

2020 Summer National Meeting
Conference Call

VALUATION OF SECURITIES (E) TASK FORCE

Friday, August 7, 2020

12:30 p.m. – 1:30 p.m. ET / 11:30 a.m. – 12:30 p.m. CT / 10:30 a.m. – 11:30 a.m. MT / 9:30 a.m. – 10:30 a.m. PT

ROLL CALL

Robert H. Muriel, Chair	Illinois	Chlora Lindley-Myers	Missouri
Doug Ommen, Vice Chair	Iowa	Bruce R. Range	Nebraska
Lori K. Wing-Heier	Alaska	Marlene Caride	New Jersey
Ricardo Lara	California	Linda Lacewell	New York
Andrew N. Mais	Connecticut	Jessica Altman	Pennsylvania
Trinidad Navarro	Delaware	Kent Sullivan	Texas
David Altmaier	Florida	Todd E. Kiser	Utah
Dean L. Cameron	Idaho	Scott A. White	Virginia
Vicki Schmidt	Kansas	Mike Kreidler	Washington
James J. Donelon	Louisiana	Mark Afable	Wisconsin
Kathleen A. Birrane	Maryland		
Gary Anderson	Massachusetts		

NAIC Support Staff: Charles A. Therriault

AGENDA

1. Consider Adoption of its May 14 and July 1, 2020 minutes. Attachment One
Attachment Two
—Kevin Fry (IL)
2. Consider Adoption of a Proposed Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to Map Short-term CRP Ratings to NAIC Designation Categories Attachment Three
(Doc. ID 2020-023-01)
—Kevin Fry (IL), Charles Therriault (NAIC), Eric Kolchinsky (NAIC)
3. Consider Adoption of a Proposed Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to Add Supranational Entities Filed with the SVO to the Sovereign NAIC Designation Equivalent List Attachment Four
(Doc. ID 2020-021-01)
—Kevin Fry (IL), Charles Therriault (NAIC), Eric Kolchinsky (NAIC)
4. Receive a Proposed Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to Add Instructions for ETFs that Contain a Combination of Preferred Stocks and Bonds Attachment Five
(Doc. ID 2019-011-01)
—Kevin Fry (IL), Charles Therriault (NAIC)
5. Receive a Proposed Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to Update Guidance on Initial and Subsequent Annual Filings, and Methodologies and Documentation Attachment Six
(Doc. ID 2020-025-01)
—Kevin Fry (IL), Charles Therriault (NAIC)

6. Hear a Staff Report on Projects Before the Statutory Accounting Principles (E) Working Group
—Kevin Fry (IL), Julie Gann (NAIC)
7. Hear an SSG Staff Report on RMBS/CMBS Modeling
—Eric Kolchinsky (NAIC)
8. Consider Adoption of 2021 Charges
—Kevin Fry (IL), Charles Therriault (NAIC)
9. Adjournment

Attachment Seven

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Draft Pending Adoption

Draft: 6/2/2020

Valuation of Securities (E) Task Force
Conference Call
May 14, 2020

The Valuation of Securities (E) Task Force met via conference call May 14, 2020. The following Task Force members participated: Robert H. Muriel, Chair, represented by Kevin Fry (IL); Doug Ommen, Vice Chair, represented by Carrie Mears (IA); Lori K. Wing-Heier represented by Wally Thomas (AK); Ricardo Lara represented by Laura Clements (CA); Andrew N. Mais represented by Kathy Belfi (CT); David Altmaier represented by Ray Spudeck (FL); Dean L. Cameron represented by Eric Fletcher (ID); Vicki Schmidt represented by Tish Becker (KS); James J. Donelon represented by Stewart Guerin (LA); Gary Anderson represented by John Turchi (MA); Al Redmer Jr. represented by Matt Kozak (MD); Chlora Lindley-Myers represented by Debbie Doggett (MO); Bruce R. Ramge represented by Lindsay Crawford (NE); Marlene Caride represented by John Sirovetz (NJ); Linda A. Lacewell represented by Jim Everett (NY); Jessica K. Altman represented by Kimberly Rankin (PA); Kent Sullivan represented by Jamie Walker (TX); Todd E. Kiser represented by Jake Garn (UT); Scott A. White represented by Doug Stolte (VA); Mark Afable represented by Randy Milquet (WI).

1. Adopted its 2019 Fall National Meeting and Feb. 4, 2020, Minutes

Mr. Fry said the Task Force met Feb. 4, 2020, and Dec. 8, 2019. During its Feb. 4, 2020, meeting, the Task Force took the following action: 1) discussed amendments to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to: a) remove the financial modeling instructions for residential mortgage-backed securities (RMBS)/commercial mortgage-backed securities (CMBS); and b) clarify that the sovereign rating limitation applies to filing exemption (FE); 2) received an updated amendment to the P&P Manual for the definition and instructions for principal protected notes (PPNs); and 3) adopted an amendment to reflect the U.S. Securities and Exchange Commission's (SEC) adoption of a new rule to modernize the regulation of exchange-traded funds (ETFs).

Mr. Thomas made a motion, seconded by Ms. Clements, to adopt the Task Force's Feb. 4, 2020 (Attachment) and Dec. 8, 2019 (see *NAIC Proceedings – Fall 2019, Valuation of Securities (E) Task Force*) minutes. The motion passed unanimously.

2. Adopted an Updated Amendment to the P&P Manual of Instructions to Map Financial Modeled RMBS/CMBS Security NAIC Designations to NAIC Designations Categories

Mr. Fry said the next item is to discuss the amendment to map the financially modeled RMBS/CMBS securities to NAIC designation categories. This amendment was received at the 2019 Fall National Meeting, and its purpose is for year-end 2020 to have an electronic-only column that will capture the 20 new NAIC designation categories. The existing NAIC designations 1–6 will still apply for RBC, but the NAIC designation categories will be captured to study that data. This amendment will map into that electronic-only NAIC designation category column. Comments were received from industry about mapping zero loss securities, and in talking with NAIC staff, the mapping was made to the midpoint of the NAIC designation category. NAIC staff agreed that with zero loss securities, it may make sense to consider mapping them to the 1.A, which is the strongest result through the modeling process where there are no losses through the most extreme scenarios. The Task Force did look at the policy issue of whether it should continue to use price break points in the future, and it talked about using a single NAIC designation, as was done in the past before modeling. The Task Force received comments from different stakeholders that it was not the direction that many wanted to go; that option is not being considered at this time.

Josh Bean (Transamerica Capital Strategy representing the American Council of Life Insurers—ACLI) said that the ACLI and North American Securities Valuation Association (NASVA) comment letter expressed support for the proposal but did request the maintenance of the standard for mapping RMBS and CMBS tranches that have no expected loss under any of the modeling scenarios to the highest grade of NAIC designation categories.

Steve Broadie (American Property and Casualty Insurance Association—APCIA) said he also supports the amendment, as revised.

Mr. Kozak made a motion, seconded by Ms. Crawford, to adopt the revised amendment to map financially modeled NAIC designations for RMBS/CMBS to NAIC designation categories, including mapping the zero-loss bonds to the 1.A NAIC designation category. The motion passed unanimously.

3. Adopted a Proposed Amendment to the P&P Manual for PPNS with an Updated Definition and Instructions

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Mr. Fry said this agenda item is to consider adoption of the updated amendment defining principal protected securities. The Task Force began discussing this agenda item at the 2019 Summer National Meeting. NAIC staff identified certain classes of securities where the credit ratings did not reflect a state insurance regulator's view of risk. NAIC staff recommended that those securities no longer be eligible for FE and should be filed with the Securities Valuation Office (SVO). The Task Force asked NAIC staff to work with industry and other interested parties on the definition to create language that would not create any unintended consequences but still achieve the objective of the Task Force.

Charles Therriault (NAIC) said as mentioned, Investment Analysis Office (IAO) staff met with industry many times to exchange ideas on this proposal and hear each other's concerns on the definition of principal protected securities. The updated definition in this amendment, which was previously exposed, is the culmination of those discussions and provides an excellent outline of the regulatory and analytical issues presented by these securities. The framework identifies principal protected securities (PPS) as a type of security that repackages one or more underlying investments for which contractually promised payments according to a fixed schedule (principal and, if applicable, interest, make whole payments and fees) are satisfied by proceeds from an underlying bond(s) and that if purchased by an insurance company on a stand-alone basis would be eligible for FE, but for which the repackaged security structure enables potential returns from other underlying investments. Also, the insurer would obtain a more favorable risk-based capital (RBC) charge or regulatory treatment for the PPS through FE than it would were it to separately file the underlying investments. Investments meeting these criteria will need to be filed with the SVO to determine if the security possesses other non-payment risks, something that only the SVO can assess under its Subscript S authority. There were a few noted exclusions, such as defeased or pre-refunded securities, and broadly syndicated securitizations.

Mr. Therriault said NAIC staff believe this criteria, which was discussed exhaustively with interested parties, hit upon the core issue—restructuring an investment to receive a more favorable RBC charge without a commensurate change to the risk profile. The SVO would also have adequate analytical discretion necessary to make those determinations. At industry's request, included in the definition are examples of these transactions. The goal of adding the examples was to provide additional clarity as to the regulatory concern. However, the examples are only meant to be examples and do not reflect all possible variants. The current stressed credit markets only reinforce how critically important it is to accurately reflect the investment risk. IAO staff recommend that the Task Force adopt this amendment but consider an adequate time for insurers to transition to this new requirement.

Mr. Fry said one message that is clear is that if the Task Force were to adopt this amendment and make these securities ineligible for FE, there is still a route to assign an NAIC designation. The NAIC designation might be different, but it is likely that most of these could be assigned an NAIC designation. One thing for the Task Force to consider is how it will implement this change and give time to those insurers that have exposure to these investments. An effective implementation date of Jan. 1, 2021, would mean that for year-end 2020, there would not be an RBC impact and give insurers time in year 2021. There should be a date by which they should be filed with the SVO in 2021 to give the SVO time to review them, if the Task Force took that approach instead of an immediate adoption.

Ms. Belfi, Mr. Thomas, Mr. Sirovets, Mr. Milquet, Ms. Becker and Ms. Mears all agreed to extend the effective date for the amendment to Jan. 1, 2021, with a mid-year 2021 filing deadline.

Mr. Fry said there were three comment letters. One was from Connie Jasper Woodroof (Sapiens), which requested the amendment title be changed from "principal protected notes" to avoid confusion with the abbreviation "PPN," which has another meaning. These securities could instead be called "principal protected securities."

Mr. Bean said the joint ACLI and NASVA comment letter supports the adoption of the scope guidance and also supports the discussion by the members of the Task Force on the effective date. The comment letter did request some continuing engagement by the IAO as this advances into the implementation phase with an illustrated walkthrough of the weighted average rating factor (WARF) methodology specially using a transaction type example that was provided in the proposed amendment and some additional discussion around the new administrative filing process.

John Guyot (Security Benefit Life Insurance Company) said that there were no additional comments other than what was provide in their comment letter and that he appreciates the direction in delaying the implementation effective date.

Mr. Milquet asked what the procedure would be for securities purchased after the Jan. 1, 2021, implementation effective date. Mr. Therriault said that it would only be the securities acquired prior to the Jan. 1, 2021, implementation effective date that would need to be filed by the suggested July 1, 2021, deadline and any PPS acquired after the implementation effective date would follow the existing filing deadline instructions.

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Ms. Belfi made a motion, seconded by Mr. Sirovets, to adopt this amendment, with the title and text revised to call them principal protected securities or PPS, removing these securities from FE eligibility and requiring all PPS, including those currently designated under the FE process, to be submitted to the SVO for review under the Subscript S authority beginning Jan. 1, 2021, and filed with the SVO by July 1, 2021, if previously owned. The motion passed unanimously.

4. Received and Exposed an IAO Issue Paper on NAIC Staff Concerns about Bespoke Securities and Reliance on CRP Ratings

Mr. Fry said item four on the agenda is to receive an IAO issue paper on bespoke securities and reliance on credit ratings provider (CRP) ratings. This item was discussed at the 2019 Summer National Meeting, where the Task Force began talking about this concept of certain securities that were not broadly marketed and with one rating or a private rating. The Task Force has tried to develop a process for state insurance regulators to better understand these risks and, after hearing that report, directed NAIC staff to work on recommendations along those lines.

Mr. Therriault said NAIC staff have been raising their concerns about bespoke securities and the excessive reliance upon rating agency ratings to the Task Force for some time. The paper mentions the discussion that occurred during the Task Force's May 2019 educational seminar, but these concerns go back much further. During the 2019 Summer National Meeting, the Task Force requested NAIC staff to summarize these concerns and make recommendations to remediate them in an issue paper, which was done with this memorandum. Two primary but interrelated concerns were identified:

- a) Bespoke securities: These are securities that are not broadly syndicated, created for one or a few investors, and assigned a rating—often private—by only one ratings provider, and the participants often deliberately keep the terms of structure private.
- b) Reliance on CRP ratings: The Task Force uses ratings to determine NAIC designations under the FE policy, which includes recognizing private ratings, but there is no explicit oversight assigned to the NAIC staff to monitor CRP rating use or their analytical basis despite this extensive reliance.

As requested by the Task Force, NAIC staff have made several recommendations in this issue paper that they believe will remediate many of these issues. In preparing these recommendations, NAIC staff also considered the recommendations made in response to the 2008 Great Recession by the Ratings Agency (E) Working Group in its memorandum, dated April 28, 2010, to the Financial Condition (E) Committee. Those recommendation were subsequently adopted by that Committee and the NAIC. A few of the Ratings Agency (E) Working Group's recommendations are included in the issue paper, and its full report to the Financial Condition (E) Committee is included as an attachment. Many of the recommendations by the Working Group are consistent with the recommendation in this issue paper, including:

- a) Explore how to reduce reliance on ratings.
- b) Consider alternatives to assess insurers' investment risk, including expanding the role of and state insurance regulator reliance on the SVO.
- c) When considering continuing to use ratings in insurance regulation, take into account steps taken to correct the prior ratings shortfalls.
- d) Establish a process to monitor and evaluate rating agency activities, including permitting timely intervention to set regulatory treatment of risk securities.
- e) Modify the FE rule, including developing alternative methodologies for assessing structured security risks.

Mr. Therriault said that these recommendations were approved by the Financial Condition (E) Committee in 2010, but they were not fully implemented, and many are being recommended again in this issue paper as they are still relevant today. The IAO staff recommend that the issue paper be exposed for a lengthy comment period. There are no actionable items in the issue paper but request the Task Force to authorize the SVO to begin developing proposals to remediate these long-standing issues identified in the issue paper and by the Ratings Agency (E) Working Group.

My. Fry said that he thinks a long exposure period would be appropriate. The Task Force is not looking to make changes in the middle of this current financial situation and is aware of work going on with other groups. It is important to expose this and continue the discussion. He said that he recalls the work in 2010 of the Ratings Agency (E) Working Group. That report did not say the Task Force would not use ratings; it said that the Task Force should not blindly rely on ratings. In certain situations, RMBS and CMBS, the Task Force no longer uses ratings and models those securities. There was a similar decision today with PPS. The purpose of this paper is to identify areas where ratings are not working for regulatory purposes, and the Task Force encourages the SVO to make incremental recommendations to address these situations.

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Mike Reis (Northwestern Mutual representing the ACLI) said the ACLI supports a long exposure due to the COVID-19 virus and what it is doing to the ACLI's capability to address these issues. He also said he thinks there is overlap with what is occurring at the Statutory Accounting Principles (E) Working Group.

Mr. Everett made a motion, seconded by Mr. Guerin, to expose the issue paper for a 90-day public comment period ending Aug. 16 and begin drafting incremental recommendations for the Task Force to consider addressing these risks. The motion passed unanimously.

5. Received and Exposed a Proposed Amendment to the P&P Manual with Updated Instructions for Nonconforming CTL Transactions that Relied Upon Credit Ratings

Mr. Fry said the next item relates to P&P Manual instructions for nonconforming credit tenant loan (CTL) transactions. All CTL transactions need to be filed and designated by the SVO, rating agency ratings cannot be used, and CTLs are not eligible for FE. There is a set of securities that do not meet the criteria for CTL but have been rated by rating agencies. Industry made the assumption that these transactions were eligible for FE, which the Task Force has now said they are not. Last year, the Task Force agreed to try to find a solution for these securities and not take any immediate action. Part of this was worked out for some of these nonconforming CTLs with the recent adoption of guidance for ground lease financing transactions. Mr. Fry said that Marc Perlman (NAIC) will summarize this amendment to address this additional group of securities.

Mr. Perlman said that the Task Force and NAIC staff heard from industry on a few occasions that they are very concerned about this population of securities that have the basic legal and structural characteristics of a CTL but have a variation or deviation that does not conform to the existing guidance. Included with this CTL amendment, there is an update to the Task Force policy on "The Use of Credit Ratings of NRSROs in NAIC Processes." The policy currently states, "The sole NAIC objective in obtaining and using publicly available credit ratings is to conserve limited regulatory resources; e.g. the resources of the SVO." The policy then clarifies that in its use of CRP ratings, the NAIC is not "endorsing the credit rating or analytical product of any CRP." Nothing about the policies related to the use of CRP ratings should be interpreted, as was seemingly the case with the nonconforming CTLs and certain other investments, that the Task Force has approved the use of CRP ratings for the determination of NAIC designations or for any other purpose, other than conserving SVO staff resources. The updates to this policy guidance affirm the Task Force's role in making all decisions on the use of CRP ratings and provides additional guidance to insurance company filers on what to do if they are uncertain about the filing procedure to avoid this situation in the future.

The SVO further recommends a "grandfathering" provision for previously owned nonconforming CTLs by filing them with the SVO for assessment. It will also authorize the SVO to use its judgement in assessing eligibility and assignment of an NAIC designation. SVO staff recommend exposing this amendment and simultaneously referring it to the Statutory Accounting Principles (E) Working Group requesting it to affirm that it would consider these nonconforming CTLs to have the characteristics of a bond if assigned an NAIC designation by the SVO staff.

Mr. Everett asked if VO staff knew how far back these deals go and what the documentation is going to entail. Mr. Therriault said they do go back some time and expects that documentation will be available. The SVO would be looking for the transaction legal agreements and the rating agency analysis and expects that industry will still have those documents for investments they own.

Mr. Reis said there is a meaningful number of these securities that currently do not have a home and need to be addressed. He said the ACLI appreciates this issue being brought forward along with the referral to Statutory Accounting Principles (E) Working Group.

John Garrison (Lease-Backed Securities Working Group) said the Lease-Backed Securities Working Group has been working with the SVO over the past few years on several types of securities not explicitly covered in the P&P Manual, such as ground lease financing transactions and other lease-based securities that do not meet the P&P Manual's definition of a CTL. The group is committed to working closely with the SVO, the Task Force, the Private Placement Investors Association (PPIA), the ACLI, NASVA and other key parties to develop clear and consistent guidelines for all real estate and lease-backed securities. Mr. Garrison said the collective goal should be to avoid using terms such as nonconforming CTLs, which may create confusion and complexity to investors, state insurance regulators and industry alike. In December 2019, the Task Force adopted guidance for ground lease financing transactions, and Mr. Fry complimented this work as "the best of what the Task Force does when it works with industry," noting that the SVO worked closely with industry to come to a solution. It was also noted at that meeting that the Task Force will need to do additional work to determine a solution for these other types of lease-backed securities that do not meet the strict definitions of either CTLs or ground lease financing (GLF) transactions. The framework for GLF

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transactions could be used for this effort. The first few months of this year have been devoted to filing the new GLF transactions through the Regulatory Treatment Analysis Service (RTAS) process, and these efforts have resulted in appropriate outcomes and facilitated ongoing refinements to the submission process. The April 30 memorandum from the SVO notes that “nonconforming CTL transactions acquired by insurers after Dec. 31, 2019, shall not be reported as bonds,” and the Lease-Backed Securities Working Group believes this guidance would be a mistake. Mr. Fry thanked Mr. Garrison for his comments. Mr. Fry said that this was just an exposure and that the Task Force would strive for a solution by the end of the year.

Ms. Thomas made a motion, seconded by Ms. Rankin, to expose this amendment updating the Task Force policy on “The Use of Credit Ratings of NRSROs in NAIC Processes” and instructions for nonconforming CTL transactions that relied upon credit ratings for a 30-day public comment period ending June 17 and send a referral to the Statutory Accounting Principles (E) Working Group.

6. Received and Exposed a Proposed Amendment to the P&P Manual for Technical NAIC Designation Category Corrections

Mr. Fry said the agenda item is to receive an amendment for technical NAIC designation category corrections. This agenda item is similar to what the Task Force did earlier when preparing to create an electronic-only column that will have 20 designations, and there were some decisions that had to be made with where on the scale does the 1 fall—1.A or 1.F. A few recommendations have been made about this exposure for some securities to receive a 1.A, which is the strongest of the seven categories of an NAIC 1. There are also recommendations for the 5 GI process to set them to a 5.B GI. This guidance needs to be updated in the P&P Manual.

Mr. Everett said in the RBC instructions, there are no lines for these. He asked what the use of the designation would be here. Mr. Therriault said every security on schedule D requires an NAIC designation and an accompanying NAIC designation category. This is a technical correction to give reporting instructions for NAIC designations assigned by policy to also have an NAIC designation category. Mr. Everett asked if any of these anticipated changes or identified securities might be adjusted for more than an administrative adjustment. Mr. Therriault said the recommendations in the amendment were for NAIC designations set by policy, such as the 5GI being set to 5.B GI, in NAIC staff’s recommendation, to accommodate the NAIC designation category using the midpoint NAIC designation modifier, in this instance.

Nancy Bennett (American Academy of Actuaries—Academy) said the exposure appears to be putting U.S. government Treasury securities in category 1.A, which means that those types of securities will get an RBC factor assigned to them. She said that U.S. Treasury securities have always gotten a zero RBC and asked if that was intentional or a mistake. Mr. Therriault said that this amendment is for a production of an NAIC designation, and there are separate instructions for RBC purposes. Ms. Bennett suggested that what is being proposed looks different from what was adopted a couple of weeks ago. Mr. Fry said that he thinks there is a category that is different from a 1.A for RBC reporting, but that can be sorted out in the exposure period.

Chris Anderson (Anderson Insights LLC) said there are seven designations—zero through six. He said if the full faith and credit Treasury is listed in the P&P Manual and picks up an NAIC 1, it will pick up an RBC factor. In order to avoid that, it will have to be zero. If you assign a 1 to these exempt securities, they will pick up RBC factors in the calculations. Mr. Therriault said the text in the amendment is an existing instruction in the P&P Manual to assign these securities an NAIC designation by policy. The only new instruction in this amendment is the addition of the NAIC designation category; all the other declarations for NAIC designation treatment by policy remain the same. Julie Gann (NAIC) said NAIC staff have been working with RBC staff regarding the mapping. The additional category that separated out these securities would be 1.A for reporting and would be divided in the RBC calculations. Ms. Gann said that she would work with the RBC team to make sure that is clear and, if need be, to revise the RBC guidance during the exposure period. John Dubois (MassMutual) said for an extension of this, it will also need to apply to asset valuation reserve (AVR) as well as RBC. He said the exempt are also getting a zero factor for AVR. Mr. Anderson said while this is an update of the language that is in the P&P, as it exists today, it does not provide for zero factor.

Karla Streeter (MetLife) said at the last NASVA meeting in March, the need to include an NAIC designation category grid for short-term securities in the P&P Manual was discussed with Mr. Therriault. The long-term securities have the NAIC designation modifier, but there is not one for the short-term investments. She said insurance companies need those because it is required for the schedules at year-end. Mr. Therriault had asked NASVA to bring it up so the Task Force can consider adding those to the P&P Manual grid. Mr. Therriault said that a separate amendment to address this can be drafted.

Mr. Milquet made a motion, second by Mr. Sirovets, to receive this amendment for technical NAIC designation category corrections and expose it for a 30-day public comment period ending June 17.

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7. Heard a Report from the SSG on RMBS and CMBS

Mr. Fry said the next item on the agenda is to hear a report from Eric Kolchinsky (Structured Securities Group/SSG) on RMBS and CMBS.

Mr. Kolchinsky said as a result of the fallout from COVID-19, as well as the various shutdowns and disruptions in business activities, there has been a number of questions on how the SSG will respond with year-end modeling given these developments. The first way this can be addressed is through the economic scenarios. Starting in 2016, interested parties requested that the NAIC to explore “through the cycle” (TTC) modeling, meaning the models for real estate would not change depending upon what part of the cycle you were in. The current models are pro-cyclical (depend upon what part of the cycle you are in). As year-end approaches, there is a good chance that there will be downward economic scenarios that may not be the best alternative. NAIC staff was and continues to be supportive of TTC modeling. A set of RMBS TTC economic scenario models was exposed in 2017, including R code, that could be used to generate those scenarios. However, due to time constraints, corresponding CMBS scenarios were never developed. Developing these TTC models is within the Task Force’s discretion. Mr. Kolchinsky said if this is something that the Task Force would like the SSG to pursue, the TTC models can be re-exposed, and the SSG can begin working on a CMBS TTC model.

Mr. Kolchinsky said the SSG has also been asked to consider adjustments for collateral. In many cases, there is an increase in forbearances in mortgages. It is difficult to determine how much is going through the system because of the lag in reporting on the residential and commercial loan side. Lodging, retail and office space seem to have been affected the greatest in the medium-to long-term. SSG staff believe that considering that our analysis will take place at year-end, it is too early to make these decisions. With the benefit of time, a better understanding of the permanence of the effects of the COVID-19 non-payments will emerge. He said the SSG would like guidance from the Task Force on the development of the TTC models. Mr. Kolchinsky said SSG staff will come back to the Task Force with any recommendation on collateral adjustments and hope to produce mid-year analysis this year – most likely in early fall.

Mr. Fry said that the Task Force has looked at the TTC models before, but they received a lukewarm reception by industry. Given the current environment, he said the Task Force would appreciate feedback on these models.

8. Discussed Temporarily Extending Insurers’ 2020 Initial Filing Deadline from 120 Days to 165 Days for Newly Acquired or Securities in Transition

Mr. Fry said the next item to discuss is to temporarily extend the 2020 initial filing deadline from 120 days to 165 days for newly acquired or in-transition securities. NAIC staff recommended this because of the challenges of working from home due to COVID-19.

Tracey Lindsey (NASVA/Nationwide) and Michael Monahan (ACLI) said they appreciate and fully support the initial filing extension for this year as there will likely be additional work filing material credit events and providing additional information on annual updates.

Mr. Fry asked if there were any objections to this filing deadline extension by the Task Force members, and no members objected. Mr. Fry directed NAIC staff to include in the minutes that the filing deadline for the initial filing of newly acquired or in-transition securities in 2020 would be 165-days instead of the usual 120-days.

9. Heard an NAIC Staff Report on Rating Agency Actions YTD

Michele Wong (NAIC) said the global economic impact of the COVID-19 pandemic and the sharp decline in oil prices have contributed to significant pressure on credit quality. Many companies are experiencing a decline of revenue and cash flow. Rating agencies have taken a record number of negative rating actions. The credit impact has been pretty broad-based touching all sectors. The sectors experiencing the most rating actions are autos, transportation, travel and leisure, hotel and gaming, media and entertainment, retail and restaurants, and oil and gas. Highly leveraged companies account for the majority of rating action as they tend to have weaker liquidity and refinancing profiles.

Moody’s took approximately 1,200 rating actions in March and April, with approximately half resulting in downgrades. About 18% of Moody’s global corporate rated universe, with 90% of that high yield and 10% investment grade. Moody’s downgraded 23% of high yield companies, but only about 6% of investment grade companies. About one-third of Moody’s rated portfolio has a negative bias reflecting the high level of uncertainty surrounding the end of the health crisis and the speed and shape of economic recovery. At the end of April, about 8% of companies across all rating categories were on review for downgrade, and 27% carried a negative outlook. Fallen angels are issuers that have been downgraded from investment grade to high yield.

Moody's had 27 fallen angels. Oil, gas, auto and retail sectors account for 85% of that Fallen Angel debt. The number of potential fallen angels or issuers that are currently rated and either under review for downgrade or have a negative outlook has increased to 75 issuers from about 35 at the beginning of 2020.

Standard & Poor's (S&P) took almost 1,700 rating actions as of May 8 with almost half downgrades, 10% credit watch negative placement and the rest negative outlook revisions. S&P downgrades represented 18% of rated issuer universe, and 4.5% of rated issuers were downgraded more than one notch. High-yield issuers represented about 70% of S&P's rating actions, with 60% of them at the single-B and below ratings level. More than two-thirds of issuers in the auto, oil and gas, retail, and leisure sectors are on CreditWatch negative or have a negative outlook, so further downgrades are possible. At S&P, fallen angels totaled 23 as of mid-April. The midstream energy, oil and gas, autos, and retail and restaurants sectors have had the largest number of fallen angels.

Ms. Wong said that this information was being shared with members of the Task Force in a "Rating Agency Newsletter." There was a request to share this information. Mr. Kolchinsky responded that this information is publicly available to subscribers to those rating agency services but that the NAIC is not permitted to share that information with outside parties.

10. Heard an NAIC Staff Report on Requirements for Material Credit Events and Issuer Amendments or Refinancing an Existing Issue

Linda Phelps (NAIC) said business disruptions related to COVID-19 are obviously affecting many of the companies that insurers have invested in. The SVO would like to remind insurers to remain vigilant in their surveillance activities and remember to promptly file material change statements with the SVO. An insurance company is obligated to report any "material change" of an investment that could affect the assessment of credit quality. Guidance on what is considered a "change in credit characteristics" or a "material change" can be found in the P&P Manual and can include the following:

- Any material changes in business or financial characteristics.
- A bankruptcy, insolvency or court-ordered reorganization.
- A payment default or an uncured and unwaived covenant default.
- A workout or restructuring resulting in modification of terms (e.g., interest rate, extension of the time for the payment of any amount due)
- A determination that an issue is impaired

Material change filings are the responsibility of all holders of the investment, not just the lead lender.

- Filing should include any relevant business or financial information and/or legal documentation relating to loan modification or forbearance activity.

For 2020 filings, the SVO's overall measured and thoughtful approach to assessing credit quality has not changed and is in line with the approach taken by many rating agencies.

- Continue to consider the business and financial positions of the companies.
- Look at both historical financial information along with more recent performance based on information provided by filers and publicly available sources.
- Liquidity will be an important consideration.
- The impact to designations as a result of COVID-19 disruptions will vary by industry and for individual participants. The SVO anticipates outcomes will range from no change at all to multi-notch downgrades to defaults.
- The impact of business disruptions is expected to be greater for speculative grade companies as compared to better positioned investment grade companies.

The SVO expects the evaluation of credit risk to be a fluid process throughout the year given the many unknowns at this point. While the SVO does not typically receive many material change filings, they will be important this year, and the SVO encourages insurers to file them promptly.

11. Heard an NAIC Staff Report on the Year-End Process and Carry-Over

Mr. Therriault said as of Dec. 31, 2019, the SVO had completed 11,060 filings for the year and had a total backlog of 869 security filings. This security filings backlog was down 241 filings versus the Dec. 31, 2018, backlog of 1,110 security filings. This was the first year-end using the carry-over administrative symbols. There were 354 year-end (symbol "YE"), carry-over

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filings that had their previous NAIC designation extended over year-end. There were 514 initial-filing (symbol “IF”) carry-over filings that permitted self-reporting of an NAIC designation, reflecting that it was properly filed with the SVO. There was only one filing that the SVO was unable to accept for year-end carry-over processing. As of April 30, 2020, there were only six remaining filings from the prior filing year. From the SVO perspective, the 2019 backlog was manageable, and the new carry-over administrative process worked as expected.

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

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Draft: 7/23/2020

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Valuation of Securities (E) Task Force
Conference Call
July 1, 2020

The Valuation of Securities (E) Task Force met via conference call July 1, 2020. The following Task Force members participated: Robert H. Muriel, Chair, represented by Kevin Fry (IL); Doug Ommen, Vice Chair, represented by Carrie Mears (IA); Lori K. Wing-Heier represented by Wally Thomas (AK); Ricardo Lara represented by Laura Clements (CA); Andrew N. Mais represented by Kathy Belfi (CT); David Altmaier represented by Ray Spudeck (FL); Dean L. Cameron represented by Eric Fletcher (ID); Vicki Schmidt represented by Tish Becker (KS); James J. Donelon represented by Stewart Guerin (LA); Kathleen A. Birrane represented by Matt Kozak (MD); Chlora Lindley-Myers represented by Debbie Doggett (MO); Bruce R. Ramage represented by Lindsay Crawford (NE); Marlene Caride represented by John Sirovetz (NJ); Linda A. Lacey represented by Jim Everett (NY); Jessica K. Altman represented by Kimberly Rankin (PA); Kent Sullivan represented by Jamie Walker (TX); Todd E. Kiser represented by Jake Garn (UT); Scott A. White represented by Doug Stolte (VA); and Mark Afable represented by Randy Milquet (WI).

1. Adopted a Proposed Amendment to the P&P Manual for Technical NAIC Designation Category Corrections

Mr. Fry said this proposed non-substantive amendment was received during the Task Force's May 14 conference call and was exposed for a 30-day public comment period that ended on June 17. The amendment makes several technical updates that are needed prior to year-end, related to the implementation of NAIC designation categories. The Securities Valuation Office (SVO) identified 14 policy-based instructions that assign NAIC designations. In this case the SVO is only assigning one through six, and under the new NAIC designation category, the Task Force has to break that down in 20 of either 1.A. or 1.B. or 2.A. B, C. There are 14 policy-based decisions that needed to be corrected in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual). One example of these are the U.S. government securities that were assigned an NAIC 1 and now are an NAIC 1.A under the new policy.

Charles A. Therriault (NAIC) said the SVO had permitted some proposals when this was originally considered in December 2017 when it first came up with the concept of NAIC designation categories. He said the SVO had put some ideas out there about administrative symbols for the U.S. Government Full Faith and Credit and other government entities, but the Task Force directed the SVO not to proceed with it in 2018. This is why the NAIC has the category symbols it has today. Mr. Therriault said the SVO is happy to initiate a second project to look at that in conjunction with Capital Adequacy (E) Task Force and believes it to be beneficial for that purpose.

Mr. Everett said he had received comments from a couple of companies that suggested this will be helpful because some companies have the securities in and have to pull out for asset valuation reserve (AVR) and interest maintenance reserve (IMR). Using this will prevent the necessity of two calculations when just being able to identify them through designation will enable them to pull them out easily.

Mr. Thomas made a motion, seconded by Mr. Milquet, to adopt the amendment for technical NAIC designation category correction. The motion passed unanimously.

2. Adopted an Amendment to Rename the U.S. Direct Obligations/Full Faith and Credit Exempt List to the NAIC U.S. Government Money Market Fund List and Discontinue the NAIC Bond Fund List

Mr. Fry said the next item on the Task Force's agenda is to consider adoption of an amendment to rename the U.S. Direct Obligations/Full Faith and Credit Exempt List to the NAIC U.S. Government Money Market Fund List and discontinue the NAIC Bond Fund List. This was first discussed by the Task Force during its Oct. 31, 2019, conference call. The proposal was exposed for a 45-day public comment period that ended on Dec. 16, 2019. It was also referred to the Statutory Accounting Principles (E) Working Group.

As mentioned in the staff memorandum dated Sept. 30, 2019, the first proposed change is to rename the U.S. Direct Obligations/Full Faith and Credit Exempt List to the much simpler description, and the second is to eliminate the NAIC U.S. Government Money Market Fund List.

There were only four funds on this list for 2019; only one of those four was owned by an insurance company. Part of the criteria to be on the list is to maintain the highest market risk rating. Market risk ratings is going to go away, and this will not be a

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criteria anymore. This is another reason why this list should go away, and there is still the exchange-traded fund's (ETF) approved route.

Mr. Everett asked what will be replacing the risk rating. Mr. Therriault said there is no replacement for the market risk rating.

Ms. Mears made a motion, seconded by Mr. Kozak, to adopt the amendment to rename the U.S. Direct Obligations/Full Faith and Credit Exempt List to the NAIC U.S. Government Money Market Fund List and discontinue the NAIC Bond Fund List. The motion passed unanimously.

3. Exposed a Proposed Amendment to the P&P Manual to Map Short-term CRP Ratings to NAIC Designation Categories

Mr. Fry said that during the Task Force's May 14 conference call, the North American Securities Valuation Association (NASVA) requested the table in the P&P Manual mapping credit rating provider ratings for short-term instruments be updated to also map them to NAIC designation categories. The Task Force directed SVO staff to draft that update, now reflected in this amendment. He asked Mr. Therriault to provide a summary of this change.

Mr. Therriault said short-term ratings do not have a one-for-one mapping to long-term credit ratings. The short-term ratings cover a range of long-term ratings. Moody's Prime-1 (P1) short-term rating covers the long-term rating range that includes: Aaa, Aa1, Aa2, Aa3, A1, A2 and A3. The SVO recommends mapping the NAIC designation category to the mid-point of these long-term rating ranges. In this instance, the P1 short-term rating would be mapped to the NAIC designation category of 1.D or a Moody's long-term rating equivalent of Aa3. This approach was applied to each short-term rating mapping.

There were also updated references to policies related to the use of credit ratings in the P&P Manual along with a footnote to identify that there are many more ratings symbols than those displayed on the this generic list when the various combinations of prefixes and suffixes are included. There was also one previous erratum in the long-term ratings table that was identified; the AM Best rating symbol bbb+ was mapped to both NAIC designation category 2.A and 2.B. The table was missing the AM Best rating symbol bbb, which has now been added and mapped to 2.B. This was only an issue in the P&P Manual and did not affect any NAIC system.

Mr. Therriault said the SVO does not currently translate, compile or publish short-term security ratings into NAIC designations in the AVS+ system. If the Task Force would like the SVO to do so, it would need to be a separate initiative. The SVO recommends the Task Force expose this non-substantive update for public comment.

Mr. Monahan (American Council of Life Insurers—ACLI) said the ACLI supports an expedited 25-day exposure period for this item. Mr. Fry directed the SVO to expose this amendment for a 25-day public comment period ending Jul. 27, 2020.

4. Exposed a Proposed Amendment to the P&P Manual to Add Supranational Entities Filed with the SVO to the Sovereign NAIC Designation Equivalent List

Mr. Fry introduced the next item to add supranational entities filed with the SVO to the Sovereign NAIC Designation Equivalent List. He asked Mr. Therriault to provide a summary.

Mr. Therriault said the SVO publishes a list of sovereign NAIC designation equivalents that are used to cap the NAIC designation and NAIC designation category that can be assigned by the SVO. This amendment refers to that list but is unrelated to the proposal the Task Force discussed earlier this year on constraining all NAIC designations to the Sovereign NAIC Designation Equivalent List. Instead, this proposal is being recommended to address insurer reporting issues on the Supplemental Investment Risk Interrogatories (SIRI) reports. Lines 5–10 of that report require insurers to list foreign investments by country sovereign rating. The guidance indicates that a country not on the SVO's Sovereign NAIC Designation Equivalent List should be reported as an NAIC 3 or below. Supranational entities are international groups or unions that share decision making and vote on issues concerning the collective body. The European Union (EU) and World Trade Organization (WTO) are both supranational entities. Operating in multiple countries, supranational entities are not controlled by a single sovereign country and, in this context, it is only being used for governmental entities.

The proposed amendment would permit the SVO to include on the Sovereign NAIC Designation Equivalent List supranational entities, submitted to it for review by insurers, for which the SVO is able to determine an appropriate NAIC designation equivalent. The SVO recommends the Task Force expose the amendment for a public comment period. If adopted by the Task Force, the SVO would recommend this being referred to the Blanks (E) Working Group to request updates to the Supplemental Investment Risk Interrogatory instructions to reference the Sovereign NAIC Designation Equivalent List for both sovereign

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countries and supranational entities and to remove direct references to rating agency ratings (e.g., Moody's and Standard & Poor's [S&P]) on the report.

Mr. Monahan said the ACLI supports an expedited 25-day exposure period for this item also.

Mr. Fry directed SVO staff to expose this proposed amendment to the P&P Manual adding instructions to include supranational entities filed with the SVO to the Sovereign NAIC Designation Equivalent List if the SVO can determine an appropriate NAIC designation for a 25-day public comment period ending Jul. 27, 2020.

5. Exposed a Proposed Amendment to the P&P Manual to Update Guidance for Working Capital Finance Investments Consistent with the Statutory Accounting Principles (E) Working Group Adoption of Changes to SSAP No. 105R

Mr. Fry said the next item on the agenda is the proposed amendment to the P&P Manual to incorporate updates made to *Statement of Statutory Accounting Principles (SSAP) No. 105R—Working Capital Finance Investments*, which the Statutory Accounting Principles (E) Working Group adopted on May 20. He asked Marc Perlman (NAIC) to explain the amendment.

Mr. Perlman said early last year, industry requested modifications to the working capital finance investments (WCFI) requirements in SSAP No. 105. SSAP No. 105 took a fixed approach to a number of legal and structural issues in WCFI transactions, which are routinely handled differently, and thereby prevented the SVO from exercising proper analytical discretion. The Task Force referred industry's request to the Statutory Accounting Principles (E) Working Group in March 2019. The Working Group incorporated seven of the industry-requested modifications to the WCFI program requirements in what is now SSAP No. 105R, which became effective June 30.

Mr. Perlman said the SVO is proposing amending the WCFI section of the P&P Manual to remove certain requirements that were removed from SSAP No. 105 and thereby make it consistent with the new version, SSAP No. 105R. These amendments include removing the requirement that the SVO determine if the international finance agent is the functional equivalent of the U.S. regulator. Removing the finance agent prohibitions on commingling and broadening the independent review requirements allow independent review of the finance agent by either audit or through an internal control report.

Mr. Fry said that this would need more time for consideration and suggested a 45-day public comment period. Mr. Monahan said the ACLI supports a 45-day public comment period. Mr. Everett also recommended a 45-day public comment period.

Mr. Fry directed the SVO to expose this proposed amendment to the P&P Manual to update guidance for WCFI consistent with the Statutory Accounting Principles (E) Working Group adoption of changes to SSAP No. 105R for a 45-day public comment period ending Aug. 17, 2020.

6. Exposed an SVO Staff Report on the Use and Regulation of Derivatives in ETFs

Mr. Fry said the next item on the agenda is to receive a memorandum from the SVO on the use and regulation of derivatives in ETFs. Mr. Fry asked Mr. Perlman to provide a summary

Mr. Perlman said that at the instruction of the Task Force, the SVO drafted this memorandum so that the Task Force can better understand: 1) how ETFs currently use derivatives; 2) how that use is currently regulated; 3) how that regulation might change; and 4) how all this affects the SVO's analysis of ETFs that use derivatives.

ETFs, like other U.S. Securities and Exchange Commission (SEC)-registered fund types, use derivatives to manage exposure to specific investments and risks as part of their investment strategies. Derivative involve leverage, which can magnify an ETF's gains and losses and also obligate the ETF to make a future payment or deliver assets to a counterparty. Losses on derivatives, therefore, can result in counterparty payment obligations that directly affect the capital structure of an ETF and the relative rights of the ETF's counterparties and shareholders.

Section 18 of the Investment Company Act of 1940 was designed to limit the leverage a fund can incur. In a subsequent Policy Release and several no-action letters, the SEC has taken the position that "evidence of indebtedness" would include all contractual obligations to pay in the future, including commonly used derivatives. Funds, however, were permitted to use "segregated accounts" to cover their senior securities. The SEC has commented, though, that asset segregation may not be providing the intended protections and may not address undue speculation and asset sufficiency concerns.

In November 2019, the SEC proposed Rule 18f-4 to "provide an updated and more comprehensive approach to the regulation of funds' use of derivatives." The rule would generally permit funds, including ETFs, to enter into "derivative transactions" so

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long as the fund complies with certain conditions and disclosures. These include compliance with an outer limit on fund leverage based on the fund's value-at-risk (VaR) when compared with a designated reference index, which would approximate the VaR of the fund's unleveraged portfolio. The board of directors would need to create a new role of derivatives risk manager to administer a derivatives risk management program, which would include all policies and procedures designed to manage the fund's derivative risks, including: 1) risk identification and assessment; 2) guidelines; 3) stress testing; 4) backtesting; 5) internal reporting; and 6) periodic review.

Importantly, the proposed rule would create an exception for limited users of derivatives, which would not need to comply with many of the requirements like the VaR and the derivatives risk management program. Funds with derivative exposure of less than 10% of its assets and those that solely hedge currency risk would be considered limited users.

The comment period for Rule 18f-4 ended in March, and the final rule has not been published.

The SVO does not expect the rule to affect how it analyzes derivatives in ETFs. According to the P&P Manual, the purpose of a fund derivative (or speculative characteristics) analysis is to determine whether the cash flow is fixed income (or bond)-like. The SVO's primary analytic focus will remain the determination of whether an ETF's cash flows, accounting for its use of derivatives, is fixed income-like. It is possible that derivatives risk management programs and VaR limits testing could provide increased transparency about an ETF's use of derivatives, which could instruct the SVO's determination of whether an ETF's cash flow is fixed income-like. However, since ETFs on the SVO-Identified Bond ETF List and SVO-Identified Preferred Stock ETF List should "predominantly hold" bonds or preferred stock, respectively, pursuant to the P&P Manual, most eligible ETFs likely already fall under the exception for limited users of derivatives and may not need to comply with all requirements of the rule.

Mr. Monahan requested that the SVO staff report be exposed for a 45-day public comment period.

Mr. Fry directed the SVO staff to expose the SVO report on the use and regulation of derivatives in ETFs for a 45-day public comment period ending Aug. 17, 2020.

7. Discussed Any Other Matters

Mr. Fry asked if there were any other matters to discuss. Mr. Monahan mentioned that there was a discussion by the Capital Adequacy (E) Task Force on hybrid securities. Mr. Therriault said there was a discussion about assigning only NAIC designations and not NAIC designation categories to hybrid securities. Mr. Therriault said that any securities that would be translated by the SVO would follow the Valuation of Securities (E) Task Force instructions to produce NAIC designation categories. He said he recommends using the greater granularity provided by the NAIC designation categories. Mr. Therriault said he is uncertain if a referral would be made from the Capital Adequacy (E) Task Force to the Valuation of Securities Task (E) Force requesting their opinion and recommendation on this issue.

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

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EMORANDUM

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

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

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

RE: Proposed Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) with Update to the General Mapping of Credit Rating Provider Ratings, Long and Short-term, to NAIC Designations and NAIC Designation Categories

DATE: April 30, 2020

1. Summary – On the Task Force call of May 14, 2020 the North American Securities Valuation Association (NASVA) requested that the table mapping Credit Rating Provider (CRP) ratings for short-term instruments be updated to also map them to NAIC Designation Categories. The Task Force directed the SVO to draft an update to this general mapping table. Unlike long term ratings, there is not a direct one-for-one set of rating symbols for short-term investments that map to every NAIC Designation Category. Because there is not a direct one-for-one mapping, SVO staff have used their judgement to map the NAIC Designation Category to the mid-point of the range of long term ratings covered by each short-term rating. As an example, Moody’s Prime-1 or P1 short-term rating covers the long-term rating range consisting of Aaa, Aa1, Aa2, Aa3, A1, A2 and A3 (*Moody’s - Rating Symbols and Definitions, June 2018*). The SVO staff has recommended mapping the Moody’s short-term P1 rating symbol to the mid-point of this range or an NAIC Designation Category 1.D. The SVO staff applied this mid-point approach to each short-term rating mapping.

The SVO staff also updated the description of the mappings for both long-term and short-term rating symbols to reflect that these are “Generic Rating Symbols.” CRPs use a variety of symbols; including, combinations of prefixes and suffixes that provide additional information about the rating symbol which are described in the CRP’s documentation. There are over 2,000+ unique rating symbols used by CRPs to describe long-term securities. The SVO webpage (<https://www.naic.org/svo.htm>) maintains a master list of Credit Ratings Eligible for Translation to NAIC Designations.

The SVO does not currently translate short-term security ratings as part of its Compilation and Publication of the SVO List of Investment Securities to produce the NAIC designations incorporated into the NAIC’s AVS+ product. If the Task Force would like the SVO to also produce, compile and publish translations for the short-term securities, a separate project will need to be initiated.

2. Recommendation – The SVO staff recommends mapping the short-term CRP rating symbols to the NAIC Designation Category which is equivalent to the mid-point of the range of long term ratings covered by the short term rating. The SVO staff also recommends updating the title of the mapping tables to reflect that these are

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“generic” rating symbols, referencing additional sections of the P&P Manual pertinent to the use of CRP ratings and Filing Exemption and adding a footnote describing where to locate the master list of Credit Ratings Eligible for Translation to NAIC Designations on the SVO webpage.

3. Proposed Amendment – The following shows the proposed revisions in Part Three with *drafting notes* identifying the changes.

PART THREE

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

LIST OF NAIC CREDIT RATING PROVIDERS

... (Table orientation changed for display in this amendment. The two tables below would be deleted.)

			Credit Rating Providers (Pursuant to the guidance in this Manual; particularly, Part One, "The Use of Credit Ratings of NRSROs in NAIC Processes," "Filing Exemptions," "Policies Applicable to Specific Asset Classes," and Part Three, "Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities")								
NAIC Designation	NAIC Designation Modifier	NAIC Designation Category	Moody's Investor's Service	Standard and Poor's	Fitch Ratings	Dominion Bond Rating Service	A.M. Best Company	Morningstar Credit Ratings, LLC	Kroll Bond Rating Agency	Egan Jones Rating Company	HR Ratings de Mexico, S.A. de C.V.
1	A	1.A	Aaa	AAA	AAApr, AAA	AAA, Pfd-1 (high)	aaa	AAA	AAA	AAA	HR AAA (G)
1	B	1.B	Aa1	AA+	AA+	AA (high), Pfd-1	aa+	AA+	AA+	AA+	HR AA+ (G)
1	C	1.C	Aa2	AA	AA	AA, Pfd-1 (low)	aa	AA	AA	AA	HR AA (G)
1	D	1.D	Aa3	AA-	AA-	AA (low), Pfd-1	aa-	AA-	AA-	AA-	HR AA- (G)
1	E	1.E	A1	A+	A+	A (high)	a+	A+	A+	A+	HR A+ (G)
1	F	1.F	A2	A	A	A	a	A	A	A	HR A (G)
1	G	1.G	A3	A-	A-	A (low)	a-	A-	A-	A-	HR A- (G)
2	A	2.A	Baa1	BBB+	BBB+	BBB (high), Pfd-2 (high)	bbb+	BBB+	BBB+	BBB+	HR BBB+ (G)
2	B	2.B	Baa2	BBB	BBB	BBB, Pfd-2	bbb+	BBB	BBB	BBB	HR BBB (G)
2	C	2.C	Baa3	BBB-	BBB-	BBB (low), Pfd-2 (low)	bbb-	BBB-	BBB-	BBB-	HR BBB- (G)
3	A	3.A	Ba1	BB+	BB+	BB (high), Pfd-3 (high)	bb+	BB+	BB+	BB+	HR BB+ (G)
3	B	3.B	Ba2	BB	BB	BB, Pfd-3	bb	BB	BB	BB	HR BB (G)
3	C	3.C	Ba3	BB-	BB-	BB (low), Pfd-3 (low)	bb-	BB-	BB-	BB-	HR BB- (G)
4	A	4.A	B1	B+	B+	B (high), Pfd-4 (high)	b+	B+	B+	B+	HR B+ (G)
4	B	4.B	B2	B	B	B, Pfd-4	b	B	B	B	HR B (G)
4	C	4.C	B3	B-	B-	B (low), Pfd-4 (low)	b-	B-	B-	B-	HR B- (G)
5	A	5.A	Caa1	CCC+	CCC+	CCC (high), Pfd-5 (high)	ccc+	CCC+	CCC+	CCC+	HR C+ (G)
5	B	5.B	Caa2	CCC	CCC	CCC, Pfd-5	ccc	CCC	CCC	CCC	HR C (G)
5	C	5.C	Caa3	CCC-	CCC-	CCC (low), Pfd-5 (low)	ccc-	CCC-	CCC-	CCC-	HR C- (G)
6	6	6	Ca	CC	CC	CC (high)	cc	CC	CC	CC	HR D (G)
6	6	6	C	C	C	CC	c	C	C	C	
6	6	6		D	DDD	CC (low)	d	D	D	D	
6	6	6			DD	C (high)					
6	6	6			D	C					
6	6	6				C (low)					
6	6	6				D					

			Credit Rating Providers (Pursuant to the terms of Section 4 of Part One and as specifically noted in Part Three, Section One, (vi) List of NAIC CRPs.)								
NAIC Designation	NAIC Designation Modifier	NAIC Designation Category	Moody's Investor's Service	Standard and Poor's	Fitch Ratings	Dominion Bond Rating Service	A.M. Best Company	Morningstar Credit Ratings, LLC	Kroll Bond Rating Agency	Egan Jones Rating Company	HR Ratings de Mexico, S.A. de C.V.
			Commercial Paper and Short Term Counterparty Ratings	Commercial Paper	Commercial Paper	Commercial Paper and Short Term Debt	Commercial Paper and Short Term Debt	N/A	Short-Term and Commercial Paper Ratings	Commercial Paper	N/A
1			P1	A-1+, A-1	F1+, F1	R1 (high), R-1 (middle), R-1 (low)	AMB-1+, AMB-1		K1+, K1	A1+, A1, A	
2			P2	A-2, A-3	F2, F3	R-2 (high), R-2 (middle), R-2 (low)	AMB-2		K2	A2, A3	
3			P3			R-3	AMB-3		K3		
4				B	B				B	B	
5				C	C	R-4			C	C	
6			NP	SD, D	D	R-5, D	AMB-4		D	D	

... (Table orientation changed for display in this amendment. The two tables below would be inserted.)

			Credit Rating Providers (Pursuant to the guidance in this Manual; particularly, Part One, "The Use of Credit Ratings of NRSROs in NAIC Processes," "Filing Exemptions," "Policies Applicable to Specific Asset Classes," and Part Three, "Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities")								
NAIC Designation	NAIC Designation Modifier	NAIC Designation Category	Moody's Investor's Service	Standard and Poor's	Fitch Ratings	Dominion Bond Rating Service	A.M. Best Company	Morningstar Credit Ratings, LLC	Kroll Bond Rating Agency	Egan Jones Rating Company	HR Ratings de Mexico, S.A. de C.V.
1	A	1.A	Aaa	AAA	AAApr, AAA	AAA, Pfd-1 (high)	aaa	AAA	AAA	AAA	HR AAA (G)
1	B	1.B	Aa1	AA+	AA+	AA (high), Pfd-1	aa+	AA+	AA+	AA+	HR AA+ (G)
1	C	1.C	Aa2	AA	AA	AA, Pfd-1 (low)	aa	AA	AA	AA	HR AA (G)
1	D	1.D	Aa3	AA-	AA-	AA (low), Pfd-1	aa-	AA-	AA-	AA-	HR AA- (G)
1	E	1.E	A1	A+	A+	A (high), Pfd-1	a+	A+	A+	A+	HR A+ (G)
1	F	1.F	A2	A	A	A (low), Pfd-1	a	A	A	A	HR A (G)
1	G	1.G	A3	A-	A-	A (low), Pfd-1	a-	A-	A-	A-	HR A- (G)
2	A	2.A	Baa1	BBB+	BBB+	BBB (high), Pfd-2	bbb+	BBB+	BBB+	BBB+	HR BBB+ (G)
2	B	2.B	Baa2	BBB	BBB	BBB, Pfd-2	bbb	BBB	BBB	BBB	HR BBB (G)
2	C	2.C	Baa3	BBB-	BBB-	BBB (low), Pfd-2	bbb-	BBB-	BBB-	BBB-	HR BBB- (G)
3	A	3.A	Ba1	BB+	BB+	BB (high), Pfd-3	bb+	BB+	BB+	BB+	HR BB+ (G)
3	B	3.B	Ba2	BB	BB	BB, Pfd-3	bb	BB	BB	BB	HR BB (G)
3	C	3.C	Ba3	BB-	BB-	BB (low), Pfd-3	bb-	BB-	BB-	BB-	HR BB- (G)
4	A	4.A	B1	B+	B+	B (high), Pfd-4	b+	B+	B+	B+	HR B+ (G)
4	B	4.B	B2	B	B	B, Pfd-4	b	B	B	B	HR B (G)
4	C	4.C	B3	B-	B-	B (low), Pfd-4	b-	B-	B-	B-	HR B- (G)
5	A	5.A	Caa1	CCC+	CCC+	CCC (high), Pfd-5	ccc+	CCC+	CCC+	CCC+	HR C+ (G)
5	B	5.B	Caa2	CCC	CCC	CCC, Pfd-5	ccc	CCC	CCC	CCC	HR C (G)
5	C	5.C	Caa3	CCC-	CCC-	CCC (low), Pfd-5	ccc-	CCC-	CCC-	CCC-	HR C- (G)
6		6	Ca	CC	CC	CC (high), Pfd-5	cc	CC	CC	CC	HR D (G)
6		6	C	C	C	C, Pfd-5	c	C	C	C	
6		6		D	DD	CC (low), Pfd-5	d	D	D	D	
6		6			DD	C (high), Pfd-5					
6		6			D	C, Pfd-5					
6		6				C (low), Pfd-5					
6		6				D, Pfd-5					

			Credit Rating Providers (Pursuant to the guidance in this Manual; particularly, Part One, "The Use of Credit Ratings of NRSROs in NAIC Processes," "Filing Exemptions," "Policies Applicable to Specific Asset Classes," and Part Three, "Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities")								
NAIC Designation	NAIC Designation Modifier	NAIC Designation Category	Moody's Investor's Service	Standard and Poor's	Fitch Ratings	Dominion Bond Rating Service	A.M. Best Company	Morningstar Credit Ratings, LLC	Kroll Bond Rating Agency	Egan Jones Rating Company	HR Ratings de Mexico, S.A. de C.V.
			Commercial Paper and Short Term Counterparty Ratings	Commercial Paper	Commercial Paper	Commercial Paper and Short Term Debt	Commercial Paper and Short Term Debt	N/A	Short-Term and Commercial Paper Ratings	Commercial Paper	N/A
1	A	1.A									
1	B	1.B									
1	C	1.C									
1	D	1.D	P1	A-1+	F1+	R1 (high)	AMB-1+		K1+	A1+	
1	E	1.E		A-1	F1	R-1 (middle)	AMB-1		K1	A1	
1	F	1.F									
1	G	1.G									
2	A	2.A		A-2	F2	R-1 (low)				A	
2	B	2.B									
2	C	2.C	P3	A-3	F3	R-2 (high)	AMB-2		K2	A2	
2	A	3.A									
2	B	3.B									
2	C	3.C									
3	A	3.A									
3	B	3.B									
3	C	3.C									
4	A	4.A									
4	B	4.B		B	B				B	B	
4	C	4.C									
5	A	5.A									
5	B	5.B	NP	C	C	R-4			C	C	
5	C	5.C									
6		6		SD	D	R-5	AMB-4		D	D	
6		6		D		D					

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EMORANDUM

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

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

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

RE: Proposed Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to Permit Supranational Entities Filed with the SVO to be Added to the Sovereign NAIC Designation Equivalent List

DATE: April 30, 2020

1. **Summary** – The SVO maintains the Sovereign NAIC Designation Equivalent list and publishes it on its webpage (<https://www.naic.org/svo.htm>). This list is used to cap the NAIC Designation that can be assigned by the SVO to an investment at the Sovereign Designation Equivalent. The SVO discussed this list with the Task Force at its February 4, 2020 meeting and received instructions from the Task Force to research and develop criteria for an acceptable sovereign rating exception methodology, the SVO is still working on that separate issue. Insurers have been using this list to assist them in their reporting of Sovereign NAIC Designation Equivalents on the Supplemental Investment Risks Interrogatories (SIRI). The SVO has received requests from insurers to include supranational organizations or entities on the Sovereign NAIC Designation Equivalent list to assist with this SIRI reporting. This amendment proposes adding supranational entities to the Sovereign NAIC Designation Equivalent list if an insurer files a request with the SVO and the SVO is able to determine an appropriate NAIC designation equivalent.

2. **Description** - A supranational organization is an international group or union in which the power and influence of member states transcend national boundaries or interests to share in decision making and vote on issues concerning the collective body. The European Union and the World Trade Organization are both supranational entities. In the EU, each member votes on policies that will affect all member nations. The benefits of this construct are the synergies derived from social and economic policies and a stronger presence on the international stage.

For an organization to be supranational, it must operate in multiple countries. While applicable to multinational corporations, the term in this context is being used only for government entities because they often have regulatory responsibilities within their standard operations. These responsibilities can include the creation of international treaties and standards for international trade. As an entity that operates in multiple countries, a supranational organization is not controlled by a single sovereign country.

3. **Recommendation** – The SVO staff recommends permitting it to include supranational entities on the Sovereign NAIC Designation Equivalent list if an insurer files the supranational entity with the SVO and the SVO can determine an appropriate NAIC designation equivalent.

4. **Proposed Amendment** – The following shows the proposed revisions in Part Three with text in red identifying the changes.

PART THREE

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

GENERAL CORPORATE AND MUNICIPAL METHODOLOGY FOR INDEPENDENT CREDIT QUALITY ASSESSMENT

...

FOREIGN SECURITIES

Foreign Sovereign Government and Supranational Entities

34. A reporting insurance company that owns a security issued by a foreign sovereign government, an agency or political subdivision of a foreign sovereign government or a supranational entity (entities with more than one sovereign government as a member), or that is guaranteed directly or indirectly by such an entity, must file such security with the SVO accompanied by a prospectus and investment committee memorandum.
35. Insurance companies shall not file issues with the SVO if the issuer does not have a sovereign rating from an NAIC CRP. If the issuer is not rated by an NAIC CRP, proof of a guarantee from an NAIC CRP-rated foreign sovereign government may be submitted. Where a reporting insurance company has filed a foreign security accompanied by an Audited Financial Statement, in English, the SVO will assess the security in accordance with the applicable corporate methodology, but the NAIC Designation it may assign shall be limited by the sovereign rating of the issuer's country of origin, **or the issuing supranational entity, as applicable, as reflected in the Sovereign NAIC Designation Equivalent list**. This section should not be read as prohibiting the presentation of transactions structured to eliminate foreign sovereign risk.
36. The insurance company must file all foreign securities for which the information required by this Manual is available. For those foreign securities held by a "Sub-paragraph D Company" as defined in Part One, where the required information is not available for the SVO to value the security, the NAIC Designation may be determined by the reporting insurance company. This determination shall carry an F suffix. In no case shall the NAIC Designation exceed the sovereign rating of the issuer's country of origin, **or the issuing supranational entity, as applicable, as reflected in the Sovereign NAIC Designation Equivalent list**. The company shall provide its domestic regulator with a description of the procedure it used to evaluate and assign ratings to these foreign securities. In addition, the company shall retain the documentation supporting each designation assigned by it until the next domestic insurance department examination.
37. **The SVO shall maintain and publish a list of Sovereign NAIC Designation Equivalents on its webpage (<https://www.naic.org/svo.htm>) and may include on that list the NAIC Designation equivalent for supranational entities submitted to it for review by insurers if, in its sole discretion, it is able to determine an appropriate NAIC Designation equivalent.**

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Supranational Entities\2020-021.01 PP Manual Amend - Supranational NAIC Designations.docx



MEMORANDUM

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

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

CC: Marc Perlman, Investment Counsel, NAIC Securities Valuation Office (SVO)
Eric Kolchinsky, Director, NAIC Structured Securities Group (SSG) and Capital Markets Bureau

RE: Proposed Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to Add Instructions for ETFs that Contain a Combination of Preferred Stocks and Bonds

DATE: September 30, 2019

1. Summary – The P&P Manual authorizes the SVO to review and determine that a fund’s cash flow can be appropriately characterized as fixed income for regulatory purposes, and if so, assign an NAIC Designation to reflect the credit risk associated with the fund’s cash flow and include the name of the fund on the appropriate NAIC List. For inclusion on the SVO-Identified bond or preferred stock ETF list, the ETF must predominantly hold either a portfolio of bonds or preferred stock. This guidance restricts the SVO from reviewing ETFs that hold a portfolio of both bonds and preferred stock. This proposed amendment would provide authorization for the SVO to review ETFs that hold both bonds and preferred stock for possible inclusion on the preferred stock ETF list.

2. Proposed Amendment – The text referencing the Investments in Funds is shown below, edits in red-underline, as it will appear in the 2019 P&P Manual format.

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2019 P&P Manual

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

The SVO-Identified Bond ETF List and the SVO-Identified Preferred Stock ETF List

255. Description – At this time, ETFs operate under an Exemptive Order granted by the SEC that provides relief from the application of provisions of the Investment Company Act of 1940 that would otherwise apply. ETFs issue creation units to initial investors in exchange for a specified portfolio of bonds. The initial investor can hold the creation units or sell the ETF shares that constitute the creation unit on the exchange on which the ETF is registered. Other investors may purchase ETF shares; including to reconstitute and redeem a creation unit. Shares of ETF are not redeemable to the fund but are traded on registered exchanges at a price set by the market. Shares of ETFs are expected to trade at or near par because of arbitrage related to the value of the portfolio or of the ETF shares. For inclusion on the SVO-Identified bond ETF list, the ETF must hold a portfolio of bonds, ~~preferred stock or a combination of bonds and preferred (or preferred stock)~~ that tracks a specified bond index (a passive investment); or it must a portfolio of bonds, ~~preferred stock or a combination of bonds and preferred (or preferred stock)~~ that it actively manages pursuant to a specified investment objective.

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257. An ETF on the SVO-Identified Preferred Stock ETF List is in scope of SSAP No. 32—Preferred Stock and reported on Schedule D, Part 2, Section 1. ~~The SVO may include ETFs that hold a portfolio of bonds and preferred stock on the SVO-Identified Preferred Stock ETF List.~~ These investments are reported at either amortized cost or fair value based on assigned NAIC Designation.

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MEMORANDUM

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

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

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

RE: Proposed Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to Update Guidance on Initial and Subsequent Annual Filings, and Methodologies and Documentation

DATE: July 15, 2020

- 1. Summary** – The SVO has recently encountered several situations where insurance companies have requested clarification or have declined to provide information necessary to enable it to complete its analysis. The SVO is not a party to the transactions it reviews and, therefore, is dependent upon the insurance companies to provide this information critical to its analysis. The attached proposed amendment reinforces the expectation that insurance companies will provide necessary documentation in a timely manner to the SVO and further outlines the types of information the SVO may require.
- 2. Recommendation** – The SVO recommends that the Task Force update the guidance in the P&P Manual for initial and subsequent annual filings and assessment methodologies to reinforce documentation and information requirements.
- 3. Proposed Amendment** – The following text in red shows the proposed revisions in Part One, Part Two, and Part Three of the P&P Manual.

PART ONE

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

...

FILING SECURITIES WITH THE SVO

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

Obligation to File Securities with the SVO

48. Insurance companies domiciled in any state of the United States, or any of its territories or possessions, that have adopted laws incorporating the standards in the NAIC Financial Regulation Standards and Accreditation Program that require the use of NAIC Designations or other analytical products for Investment Securities are required by those laws to file purchases of Investment Securities with the SVO as indicated in this Manual to obtain the NAIC Designation or other analytical product required by state law.
49. Investment Security means an instrument that documents a lending transaction between an insurance company as lender and a non-affiliated borrower, where the borrower’s sole motivation is to borrow money and the insurance company’s sole motivation is to make a profit on the loan that the state of domicile regulates by reference to the NAIC Financial Regulation Standards and Accreditation Program.
50. The SVO shall have no authority to issue NAIC Designations or any other NAIC analytical product to an insurance company for a Regulatory Transaction. This Manual provides that the SVO may assist a state insurance department in the assessment of the security component of a Regulatory Transaction and may issue an SVO Analytic Value to the department at the conclusion of the assessment. This Manual also provides instructions to insurance companies on how to report the security component of a Regulatory Transaction on investment schedules.

Who Must File

51. Filing a security with the SVO is the responsibility of the insurance company within 120 days after settlement of the investment. The expectation is that the filing of a security with the SVO is the responsibility of the insurance company lender with the largest dollar investment in the individual security (i.e., CUSIP or issue specific); however, all insurers are responsible to comply with all filing requirements in this Manual.

States May Require a Filing of Exempt or Other Transactions

52. Any provision in this Manual that exempts a transaction, security, financial asset or investment from being filed with the SVO does not prohibit a state insurance regulator from requiring its domiciled insurance company to file the transaction, security, financial asset or investment with the SVO for analysis and/or assignment of an NAIC Designation. Also, nothing in this Manual prohibits a state insurance regulator from asking for SVO or SSG analytical assistance with respect to any investment related activity, or in connection with assessment of investment-related aspects of a Regulatory Transaction, and directing an insurance company to file relevant information with the SVO or the SSG for that purpose.

Filing Requirements

53. **Initial** – Insurers that file a security must provide the SVO with the information necessary to evaluate the credit risk for the security.
54. **Annual** – Insurers that file a security are also required to provide the SVO with the information necessary to evaluate the credit risk for the security on an annual basis.
55. **Material Credit Events Filing** – It is the responsibility of the insurance company to file all information that indicates a change in the credit characteristics of the issuer or a material change in the terms of the agreement. A material change is an event that affects or is substantially likely to affect the issuer's ability to pay the insurer the obligation due to it in accordance with the original terms of the transaction. If an insurer determines that a bond is impaired under the statutory accounting procedures in *SSAP No. 26R—Bonds*, then the impairment should also be considered to be a material change. Material changes should be reported to the SVO on the Material Change/Additional Information ATF.
56. **Information and Documentation Requirements** – This can be found in Part Three as part of the description of the methodology that applies to specific types of securities or investments and the instructions on how to submit through VISION is on the NAIC website: www.naic.org/svo_vision.htm.

PART TWO
OPERATIONAL AND ADMINISTRATIVE INSTRUCTIONS
APPLICABLE TO THE SVO

GENERAL FILING PROCEDURES

...

FILING PROCESS AND REQUIRED DOCUMENTS

Initial and Subsequent Annual Filings

57. An insurance company makes an initial **and subsequent annual** filing by providing the SVO with ~~the~~ **any applicable** completed form(s) and the information, documents and data necessary for the SVO to conduct an analysis of the issuer's creditworthiness and the terms of the security.

Informational Deficiencies

58. When an insurance company submits an initial **or subsequent annual** filing, the SVO logs the submission by date and time received and the filing is assigned to the appropriate staff analyst. If the ~~staff analyst~~ **SVO** determines that there is an informational deficiency, **then the SVO he or she** will advise the insurance company that submitted the filing.
59. If the SVO identifies an information deficiency, the transaction is held by the SVO without processing for a period not to exceed 45 days. If the insurance company has not filed the necessary information with the SVO at the completion of the 45 days, the SVO discards the filing and all documentation submitted with it and enters a note in VISION to reflect that the filing was discarded due to insufficient information.
60. On an exception basis, the SVO may grant an extension to the insurance company not to exceed 90 days in total with the time period to begin on the date that the SVO issues an information request. If the SVO grants this extension, and if the insurance company fails to provide the information requested within the time provided, the SVO will discard the filing and all documentation submitted with it at the end of the 90-day period and Work Flow will reflect that the filing was discarded due to insufficient information.
61. If the SVO determines it requires additional information after it has received a response to its request for additional information, a new 45-day period begins, unless an extension is granted as indicated above, in which case a new 90-day period will begin.

Filing Procedures and Documentation Requirements

62. Filing procedures and documentation requirements can be accessed at <https://vision.naic.org>.

NOTE: See Part Three, which contain filing procedures and documentation requirements for the asset classes identified there.

PART THREE
SVO PROCEDURES AND METHODOLOGY FOR PRODUCTION
OF NAIC DESIGNATIONS

GENERAL CORPORATE AND MUNICIPAL METHODOLOGY FOR INDEPENDENT CREDIT QUALITY ASSESSMENT

NOTE: See “Special Instructions” (discussing Short-Term Investments, Circular Transactions, Mandatory Convertible Securities, Unrated Hybrid Securities and Sub-Paragraph D Companies) in Part One for policies that impact assignment of NAIC Designations.

27. Corporate bonds defined as the Obligations¹ of domestic and foreign corporations, and preferred stock shall be distinguished on the basis of the categories discussed below. The creditworthiness of the issuer of any particular category of Obligation shall be assessed by reference to the general, and any special, rating methodology discussed in this Part, unless the context of the analysis requires a different approach.
28. Consistent with the SVO’s authority to use reasonable analytical discretion in its assessments, the SVO may utilize methodologies or request additional documents and information from insurance companies, if the SVO deems it appropriate and necessary to conduct its analysis for any investment that it reviews.

Independent Assessment

29. If the security under consideration is unrated, or if an analyst has conducted an independent analysis of the NAIC CRP-rated security, the analyst shall make an independent assessment of the issuer, the security or both.

FINANCIAL ANALYSIS

Audited Financial Statement Required

29. As a first step in the independent assessment, the analyst shall conduct an independent financial analysis of the issuer based on the financial information presented in the Audited Financial Statement, as defined in this Manual, **submitted by the insurance company**.
30. The SVO shall base its financial analysis on at least three years of historical audited financial information and a minimum of one year of projected financial information (if available) when the issuer has an operating history of three years or more.
31. **The SVO may request and consider interim financial statements, if the SVO deems the information necessary for its analysis or to maintain a previously assigned NAIC Designation and NAIC Designation Category.**

¹ **Obligation** means bonds, notes, debentures, certificates, including equipment trust certificates, production payments, bank certificates of deposit, bankers’ acceptances, credit tenant loans, loans secured by financing net leases and other evidences of indebtedness for the payment of money (or a participation, certificates or other evidences of an interest in any of the foregoing), whether constituting general obligations of the issuer or payable only out of certain revenues or certain funds pledged or otherwise dedicated for payment.

32. However, the SVO may assign an NAIC Designation based on less than three years of financial information in circumstances where the issuer's operating history is less than three years or because the issuer's legal identity has been subsumed as a result of a merger into a new entity or due to other documentable business circumstances.
33. Where three years of financial information is not available, the analyst shall review such information as is available, and shall determine if the time period for which information is available is sufficient to produce a professionally sound opinion.

Calculation of Ratios

34. Financial analysis shall culminate in the calculation of such financial ratios as the analyst feels highlight appropriate aspects of the financial performance of the issuer that bear on its ability to meet the obligation owed to the insurance company.

LEGAL ANALYSIS

Legal review

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

OTHER ANALYSIS

Other information

36. The SVO may review and consider any other public or private information (including insurance company internal credit analysis memoranda) provided by the insurance company or obtained through its own research, that it considers relevant or necessary to analyze the transaction and consistent with its Use of Generally Accepted Techniques or Methodologies.

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VALUATION OF SECURITIES (E) TASK FORCE PROPOSED 2021 CHARGES

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

Ongoing Support of NAIC Programs, Products or Services

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

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

NAIC Support Staff: Charles Therriault, Marc Perlman

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