPs rate the security as investment grade. Provided insurers are allowed to attend and speak at the VOSTF Sub-group presentation in Step 8, the Undersigned believe that the proposed appeals process could be streamlined, thereby avoiding the questions and challenges mentioned above.

Rather than having the formal appeal process as laid out in Step 13, the Undersigned propose that, at any time during the ratings review process, insurers could obtain a second CRP rating on the security. This would effectively provide three separate views regarding a security's risk profile—the original CRP rating, the IAO's recommended designation, and the second CRP rating. Similar to the FE process for public securities, the NAIC could then use the second-lowest of the three independent risk views (the two CRP ratings and the IAO's recommended designation) to determine risk-based capital treatment. The Undersigned believe that this proposed approach balances Regulators' need for multiple views of risk on unique securities or methodologies and has an inherent level of conservatism (through use of the "second-lowest risk assessment" construct). However, the Undersigned's proposed solution also would be an efficient and easy-to-understand approach and would avoid placing the IAO in a position where it must indirectly endorse a particular CRP or credit risk assessment service.

The Undersigned do wish to clarify, however, that while we support providing insurers with the option of seeking a second CRP rating, we would not support making two CRP ratings a requirement for all FE securities. One of the benefits of the ratings discretion exposure as proposed, is that it recognizes a large subset of privately rated securities where Regulators and the IAO have no Regulatory concerns. What the Undersigned want to avoid is a process that would require two or more CRP ratings for these non-controversial securities to receive FE treatment. Many debt issuers do not wish to invest the time and cost necessary to obtain two ratings. Likewise, insurers do not want to drive these issuers away from the insurance-dominated private placement market to the commercial bank lending market or to other capital markets. However, for situations where Regulators or the IAO have significant Regulatory concerns and wish to challenge a specific CRP rating or methodology, the Undersigned believe providing an option for a second CRP rating, that would effectively serve as a third datapoint for risk assessment, would be helpful.

Lastly, in **Step 15**, the SVO Director provides a summary of CRP Ratings Discretion activity at the Summer National Meeting. It is not clear whether this report would be publicly available to insurers and the capital markets. The Undersigned feel that aggregated reporting is important for providing transparency and limiting capital markets disruption. We request that such reports be shared publicly and occur at every NAIC National Meeting, as opposed to annually. After the CRP Ratings Discretion process has been in place for a few years, there may be an opportunity to move to a less frequent aggregated reporting process. But initially, our expectation is that multiple CRP ratings may receive additional

review. We believe increased public reporting frequency is warranted to clearly communicate with insurers the number and types of ratings questions that are being raised, and how these questions are being addressed. In addition, the Undersigned suggest that the process be revisited in the future (perhaps annually) so that Regulators, the IAO, and Industry can collectively assess what is working well, and where the process can be enhanced. To the extent that (E) Committee is developing a due diligence framework to manage and oversee use of CRP ratings, these regular evaluations would also help ensure that the ratings discretion process is aligned with (E) Committee's framework and objectives.

The Undersigned feel that incorporating the suggestions above would create a process that strikes an appropriate balance.<sup>1</sup> The enhanced process recognizes Regulators' desire for oversight and discretion over the FE process, but includes enough checks, balances, and involvement from insurers to ensure clear transparency and provide due process. Implementing the suggested changes would help minimize uncertainty for insurers and prevent unnecessary capital market disruption. The Undersigned appreciate the chance for input and the significant enhancements that have already been included in this exposure. We hope that Regulators will incorporate our recommended enhancements in the spirit of providing strong due process and transparency.

Note that in Appendices A & B, the Undersigned have provided a revised list of steps along with proposed edits to the P&P Manual that align with our comments and requested changes. Suggested deletions to P&P Manual language are indicated with ~~strikethroughs~~. Additions are highlighted in blue. We stand ready to work constructively with the NAIC to discuss our ideas further and implement changes.

Sincerely,



Mike Monahan  
ACLI



Tracey Lindsey  
NASVA



John Petchler  
on behalf of PPIA Board of Directors

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

<sup>1</sup> The Undersigned have focused most of our commentary on high-level observations regarding the proposed ratings discretion process and on the related P&P Manual changes needed to support this process. In our discussions, implementation questions were raised, such as whether we might need additional codes beyond the two new codes proposed in the exposure. In the interest of moving the process forward, we have chosen not to focus on implementational details in our response letter. We feel it is in all stakeholders' interests to agree on the appropriate procedural steps first and can work through details like codes or other implementation issues later. NASVA has agreed to create flow charts, once a final process is set, which will help identify any details that have yet to be addressed.

<sup>2</sup> The American Council of Life Insurers (“ACLI”) is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI’s member companies are dedicated to protecting consumers’ financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI’s 280 member companies represent 94 percent of industry assets in the United States. For more information, visit [www.acli.com](http://www.acli.com).

<sup>3</sup> The Private Placement Investors Association (“PPiA”) is a business association of insurance companies, other institutional investors, and affiliates thereof, that are active investors in the primary market for privately placed debt instruments. The association exists to provide a discussion forum for private debt investors; to facilitate the development of industry best practices; to promote interest in the primary market for privately placed debt instruments; and to increase accessibility to capital for issuers of privately placed debt instruments. The PPiA serves 66 member companies and works with regulators, NASVA, the ACLI, the American College of Investment Counsel, and the investment banking community to efficiently implement changes within the private placement marketplace. For more information, visit [www.usppia.com](http://www.usppia.com).

<sup>4</sup> The National Association of Securities Valuation Analysts (“NASVA”) is an association of insurance company representatives who interact with the NAIC Securities Valuation Office (“SVO”) to provide important input, and to exchange information, in order to improve the interaction between the SVO and its users. In the past, NASVA committees have worked on issues such as improving filing procedures, suggesting enhancements to the NAIC’s ISIS electronic security filing system, and commenting on year-end processes.

## Appendix A

The Undersigned have included a revised list of process steps below, that reflect our suggested changes to the proposed ratings discretion process. We have started with the IAO's outlined process and edited accordingly. Deletions are indicated with ~~strikethroughs~~ while additions are highlighted in blue.

- 1) SVO staff identifies a FE security with an NAIC Designation determined by a rating that appears to be an unreasonable assessment of risk.
- 2) SVO Senior Credit Committee (SCC) meets to determine if it agrees that the rating appears an unreasonable assessment of risk and, if so, places the security "Under Review". [Please list who will comprise the SVO SCC. We assume it will include the Heads of the SVO and SSG, General Counsel of the SVO, and the Heads of Credit at the SVO?]
- 3) If the SVO SCC votes to put the security "Under Review" an information request will be sent through VISION to insurers that hold that security in their VISION portfolio and an the SVO Administrative Symbol assigned to identify them in VISION and AVS+.
- 4) If the information request is not responded to, the SVO may reach out to the domiciliary Chief Financial Examiner.
- 5) Upon receipt of all necessary documentation through the information request, the SVO will then perform a full analysis of the security and coordinate with the interested insurer(s) on any questions or issues the SVO may have about the security.
- 6) SVO SCC re-convenes and determines, based on its full analysis of all necessary information, whether the FE NAIC Designation is three (3) or more notches different than the SCC's opinion.
- 7) If the SVO SCC opinion differs from the FE produced NAIC Designation Category by a material three (3) or more notches, ~~the specific ratings for that security will be removed from FE.~~ the SCC will present its analysis to a Sub-group of the Task Force to provide oversight over the FE removal process. As part of this process:
  - a) An anonymized summary, detailing the regulatory concern or issue will be published on the SVO webpage or some other insurer-accessible location for transparency. This will be posted at quickly as possible, following Step 6, but no later than one week in advance of the meeting with the Task Force Sub-group. [Note: Insurers request samples of such summaries for securities/ratings where the IAO has concerns in advance of the effective date of this exposure; so, we can get a sense for how substantive such summaries will be.]
  - b) The IAO will notify insurers who hold the security with an Eligible CRP Credit Rating in question, of the meeting with the Task Force Sub-group. Insurers will be allowed to attend the meeting, at their option, and a designated spokesperson for the insurer will be allowed to speak or answer questions.
  - c) The Task Force Sub-group will then determine whether it or not it agrees with the SVO SCC's recommendation to remove a CRP rating from the FE process.
  - d) The anonymized summary that was posted in advance of the Task Force Sub-group review will be updated to reflect the Task Force Sub-group's decision.

~~8) The SCC will present its analysis to a sub-group of the Task Force to provide oversight over the FE removal process and enable the Task Force to provide feedback to the SVO.~~

8) If the Task Force Sub-group, as referenced in Step 7, disagrees with the SVO SCC's recommendation to override an Eligible CRP Credit Rating, then the specific CRP rating will remain in place for FE purposes.

If the Task Force Sub-group agrees with the SVO SCC's recommendation to override the CRP rating, and this decision occurs before October 1<sup>st</sup> of any calendar year, then the specific CRP rating will be removed from FE.

If the Task Force Sub-group agrees with the SVO SCC's recommendation to override the CRP rating, but this decision occurs on or after October 1<sup>st</sup> of any calendar year, then the insurers who hold the security must indicate to the IAO whether they wish to pursue an appeal. If the insurers wish to pursue an appeal, then the rating CRP rating in question will be designated with an additional disclosure code, indicating that the rating has been overridden by the SVO SCC and the Task Force Sub-group, but that an appeal is underway, such appeal of which must be resolved in the following calendar year. [NOTE: Please see our suggestion in the letter to potentially develop a new disclosure code for this purpose, or to work with the IAO to develop a mutually agreeable solution.]

9) If there are no alternative CRP ratings, the SVO SCC's assessment will be entered into VISION. If an alternative CRP rating ~~is subsequently received~~ already exists, it will be incorporated into the FE process, as applicable.

10) If the SVO SCC assesses the issue is part of a recurring pattern, the SVO Director will inform the ~~chair and decide if an issue paper, referral or amendment is needed.~~ Task Force Chair and decide a best course of action, whether that be an issue paper, referral or amendment, or further monitoring. This decision will be publicly communicated to provide transparency to stakeholders.

11) An anonymized summary of each unique issue or situation will be published on the SVO webpage or some other insurer accessible location for transparency.

12) An insurer may appeal to the Task Force chair if they believe the SVO did not follow the procedures outlined in the P&P Manual.

13) If an insurer(s) wishes to appeal the SVO SCC's analytical assessment, it may ~~request the NAIC's IAO to contract, at the insurer(s) expense, with an independent third-party acceptable to the NAIC IAO to perform a blind review of the security (e.g. without knowledge of the SCC's, insurer's or CRP's assessment) with the information provided through the information request. If the independent third-party review results in an NAIC Designation Category that is one (1) or less notches different from the FE produced NAIC Designation Category, then the SVO SCC's opinion will be overridden by the reinstatement of the CRP rating(s). If the independent third-party review results in an NAIC Designation Category that is more than one (1) notch different from the FE produced NAIC Designation Category, then the SVO SCC's opinion will remain.~~ do so by obtaining an additional Eligible CRP Credit Rating from a separate Eligible CRP Credit Rating Provider. This new CRP rating ~~which~~ will serve as a third, independent view of credit risk (in addition to the SVO SCC's analytical assessment and the original Eligible CRP Credit Rating which was overturned). For purposes of determining the final NAIC Designation, the IAO will take the second-lowest of all available risk assessments and used this to assign an NAIC-equivalent Designation which will also be used to determine capital requirements.

14) The SVO will identify through SVO Administrative Symbols when a CRP rating(s) has been removed from the Filing Exemption process for a security.

15) ~~At the Spring National Meeting, the SVO Director will summarize FE discretion actions take for the preceding year.~~ The SVO Director will prepare a report summarizing FE discretion challenges and actions in conjunction with each NAIC National Meeting. Such report will be shared publicly as part of the Task Force Agenda Materials. At the Spring National Meeting, the SVO Director will summarize FE discretion actions taken for the preceding year and will discuss with the Task Force any proposed changes to the ratings discretion process.

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

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

### **Determinations**

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

### **Directives**

81. The IAO shall:

- Recommend improvements to the production of NAIC Designations based on NRSRO credit ratings.
- Identify monitoring and communication procedures that enhance the possibility of regulatory intervention by the VOS/TF to respond to risks to insurer solvency posed by securities in the filing exempt population.

- Identify and develop correctives to the administrative, operational and system-based causes of reporting exemptions in the filing exempt process.
- Change the NAIC Designation equivalent calculated for filing exempt securities when necessary to correct errors or other anomaly that occur in the automated filing exempt process.
- Develop a staff-administered reporting exceptions resolution process that incorporates state insurance regulator and insurance companies' participation.
- In furtherance of the above directives, exclude specific otherwise Eligible NAIC CRP Credit Ratings from the automated filing exemption process in accordance with the administrative procedures outlined in Part Two of this Manual, if the IAO, following a self or state regulator-initiated review, determines the resulting NAIC Designation equivalent does not provide a reasonable assessment of risk for regulatory purposes.

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

## **SVO ORGANIZATION**

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### **SVO Administrative Symbols**

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

### **SVO Analytical Department Symbols**

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

...

- **UR** means the NAIC Designation assigned pursuant to the filing exemption process is under review by the NAIC's Investment Analysis Office.
- **DR** means that one or more otherwise Eligible NAIC CRP Credit Ratings have been removed from the filing exemption process when determining the NAIC Designation through the IAO's discretion procedures.

## **PROCESS FOR PLACING A FILING EXEMPT SECURITY UNDER ANALYTICAL REVIEW FOR POSSIBLE REMOVAL FROM FILING EXEMPTION**

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### **Overview**

164. This section outlines the process by which a state insurance regulator or IAO staff can contest an NAIC Designation Category assigned through the filing exemption process which it thinks is not a reasonable assessment of risk of the security for regulatory purposes.

**(Note: The guidance in this part is effective as of January 1, 2025, but this date may be amended if additional time is needed to implement the necessary NAIC technological enhancements to IAO systems.)**

### **Request for Information**

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

166. The SCC will convene to determine if, in its opinion, the NAIC Designation Category assigned pursuant to the filing exemption process is a reasonable assessment of risk of the security for regulatory purposes. As part of its review, the SCC may consider observable factors, among others, such as (i) a comparison to peers rated by different CRPs, (ii) consistency of the security’s yield at issuance or current market yield to securities with equivalently calculated NAIC Designations rated by different CRPs, (iii) the IAO’s assessment of the security applying available methodologies, and (iv) any other factors it deems relevant. If the SCC’s opinion is that the assigned NAIC Designation Category is likely a reasonable assessment of risk of the security for regulatory purposes, no further action will be taken at that time. If the SCC’s opinion is that the assigned NAIC Designation Category is likely not a reasonable assessment of risk of the security for regulatory purposes, an information request will be initiated and the security will be identified as “Under Review”.

167. The IAO will notify insurance company holders of a security determined to be a Filing Exempt Security “Under Review” by issuing an information request and publishing a separate SVO Analytical Department Symbol of “UR” for Under Review in NAIC systems for that security that will not be reported on the statutory investment schedules. The purpose of the information request is to provide the IAO staff with sufficient information to perform a full analysis of the security. Consistent with the informational deficiencies instructions in this Manual, security information consistent with an Initial Filing should be provided to the IAO within 45 days, unless an extension has been granted to the insurance company by the IAO, not to exceed 90 days in total from the date that the IAO issues an information request. The IAO may contact the insurance company’s domiciliary chief financial regulator for assistance after the initial 45 days if there has been no meaningful response. If after 90 days additional information equivalent to a complete filing has not been provided to the IAO, the IAO may proceed with removal of the otherwise Eligible NAIC CRP Credit Rating(s) from the Filing Exempt process.

#### **Full Review**

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

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

#### **Materiality Threshold for IAO Analysis**

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

171. The IAO will consider the materiality of the difference between the Eligible NAIC CRP Credit Rating used in the filing exempt process and the IAO’s own assessment of the risk. The IAO will continue with the process of determining whether removal of an otherwise Eligible NAIC CRP Rating from the Filing Exempt process is appropriate, ~~remove an otherwise Eligible NAIC CRP Credit Rating from the Filing Exemption process~~ only if the SCC determines, based upon its review, that the Eligible NAIC CRP Credit Rating for the security is three (3) or more notches different than the IAO’s assessment (e.g. NAIC Designation Category 1.G versus 2.C) (the “Materiality Threshold”).

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

172. Regardless of the VOS/TF's sub-group's decision (as discussed in item 173 below), IAO staff will post an anonymized summary of each unique CRP ratings issue and challenge on its webpage or some other insurer-accessible location. The summary will anonymize the name of the security and the Eligible CRP's rating (instead discussing the CRP rating in terms of NAIC Designation-equivalents); however, the summary will be detailed enough to describe the nature of the security, the regulatory or ratings methodology concern, and (after being reviewed by the VOS/TF sub-group as discussed in in item 173 below) whether the VOS/TF sub-group determined the rating should be reaffirmed or overturned.

173. The SCC shall discuss and explain its analytical basis for any Eligible NAIC CRP Credit Rating being removed from Filing Exemption eligibility with a sub-group of the VOS/TF (the composition of which ~~to~~ will be determined by the VOS/TF chair). The SCC will notify the insurers who hold the security or transaction. The insurers may voluntarily attend this meeting, at their option, and a spokesperson for the insurers may present at this meeting or answer questions from VOS/TF. ~~for so long as the VOS/TF chair deems such meetings necessary.~~

174. The VOS/TF sub-group will determine whether or not it agrees with the SCC's recommendation to remove the Eligible CRP Credit Rating in question from Filing Exemption eligibility. Should the VOS/TF sub-group agree, the IAO will remove an otherwise Eligible NAIC CRP Credit Rating from the Filing Exemption process, unless the VOS/TF decision occurs on or after October 1<sup>st</sup> of any calendar year and the insurers who hold the security wish to appeal the decision. [Interim solution for this scenario to be developed jointly with IAO.] Should the VOS/TF sub-group disagree, then the Eligible CRP Credit Rating will stand.

175~~3~~. If the SCC identifies that there is a recurring analytical pattern or concern, the IAO Director(s) will inform the VOS/TF chair and decide together an appropriate course of action. Should the SCC and the VOS/TF Chair determine that ~~if~~ an issue paper, referral, amendment to this Manual, or some other action is needed, this will also be documented on the SVO's webpage or some other insurer-accessible location.

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

176~~4~~. If the IAO SCC determines that the NAIC Designation Category assigned pursuant to the Filing Exemption process *does not* meet the Materiality Threshold, the Eligible NAIC CRP Credit Rating shall remain eligible for Filing Exemption, the SVO Analytical Department Symbol "UR" will be deactivated, and no further action will be taken at that time. The IAO's determination to maintain the filing exemption eligibility of an Eligible NAIC CRP Credit Rating shall not preclude the IAO from placing the same Eligible NAIC CRP Credit Rating

under analytic review at a later date following a subsequent review should changing conditions warrant.

177~~5~~. If the IAO SCC determines that the NAIC Designation Category assigned pursuant to the Filing Exemption process *does* meet the Materiality Threshold, *and the IAO SCC has presented the Eligible CRP Credit Rating in question to VOS/TF and received approval from VOS/TF to proceed*, then the IAO will block the otherwise Eligible NAIC CRP Credit Rating in NAIC systems to prevent it from using the automated Filing Exempt Securities Process.

178~~6~~. If an Eligible NAIC CRP Rating has been removed from Filing Exemption eligibility for a security according to this section and the security has another Eligible NAIC CRP Rating which has not been removed or one is subsequently received, then the security can receive its NAIC Designation Category through the Filing Exemption process based on the other Eligible NAIC CRP Rating(s). If there is no alternate Eligible NAIC CRP Rating in NAIC systems, the SCC's NAIC Designation Category will be entered into NAIC systems to assign an NAIC Designation Category to the security.

179~~7~~. As noted in this Manual, any insurer that owns a security for which the SVO has provided an NAIC Designation, a classification or a valuation, may request a clarification of the decision from the SVO (Requests for Clarification of SVO Decisions).

### **Use of Second CRP Eligible Credit Rating as a Form of Potential Appeal**

180. At any time in the process, insurers may obtain and file a second CRP Eligible Rating for the security in question with the SVO. When two or more Eligible CRP Credit Ratings are available, and the NAIC Designation Category recommended by the SCC differs from both of these ratings, the SCC will defer to the second-lowest of all available risk assessments (whether a CRP rating or the IAO's recommended designation) to determine the final assigned NAIC Designation Category.

181. Should that second-lowest risk assessment be one of the two or more Eligible CRP Credit Ratings, the IAO will allow that second-lowest rating to remain part of the Filing Exemption process, but will block the higher Eligible CRP ratings in NAIC systems, to prevent that highest CRP rating from using the automated Filing Exempt Securities Process. Should the IAO's recommended NAIC designation be the second-lowest view of risk, then the IAO will delete all otherwise Eligible NAIC CRP Credit Ratings in NAIC systems to prevent them from using the automated Filing Exempt Securities Process.

182. Once the process is final, the IAO will update and finalize its ~~also publish an~~ anonymized summary of each unique situation encountered for the securities and ratings subject to removal from Filing Exemption Eligibility and publish it on an insurer-accessible web location.

### **Appeal to the VOS/TF**

183~~7~~. An insurer that thinks the IAO did not make its Filing Exemption determination regarding the insurer's security in accordance with the procedures in this Manual ~~it~~ may

request consideration of the concern by the VOS/TF pursuant to “Review of SVO Decisions by the VOS/TF” in this Manual.

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### **Analytical Appeal to an Independent Third-party**

~~179. An insurer that disagrees with the SCC’s final analytical assessment may request, at its own expense, that the NAIC’s IAO contract with an independent third-party acceptable to the IAO to perform a blind analysis of the security (e.g. without knowledge of the SCC’s, insurer’s or CRP’s assessment) based upon the information provided through the information request and consistent with the objectives and purposes of an NAIC Designation Category.~~

~~180. If the independent third-party’s assessment results in an NAIC Designation Category that differs from the NAIC Designation Category assigned pursuant to the Filing Exemption process by no greater than a one (1) notch, the originally assigned NAIC Designation Category will remain in force and the Eligible NAIC CRP Credit Rating remain eligible for Filing Exemption.~~

~~181. If the independent third-party’s assessment results in an NAIC Designation Category that that differs from the NAIC Designation Category assigned pursuant to the Filing Exemption process by greater than one (1) notch, the SCC’s opinion will remain in force and the Eligible NAIC CRP Credit Rating will remain ineligible for Filing Exemption.~~

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

184~~2~~. If an insurer would like the IAO to re-evaluate an Eligible NAIC CRP Credit Rating that was removed from Filing Exemption Eligibility for possible reinstatement in a subsequent filing year, it can follow the operational steps outlined in Appeals of SVO Determinations in this Manual to submit the request.

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

185~~3~~. For each NAIC National Meeting ~~t~~<sup>h</sup>e IAO Director(s) will prepare and discuss a summary of the removed from Filing Exemption Eligibility actions taken since the last summary, and publish this summary on its web page or in some other insurer-accessible location ~~over the prior calendar year.~~

~~184. The IAO will also publish an anonymized summary of each unique situation encountered for the securities subject to removal from Filing Exemption Eligibility and publish it on an insurer-accessible web location.~~

186. VOS/TF and the IAO will revisit the process of removal of Eligible CRP Credit Ratings annually, and propose changes, as necessary, to continue to refine the process.

187. To facilitate transparency as to the SVO’s application of discretion, the SVO Analytical Department Symbols “DR’ will be added in NAIC Systems to securities with a blocked

otherwise Eligible NAIC CRP Credit Rating(s). The SVO Analytical Department Symbols, "DR" *will be* reported on the insurer's statutory investment schedules for the effected security as SVO Administrative Symbols.



January 26, 2024

VIA ELECTRONIC SUBMISSION

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

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

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

The American Investment Council (“AIC”)<sup>1</sup> appreciates the opportunity to comment on the proposed *Amendment to the Purposes and Procedures Manual (“P&P Manual”) of the National Association of Insurance Commissioners (“NAIC”) Investment Analysis Office (“IAO”) Authorizing the Procedures for the NAIC Securities Valuation Office’s (“SVO”) Discretion Over NAIC Designations Assigned Through the Filing Exemption (“FE”) Process* (“Proposed Amendment”)<sup>2</sup> that was released for public comment during the Task Force’s December 2, 2023 meeting. As noted in our October 9, 2023 letter<sup>3</sup> to the Financial Condition (E) Committee regarding its draft *Framework for Regulation of Insurer Investments – A Holistic Review* (“Framework Memo”),<sup>4</sup> we support a comprehensive, methodological and holistic review of the myriad of recent investment-related initiatives undertaken by various NAIC working groups and

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

<sup>2</sup> The Proposed Amendment is available at: <https://content.naic.org/sites/default/files/inline-files/2023-005.15%20P%26P%20SVO%20Discretion%20-%20Revised%20v4.pdf>.

<sup>3</sup> Our October 9, 2023 letter is available at: <https://www.investmentcouncil.org/aic-comment-letter-to-e-committee-re-holistic-framework/>.

<sup>4</sup> The Framework Memo is available at: [https://content.naic.org/sites/default/files/inline-files/Framework%20for%20Investments%20Exposed%20by%20E%20Committee\\_0.pdf](https://content.naic.org/sites/default/files/inline-files/Framework%20for%20Investments%20Exposed%20by%20E%20Committee_0.pdf).

task forces (including this Task Force), and commend state insurance regulators for recognizing the need to conduct a holistic review of those initiatives.

As you are aware, the Framework Memo includes a recommendation that the NAIC “retain overall utilization of [Credit Rating Providers (“CRPs”)] with the implementation of a strong due diligence framework” as a “primary focus of the NAIC.” While the Framework Memo also notes that the SVO should retain the ability to perform individualized credit assessments and utilize regulatory discretion, that function is referred to as a “backstop” that should only be utilized “rarely” and “under well-documented and governed parameters.” To that end, we respectfully ask that the Task Force reconsider (i) whether implementing the current iteration of the Proposed Amendment before establishing a CRP due diligence framework or determining whether CRP ratings are fit for purpose is consistent with the principles set out in the Framework Memo, and (ii) whether adopting the current iteration of the Proposed Amendment would satisfy the E Committee’s underlying charge to establish criteria in the foregoing context that “ensure greater consistency, uniformity, and appropriateness to achieve the NAIC’s financial solvency objectives.”

**I. A Strong CRP Due Diligence Framework Should be the Task Force’s Initial Focus**

We agree with the E Committee’s recommendation, as set out in the Framework Memo, that the “primary focus” of any NAIC initiative related to CRP ratings should be the establishment and maintenance of a CRP due diligence framework. Further, in light of the resource constraints noted in the Framework Memo, we recommend that this due diligence framework be prioritized over the expansion of the SVO’s individualized credit assessment function contemplated by the Proposed Amendment. We also propose that individualized credit assessments only be utilized where the CRP due diligence process indicates that CRP rating for one or more investments is not fit for purpose.

Prioritizing a CRP due diligence framework is consistent with the Framework Memo’s objective of deploying the “most effective use of regulatory resources in the modern environment of insurance regulation for investments.” As the Task Force is aware, and noted in public meetings, it would be inefficient and costly to replicate CRP functions such as the maintenance of robust, public methodologies, considerable expertise and resources, and other compliance-related functions associated with U.S. Securities and Exchange Commission (“SEC”) oversight and reporting obligations.<sup>5</sup> As a result of these highly-regulated functions, CRP ratings also provide certainty and, in many cases, liquidity for investments. The current FE system promotes competition among CRPs and facilitates investor access to a variety of opinions on individual credits and methodologies. As drafted, the Proposed Amendment would, in many instances, serve to replace those existing checks and balances with the SVO’s own judgment, creating market uncertainty and potential illiquidity.

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<sup>5</sup> For example, CRPs are required to certify and disclose rating methodologies, conflicts of interest and internal controls.

## **II. A Transparent Analysis of the Need for the Proposed Amendment Should Precede Consideration of the Proposed Amendment**

Given that the NAIC has not identified specific gaps or flaws in CRP methodologies or widespread ratings failures that render CRP ratings unfit for purpose, we respectfully suggest the Proposed Amendment would create more problems than it solves. It is incumbent upon the NAIC to provide additional insight into the specific concerns that necessitate the Proposed Amendment in the first instance. This additional insight should include anonymized examples where ratings have been found to be unfit for purpose, the rationale supporting such analysis and the best path forward to address such issues in a targeted way that does not create market uncertainty. If such an analysis ultimately concluded that one or more CRP ratings are not fit for purpose, regulators should first explore whether other, less intensive, more transparent, and more standardized adjustments to the pre-existing FE and designation processes could cure the defect.

To date, we are not aware of any public initiative to determine whether CRP ratings are fit for purpose (either broadly or specific to certain assets) nor are we aware of any initiative to establish the underlying criteria to make such a determination. Further, as suggested by the Framework Memo, regulatory concerns related to CRP reliance can be addressed through the CRP due diligence analysis already underway, as well as through other tools that are already available to regulators. We do not believe there is a need for the SVO to challenge individual security designations.

## **III. The Proposed Amendment May Not Satisfy the Underlying E Committee Charge**

The Task Force's charge with respect to the present workstream is to "establish criteria to permit staff's discretion over the assignment of NAIC designations for securities subject to the FE process to ensure greater consistency, uniformity, and appropriateness to achieve the NAIC's financial solvency objectives." It is not clear, however, how the Proposed Amendment would satisfy that charge. On its face, the current proposal would appear to ensure *less* consistency and uniformity, and we are not aware of any public study or analysis that outlines how the proposal ensures greater appropriateness than the current CRP-rating-based FE process. Further, the Proposed Amendment does not include any language indicating that the SVO would only use discretion as a "backstop", nor does the Proposed Amendment contain "well-documented" parameters for how the SVO will utilize this discretion.

Rather, the Proposed Amendment appears to insert an opaque decision-making process into an otherwise relatively consistent, uniform, and appropriate process. Specifically, rather than a set of pre-established criteria, the Proposed Amendment's process for placing an FE security under review relies heavily on the opinions of SVO staff and those of an undefined Senior Credit Committee ("SCC")<sup>6</sup>, as to whether the NAIC Designation Category assigned pursuant to the FE process is a "reasonable assessment of risk of a security for regulatory purposes" (Proposed Amendment at ¶¶ 165, 166). To that end, as part of the NAIC's financial solvency objectives, we believe that the Task Force should be more integrally involved in making a decision about whether

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<sup>6</sup> Per an SVO report to the Task Force during the 2023 Fall National Meeting, it appears that the SCC is expected to be comprised entirely of SVO staff, however the composition of the SCC is not defined in the Proposed Amendment itself.

a CRP rating represents a reasonable assessment of risk of a security under review and, in any event, the Proposed Amendment should specify the composition of the SCC.

#### **IV. Conclusion**

Implementing fundamental changes to the investment regulatory framework without first addressing these critical considerations could have serious consequences and unnecessarily deprive insurers of vital investment options. ***In light of these considerations, we ask the Task Force to first consider whether CRP ratings are fit for purpose and urge you to assess whether additional, more foundational, work is required prior to considering the Proposed Amendment.*** Should the NAIC decide to proceed with this Proposed Amendment, we urge regulators to alter the proposal to facilitate an immediate appeal to a domestic regulator, and permit appeal to a mutually agreed upon third party funded by the NAIC. We also urge regulators to engage an independent third party to audit the implementation of any final proposal, and to audit the SVO, including their investment review policies, procedures, methodologies (including any reliance on outside vendors), and surveillance of securities assigned an NAIC designation. This independent third party should also identify and assist regulators in eliminating any conflicts of interest with respect to the SVO's review of insurance company investments. Thank you for your consideration of these comments. We look forward to continuing to work with you on these important issues.

Sincerely,

/s/ Rebekah Goshorn Jurata  
General Counsel  
American Investment Council



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January 26, 2024

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

*Re: Amendment to the P&P Manual of the NAIC Investment Analysis Office Authorizing the Procedures for the SVO's Discretion Over NAIC Designations Assigned Through the Filing Exemption Process*

Dear Ms. Mears and Task Force Members,

Clearly the NAIC should not rely “blindly” on decisions of others, even regulated rating agencies, so it is reasonable to develop the means to evaluate the reliability of the credit ratings used by the NAIC. The Proposal as written describes one way of doing this but it is prudent to consider not just one approach but also whether there are better alternatives.

There actually is an alternative to the Proposal that would use objective, quantitative and unbiased measures to identify potential issues based on the persistency of ratings. It is relatively simple to administer and it addresses many of the problems inherent in the Proposal. It would:

- Use scarce resources to perform due diligence on rating agencies rather than attempting to reproduce their work by “synthesizing CRP functions” (as advocated in the Financial Condition [E] Committee’s draft “Framework for Regulation of Insurer Investments – A Holistic Review”)<sup>1</sup>
- Provide an objective means for assessing the reliability of what are actually opinions of credit quality by using facts and quantitative analysis
- Provide a means for evaluating the full range of rated securities out of a population of hundreds of thousands and not just a relative handful, one by one
- Conserve “limited regulatory resources” of the VOS/TF and the SVO (as in ¶80 of the Proposal) by eliminating lengthy and complicated reviews
- Offer transparency into the positions and decisions of the NAIC
- Avoid putting insurers in the position of having to justify the credit opinions of NRSROs without their direct participation and involvement
- Require minimal involvement of regulators, acting as VOS/TF members, by not requiring them to resolve what amount to differences of opinions between their staff and insurers

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<sup>1</sup> <https://content.naic.org/sites/default/files/inline-files/Framework%20for%20Investments%20Exposed%20by%20E%20Committee.pdf>

- Avoid putting the NAIC itself in the position of publicly picking winners and losers among competing NRSROs on the basis of opinions rather than facts
- Avoid unnecessary confrontation and
- Minimize market disruption and delays in rendering decisions that would adversely affect markets

### **The Better Alternative -- A Quantitative and Unbiased Method**

There is an alternative that the VOS/TF should consider. It measures explicitly how well ratings meet the ultimate test -- and that is the test of time. Measuring persistency would separate “good” ratings from “bad” ratings -- the good ones are the ones that are durable and persist through time. This approach addresses every one of the concerns listed above.

Data is the key. Actual performance data provides a much more reliable and justifiable method for identifying potential problems than conducting challenges and debates over how opinions are determined.

Data is available. A key part of the reforms imposed on NRSROs by the SEC is its requirement for uniform and systematic reporting of ratings “transitions”, which are rating upgrades and downgrades. For many years all NRSROs have provided their performance statistics to the public in standardized formats as required by their regulator. Actual performance is the best method of determining the quality of a rating.

There has been some informal criticism by staff of SEC-mandated data. If, on review, the VOS/TF concludes that this historical data provides a reasonable basis for making decisions then it would be relatively simple to use it to identify ratings that are not reliable for a broad range of asset types and from certain rating agencies.

Should the NAIC decide for some reason that it needs more than SEC data then it can essentially do this itself. It can use its own data to examine ratings transitions over time for Filing Exempt securities. This would involve somewhat more effort than using what is immediately available but it, too, would produce objective results based on data and not require subjective evaluations of various opinions. Either way, data is the key.

### **Problems in the Proposal, as Exposed, Are Solved by This Alternative**

The Proposal suffers from every one of the defects listed above and more. The SVO provides Designations for only about 10,000 out of the hundreds of thousands of bonds owned by insurers. How is it reasonable to expect that challenges made one-by-one will efficiently uncover situations where ratings may be unreliable especially where the SVO is already so obviously overburdened? The selection process as proposed singles out higher-yielding bonds but doesn't account for the reasons they may offer better returns<sup>2</sup> and this will cause significant inefficiencies and potential negative bias. Opinions generated by the SVO are based on much less information than what is available to the rating agencies whose ratings they are challenging, especially for private placements, so this introduces another source of potential negative bias in SVO analyses. Insurers

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<sup>2</sup> According to the Report of the Risk Subgroup of the Invested Asset Working Group of the NAIC Valuation of Securities Task Force, August 26, 2008 these are: deferral, event, liquidity, call, extension, currency and leverage.

are expected to appear before the SVO to defend the decisions of rating agencies when the SVO itself can selectively choose certain provisions in an indenture without the demonstrating that its objections are based on a thorough analysis of the totality of the terms in the offering. And this is not a comprehensive list of problems.

### **Comparing the Proposal to this Alternative**

The question for the VOS/TF is not whether either approach is “perfect”; just which one is better at evaluating the reliability of rating agency ratings. The Proposal relies very heavily on the efficacy of its screening process because of the relatively limited capacity to examine securities in detail. Flagging too many securities will be wasteful and too few will miss potential risks. The alternative would evaluate the full universe of FE securities. Under the Proposal the NAIC staff would challenge NRSRO rating opinions and if an insurer disagreed and then the insurer itself would be required to defend the opinion of the rating agency. The only party between the adversaries would be regulators serving on the VOS/TF. The alternative is much better aligned with the essence of the Financial Condition Committee’s Framework draft and would not require the NAIC to “synthesize” the functions of rating agencies. It would also not put the VOS/TF in between two parties disagreeing about opinions. Under the Proposal, after a long and complicated decision process, the NAIC would either accept or publicly reject the rating opinion of a rating agency in favor of the opinion of its own staff. The alternative avoids this by using objective data to identify what could be broader, more systematic problems with ratings that need attention along the lines laid out in the Proposal itself.

### **Summary**

There is an alternative to the Proposal that seems much better. The ultimate purpose is to determine if ratings are unreliable and action is needed. This alternative accomplishes that. It is conceivable that at some point regulators serving as VOS/TF members will discover that they must make difficult decisions regarding rating agencies. Hopefully this will not be the case, but if it is then even those members with expertise in assessing the creditworthiness of potentially complex assets could find it challenging to decide objectively and impartially. Impartiality would be even more difficult if their staff support consisted of those who themselves are challenging ratings.

By adopting this alternative to the present Proposal the NAIC would be in a much better position to determine if action is needed, and then to follow through. Its decisions would be based on facts and data so it could demonstrate how it identified problems and, if necessary, reject what in the end it determines are unreliable opinions of creditworthiness. In short, by adopting this alternative approach it could determine and justify its decisions objectively





January 26, 2024

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

Via email: [ctherriault@naic.org](mailto:ctherriault@naic.org) and [dgenaol@naic.org](mailto:dgenaol@naic.org)

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

Dear Ms. Mears:

We appreciate the opportunity to provide feedback on the proposed Challenge Right. We are supportive of this concept and believe it will help to implement the Framework for Regulation of Insurer Investments' (the "Framework") goal of ending blind reliance on CRPs while allowing for the continuation of the FE process and avoiding replication of the significant capabilities of CRPs.

We offer the following perspectives regarding the implementation of the Challenge Right:

1. **"Rarely Used"**: As envisioned in the Framework, a "backstop" giving the SVO the ability to perform individualized credit assessments and utilize regulatory discretion under well-documented and governed parameters, "ideally would be rarely used if other governance is optimized." We believe SVO discretion should be used to eliminate outlier ratings and not to provide commentary or perspectives on asset classes or structures. The Challenge Right should not be used to substitute an internal model for the collective judgment of the rating agencies. If concern grows regarding broader asset classes or other market wide trends, we recommend that VOSTF/SVO should provide market commentary or issue requests for information to support analysis. These tools will be substantially more effective at addressing market concerns when compared to a series of individual security challenges.
2. **Transparency and Candor**: Transparency and candor are critical to a healthy regulatory environment – and equally important for insurers, regulators, and the SVO alike. We recommend that the SVO develop processes to ensure that its assessment methods and challenges are transparent to participants and rating agencies. We also recommend that the SVO continue to improve its communication protocols in conjunction with VOSTF so that market participants understand the nature and detail of regulatory concerns and challenges.

We believe that markets generally do adjust to objective regulatory concerns when they are fully understood.

3. **Improvement Over Time:** As with any new regulatory tool, unforeseen substantive and/or procedural issues may arise upon implementation. We recommend that VOSTF and the SVO review the performance of the Challenge Right on an annual basis to (i) ensure compliance with the P&P Manual, (ii) assess whether any improvements should be made and (iii) confirm that the principles of the Framework are being met, in particular, the principles of regulatory transparency and allowing multiple credit opinions to be acceptable in the market. This review should ensure that the Challenge Right does not indirectly result in a monocratic model or become a herding tool toward any specific rating agency or method.

Once again, we appreciate the opportunity to comment on this proposal.

Sincerely,



Michael Consedine  
Executive Vice President  
Head of US Government Relations & Regulatory Affairs

CC: Charles Therriault; Denise Genao

January 26, 2024

**Via email**

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

Egan-Jones Ratings Company ("Egan-Jones") appreciates the opportunity to comment on the above-referenced proposed amendment. As a threshold matter, we are concerned that in attempting to eliminate blind reliance on ratings, the market impact of the proposal may not have been fully considered. While we understand the NAIC desire to not blindly rely on credit ratings, we would submit the actual performance of the rating firms support the reliance placed on ratings by the Nationally Recognized Statistical Rating Organizations ("NRSROs"). We are also concerned that the Securities Valuation Office ("SVO's") role as a regulator who also is a market participant who issues designations, which are functionally equivalent to ratings, creates at least an appearance of a conflict that requires procedures that instill confidence in the market. Lastly, we believe that among other items, the current proposed amendments lack transparency and result in market uncertainty, which we believe has already affected the markets. In this letter, we address these concerns in more detail as well as ideas to improve the proposed amendments in the event that the NAIC chooses to go forward with some form of the proposed amendments.

**A. BACKGROUND AND OBSERVATIONS**

**1. The Usage of Ratings and the NAIC.** Ratings issued by an NRSRO are opinions regarding the probability of an obligor repaying their obligations on time and in full. While we understand that the Securities Valuation Office ("SVO") of the NAIC is currently also seeking to clarify the definition Designations, we believe that Designations effectively perform the same function as ratings. Since ratings pertain to future events, there is a possibility that future events are different than those expressed via an initial rating. However, ratings are updated at least annually (and more

frequently if there are material events/changes of which the NRSRO becomes aware) thereby providing the opportunity for changes if there is a material change in the obligor's financial condition.

**2. Concern with NRSRO Ratings** - The NAIC/SVO have raised concerns about the blind reliance on NRSRO ratings as the basis for implementing the proposed amendments. We would argue that there is little or no support for those concerns. One way to measure the accuracy of ratings is the probability of default implied by a certain rating level and the actual default realized. For example, if the one-year probability of default for a "B" rated instrument is 10% and an investor held 10 such instruments, the expectation is that one default would be realized at the end of the year (i.e., 10 times 10% = 1). If the actual defaults were materially greater than 1 and there was no material exogenous event, then one might conclude that the rating firm was *too liberal*. Given the fact that there is no effective difference between ratings and designations, both should be subjected to the same process for measuring accuracy.

Egan-Jones historical performance is set forth below and on **Appendix A** attached to this letter. What the white paper shows is that for 2023 is that the implied number of defaults that should have been expected based on the number of ratings issued was 60. In actuality, there were two defaults and both of those were covenant defaults as opposed to payment defaults. The result was amending covenants but zero payment defaults in the 2023 portfolio. Similarly, for the 2022 calendar year, 56 defaults should have been expected. In actuality, there was one default which again, was a covenant default and not a payment default. As shown by the information below and on **Appendix A**, if anything the ratings issued by Egan-Jones over the past two years were more conservative and not too liberal. (Note: see Appendix for Methodology.)

| <b>Year</b>              | <b>Outstanding Deals<sup>1</sup></b> | <b>Wtd avg probability of default</b> | <b>Expected (#)<sup>2</sup></b> | <b>Actual (#)<sup>3</sup></b> |
|--------------------------|--------------------------------------|---------------------------------------|---------------------------------|-------------------------------|
| <b>2024</b>              | 2,816                                | 2.6%                                  | 72                              | <i>TBD</i>                    |
| <b>2023</b>              | 2,545                                | 2.4%                                  | 60                              | 2                             |
| <b>2022</b>              | 2,167                                | 2.5%                                  | 55                              | 1                             |
| <b>2021</b>              | 1,547                                | 3.1%                                  | 48                              | 0                             |
| <b>2020</b>              | 1,209                                | 2.6%                                  | 32                              | 2                             |
| <b>2019</b>              | 733                                  | 1.9%                                  | 14                              | 0                             |
| <b>Total, excl. 2024</b> | <b>8,201</b>                         | <b>2.5%</b>                           | <b>209</b>                      | <b>5</b>                      |

<sup>1</sup> Outstanding ratings on January 1

<sup>2</sup> The expected default number is based on the issuer or obligor rating in the deal. If the issuer or obligor rating is not available, the highest rated instrument is usually picked for the deal.

<sup>3</sup> Based on information reported to Egan-Jones

The SVO has pointed to a study purporting to show that ratings firms at times offer ratings that are not identical for the same security, therefore claiming that ratings firms are “increasingly less reliable.” However, differing opinions among ratings firms does not imply “unreliability.” (See SVO Memorandum (Nov. 29, 2021)).

Assigning ANY provider of ratings/designations with the authority to over-ride others analysis is dangerous particularly when one does not have direct access to management including explanations of developments in mostly private firms.

**3. Regulator Role/Market Impact.** The SVO serves as a quasi-regulator in that it assists the state regulators/commissioners in overseeing the insurance industry. At the same time, it acts in certain cases as a market participant whereby it issues Designations for a fee. The Designations effectively compete with ratings issued by NRSROs. It is extremely unusual that a party serving in a regulatory role also acts as a market participant.

The current proposal provides the SVO with the ability to override ratings issued by NRSROs. We believe that because of the SVOs dual role, this proposal has already had a chilling effect on the markets as market participants are uncertain as to the potential impact of granting such power to the SVO. Possible effects of the proposal include encouraging issuers to use the SVO rather than risk having an investment impaired by an effective rating which is later cut by the SVO. To the extent issuers are not encouraged to use the SVO, they may be encouraged to rely only on ratings issued by the biggest firms as the SVO has stated on numerous occasions that it frequently uses large NRSRO methodologies, primarily Moody’s Investors Service (“Moody’s”) and Standard & Poor’s (“S&P”), when it reviews securities. The natural reaction of the markets is to gravitate towards the ratings of those firms or the SVO to avoid the risk of a rating being overridden by the SVO. The other risk is that the markets may exclude insurance company investors or not issue debt at all. Each of these results risk hurting the insurance companies and their policy-holders.

**4. Substantial Current Oversight of NRSROs.** NRSROs are currently regulated by the SEC. The SEC conducts thorough and widespread annual examinations of all NRSROs and is not hesitant to act when appropriate. For example, post the 2008 credit crisis, the major rating firms were fined over \$2B and forced to make major improvements in their operations in an effort to improve the quality and transparency of ratings. Furthermore, the Department of Justice (“DOJ”) has engaged in cases where it is deemed appropriate. For example, the DOJ intervened when S&P proposed a change in its methodology for rating insurance companies which would have the effect of discriminating against other rating firms, particularly against the non-dominant NRSROs.

In addition, the SEC regulations provide the NAIC with information on all of the NRSROs. Specifically, the NRSROs are subject to:

- (a) An annual examination by the SEC;
- (b) regulations governing conflicts of interest and other inappropriate actions to ensure independence of the ratings process; and

- (c) required disclosures on public website of every NRSRO of their models, methodologies and performance history so all of that information is already publicly available and transparent to any user of credit ratings.

## **B. PROPOSED ENHANCEMENTS TO THE PROPOSAL**

**1. Restructure the SVO and separate roles.** We believe that the dual role of the SVO has created market uncertainty and risks further disrupting the market to the detriment of insurance companies and their policyholders. Our recommendation is that to better assist regulators, the goal of the NAIC should be to implement the following:

- (a) Separate the SVO into a policy unit and an analytical unit.
- (b) The SVO analytical unit should meet similar standards as the SEC requires of the NRSROs.
- (c) The SVO policy unit would have access to independent research and should be tasked with considering the impacts to all stakeholders including the SVO analytical unit as it works with the VOSTF to formulate policy.
- (d) This restructuring described above would help mitigate and manage the conflicts of interest and separation of duties issues that are embedded in the current SVO structure.
- (e) Due to the level of concerned comments related to this proposal, a working group should be formed to serve as a forum for all affected stakeholders to provide input before a new version of this proposal is drafted.

**2. Specific comments/suggestions on the current proposal.** In addition to the restructuring, or in the event that the NAIC chooses to proceed without such a restructuring, we would suggest that the following comments be incorporated into the proposal in order to minimize the market impact. This is especially true given the concern of the multiple roles of the SVO:

- (a) Proper transparency must be required of the SVO to avoid unnecessary market disruptions. By transparency, we mean that there must be a written report issued by the SVO explaining why the rating is being overridden and discussing the model and methodologies used. It should state similar cases whereby a more accurate methodology would be appropriate and include complete financial projections for the determination of the appropriate rating. There can be no confidence in the analysis if there is no transparency and without this, the proposal must be withdrawn.
- (b) The proposal must be positioned in a way that is clear that it serves as a rarely used backstop that should be only used in situations when there is a material solvency impact on a specific insurer or a growing concentration to a unique type of investment.
- (c) Due process is critical. Because of the SVO's multiple roles in the process there needs to be an independent judge and the SVO cannot serve multiple roles as part of the same process.

- (d) The NRSROs should be allowed to participate in the process and defend their work. The NRSRO is the party in the best position to explain why the current rating was issued.
- (e) Until the process is complete (including any appeal), no communication should be made which could interpret a rating change/override which may not occur. To do otherwise could impact the markets prior to there being complete information.
- (f) All credit assessments (i.e., ratings issued by NRSROs, and Designations issued by the SVO) should be subject to the same process. This is why it's critical that an independent third-party be involved. Otherwise, the markets will assume that the SVO Designations are beyond question which could have the effect of directing business to themselves, thereby inappropriately increasing the SVO's revenues. There is no reason to believe that the SVO's credit assessments are better than those of the NRSROs and the potential for increasing their own revenues could impact the markets.
- (g) Consideration should be given to limiting the period of time that a rating can be challenged. At some point there should be certainty as to the rating and we would recommend 12 months from issuance.
- (h) The appeals process needs to be more clearly defined. The party hearing the appeal needs to be a neutral third party and jointly selected with the other interested parties. In addition, the legal issues associated with using another rating firms in this process should be carefully considered and we believe it may prove unworkable.
- (i) More consideration should be given as to where the SVO gets the authority to institute this policy. If this authority ultimately comes from the state insurance codes, then should the state regulators make the final decisions? The current proposal does not seem to provide the state regulators the ability to make the final determinations.
- (j) Determine if the NAIC has the resources to implement the proposal and whether this is the best approach for accomplishing the stated objective which is to ensure adequate risk-based capital.

We appreciate the opportunity to comment on the current proposal. We are available to discuss the proposed amendments along with our concerns and to work with the VOS Task Force/NAIC and/or SVO.

Sincerely

*Eric Mandelbaum*

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**APPENDIX A**



*Founded 1995*

**Egan-Jones: Outstanding Ratings Performance**

Egan-Jones Ratings was founded at the request of major institutional investors for the purpose of providing timely, accurate ratings. One measure of Egan-Jones’ success in delivering on its early promise is demonstrated below.

Egan-Jones’ ratings have out-performed expectations. Each rating has an imbedded probability of default within the next 12 months. Multiplying the number of outstanding ratings by each rating’s probability of default results in the expected number of defaults.

For example, if an investor holds 10 instruments for which the implied probability default is 10%, 1 default would be expected in the next 12 months (i.e., 10 instruments x 10% PD = 1).

| Year                     | Outstanding Deals <sup>4</sup> | Wtd. avg probability of default | Expected (#) <sup>5</sup> | Actual (#) <sup>6</sup> |
|--------------------------|--------------------------------|---------------------------------|---------------------------|-------------------------|
| <b>2024</b>              | 2,816                          | 2.6%                            | 72                        | <i>TBD</i>              |
| <b>2023</b>              | 2,545                          | 2.4%                            | 60                        | 2                       |
| <b>2022</b>              | 2,167                          | 2.5%                            | 55                        | 1                       |
| <b>2021</b>              | 1,547                          | 3.1%                            | 48                        | 0                       |
| <b>2020</b>              | 1,209                          | 2.6%                            | 32                        | 2                       |
| <b>2019</b>              | 733                            | 1.9%                            | 14                        | 0                       |
| <b>Total, excl. 2024</b> | <b>8,201</b>                   | <b>2.5%</b>                     | <b>209</b>                | <b>5</b>                |

Additional comfort can be derived from a study from the European Securities and Markets Authority (“ESMA”), which determined no notching for Egan-Jones’ ratings was appropriate.<sup>7</sup>

**Conclusion** - Egan-Jones has distinguished itself in providing timely, accurate ratings and is happy to discuss its approach and results.

<sup>4</sup> Outstanding ratings on January 1

<sup>5</sup> The expected default number is based on the issuer or obligor rating in the deal. If the issuer or obligor rating is not available, the highest rated instrument is usually picked for the deal.

<sup>6</sup> Based on information reported to Egan-Jones

<sup>7</sup> Source: <http://www.esma.europa.eu/regulation-and-policy/external-credit-assessment-institutions-ecai/draft-implementing-technical-standards-on-the-mapping-of-ecais-credit-assessments>

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Thomas R. Sullivan  
Sullivan Strategy and Advisory Services, LLC

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January 26, 2024

VIA ELECTRONIC SUBMISSION

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

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

Dear Ms. Mears,

As former regulators who are deeply invested in the efficacy of the state insurance regulatory system, we appreciate the opportunity to comment on the proposed *Amendment to the Purposes and Procedures Manual ("P&P Manual") of the National Association of Insurance Commissioners ("NAIC") Investment Analysis Office ("IAO") Authorizing the Procedures for the NAIC Securities Valuation Office's ("SVO") Discretion Over NAIC Designations Assigned Through the Filing Exemption ("FE") Process* that was released for public comment on December 2, 2023.

Based on our experience as regulators, who have been engaged in prior explorations of the filing exemption process, we appreciate regulators' need and responsibility to understand third-party ratings and have confidence that such ratings are an appropriate measure of investment risk, through an regulator-specific lens. We support recent prior proposals aimed at this goal, including the requirement that rating rationale reports be filed with the SVO to provide regulators with full available information underlying third-party ratings. We are confident that such ratings rationale reports will serve as an important source of information for regulators, given that under SEC regulations the methodologies used in private ratings cannot deviate from public methodologies that are subject to public notice and comment, and because, as we have seen, violations of this federal rule subject rating agencies to SEC enforcement actions.

We understand that regulators support an additional method of reviewing ratings on individual securities, and to that end, we also have specific suggestions on the December 2 proposal outlined below in redline form to the proposed process steps, as well as to the P&P manual itself. We hope that our suggestions are useful to regulators as you proceed.

Our comments are aimed to improve regulator understanding of SVO concerns, insurer and rating agency responses to those concerns, and allow for regulator decision-making in light of fulsome

information. We also suggest adding a mechanism to understand the outcomes of rating challenges over time and believe that reliance on an independent third party will increase understanding and confidence in this regime, to the benefit of all involved.

We share your desire to ensure that third-party ratings are an appropriate assessment of insurance investment risk, as you execute your mandate of policyholder protection and insurer solvency. As outlined in our proposed changes to the P&P Manual, the development around a process in the following key areas is vital. That is, the ability for the Domestic Regulator to be part of the entire process, a robust process that includes a regulator mechanism (sub-group VOSTF) for review of a particular FE security in question, and a mechanism that will allow a vigorous process in a case of appeal. As all of these proposed changes overlap with the broader work that is being conducted through the E Committee, we strongly urge the VOS Task Force to consider aligning your proposed changes with the broader initiative within the E Committee in order to put consistent governance practices in place.

We hope that our perspective is useful as you consider next steps and would be happy to discuss any aspect of our comments at your convenience. Thank you for your continued focus on these important issues and for your consideration of our views.

Sincerely,

Tom Sullivan

Kathy Belfi



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

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

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

DATE: November 3, 2023

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**Summary:** At the Summer National Meeting held on Aug. 14, 2023, the Task Force discussed an initial draft of a proposed amendment to the P&P Manual authorizing the procedures for the SVO's discretion over NAIC designations assigned through the filing exemption (FE) process. The Task Force directed the SVO staff to consider the feedback from Task Force members and interested parties and update the proposal. The revised amendment in this memorandum reflects the actionable comments received from Task Force members and interested parties that align with the following charges given to the Task Force from the Financial Condition (E) Committee (emphasis added):

- Identify potential improvements to the filing exempt (FE) process (the use of credit rating provider [CRP] ratings to determine an NAIC designation) to ensure greater consistency, uniformity, and appropriateness to achieve the NAIC's financial solvency objectives.
- Implement policies to oversee the NAIC's staff administration of rating agency ratings used in NAIC processes, including staff's discretion over the applicability of their use in their administration of FE.
- Establish criteria to permit staff's discretion over the assignment of NAIC designations for securities subject to the FE process (the use of CRP ratings to determine an NAIC designation) to ensure greater consistency, uniformity, and appropriateness to achieve the NAIC's financial solvency objectives.



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

- 1) SVO staff identifies a FE security with an NAIC Designation determined by a rating that appears to be an unreasonable assessment of risk.
- 2) SVO Senior Credit Committee (SCC) meets to determine if it agrees that the rating appears an unreasonable assessment of risk and, if so, places the security "Under Review".
- 3) If the SVO SCC votes to put the security "Under Review" an information request will be sent through VISION to insurers that hold that security in their VISION portfolio and an the SVO Administrative Symbol assigned to identify them in VISION and AVS+ and domiciliary regulator(s) for every insurer that holds the security and the sub-group of VOSTF (which must include domiciliary regulator(s) of affected insurers as interested regulators). Notification to affected insurers, affected CRPs, domiciliary regulators and such sub-group of VOSTF shall include the methodology the SVO used to determine the rating "appears to be an unreasonable assessment of risk." Notification to affected insurers shall also include the SVO's rationale for determining the selected methodology is appropriate for the review of this security type and specifically identify the basis for the determination of unreasonableness with reference to the methodology used by the CRP. This notification shall be considered confidential supervisory information. Upon notification, any domiciliary regulator may elect to participate in any further conversations regarding the security review. Conversations involving domiciliary regulators shall be treated as confidential supervisory information.
- 4) One insurer may satisfy the information request on behalf of all insurance company holders; however, if the information request is not responded to by [XX] days, the SVO may reach out to the all applicable domiciliary Chief Financial Examiners to request engagement from the insurance company holders of the security at issue.
- 5) Upon receipt of all necessary documentation through the information request, the SVO will then perform a full analysis of the security and coordinate with the interested insurer(s) and other relevant stakeholders, including the CRP that rated the transaction, on any questions or issues the SVO may have about the security or the methodology used by the CRP to analyze the security. If not already included per Step 3 above, any affected insurer may request the participation of its domiciliary regulator in these conversations.
- 6) SVO SCC re-convenes and determines, based on its full analysis of all necessary information, whether the FE NAIC Designation is three (3) or more notches different than the SCC's opinion.
- 7) If the SVO SCC opinion differs from the FE produced NAIC Designation Category by a material three (3) or more notches the specific CRP rating(s), the SVO will recommend to a sub-group of VOSTF (which must include domiciliary regulator(s) of affected insurers as an interested regulator) that the security should be removed from FE. -The involvement of the domiciliary regulator at each voting step avoids potential claims of improper

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- ~~delegation of authority under state law for that security will be removed from FE.~~
- ~~7)8) In making its recommendation to regulators, the SVO SCC shall identify in writing whether and why it believes the CRP methodology is not fit for purpose, the reason the SVO SCC's methodology is more appropriate than the CRP methodology at issue, whether the SVO SCC suggests that such CRP methodology be removed from use for FE securities and what the impact of such removal would be. The SVO SCC shall also disclose comments received from interested parties and whether and why such comments were incorporated into their final analysis.~~
- ~~9) The SCC will present its analysis to a sub-group of the Task Force to provide oversight over the FE removal process and enable the Task Force to provide feedback to the SVO.~~
- ~~8)10) Any party directly affected by the final determination shall have the right to be heard by the voting members of the applicable VOSTF sub-group. Such parties may request confidential regulator only meetings to preserve confidential supervisory information.~~
- ~~9)11) If the VOSTF sub-group determines by majority vote that the security should be removed from FE, each domestic regulator fails to override that decision, there if there are no alternative CRP ratings, the applicable VOSTF sub-group will present its recommendation to the VOSTF as a whole for a final determination. The VOSTF has final authority to approve or disapprove the subgroup's recommendation by a majority vote. If the VOSTF determines should be removed by FE and no affected insurer appeals within [30] days of notification of the vote, the SVO SCC's assessment security will be removed from FE will be entered into VISION. If an alternative CRP rating is subsequently received, it will be incorporated into the FE process, if applicable.~~
- ~~10) If the SVO SCC assesses the issue is part of a recurring pattern, the SVO Director will inform the chair and decide if an issue paper, referral or amendment is needed.~~
- ~~11) An anonymized summary of each unique issue or situation will be published on the SVO webpage or some other insurer accessible location for transparency.~~
- ~~12) An affected insurer may appeal on procedural or substantive grounds to a sub-group of the E Committee within 30 days of receiving notification of VOSTF sub-group vote. The E Committee sub-group shall include the E Committee chair and each domiciliary regulator. If the E Committee chair was previously included as a domiciliary regulator in reviewing the security at issue, the E Committee sub-group shall include the E Committee vice chair(s). the Task Force chair if they believe the SVO did not follow the procedures outlined in the P&P Manual.~~
- ~~13) As part of this appeals process, affected insurers have the right to be present in any discussion involving NAIC staff and regulators in accordance with NAIC procedures.~~
- ~~14) In support of its appeal, if an affected insurer(s), at its own expense, may provide third party analytical evidence in support of its position. Such third party may present its findings to regulators and NAIC staff as part of the appeals process. wishes to appeal the SVO SCC's analytical assessment, it may request the NAIC's IAO to contract, at the insurer(s) expense, with an independent third party acceptable to the NAIC IAO to perform a blind review of the security (e.g. without knowledge of the SCC's, insurer's or CRP's assessment) with the information provided through the information request. If the~~



~~independent third-party review results in an NAIC Designation Category that is one (1) or less notches different from the FE produced NAIC Designation Category, then the SVO SCC's opinion will be overridden by the reinstatement~~

~~13)15) The Executive Committee of the NAIC shall select an independent third-party auditor to oversee the implementation and efficacy of this process. The auditor shall conduct this review at least annually and produce a publicly available report. This report shall include: (1) a review of efficiency and reasonableness of the SVO's process, procedure and methodology for when a security is put "Under Review", removed from FE and/or subsequently surveilled, (2) an analysis of the vendors used by the SVO in this process, (3) any conflicts of interest present in the SVO's review and (4) an assessment of the capital markets impact on the totality of removing securities from Filing Exemption under this process. The auditor shall also publish a transition and stability study for all securities removed from FE using this process and designated by the SVO.~~



~~16) of the CRP rating(s). If the independent third party review results in an NAIC Designation Category that is more than one (1) notch different from the FE produced NAIC Designation Category, then the SVO SCC's opinion will remain. An anonymized summary of each unique issue or situation will be published on the SVO webpage or some other publicly accessible location for transparency. Such summary shall include the methodology used to trigger the SVO's initial review of the security and the material reasons the rating on the security was not reasonable assessment of risk and the material non-confidential comments received by stakeholders and the disposition of those comments by the applicable regulator sub-group. Such summary shall also include a certification that the SVO and applicable regulators complied with the removal from Filing Exemption review process outlined in this manual.~~

~~14)~~17) \_\_\_\_\_ The SVO will identify through SVO Administrative Symbols when a CRP rating(s) has been removed from the Filing Exemption process for a security.

~~15)~~18) \_\_\_\_\_ At the Spring National Meeting, the SVO Director will summarize FE discretion actions take for the preceding year.

**Recommendation:** It is expected that implementation of this process will require enhancements to NAIC's VISION and AVS+ applications. Funding for the application enhancements in the amendment, if adopted, will need to be approved by the Executive (EX) Committee and the initiative will need to go through the NAIC's development process. It could take 1-2 years before this proposal can be fully implemented. The SVO recommends adoption of this proposed amendment authorizing the procedures for the SVO's discretion over NAIC Designations assigned through the FE process with an effective date of January 1, 2025. The effective date can be amended, if needed, because of the dependency mentioned. The proposed text changes to P&P Manual are shown below with additions in red underline, and deletions in ~~red strikethrough~~ as it would appear in the 2022 P&P Manual format.



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## PART ONE

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

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|   |
|---|
| <b>POLICIES APPLICABLE TO THE FILING EXEMPTION (FE) PROCESS</b> |
|---|

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

#### **Determinations**

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

#### **Directives**

81. The IAO shall:

- Recommend improvements to the production of NAIC Designations based on NRSRO credit ratings.
- Identify monitoring and communication procedures that enhance the possibility of regulatory intervention by the VOS/TF to respond to risks to insurer solvency posed by securities in the filing exempt population.

- Identify and develop correctives to the administrative, operational and system-based causes of reporting exemptions in the filing exempt process.
- Change the NAIC Designation equivalent calculated for filing exempt securities when necessary to correct errors or other anomaly that occur in the automated filing exempt process.
- Develop a staff-administered reporting exceptions resolution process that incorporates state insurance regulator and insurance companies' participation.
- In furtherance of the above directives, exclude specific otherwise Eligible NAIC CRP Credit Ratings from the automated filing exemption process in accordance with the administrative procedures outlined in Part Two of this Manual, if the IAO, following a self or state regulator-initiated review, determines the resulting NAIC Designation equivalent does not provide a reasonable assessment of risk for regulatory purposes.

...



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

## **SVO ORGANIZATION**

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### **SVO Administrative Symbols**

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

### **SVO Analytical Department Symbols**

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

...

- UR means the NAIC Designation assigned pursuant to the filing exemption process is under review by the NAIC's Investment Analysis Office.
- DR means that one or more otherwise Eligible NAIC CRP Credit Ratings have been removed from the filing exemption process when determining the NAIC Designation through the IAO's discretion procedures.

## **PROCESS FOR PLACING A FILING EXEMPT SECURITY UNDER ANALYTICAL REVIEW FOR POSSIBLE REMOVAL FROM FILING EXEMPTION**

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### **Overview**

164. This section outlines the process by which a state insurance regulator or IAO staff can contest an NAIC Designation Category assigned through the filing exemption process which it thinks is not a reasonable assessment of risk of the security for regulatory purposes.

(Note: The guidance in this part is effective as of January 1, 2025, but this date may be amended if additional time is needed to implement the necessary NAIC technological enhancements to IAO systems.)

### **Request for Information**

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

166. The SCC will convene to determine if, in its opinion, the NAIC Designation Category assigned pursuant to the filing exemption process is a reasonable assessment of risk of the security for regulatory purposes. As part of its review, the SCC may consider observable factors, among others, such as (i) a comparison to peers rated by different CRPs, (ii) consistency of the security’s yield at issuance or current market yield to securities with equivalently calculated NAIC Designations rated by different CRPs, (iii) the IAO’s assessment of the security applying available methodologies, and (iv) any other factors it deems relevant. For the avoidance of doubt, the SCC will consider the same factors and use the same methodology for securities of the same or similar type. If the SCC’s opinion is that the assigned NAIC Designation Category is likely a reasonable assessment of risk of the security for regulatory purposes, no further action will be taken at that time on the security and a summary of the SCC’s opinion will be provided to a sub-group of the VOS/TF (which must include domiciliary regulator(s) of affected insurers as interested regulators). If the SCC’s opinion is that the assigned NAIC Designation Category is likely not a reasonable assessment of risk of the security for regulatory purposes, an information request will be initiated and the security will be identified as “Under Review”.

167. The IAO will notify insurance company holders of a security determined to be a Filing Exempt Security “Under Review” by issuing an information request and publishing a separate SVO Analytical Department Symbol of “UR” for Under Review in NAIC systems for that security that will not be reported on the statutory investment schedules. The IAO will also notify the domiciliary regulator(s) for every insurer that holds the security and all members of the sub-group of VOS/TF (for the avoidance of doubt such sub-group will include the domiciliary regulator(s) for each affected insurer as an interested regulator). In addition to notification in the NAIC systems, the SVO will send a notification to affected insurers, affected CRPs, domiciliary regulators and such sub-group of VOS/TF. Such notification- include the methodology the SVO used to determine the rating “appears to be an unreasonable assessment of risk.” Notification to affected insurers shall also include the SVO’s rationale for determining the selected methodology is appropriate for the review of this security type and specifically identify the basis for the determination of unreasonableness with reference to the methodology used by the CRP. This notification shall be considered confidential supervisory information. Upon notification, any domiciliary regulator may elect to participate in any further conversations regarding the security review. Conversations involving domiciliary regulators shall be treated as confidential supervisory information.

167.168. The purpose of the information request is to provide the IAO staff with sufficient information to perform a full analysis of the security. Consistent with the informational deficiencies instructions in this Manual, security information consistent with an Initial Filing should be provided to the IAO within 45 days unless an extension has been granted to the insurance company by the IAO, not to exceed 90 days in total from the date that the IAO issues an information request. One insurer may satisfy the information request on behalf of all insurance company holders; however, tThe IAO may contact the insurance company’s(ies’) domiciliary chief financial chief financial regulator for assistance after the initial 45 days if there has been no meaningful response. If after 90 days additional information equivalent to a complete filing has not been provided to the IAO, the IAO may proceed with removal of the otherwise Eligible NAIC CRP Credit Rating(s) from the Filing Exempt process.

### **Full Review**

168.169. At any time during the information request submission period or during the IAO’s subsequent analysis of the security, the insurance company holders of the security are encouraged to provide additional information to the IAO such as their internal analysis, presentations from the issuer, meetings with the issuer’s management team and any other information that may be useful or persuasive in the analysis of the security, including coordinating conversations with the CRP rating the transaction. The IAO will coordinate with the interested insurer(s) and other relevant stakeholders, including the CRP rating the security, on any questions or issues it may have about the security or the methodology used by the CRP to analyze the security. If not already included per

paragraph 167 above, any affected insurer may request the participation of its domiciliary regulator in these conversations.

~~169.~~170. Upon satisfactory receipt of the information through the information request, the IAO will perform a full analysis of the security during which time the SVO Analytical Department Symbol “UR” will remain in place but it will not be reported on the statutory investment schedules.

### **Materiality Threshold for IAO Analysis**

~~170.~~171. Upon completion of the IAO’s analysis, the SCC will reconvene to determine whether the NAIC Designation Category assigned through the automated filing exemption process is materially different from the SCC’s assessment of the security’s risk.

~~171.~~172. The IAO will consider the materiality of the difference between the Eligible NAIC CRP Credit Rating used in the filing exempt process and the IAO’s own assessment of the risk. The IAO may elect to remove an otherwise Eligible NAIC CRP Credit Rating from the Filing Exemption process only if the SCC determines, based upon its review, that the Eligible NAIC CRP Credit Rating for the security is three (3) or more notches different than the IAO’s assessment (e.g. NAIC Designation Category 1.G versus 2.C) (the “Materiality Threshold”).

## Valuation of Securities (E) Task Force Oversight

- ~~173. If the SCC disagrees with an Eligible CRP Credit rating by the Materiality Threshold, the SCC will recommend to a sub-group of VOS/TF (which must include domiciliary regulator(s) of insurance companies holding the security as interested regulators) that the security should be removed from Filing Exemption. The involvement of the domiciliary regulator at each voting step avoids potential claims of improper delegation of authority under state law. shall discuss and explain its analytical basis for any Eligible NAIC CRP Credit Rating being removed from Filing Exemption eligibility with a sub-group of the VOS/TF (the composition of which to be determined by the VOS/TF chair) for so long as the VOS/TF chair deems such meetings necessary.~~
174. In making its recommendation to regulators, the SCC shall identify in writing (a) whether and why it believes the CRP methodology is not fit for purpose, (b) the reason the SCC's methodology is more appropriate than the CRP methodology at issue, (c) whether the SCC suggests that such CRP methodology be removed from use for Filing Exempt securities and (d) what the impact of such removal would be. The SCC shall also disclose comments received from affected insurers and whether and why such comments were incorporated into its final analysis.
175. Any party directly affected by the final determination shall have the right to be heard by the voting members of the applicable VOS/TF sub-group. Such parties may request confidential regulator only meetings to preserve confidential supervisory information.
- 
- 172.—If the VOS/TF sub-group determines by majority vote that the security should be removed from Filing Exemption and each applicable domestic regulator fails to override that decision and there are no alternative Eligible CRP Credit Ratings, the applicable VOS/TF sub-group will present its recommendation to the VOSTF as a whole for a final determination. The VOS/TF has final authority to approve or disapprove the subgroup's recommendation by a majority vote. If the VOS/TF determines the security should be removed from Filing Exemption and no insurance company holding the security utilizes the appeals process outlined below within [30] days of notification of the VOS/TF sub-group vote, the security will be removed from Filing Exemption. For the avoidance of doubt, to the extent the domiciliary regulator of an insurance company that holds the security is not in the majority vote in the VOS/TF sub-group to remove the security from Filing Exemption, such domiciliary regulator shall retain the ability to overrule such vote and accept the rating for Filing Exemption for its own state regulatory purposes.
- ~~173.— If the SCC identifies that there is a recurring analytical pattern or concern, the IAO Director(s) will inform the VOS/TF chair and decide if an issue paper, referral, amendment to this Manual or some other action is needed.~~

## Assignment of NAIC Designation Category

- ~~174.~~176. If the IAO SCC determines that the NAIC Designation Category assigned pursuant to the Filing Exemption process *does not* meet the Materiality Threshold, the

Eligible NAICCRP Credit Rating shall remain eligible for Filing Exemption, the SVO Analytical Department Symbol “UR” will be deactivated, and no further action will be taken at that time. The IAO’s determination to maintain the filing exemption eligibility of an Eligible NAIC CRP Credit Rating shall not preclude the IAO from placing the same Eligible NAICCRP Credit Rating under analytic review at a later date following a subsequent review should changing conditions warrant; provided that the IAO will provide notification to the insurance companies holding the security what such changed conditions are and that the security is under review pursuant to this section of the P&P Manual.

~~175. — If the IAO SCC determines that the NAIC Designation Category assigned pursuant to the Filing Exemption process does meet the Materiality Threshold, the IAO will block the otherwise Eligible NAIC CRP Credit Rating in NAIC systems to prevent it from using the automated Filing Exempt Securities Process.~~

~~176.177. If an—the IAO SCC disagrees with one Eligible NAIC CRP Rating by the Materiality Threshold has been removed from Filing Exemption eligibility for a security according to this section and the security has another Eligible NAIC CRP Rating which has the IAO SCC not been not disagreed with by the Materiality Threshold removed or one is subsequently received, then the security can receive its NAIC Designation Category through the Filing Exemption process based on the other Eligible NAIC CRP Rating(s). If there is no alternate Eligible NAIC CRP Rating in NAIC systems, the SCC’s NAIC Designation Category will be entered into NAIC systems to assign an NAIC Designation Category to the security.~~

~~177.178. As noted in this Manual, any insurer that owns a security for which the SVO has provided an NAIC Designation, a classification or a valuation, may request a clarification of the decision from the SVO (Requests for Clarification of SVO Decisions).~~

### Appeal to the VOS/TF

~~178. — An insurer may appeal on procedural or substantive grounds to a sub-group of the E Committee within [30] days of receiving notification of VOS/TF sub-group vote. The E Committee sub-group shall include the E Committee chair and each domiciliary regulator of insurance companies holding the security. If the E Committee chair was previously included as a domiciliary regulator in reviewing the security at issue, the E Committee sub-group shall include the E Committee vice chair(s). As part of this appeals process, any insurer holding the security will have the right to be present in any discussion involving NAIC staff and regulators in accordance with NAIC procedures. that thinks the IAO did not make its Filing Exemption determination regarding the insurer’s security in accordance with the procedures in this Manual it may request consideration of the concern by the VOS/TF pursuant to “Review of SVO Decisions by the VOS/TF” in this Manual.~~

### **Analytical Appeal to an Independent Third-party**

~~179. In support of its appeal, an insurer holding the security, at its own expense, may provide third party analytical evidence in support of its position. Such third party may present its findings to regulators and NAIC staff as part of the appeals process. An insurer that disagrees with the SCC's final analytical assessment may request, at its own expense, that the NAIC's IAO contract with an independent third party acceptable to the IAO to perform a blind analysis of the security (e.g. without knowledge of the SCC's, insurer's or CRP's assessment) based upon the information provided through the information request and consistent with the objectives and purposes of an NAIC Designation Category.~~

180. ~~The Executive Committee of the NAIC shall select an independent third-party auditor to oversee the implementation and efficacy of this process. The auditor shall conduct this review at least annually and produce a publicly available report. This report shall include: (1) a review of efficiency and reasonableness of the SSC/IAO/SVO's process, procedure and methodology for when a security is put "Under Review", removed from Filing Exemption and/or subsequently surveilled, (2) an analysis of the vendors used by NAIC staff in this process, (3) any conflicts of interest present in the SSC/IAO/SVO's review and (4) an assessment of the capital markets impact on the totality of removing securities from Filing Exemption under this process. The auditor shall also publish on a publicly available webpage a transition and stability study for all securities removed from Filing Exemption using this process and designated by the SVO.~~

~~179-181. An anonymized summary of each unique issue or situation triggering review and subsequent removal from Filing Exemption of an Eligible CRP Credit Rating will be published on the SVO webpage or another publicly accessible location for transparency. Such summary shall include the methodology used to trigger the SVO's initial review of the security, the material reasons the rating on the security was not a reasonable assessment of risk and the material non-confidential comments received by stakeholders and the disposition of those comments by the applicable regulator subgroup. Such summary shall also include a certification that the SVO and applicable regulators complied with the FE review process outlined in this manual.~~

~~180. If the independent third party's assessment results in an NAIC Designation Category that differs from the NAIC Designation Category assigned pursuant to the Filing Exemption process by no greater than a one (1) notch, the originally assigned NAIC Designation Category will remain in force and the Eligible NAIC CRP Credit Rating remain eligible for Filing Exemption.~~

~~181. If the independent third party's assessment results in an NAIC Designation Category that that differs from the NAIC Designation Category assigned pursuant to the Filing Exemption process by greater than one (1) notch, the SCC's opinion will remain in force and the Eligible NAIC CRP Credit Rating will remain ineligible for Filing Exemption.~~

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

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

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

183. The IAO Director(s) will prepare a summary of the removed from Filing Exemption Eligibility actions take over the prior calendar year.
184. The IAO will also publish an anonymized summary of each unique situation encountered for the securities subject to removal from Filing Exemption Eligibility and publish it on an insurer accessible web location.
- 185.184. To facilitate transparency as to the SVO's application of discretion, the SVO Analytical Department Symbols "DR" will be added in NAIC Systems to securities with a blocked otherwise Eligible NAIC CRP Credit Rating(s). The SVO Analytical Department Symbols, "DR" will be reported on the insurer's statutory investment schedules for the effected security as SVO Administrative Symbols.

...

<https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2023/2023-11 Fall NM/05-SVO Discretion/2023-005.15 P&P SVO Discretion - Revised v4.docx>

The Lease-backed Securities Working Group

January \_\_, 2024

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

**RE: November 3, 2023 memo entitled “Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (the “P&P Manual”) Authorizing the Procedures for the SVO’s Discretion Over NAIC Designations Assigned Through the Filing Exemption Process.”**

Dear Ms. Mears

This letter is in response to the November 3, 2023 memo from Charles Therriault referenced above which included a number of proposed revisions to the original exposure from August last year regarding proposed “Procedures for the SVO’s Discretion Over NAIC Designations Assigned Through the Filing Exemption Process”.

Our group, the Lease-Backed Securities Working Group, was deeply disappointed in the November 3<sup>rd</sup> memo and the attached P&P language, which we feel was NOT responsive to the many, many comments that were received from industry on the original proposal, particularly the repeated calls for “transparency” in implementing this process.

To quote from our own letter to this Task Force in May of 2022 -- almost two years ago: “.....as long as Filing Exemption remains in place, any designation by the SVO which would override the rating of a nationally-recognized [& NAIC-approved] ratings provider should be the result of a transparent methodology and ratings report by the SVO supplied to the investor -- similar to those supplied by the nationally-recognized providers -- and also subject to appeal by the holder of the security.”

In addition to our own comments quoted above, the Task Force received an unusually high number of comment letters back in August on the original proposal: from a total of 16 interested parties in all -- indicating an unusually high level of industry concern with this proposal. Many specific concerns were voiced in these letters, but the consistent theme of all the letters was the need for the SVO to provide “transparency” in implementing its discretion over filing-exempt securities. This transparency was considered essential in order to minimize the inevitable disruption which a selective scrutiny of the ratings of otherwise-eligible “FE Securities” -- after they have been purchased by the investor -- is bound to cause in the capital markets.

Transparency is also necessary because only in this way will market participants be able to fully understand the structural risks or documentation deficiencies identified the SVO. This understanding in turn is necessary to enable investors to demand improvements in marketed investments and strengthen their portfolios in the long run -- which, after all, should be the ultimate goal of this exercise.

## The Lease-backed Securities Working Group

The revisions that were exposed in the November 3<sup>rd</sup> memo contained a number of new procedural steps, but in spite of Charles Therriault's spoken comments in that meeting, the actual exposure does not any include any requirement for transparency on the substance of the SVO analysis. That is: it does not include any requirement for the NAIC to share a written copy of its "full analysis" with the investor(s) or to disclose any information about how they arrived at their 'designation' -- or, indeed, to provide *any written materials at all* to the investor. (The exposed revisions state only that the SVO would agree to meet with investors.....to address "any questions or issues *it [the SVO]* might have about the security".)

Over the past year, the SVO has repeatedly cited "confidentiality" as the main reason it is unable to provide copies of its full analysis to investors. This seems silly to us, since confidentiality letters and non-disclosure agreements are common in the market. Indeed, the SVO already has an "application letter" as part of the RTAS process which contains a full set of "terms and conditions" governing the transfer, disclosure and confidentiality of all the information. It would seem a fairly simple process to have similar letter governing the CRP review. The SVO could simply say "if you want to see our full analysis, you have to first sign this agreement establishing the confidential nature of the information and limiting any liability on the part of the SVO -- otherwise we are under no obligation to reveal any information regarding our methodology or rationale." (Investors are already accustomed to signing similar letters when they receive private ratings from NRSROs and offering materials from issuers and placement agents.)

We have previously made the point that since credit ratings are opinions about the probability of future events, *ex ante*, there is no sure-fire way to determine if a credit rating is "correct". Basic fairness requires that if there are two differing opinions of credit quality, investors and regulators should be able to compare the two analyses side by side. Only in this way, can investors (and regulators) see, understand -- and either agree or disagree with -- the SVO's analysis.

We have already provided regulators with samples of the level of disclosure that is regularly provided by the rating agencies in their ratings reports and methodologies. Given the limited staffing and resources at the Investment Analysis Office, no one expects that they would be able to provide this same high level of disclosure. However, that does not mean that transparency should not be the goal. At a minimum, investors and regulators should be able to understand what data was examined by the IAO, what assumptions were made, what methodologies were used in the analysis, and what specific flaws or omissions were found in the original CRP analysis. Only in this way can there be a truly fair and productive conversation between regulators and investors about the credit -- which, again, should be the goal of this exercise.

Not having written materials to read ahead of time and refer to puts investors at an unfair disadvantage in any meetings with the SVO (even if such meetings are permitted), reducing the conversation to a game of "20 questions" between the SVO and the investor(s) and seriously hindering their ability to mount an effective appeal of the designation. Without a written explanation of the SVO's analysis, how can the insurer be expected to communicate the decisions of the SVO internally and "correct course" avoiding similar issues in the future? (Rating Agencies detailed "ratings rationales" -- which the SVO requires to be submitted to them for all private ratings -- typically run from 20 to 30 pages. We have no idea of the size or extent

The Lease-backed Securities Working Group

of the SVO's "full analysis", but whatever it is, investors should be permitted to see it. Investors would never stand for getting a "verbal only" explanation of a credit rating from a Rating Agency. Why should they accept that from the NAIC?)

If the SVO and the Task Force continue to insist on not providing investors with a written copy of the SVO's "full analysis" -- something we continue to believe to be essential to allow investors to demand improvements in the market....and for any meaningful appeal -- then we propose that the following language be inserted into paragraph 169 of the proposed P&P language, under "Full Review":

"169. Upon satisfactory receipt of the information through the information request, the IAO shall perform a full analysis of the security<sup>^</sup>. The IAO agrees to cooperate fully with the holders of the security in sharing its full analysis, including what data was examined, what assumptions were made, what methodologies were used in the analysis and what specific flaws or omissions were found in the CRP analysis., ~~d~~During ~~which~~ this time the SVO Analytical Department Symbol "UR" will remain in place but will not be reported on the statutory investment schedules."

We believe the regulators should find this language unobjectionable.

We appreciate the opportunity to offer these comments and are happy to discuss this letter and any questions you might have with the members of the Task Force.

Sincerely,

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



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January 25, 2024

Carrie Mears, Chair  
Valuation of Securities (E) Task Force  
National Association of Insurance Commissioners  
c/o Charles Terriault and Denise Genao  
Via Email: [ctherriault@naic.org](mailto:ctherriault@naic.org) and [dgenao1@naic.org](mailto:dgenao1@naic.org)

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

Dear Ms. Mears,

Thank you for the opportunity to comment on the Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (“the P&P Manual”) Authorizing the Procedures for the Securities Valuation Office (SVO) Discretion Over NAIC Designations Assigned Through the Filing Exemption Process (Exposure), which is intended to provide the Valuation of Securities Task Force (“VOS/TF”) with better visibility into the methodology and impact of both public and private credit ratings as well as the ability to change the filing exempt (FE) designation if deemed appropriate. The following is submitted on behalf of the member companies of the National Association of Mutual Insurance Companies (NAMIC).

NAMIC has more than 1,500-member companies representing 40 percent of the total U.S. property/casualty insurance market. NAMIC member companies serve more than 170 million policyholders and write more than \$323 billion in annual premiums. Our members’ direct written premiums account for 67 percent of homeowners’ insurance and 55 percent of automobile insurance. Through NAMIC advocacy programs it promotes public policy solutions that benefit NAMIC member companies and the policyholders they serve and fosters greater understanding and recognition of the unique alignment of interests between management and policyholders of mutual companies.

NAMIC is grateful for the changes that have been made to the Exposure so far and the dialogue that the SVO has engaged in with industry. However, lingering concerns over transparency remain in the revised version. Increased transparency in reasoning, standards, and the materiality threshold would allow effected insurers to know why the securities were flagged and better understand the reasoning of the three-notch difference between the Eligible NAIC CRP Credit Rating and the Insurance Analysis Office’s (IAO) assessment. As written now, the Exposure provides limited insight into the process; it is unclear why a security would be placed under analytical review of IAO or if there are asset classes that will typically be flagged. Paragraphs 166-170 of the Exposure give some observable factors that companies may use but there is still little clarity of the SVO’s actual proposed methodology.



Attachment Three - K  
Valuation of Securities (E) Task Force  
3/16/2024

Like other regulatory bodies and credit rating agencies, the SVO should consider publishing the methodology used to evaluate FE securities and share a written copy of its analysis, methodology, and decision with the effected insurer for their files and for discussion purposes. This type of transparency would allow for insurers to know the “rules of the road” and understand the decision of the SVO as opposed to blindly accepting and attempting to understand the change in security status. This transparency would also allow for a more fruitful dialogue between the SVO and the insurer regarding the security and its designation.

\*\*\*\*

NAMIC understands the SVO's desire to move away from a blind reliance on credit rating providers (CRP) but for the process to be fair and reasonable, insurers must have the ability to compare the two opinions of credit quality (the CRP's and the SVO's) to ensure an equitable outcome and a productive conversation. We look forward to continuing this dialogue and are incredibly appreciative of the changes made thus far.



January 26, 2024

Dear Ms. Mears, Mr. Therriault, and members of the Valuation of Securities (E) Task Force (“VOSTF”):

We appreciate the opportunity to comment on [your proposal](#) regarding the NAIC Securities Valuation Office (“SVO”) filing exemption (FE) discretion with respect to Credit Rating Provider (“CRP”) ratings.<sup>1</sup> We support your mission of enhancing risk assessment for statutory solvency purposes, and believe transparency and governance around the FE discretion is paramount for an efficient and orderly insurance investment marketplace. We would like to focus our comments and offer solutions on the three areas below.

First, it is both practical and necessary to have a well-defined framework for selecting securities to be designated as under review (i.e., UR securities) by the NAIC’s Investment Analysis Office (“IAO”). We recognize that certain CRP ratings may be misaligned for regulatory purposes and would suggest designing a transparent framework to identify those securities. That would allow the NAIC to focus its time and resources more efficiently while providing much needed transparency. Our proposed solution is to establish criteria to better identify securities that may warrant review by the IAO, consistent with our suggestions stated in our [comment letter submitted on February 13, 2023](#).<sup>2</sup>

Second, transparency around SVO’s security analysis is essential. CRP rating methodologies are publicly available, supported by significant expertise and resources and well understood by market participants. This has contributed to an efficient and orderly marketplace. The industry hopes the SVO would also share detailed guidance on its methodology by asset class. To the extent, the SVO deems its revised designation on a security being materially lower than the FE designation by three or more notches, it would be beneficial for the market to understand:

- SVO’s referenced rating methodology;
- SVO’s analysis and rationale;
- Key differences between the reference rating methodology and SVO’s analysis; and
- How will a DR security, where SVO FE discretion has applied, be surveilled? For example, will the IAO periodically update/revise a DR designation to reflect actual performance?<sup>3</sup>

Third, the followings may help address concerns around rating suitability for FE purposes:

- Enhancing due diligence on CRPs. It would be more efficient to improve NAIC’s overarching due diligence framework on CRPs, as opposed to dedicating significant resources to reviewing thousands of securities individually rated by them.
- Focusing on insurers that carry outsized investment risk relative to their capital. We recognize a primary objective is to protect policyholders through the solvency of their insurers. Therefore, it would be more efficient to focus resources on those insurers with the most significant solvency risk in accordance with regulatory guidance on capital and liquidity and so on.

Sincerely yours,  
PineBridge Insurance Solutions and Strategies

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<sup>1</sup> Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office Authorizing the Procedures for the SVO’s Discretion Over NAIC Designations Assigned Through the Filing Exemption Process, November 3, 2023.

<https://content.naic.org/sites/default/files/inline-files/2023-005.15%20P%26P%20SVO%20Discretion%20-%20Revised%20v4.pdf>

<sup>2</sup> NAIC Valuation of Securities Taskforce, 2023 Spring National, March 2023.

[https://content.naic.org/sites/default/files/national\\_meeting/2023%20VOSTF%20Spring%20NM%20Materials%20v2.pdf](https://content.naic.org/sites/default/files/national_meeting/2023%20VOSTF%20Spring%20NM%20Materials%20v2.pdf)

<sup>3</sup> According to the November 3, 2023 amendment listed in footnote 1, (1) “DR means that one or more otherwise Eligible NAIC CRP Credit Ratings have been removed from the filing exemption process when determining the NAIC Designation through the IAO discretion procedures.” (2) “UR means the NAIC Designation assigned pursuant to the filing exemption process is under review by the NAIC’s Investment Analysis Office.”



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January 26, 2024

Carrie Mears  
Chair, Valuation of Securities (E) Task Force  
National Association of Insurance Commissioners

**Re: SVO Discretion and Appeals Process**

Dear Ms. Mears,

The Structured Finance Association (SFA) appreciates the opportunity to provide feedback to the Valuation of Securities (VOS) (E) Task Force (VOS TF) on the exposure draft for the Amendment to the P&P Manual of the NAIC Investment Analysis Office Authorizing the Procedures for the SVO's Discretion Over NAIC Designations Assigned Through the Filing Exemption Process (SVO Discretion Exposure Draft).

In gathering feedback to respond to the proposal, SFA engaged with various market participants, including insurance companies, asset managers, credit rating agencies, law firms, and others who may be directly and/or indirectly impacted by the SVO Discretion Exposure Draft.

SFA has also engaged in dialogue with the American Council of Life Insurers (ACLI), with which we have many common members. As we discuss below, many of our members are supportive of the ACLI letter, particularly as it relates to creating a more robust initial rating reconsideration process that takes place prior to any appeals process. While we support ACLI's position, at the same time we acknowledge the vital importance of the structured finance market in providing liquidity to the real economy, with issuers securing over \$1.5 trillion in loans to support businesses, households, and communities in 2023 alone. The investors that provide the liquidity to this market, including many insurance companies, do so largely because of the stability of the market and predictability of returns on investment. Any proposal that introduces uncertainty into this market also runs the risk of impacting the future flow of liquidity to it. As such, SFA has elected to submit our own response to focus on questions and issues most directly impacting structured finance market participants.

We will first raise some questions aimed at seeking clarity about where and how the SVO will focus its attention when exercising its discretionary authority to remove a rating from the filing exempt process (FE). We will then move to raising issues and providing suggestions about the initial reconsideration process as currently constituted. Finally, we will share feedback on the proposed appeals process, particularly as it relates to the role and responsibilities of the neutral third party.



## **I. Scope of SVO Discretion**

At the December 2023 annual meeting of the NAIC, VOS TF publish a historical record of the SVO's ability to exercise authority over the suitability of securities for insurance company investment. Notwithstanding the existence of the NAIC's authority, we believe that it may be beneficial for the NAIC SVO to set forth a more refined scope and/or limits around how the SVO's authority will be applied as this new process is initially implemented.

While we appreciate that the SVO would not seek to irrevocably limit their authority to review any security, an acknowledgment or statement from the NAIC clarifying specific types of securities, or concerns about specific approaches to ratings that will be the initial focus of the SVO would provide a measure of certainty to market participants. Such certainty would be welcomed across the market during this transition period. Federal regulators frequently make use of commentary, guidance, FAQs, and interpretive publications that provide clear guidelines for how they will exercise their investigative and regulatory authorities. We believe that the NAIC should consider doing so here.

## **II. Initial Reconsideration Process**

As noted above, many of our members share the views enumerated by the ACLI, particularly on the importance of the SVO building out a more robust initial reconsideration process. It is of paramount importance that this process appropriately balances the interests of all affected parties while helping ensure that the NAIC VOSTF continues to fulfil its obligations. We will highlight a few issues raised by our members that should be addressed.

### *A. Due Process Considerations*

As currently envisioned, the insurance companies most directly impacted by the reconsideration of a rating would be excluded from direct involvement in the re-rating process. While a rating from a credit rating agency is an important part of an investment decision, it is not the only consideration. Indeed, insurance companies are sophisticated investors who perform their own analysis, which may differ from the analysis of a rating agency in some respects. We appreciate that the proposed process would allow impacted insurers to submit additional information or analysis in support of their views, but that limited opportunity falls short in comparison to the level of detail that would be available if impacted insurers were permitted to have direct representation before the Senior Credit Committee and VOSTF. Moreover, Section 168 leaves it up to the discretion of the Investment Analysis Office ("IAO") to coordinate with impacted insurers prior to undertaking their full analysis. Excluding insurance companies from "being in the room" during the initial reconsideration process would necessarily exclude the very investment views that led to the purchase of that security in the first place. As a result, the review process could unfairly deprive these sophisticated investors the opportunity to explain why a given rating should be considered a reasonable assessment of the relevant risk.



SFA believes that a more objective approach would be to establish an initial reconsideration process that offers the option of direct participation by impacted insurance companies, a dialectical approach that is more likely to yield the appropriate outcome. Doing so would allow insurers directly to explain and justify the views that informed their investment decision. Should the insurance company choose to participate, they should have the option to also have their investment advisor in attendance at any proceedings. Such views are especially relevant in the context of a rating that—in the view of the SVO—does not reasonably reflect the underlying credit risk. In most adjudicative proceedings, due process typically requires direct representation by the parties most proximately impacted by that decision. A final recommendation would be for the NAIC to directly notify the credit rating agency(s) whose ratings are subject to reconsideration, along with the rationale for that reconsideration. Given the role of credit rating agencies in the marketplace, direct notification from the NAIC will help align the views of the rating agencies with that of the regulators as the NAIC pursues the goals underlying the proposed changes.

#### *B. Questions on Process and Approach*

Our members have raised some questions and concerns around the approach and process that would be employed during the initial reconsideration. We believe that any method employed to remove a rating from FE must be at least as robust, replicable, and statistically sound as those used by credit rating agencies. Moreover, the specific assumptions that factor into a removal from FE must be clearly enumerated and understood.

Our members have also raised specific questions and issues on the process as outlined in the exposure draft. These questions include:

- a. In Section 81 of the revised P&P Manual, what is the basis upon which a determination of “reasonable assessment of regulatory risk” will be made for the initial reconsideration? What parameters or guardrails will define the limits of “reasonableness”?
- b. While there are timing requirements for insurers to respond to an IAO request for information (45 days, not to exceed 90 days), there are no requirements for the IAO to notify an insurer that a security is Under Review. We recommend explicit timing requirements for IAO to notify insurers that a security is Under Review.
- c. The “materiality threshold” in Section 171 is three notches. Upon what basis was the materiality threshold determined?
- d. Given that IAO would be allowed to consider post-issuance performance of the security, what impact (if any) would ongoing surveillance from a CRP have, especially when that surveillance results in a credit downgrade? How will the differences between the assumptions and methodology of an initial rating and assumptions and process of ongoing surveillance factor into the IAO reconsideration process?



- e. When the IAO determines that a security remains eligible for the Filing Exempt Process, what are the timing requirements for them to inform the insurer that the security is no longer Under Review?

### **III. Appeals Process and Neutral Third-Party**

As stated above, we believe that the current focus should be on improving the initial reconsideration process. If the process is appropriately robust and well-considered, it will reduce the instances where parties feel compelled to appeal reconsideration decisions. Nevertheless, there will always be a need for an appeals process, and we offer some member views on that process as outlined in the exposure draft.

The involvement of a neutral third-party is at the core of the proposed appeals process. We believe that it would be constructive for NAIC to provide more detail about the roles, responsibilities, and function of the neutral third-party, and how precisely it will meet their obligations. Additionally, given the role and responsibilities as laid out in the exposure draft, it would be helpful if NAIC indicated which existing capital market participants, if any, it views as able to perform the neutral third-party duties. SFA members have also questioned whether the NAIC envisions maintaining a list of approved neutral third-parties by asset class or will the NAIC review and approve a neutral third party on a case-by-case basis.

### **IV. Conclusion**

SFA believes that the NAIC should consider applying a narrow scope for the reconsideration of ratings for specific securities, especially to provide additional market certainty as this process is implemented. We also recommend that NAIC provide clarity on the approach and assumptions applicable to the initial rating reconsideration process and improving due process. Finally, the market would welcome additional details on the roles and responsibilities of the neutral third party, including whether and how credit rating providers can serve in this role.

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

Sincerely,

A handwritten signature in black ink, appearing to read "Michael Bright". The signature is fluid and cursive, written over a light blue horizontal line.

Michael Bright  
CEO  
Structured Finance Association



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

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

RE: Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (the "P&P Manual") to Incorporate Practical Expedient for PLR Issue Date

DATE: October 27, 2023

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**Summary:** The SVO has been unable to independently source the date attribute Issue Date (e.g. date of legal closing), a necessary input to determine the requirement to provide a private letter rating (PLR) rationale report. The SVO proposes permitting it to apply a practical expedient by assuming that any security subject to the private letter rating guidance that was acquired after January 1, 2022, was issued on or after January 1, 2022, unless documentation showing an earlier issue date is provided.

**Recommendation:** The SVO recommends adoption of this proposed technical amendment to provide for a practical expedient in situations where the SVO is unable to identify the issue date associated with securities that are subject to the private letter rating filing requirements. 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**

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

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...

**PL SECURITIES**

**Effective Date of Verification Procedure for PL Securities**

...

12. For (a) PL Securities issued from January 1, 2018 to December 31, 2021 subject to a confidentiality agreement executed prior to January 1, 2022, which confidentiality agreement remains in force, for which an insurance company cannot provide a copy of a private rating letter rationale report to the SVO due to confidentiality or other contractual reasons (“waived submission PLR securities”), the insurer may report such securities on such securities’ General Interrogatory (i.e., a **PLGI** security), and (b) PL Securities issued after January 1, 2022, for which an insurance company cannot provide a copy of a private rating letter rationale report to the SVO due to confidentiality or other contractual reasons (“deferred submission PLR securities”) the insurer may report such securities on such securities’ General Interrogatory (i.e., a **PLGI** security) until and including December 31, 2023, after which time, if the insurance company still cannot provide a copy of a private rating letter rationale report for whatever reason, the securities can be reported with an **NAIC 5GI** Designation and an NAIC Designation Category of **NAIC 5.B GI** in accordance with the guidance specified below.
13. For PL Securities acquired on or after January 1, 2022, for which the SVO cannot determine the security’s issue date (e.g. date of the legal closing), the SVO may assume as a practical expedient, in the absence of documentation from the insurer showing otherwise, that the issue date was on or after January 1, 2022, for determining the filing requirements for the PL Security.

<https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2023/2023-11 Fall NM/06-PLR Issue Date/2023-014.01 P&P SVO PLR Issue Date v2.docx>



Mike Monahan  
Senior Director, Accounting Policy  
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[mikemonahan@acli.com](mailto:mikemonahan@acli.com)

January 26, 2024

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

**Re: Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (the “P&P Manual”) to Incorporate Practical Expedient for PLR Issue Date**

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 December 4<sup>th</sup>, 2023.

**Background**

The VOSTF adopted an amendment, in 2021, to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) to require the filing of private rating letter rationale reports. The amendment was effective in 2022 and contained guidance specific to the security’s (original) issue date. Therefore, issue date is a needed data element for programming within the NAIC’s Vision \ AVS+ systems.

Without the ability to consistently source issue date information from third parties, there is a problem with programing around issue date. The SVO has requested the VOSTF to allow the use of a practical expedient which assumes that any security subject to the private rating letter guidance acquired on 01/01/2022 or later, was issued after 1/1/2022 unless the insurer can provide documentation showing an earlier date. This approach would incorrectly include in the pool of securities assumed to be issued on or after 01/01/2022:

- Secondary market purchases for deals issued prior to 01/01/2022.
- Deals which are issued in one year but when acquired in the next year cross issue date categories.
- Private ABS securitizations issued after 01/01/2022 where a comparable public rating rationale update is not normally produced by the CRP for a comparable publicly rated security. Paragraph

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

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

21 of Part 3 of the P&P Manual explicitly states that updated rationale reports should be filed every year “so long as such rationale update would normally be produced by the CRP for a comparable publicly rated security.”

We are concerned these forced issued dates, combined with existing inaccurate Vision \ AVS+ issue dates, will result in unintended consequences. The critical part of this process will be the annual deletion of private rating letters, from AVS+, for those private rating letter rationales that did not meet the requirements or where no rationale submission has been received for the calendar year. Ratings could be deleted based on inaccurate issue date information.

### **Comments**

We appreciate that the SVO is considering a systematic approach to source original issue date and recognize the impetus of the proposal. However, we feel that there are questions that must be answered prior to determining a solution.

First, we would like the SVO to provide industry with a dataset that contains the complete universe of securities where the original issue date is missing so that industry may assess whether the proposal would significantly resolve the data gaps. As a result, more time is needed for analysis and assistance to identify an approach that will maximize the number of securities with an accurate issue date.

Second, the proposal references that the burden of proof for the accuracy of the original issue date information rests with industry. However, insurers have encountered system problems when trying to enter the data. This information will be contained in NAIC systems, and potentially used for additional reasons, therefore the data needs to be verified and accurate. The proposal does not provide information detailing how accuracy would be measured or the requirements for meeting the burden of proof. Industry needs the ability to see and challenge issue dates currently populated within Vision.

In addition, there is concern with the timing of the AVS+ “deletion” process and the potential for unintended consequences. The deletion process is slated to be performed in December. This timeframe does not allow industry sufficient time to respond and overcome the burden of proof prior to the deletion process. More information is needed on the mechanics of this process, including:

- How long an insurer would have to respond and correct issues before the deletion process is put into place?
- The ability of an insurer to make a submission before the actual filing of the annual update or submission of a private rating letter/rationale for current year (since this does not exist today)

Finally, the SVO has sourced the majority of the current issue date information from insurer (filing) submissions. As a result, the quality of data is dependent on the accuracy of insurer filings. Many critical controls have been added in VISION since the inception in 2022. As a result, there are cases in AVS+/VISION where inaccurate data may exist which prevent companies from submitting a filing. For example, in one instance, we found a security listed in the NAIC’s systems, where the issue date stored was actually a later date than the purchase date. We would like more details on how these problems will be addressed.

In conclusion, we appreciate the SVO’s efforts and look forward to starting discussions to address the issue date data gaps. However, there are additional questions that need to be answered before putting a

solution in place. We recommend that the SVO staff work with industry to flush out any additional questions to avoid potential unintended consequences, including inaccurate year-end Schedule D reporting.

Thank you for your consideration. We look forward to partnering with regulators and SVO staff on this issue.

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

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

The Private Placement Investors Association (“PPiA”) is a business association of insurance companies, other institutional investors, and affiliates thereof, that are active investors in the primary market for privately placed debt instruments. The association exists to provide a discussion forum for private debt investors; to facilitate the development of industry best practices; to promote interest in the primary market for privately placed debt instruments; and to increase accessibility to capital for issuers of privately placed debt instruments. The PPiA serves 66 member companies and works with regulators, NASVA, the ACLI, the American College of Investment Counsel, and the investment banking community to efficiently implement changes within the private placement marketplace. For more information, visit [www.usppia.com](http://www.usppia.com).

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

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



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

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

RE: Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (the "P&P Manual") to Update U.S. Government Agency and Other U.S. Government Obligation Abbreviations

DATE: February 16, 2024

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**Summary:** In conjunction with the implementation of the principles-based bond definition, there were related modifications made to Schedule D, Part 1 of the Annual Statements. The SVO has identified abbreviations for various U.S. government or Other U.S. government entities that will need to be shortened given space limitations and need to eliminate conflicting abbreviations (e.g. "VA" for both Virginia and U.S. Department for Veterans Affairs) for insurance company statement blanks reporting purposes beginning 1/1/2025. As noted in the changes to the annual statement instructions adopted by the Blanks (E) Working Group on Nov. 17, 2023, for Column 24 - Agency, Sovereign Jurisdiction or State Abbreviation, "*For items captured as U.S. government or Other U.S. government, report "US" for treasury-issued items and for non-treasury items, report the abbreviation for the agency issuer captured within these categories. (Agency abbreviations are detailed in the Purposes and Procedures Manual of the NAIC Investment Analysis Office in the listing of agencies approved for these categories.)*"

**Recommendation:** The SVO recommends adoption of this proposed technical amendment to comply with field size limitations on insurance company statement blanks in advance of the 1/1/2025 implementation of the new statement blanks. The proposed text changes to the P&P Manual are shown below with additions in red underline, and deletions in ~~red strikethrough~~ as it would appear in the 2024 P&P Manual format.

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

## FILING EXEMPTIONS

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### FILING EXEMPTION FOR U.S. GOVERNMENT SECURITIES

#### Definitions

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78. **U.S. Government Agency** – An instrumentality of the U.S. Government the debt Obligations of which are fully guaranteed or insured as to the timely payment of principal and interest by the full faith and credit of the U.S. Government. This category includes in addition to direct claims on, and the portions of claims that are directly and unconditionally guaranteed by, the U.S. Government agencies listed below, claims collateralized by securities issued or guaranteed by the U.S. Government agencies listed below for which a positive margin of collateral is maintained on a daily basis, fully taking into account any change in the insurance company’s exposure to the obligor or counterparty under a claim in relation to the market value of the collateral held in support of that claim.

#### U.S. Government Full Faith and Credit – Filing Exempt

Army and Air Force Exchange Service (AAFES)  
Commodity Credit Corporation (CCC)  
Export–Import Bank of the United States (EXIM **Bank**)  
Farmers Home Administration (FmHA) – Certificates of Beneficial Ownership  
Federal Deposit Insurance Corporation (FDIC)  
Federal Housing Administration (FHA)  
General Services Administration (GSA)  
Government National Mortgage Association (GNMA)  
National Credit Union Administration (NCUA)  
Overseas Private Investment Corp (OPIC)  
Small Business Administration (SBA)

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U.S. Agency for International Development (USAID)  
U.S. Department of Agriculture (USDA)  
U.S. Department of Health and Human Services (**USHHS**)  
U.S. Department of Housing and Urban Development (**USHUD**)  
U.S. Department of the Treasury (**UST**)  
U.S. Department of Veterans Affairs (**USVA**)  
U.S. International Development Finance Corporation (**USIDFC**)  
U.S. Maritime Administration (**MARADUSMA**)  
Washington Metropolitan Area Transit Authority (**WMTA**)

## Definitions Filing Exemption for Other U.S. Government Obligations

79. Obligations issued and either guaranteed or insured, as to the timely payment of principal and interest, by the government agencies or government-sponsored enterprises listed below are filing exempt. They are not backed by the full faith and credit of the U.S. Government. The filing exemption here is based on an analytical judgment that the combined creditworthiness of the entity itself and U.S. government support for that entity provides confidence that the issuer will be able to pay its obligation on a full and timely basis at the level of an NAIC 1 quality designation and an NAIC Designation Category of NAIC 1.A. For the avoidance of doubt, preferred stock or similar securities of the government agencies or government-sponsored enterprises listed below are not considered guaranteed or insured and hence are not subject of this section.

|   |
|---|
| <b>Filing Exempt Other U.S. Government Obligations<br/>if issued and either fully guaranteed or insured by:</b> |
|---|

|   |
|---|
| Federal Agricultural Mortgage Corporation ( <del>Farmer Mae</del> FAMC)<br>Federal Farm Credit Banks (FFCB)<br>Federal Financing Bank (FFB)<br>Federal Home Loan Banks (FHLB)<br>Federal Home Loan Mortgage Corporation ( <del>Freddie Mae</del> FHLMC)<br>Federal National Mortgage Association ( <del>Fannie Mae</del> FNMA)<br>Financing Corporation (FICO)<br>Resolution Funding Corporation ( <del>REFCorp</del> RFCorp)<br>Tennessee Valley Authority (TVA) |
|---|

<https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-03-19 NAIC Spring NM/05-Blanks abbreviations/2024-002.01 P&P Manual US Government Abbreviations.docx>

SVO



**NAIC**  
NATIONAL ASSOCIATION OF  
INSURANCE COMMISSIONERS

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

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

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

RE: Technical Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (the "P&P Manual") regarding Subsidiary, Controlled and Affiliated (SCA) and Related Party Bond or Preferred Stock Investments

DATE: January 16, 2024

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**Summary** – In December 2022, the Task Force adopted amendments to the Subsidiary, Controlled and Affiliated ("SCA") and Related Party Bond or Preferred Stock Investments section of the P&P Manual, to more clearly define SCA investments and include related party investments. Within the definition of an SCA and related party bond, reference was made to paragraph 4.a. in *SSAP No. 43R – Loan-Backed and Structured Securities* to define which structured or loan-backed investments would qualify as an SCA or related party bond. Subsequent to the adoption of the P&P Manual Amendment, *SSAP No. 43R – Loan-Backed and Structured Securities* was amended so the paragraph reference in the P&P Manual is no longer accurate. Additionally, with the implementation of the Principals Based Bond Definition by the Statutory Accounting Principles (E) Working Group the name of *SSAP No. 43R* will be changing from "Loan-Backed and Structured Securities" to "Asset-Backed Securities" on January 1, 2025.

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

**Proposed Amendment** - The proposed text changes to P&P Manual are shown below with additions in red underline, deletions in ~~red strikethrough~~ as it would appear in the 2024 P&P Manual format.



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



**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. 43R~~ – *Loan-Backed and Structured Securities\**, qualify as a related party investment due to the reporting insurance company’s credit 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.

\*NOTE: As of January 1, 2025, when the name of SSAP No. 43R changes to “SSAP No. 43 - Asset-Backed Securities”, the name in this paragraph and any other references to SSAP No. 43R in this Manual will be changed accordingly.

[https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-03-19 NAIC Spring NM/06-SCA References to SSAPs/2024-003.01\\_VOSTF\\_TechAmend\\_SVO\\_RelatePartiesv2.docx](https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-03-19 NAIC Spring NM/06-SCA References to SSAPs/2024-003.01_VOSTF_TechAmend_SVO_RelatePartiesv2.docx)



1TO: Carrie Mears, Chair, Valuation of Securities (E) Task Force  
Members of the Valuation of Securities (E) Task Force

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

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

RE: SVO 2024 Carry Over Filings

DATE: February 16, 2024

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For 2023, the SVO reviewed 15,549 filings comprised of 3,893 initial filings, 11,257 annual updates, 12 appeals, 366 material changes, and 21 renumbering requests (e.g. CUSIP changes). In comparison, in 2022 the SVO reviewed 12,983 filings comprised of 3,562 initial filings, 9,291 annual updates, 61 material changes and 17 appeals.

**2023 Completed Filings**

| Category                 | Filing Type  |               |           |                 |             | Total         |
|--------------------------|--------------|---------------|-----------|-----------------|-------------|---------------|
|                          | Initial      | Annual Update | Appeals   | Material Change | Renumbering |               |
| Corporate                | 1,083        | 5,443         | 12        | 13              | 21          | 6,572         |
| Counterparty Derivatives | 18           | 48            | -         | -               | -           | 66            |
| ETF                      | 8            | 219           | -         | -               | -           | 227           |
| Money Market Fund        | 22           | 153           | -         | -               | -           | 175           |
| Municipal                | 149          | 216           | -         | -               | -           | 365           |
| Private Letter Rating    | 2,012        | 1,865         | -         | -               | -           | 3,877         |
| QUSFI                    | 14           | 131           | -         | -               | -           | 145           |
| Regulatory Transaction   | -            | 46            | -         | -               | -           | 46            |
| RTAS                     | 69           | -             | -         | -               | -           | 69            |
| Sovereign                | 2            | 17            | -         | -               | -           | 19            |
| Structured Settlements   | -            | 743           | -         | -               | -           | 743           |
| Structured Security      | 516          | 2,376         | -         | 353             | -           | 3,245         |
| <b>Grand Total</b>       | <b>3,893</b> | <b>11,257</b> | <b>12</b> | <b>366</b>      | <b>21</b>   | <b>15,549</b> |

The total number of filings includes 3,879 manually processed private rating letters that comprised 2,407 ratings, 1,305 rationale reports that were not billed and 167 filings that were rejected. In 2022 there were 1,961 manual processed private rating letter ratings.

There were also 1,262 carry-over filings for year-end 2023 versus 1,199 in 2022 and 828 in 2021. There were 312 received a “IF” for an accepted initial filing and 950 received a “YE” for an accepted annual update. This represented a carry-over rate for 2023 of 8.1% which is slightly lower than the carry-over rate of 9.2% for 2022 and higher than the carry-over rate of 6.7% for 2021. Generally, a carry-over rate of 10% or higher would be an indication that there is an analytical resource constraint issue for the SVO. As of February 14<sup>th</sup>, there were still 424 carry-over filings remaining.

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

We were also asked to summarize the range of industries the SVO reviews. On the following page is a summary by 77 major industry groupings out of the 332 different Standard Industrial Classification system codes (SIC Code) on which we received filings. There were 4,907 filings without an SIC Code major industry grouping. These are often filing types such as replication synthetic asset transactions (RSATs), structured settlements, credit tenant loans, municipal securities, QUSFI filings and some private rating filings.

<https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-03-19 NAIC Spring NM/07-SVO Year-end Carry-over Filings/2024-xxx.xx SVO Carry Over Filings 2023.docx>

| Major Industry Group   | Number of Filings | % of Filings  |
|--|-------------------|---------------|
| Agricultural Production Crops  | 13                | 0.1%          |
| Agricultural services  | 27                | 0.2%          |
| Agriculture Production Livestock and Animal Specialties  | 1                 | 0.0%          |
| Amusement and recreation services  | 193               | 1.2%          |
| Apparel and accessory stores   | 5                 | 0.0%          |
| Apparel and other finished products made from fabrics and similar materials                                    | 33                | 0.2%          |
| Automotive dealers and gasoline service stations   | 13                | 0.1%          |
| Automotive repair, services, and parking   | 77                | 0.5%          |
| Building Construction General Contractors and Operative Builders   | 53                | 0.3%          |
| Building materials, hardware, garden supply, and mobile home dealers   | 25                | 0.2%          |
| Business services  | 523               | 3.4%          |
| Chemicals and allied products  | 223               | 1.4%          |
| Coal mining  | 9                 | 0.1%          |
| Communications   | 80                | 0.5%          |
| Construction Special Trade Contractors   | 109               | 0.7%          |
| Depository institutions  | 120               | 0.8%          |
| Eating and drinking places   | 31                | 0.2%          |
| Educational services   | 256               | 1.6%          |
| Electric, gas, and sanitary services   | 2182              | 14.0%         |
| Electronic and Other Electrical Equipment and Components, except Computer Equipment                            | 378               | 2.4%          |
| Engineering, accounting, research, management, and related services  | 257               | 1.7%          |
| Executive, legislative, and general government, except finance   | 17                | 0.1%          |
| Fabricated metal products, except machinery and transportation equipment                                       | 70                | 0.5%          |
| Fishing, hunting, and trapping   | 16                | 0.1%          |
| Food and kindred products  | 300               | 1.9%          |
| Food stores  | 143               | 0.9%          |
| Forestry   | 23                | 0.1%          |
| Furniture and fixtures   | 14                | 0.1%          |
| General merchandise stores   | 10                | 0.1%          |
| Health services  | 293               | 1.9%          |
| Heavy Construction Other Than Building Construction Contractors  | 68                | 0.4%          |
| Holding and other investment offices   | 744               | 4.8%          |
| Home furniture, furnishings, and equipment stores  | 10                | 0.1%          |
| Hotels, rooming houses, camps, and other lodging places  | 14                | 0.1%          |
| Industrial and commercial machinery and computer equipment   | 266               | 1.7%          |
| Insurance agents, brokers, and service   | 53                | 0.3%          |
| Insurance carriers   | 177               | 1.1%          |
| Leather and leather products   | 2                 | 0.0%          |
| Legal services   | 11                | 0.1%          |
| Local and suburban transit and interurban highway passenger transportation                                     | 25                | 0.2%          |
| Lumber and wood products, except furniture   | 32                | 0.2%          |
| Measuring, Analyzing, and Controlling Instruments; Photographic, Medical and Optical Goods; Watches and Clocks | 163               | 1.0%          |
| Membership organizations   | 4                 | 0.0%          |
| Metal mining   | 14                | 0.1%          |
| Mining and quarrying of nonmetallic minerals, except fuels   | 24                | 0.2%          |
| Miscellaneous manufacturing industries   | 81                | 0.5%          |
| Miscellaneous repair services  | 5                 | 0.0%          |
| Miscellaneous retail   | 62                | 0.4%          |
| Miscellaneous Services   | 32                | 0.2%          |
| Motion pictures  | 8                 | 0.1%          |
| Motor freight transportation and warehousing   | 65                | 0.4%          |
| Museums, art galleries, and botanical and zoological gardens   | 5                 | 0.0%          |
| National security and international affairs  | 10                | 0.1%          |
| Nonclassifiable Establishments   | 18                | 0.1%          |
| Non-Depository Credit Institutions   | 280               | 1.8%          |
| Oil and gas extraction   | 107               | 0.7%          |
| Paper and allied products  | 51                | 0.3%          |
| Personal services  | 25                | 0.2%          |
| Petroleum refining and related industries  | 28                | 0.2%          |
| Pipelines, except natural gas  | 65                | 0.4%          |
| Primary metal industries   | 23                | 0.1%          |
| Printing, publishing, and allied industries  | 49                | 0.3%          |
| Private households   | 3                 | 0.0%          |
| Public finance, taxation, and monetary policy  | 23                | 0.1%          |
| Railroad transportation  | 30                | 0.2%          |
| Real estate  | 1156              | 7.4%          |
| Rubber and miscellaneous plastics products   | 58                | 0.4%          |
| Security and commodity brokers, dealers, exchanges, and services   | 104               | 0.7%          |
| Social services  | 29                | 0.2%          |
| Stone, clay, glass, and concrete products  | 36                | 0.2%          |
| Textile mill products  | 17                | 0.1%          |
| Transportation by air  | 210               | 1.4%          |
| Transportation equipment   | 220               | 1.4%          |
| Transportation services  | 202               | 1.3%          |
| Water transportation   | 151               | 1.0%          |
| Wholesale Trade-Durable Goods  | 226               | 1.5%          |
| Wholesale Trade-Non-Durable Goods  | 162               | 1.0%          |
| (blank)  | 4907              | 31.6%         |
| <b>Grand Total</b>   | <b>15549</b>      | <b>100.0%</b> |