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

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

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

RE: P&P Manual Amendment to Change the Effective Date for the Financial Modeling of CLOs by SSG to 2025

DATE: April 16, 2024

Summary: At the 2024 Spring National Meeting the Structured Securities Group (SSG) requested a change to the effective date for the financial modeling of collateralized loan obligations (CLOs) to assign NAIC Designations and NAIC Designation Categories to year-end 2025 from year-end 2024. The Task Force agreed to this change. The additional time will permit SSG to improve the methodology and allow better alignment with the approach of other NAIC workstreams.

Recommendation: The Securities Valuation Office (SVO) recommends inclusion of the attached notice in the 2024 *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) informing insurers of the implementation date change and including it on the Task Force's webpage of Adopted Interim Changes to the P&P Manual. The proposed text changes to the P&P Manual are shown below with additions in red underline and deletions in ~~red strikethrough~~, as it would appear in the 2023 P&P Manual.

PREVIOUSLY ADOPTED AMENDMENTS TO THE P&P MANUAL EFFECTIVE IN ~~2024~~ 2025

The following amendments were adopted by the VOS/TF in 2023 to be effective for ~~2024~~ 2025.

- **Adopted an amendment including Collateralized Loan Obligations (CLO) as a Financially Model Security in Part Four** – A collateralized loan obligation (CLO) is type of structured security backed by a pool of debt, typically corporate loans with low credit ratings. An insurer that purchases every tranche of a CLO holds the exact same investment risk as if it had directly purchased the entire pool of loans backing the CLO. The aggregate risk-based capital (RBC) factor for owning all of the CLO tranches should be the same as that required for owning all of the underlying loan collateral. If it is less, it means there is risk-based capital (RBC) arbitrage. As noted in the Investment Analysis Office's (IAO) memo of May 25, 2022, "Risk Assessment of Structured Securities – CLOs", it is currently possible to materially (and artificially) reduce C1 capital requirements just by securitizing a pool of assets. The Task Force assigned the Structured Securities Group (SSG) the responsibility of financially modeling CLO investments and evaluating all tranche level losses across all debt and equity tranches under a series of calibrated and weighted collateral stress scenarios to assign NAIC Designations that create equivalency between securitization and direct holdings, thereby eliminating RBC arbitrage. This amendment is effective beginning with year-end ~~2024~~2025.

The Valuation of Securities (E) Task Force adopted this amendment on Feb. 21, 2023

PART FOUR
THE NAIC STRUCTURED SECURITIES GROUP

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Use of Financial Modeling for Year-End Reporting for CLO, RMBS and CMBS

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24. Beginning with year-end ~~2024~~ 2025 for CLOs, probability weighted net present values will be produced under NAIC staff supervision by SSG using its financial model with defined analytical inputs selected by the SSG. SSG will model CLO investments and evaluate all tranche level losses across all debt and equity tranches under a series of calibrated and weighted collateral stress scenarios to assign NAIC Designation Categories for a specific CLO tranche as determined by the NAIC.

    NOTE: Please refer to SSAP No. 43R—Loan-Backed and Structured Securities for guidance on all accounting and related reporting issues.

    NOTE: Effective as of January 1, ~~2024~~ 2025, SSG will financially model CLOs.

https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-05-02 VOSTF Interim Meeting/05-CLO Effective Date/2024-007.01 PP Manual CLO Effective Date.docx