To: Director John M. Huff (MO), Chair of the Reinsurance (E) Task Force  
Stewart Guerin, Chair of the Valuation of Securities (E) Task Force  
From: Bob Carcano, Senior Counsel, NAIC Investment Analysis Office  
Cc: Charles Therriault, Director, NAIC Securities Valuation Office  
Ryan Couch, Manager, Reinsurance  
Re: Research Memorandum – Meaning and Intent of the Phrase “SVO Listed Securities” in the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786)  
Date: July 10, 2014

1. Introduction and Statement of Issue – The Reinsurance (E) Task Force has asked the SVO to research the original meaning and intent of a clause in Section 3.B of the Credit for Reinsurance Model Law (“Model Law”). Section 3.B. allows credit for reinsurance to the extent of an amount of funds held as security for the payment of reinsurance obligations. The clause under review provides that security for the payment of reinsurance obligations could take “…the form of: … Securities listed by the Securities Valuation Office …”¹ An understanding of the original intent and meaning of this clause would help identify current SVO processes that fall outside of the statutory intent and objective.

2. Summary Conclusion - The meaning of the clause hinges on whether the word listed refers to both the production and assignment of analytical values and placing the security on the list or only to placing the security on the list. The record suggests that when the Model Act was adopted listed would have referred to the entire process. However, today the NAIC clearly distinguishes between the SVO’s analytical and its compiler function. It is therefore permissible to interpret SVO in the clause as referring to the SVO’s function as compiler of the list. Accordingly, a reasonable interpretation of the clause would be: “As a guarantee that it will fulfill its reinsurance obligation, the reinsurer must deposit or pledge securities it owns that are identified on the most recent quarterly release of the NAIC Automated Valuation Service Plus online subscription service.”

3. Executive Summary – The list to which the clause refers is the NAIC’s Automated Valuation Service Plus online subscription service. A literal reading of the clause using the plain meaning of its words renders this meaning: “securities added to (or placed on) (NAIC’s Automated Valuation Service Plus online subscription service) by the SVO.” Given the longevity of the SVO’s role as a valuation service, a question arises: does the term listed refer to both assignment of a quality designation/value and placement on the list or only to placement? If we apply the plain meaning under an assumption that listing means and placement, then the clause would refer to private placement corporate and municipal bonds, ETFs and CTLs for which the SVO alone assigns quality designations and values. By the time the Model Law was developed in 1984, the SVO had been the sole source of quality designations and values for insurer owned securities since about 1943. The record very strongly suggests that the production of quality designations and values and their listing and distribution were inextricably connected in the mind of NAIC regulators at that time. However, beginning about 1995, the NAIC redefined the scope of SVO analytical duties while still maintaining the SVO as the sole compiler of the list and (through NAIC IS) its publisher. This clarifies that today the NAIC distinguishes between the act of analyzing and assigning values and the act of placing a security on the list so that these should be considered two distinct processes. Under this view, the reference to the SVO in the clause is to the SVO in its capacity as compiler of the list. Accordingly, the clause refers to any population of securities on the list that meet the reinsurance objective of the clause, including filing exempt securities. Because the clause is concerned with identifying securities that can be used as collateral and liquidated if the reinsurance obligation is not paid, we assume only securities that are held by insurers generally (not those held by a single insurer) are implied in the reinsurance context. This approach and assumption identifies the following populations of

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¹ Section 10. A. (2) of the Credit for Reinsurance Model Regulation (#786) contains an almost identical clause.
securities as within the clause: corporate, municipal private placements, CTLs & ETFs with SVO assigned NAIC Designations/Unit Prices; RMBS/CMBS assigned NAIC Designations by insurers using Structured Securities Group (SSG) Price Grids; Non-RMBS/CMBS loan-backed and structured securities; preferred stock; common stock; NAIC Designations assigned by the SSG to certain securities issued by FNMA and Freddie Mac; US full faith and credit securities assigned NAIC Designations by SVO systems per a specified convention; and non-full faith & credit GSE securities assigned NAIC Designations by SVO systems per a specified convention. We also evaluated other SVO duties but concluded they would not be encompassed within the intent of the clause. That evaluation, and a more granular identification of SVO credit assessment and valuation functions, is shown in Attachment One. Section 3 below shows and documents the research on which our observations are based.

4. Research

a. Development of the Model Law

i. Regulatory Concern - In 1982 the NAIC created the Reinsurance and Anti-Fraud Task Force (the “Reinsurance Task Force”) and referred to the Task Force an Illinois proposal that the NAIC create a comprehensive reinsurance framework that would include a model law on credit for reinsurance.2 Illinois was concerned with recent activities it encountered involving what it deemed to be questionable or fraudulent reinsurance transactions. On or about September 19, 1983, the Advisory Committee of the Reinsurance and Anti-Fraud (E) Task Force (the “Advisory Committee”) submitted a draft uniform law on credit for reinsurance to the Reinsurance Task Force.3 The uniform law would recognize credit for reinsurance as an asset or deduction from liability if the assuming insurer met specified requirements intended to provide a high level of certainty that the reinsurance obligation would be performed.4 The proposed uniform law would require that the reinsurer: be (1) authorized in the state or (2) authorized in another state with equivalent statutory credit requirements and with the assuming insurer meeting that state’s financial solvency requirements or (3) the assuming insurer maintains a trustee account in the United States or (4) domiciled in non-US jurisdiction whose laws required cessions that do not comply with the uniform law and proposed an alternative involving unauthorized reinsurance, where the ceding company could reduce its liability to the extent of certain security; in the form of funds withheld.

ii. Interpretation - In the proposed alternative reinsurance mechanism: “… (ii) Assets or securities valued and qualified as admitted assets …” were identified to be funds withheld.5 The intent of the statute can be more easily understood if we first define the words “securities,” “valued” and the phrase “admitted asset.” In accordance with a long established judicial rule of statutory construction, we give these words their plain and ordinary meaning.6 The meaning of the word “securities” (as in financial instruments) is “a certificate attesting credit, the ownership of stocks or bonds …” The meaning of the word “value,” in our context is “the monetary worth of something.” The word valued means that “value has been estimated.” The word value and valued are closely associated with the word “valuation,” which is defined as “an estimation of something’s worth, esp. one carried out by a professional

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6 Generally, when interpreting a statute, “[p]roper interpretation … requires adherence to the plain, commonsense meaning of the language therein contained rather than an application of refined and technical rules of grammatical construction.” 64 Am. Jur. 2d Public Securities and Obligations § 120. When a court interprets a statute it looks to its plain language and “gives words their ‘ordinary contemporary, common meaning’ unless they are otherwise defined in the statute itself.” Hennepin County v. Federal Nat. Mortg. Ass'n, 742 F.3d 818, 821 (8th Cir. 2014) (quoting United States v. Friedrich, 402 F.3d 842, 845 (8th Cir. 2003)).

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We do not propose a meaning for the phrase “admitted asset” because it has an established technical meaning in the NAIC regulatory community that the reader will already be familiar with. Using these concepts, a reasonable interpretation of the meaning of the clause in the initially proposed uniform law, is that in order to qualify as funds withheld, the monetary worth of the assets or securities proposed to be used as security for performance of the reinsurance contract must have been estimated and the assets or securities must meet the state law definition of an admitted asset.

b. Adopted Model Law

i. Model Law Adopted - The proposed uniform law was discussed in September and December 1983 but the Advisory Committee realized wider circulation was needed to ensure industry concerns were properly reflected. Accordingly, on December 6, 1983 the Advisory Committee asked the Reinsurance Task Force to postpone adoption of the uniform law to permit consideration of industry comments. A new draft uniform law was distributed on or around May 1, 1984 and this was adopted by the Reinsurance Task Force on June 5, 1984 (the “Model Law”). The Model Law permitted credit for reinsurance if: the reinsurer is (1) licensed in the state or (2) licensed in another state and satisfies certain financial standards or (3) maintains an adequate trusteed surplus in the United States. As an alternative the ceding company would be allowed to reduce its liability in the amount of funds held as security for the payment of (reinsurance) obligations.

ii. SVO Listed – In the adopted alternative reinsurance mechanism: “… (ii) Securities listed by the Security Valuation Office … and qualifying as admitted assets …” are identified as a form of security for the payment of (reinsurance) obligations. The meaning of the word “securities” (as in listed by the SVO) is “a certificate attesting credit, the ownership of stocks or bonds …”. The meaning of the word “security” (as in for the payment of) in the financial context is “a thing deposited or pledged as a guarantee of the fulfillment of an undertaking or the repayment of a loan, to be forfeited in the event of default.” The meaning of “list” is “a number of connected items or names written or printed consecutively.” A related meaning is “a set of items considered as being in the same category …”

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8 NAIC Proceeding, 1984-2, 836, 841, Attachment Three
11 NAIC Proceeding, 1984-2, 836
12 NAIC Proceedings 1984-2 836, 843; Attachment Three- A1, see Memorandum of the Drafting Subcommittee of the Advisory Committee to the Reinsurance Task Force, dated March 6, 1984 1984.
13 NAIC Proceeding, 1984-2, 836, 838, Attachment One-A. “ 3. A reduction from liability for the reinsurance ceded to an assuming insurer not meeting the requirements of section A shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer and such reduction shall be in the amount of funds held by or on behalf of the ceding insurer, … This security may be in the form of: (i) Cash, (ii) Securities listed by the Security Valuation Office of the National Association of Insurance Commissioners and qualifying as admitted assets …

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iii. **NAIC Usage** - As early as 1910 the NAIC referred to “... the valuation of securities held by insurance companies” (as a list). This usage was still in evidence in the 1980s and is still in use today. Another word for “list” is “compilation,” the meaning of which is “the act or process of producing something, i.e., a list, a book, or report, by assembling information collected from other sources.”

iv. **Mechanics of Listing** – Today, electronic process and systems are used to generate the list. At the current time, on completion of a credit risk assessment or a valuation of an insurer owned security, the SVO analyst enters the NAIC Designation and/or the Unit Price for the security into the VOS Database, an SVO specific electronic computer system used to store the names and descriptions of insurer owned securities with the NAIC Designations and Unit Prices assigned to them. On a quarterly basis, the SVO publishes a compilation of the information in the VOS Database. The compilation is then incorporated into the NAIC’s Automated Valuation Service Plus online subscription service (referred to as VOS Products).

v. **Interpretation** - Using these concepts (including an assumption that listing would have been understood to mean analysis and placement on the list) and the background information on NAIC practice and SVO internal processes, a reasonable interpretation of the meaning of the clause in the adopted Model Law is: *As a guarantee that it will fulfill its reinsurance obligation, the reinsurer must deposit or pledge securities it owns that are identified on the most recent quarterly release of the Automated Valuation Service Plus online subscription service, as having an NAIC Designation assigned by the SVO.*

Although this reading is supported by the text of the clause under a plain meaning analysis and the assumption that listing referred to analysis and placement on a list we believe that today this result is inconsistent with NAIC intent as expressed in the procedures that govern the listing process and those used to produce NAIC Designations and

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14 Proceedings of the National Convention of Insurance Commissioners of the United States held at Mobile Alabama, September 27 – 30, 1910, pages 47 – 49. “... the valuation of securities held by insurance companies had been obtained through the Massachusetts and New York departments, and copies of the lists furnished the other departments of the country … In December, 1909, the committee made a contract —to make the valuations required; … (who) … prepared the lists, … copies were furnished to each commissioner. A supplemental list was issued on February 21, 1910, and copies thereof likewise sent to each department. The following is a statement of account … for printing the lists of securities … It is believed that the issue by this convention each year of printed lists giving the valuation of the securities held by insurance companies … is a long step toward uniformity in valuation … it is earnestly recommended that the committee on the valuation of securities be made a permanent, and not a special, committee, and that a list of securities such as was thus published under the auspices of the convention in 1910 be issued as early as possible in January of each year.

15 NAIC Proceedings 1981 Vol. II, Attachment Three at page 47. “The CUSIP (Committee on Uniform Securities Identification Procedures) numbering system is the universal securities identification system used in the financial community. (It was designed and implemented in 1967 by the American Bankers Association Committee.) The NAIC Securities Valuation Office (SVO) presently maintains a data base of securities held by insurance companies, and publishes this list annually in the Valuations of Securities manual. The purpose of the project defined herein is to enhance the NAIC SVO data base by the addition of CUSIP numbers and CUSIP descriptions to all securities records … Analyses and listings of securities could be made more easily on the basis of any of the items of standard financial information contained in the CUSIP data formats. For example, it would be possible to list by computer securities held by insurers by maturity or yield. This would facilitate compiling a list of those securities which are vulnerable to decline in market value. (Emphasis added).


17 Purposes and Procedures of the NAIC Investment Analysis Office, July 1, 2014 - Part One, Section 3. Internal Administration (f) Valuation of Securities Database - Upon determination of either component of an Association Value, (i.e., the NAIC Designation or Unit Price), and of a classification, as the case may be, the SVO shall enter such NAIC Designation, Unit Price and classification in the NAIC’s VOS Database. For securities eligible for the filing exemption contained in Part Two, Section 4(d) of this Manual, NAIC Designations shall be assigned and entered into the VOS Database in accordance with the instructions contained in Section 3 (e) of this Part above. (g) Valuation of Securities Products - On a quarterly basis, the SVO shall publish a compilation of the information derived from the VOS Database showing reported securities together with the NAIC Designation and/or Unit Price assigned by the SVO as well as filing exempt securities derived from the FE Datafile with their NAIC Designation and/or Unit Price and Unconfirmed FE securities. The compilation so published shall be incorporated into the NAIC’s Automated Valuation Service Plus online subscription service (hereto referred to as VOS Products).
Unit Prices for insurer owned securities. We therefore believe it is appropriate to focus more closely on the original intent of the listing process and to examine more recent NAIC decisions about the production of quality designations and values in order to clarify the scope of activity encompassed by the word listing today. We believe this will provide a firmer basis to interpret the clause.  

**c. Development and Changes in the Mission of the SVO**

**i. Before the SVO** – The NAIC began to conduct uniform valuation in 1907. The word valuation is used to refer specifically to the derivation of an estimate of the worth of a security. The earliest used indicators of value for financial reporting purposes were market prices. In 1909 the NAIC created a Special Committee on the Valuation of Securities. It would decide on the valuation method to be used for the year and hire an expert to produce the valuations which the NAIC would then distribute, first in the form of pamphlets and then in a book. A number of market based valuation methods were used and a number of different entities performed the valuation. The NAIC also used non market price valuation methods, one of which was that a security paying interest and principal in accordance with the terms of the agreement was amply secured and could be amortized. The “amply secured” concept was not totally reliable either because it was difficult to know how the concept should be applied when the markets were under stress. Amortization was also identified as a useful valuation method. And at times amply

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18 When interpreting a statute, the ordinary meaning of a term may not apply when “the ordinary meaning fails to fit the text and when the realization of clear congressional policy is in tension with the result that customary interpretive rules would deliver.” 73 Am. Jur. 2d Statutes § 116 (2014). Further, “[w]here it is evident that some other meaning was intended, and the application of the commonly accepted meaning would operate to defeat the purpose of the statute and the intent of the legislature, a departure from the usual or natural meaning of the words in a statute may be deemed proper.” 73 Am. Jur. 2d Statutes § 116 (2014). Courts have held that “[i]f words used in statute have undergone a change or if the subject to which they refer has undergone modification since employment of such words in the statute, the Supreme Court, in interpreting the statute, must search for and enforce the sense which the words bore when the statute was enacted, since such was, presumably, the legislative intention.” Champion v. McLean, 95 So.2d 82 (1957). Further, when circumstances have been altered courts have held that “ascertainment of the meaning apparent on the face of a single statute need not end the inquiry.” Watt v. Alaska, 451 U.S. 259, 265 (1981) (quoting Train v. Colorado Pub. Interest Research Grp., Inc., 426 U.S. 1 (1938)). “This is because the plain-meaning rule is ‘rather an axiom of experience than a rule of law, and does not preclude consideration of persuasive evidence if it exists.’” Watt v. Alaska, 451 U.S. 259, 266 (1981) (quoting Boston Sand & Gravel Co. v. United States, 278 U.S. 41 (1928)). The Court also held that “[t]he circumstances of the enactment of particular legislation may persuade a court that Congress did not intend words of common meaning to have their literal effect.” Watt v. Alaska, 451 U.S. 259, 266 (1981).

19 Massachusetts launched uniformity efforts in 1907 when it calculated and shared valuations of insurer owned securities. The Special Committee on the Valuation of Securities used market prices at a stated date, the mean or average of a price, and other versions of market based quotations. See, for example, Proceedings of the Forty Seventh Session of the National Convention of Insurance Commissioners, September 21-24, 1915, page 11. Entities performing this function included a Mr. Scudder of the Investor’s Service, Poor's Publishing Company, the Standard Statistics Company and Moody's Investor's Service. By 1937 the "Association's book on Valuation of Securities" contained 693 pages exclusive of the supplemental list at the back of the book, State, county and municipal bonds of the United States and Canada occupied 529 pages of the book.” Proceedings of the Seventy-First Annual Session of the National Association of Insurance Commissioners, December 7-9, 1939, page 156.

20 Ample security became a feature of the Committee’s deliberations. For example, the 1916 contract with the Investor’s Service specified that “6. It is agreed that if, in making the valuation of any bond, its market value shall appear to be such as to yield the holder in excess of 6% per annum, an investigation and report will be made, upon request, as to whether such bond is amply secured.” Proceedings of the Forty Seventh Session of the National Convention of Insurance Commissioners, September 26-29, 1916, page 5. Confusion about what amply secured meant could be seen in this discussion: “… Many think that the asset value of a bond, if amply secured, is the amortized value, but this raises the question as to what is "amply secured." One is inclined to believe that all Government bonds, whether Federal, State, City or Village, School District, etc., are certain to have the interest paid regularly and the face amount paid on the date of maturity. The fact is, however, … many railroad bonds which have for years been regarded as amply secured have not been paid at maturity, … The question as to what is the real value or the asset value of a bond or stock at any particular time is … interesting and important (but it is) doubtful, whether … a proper method for determining the real or asset value of securities (could be identified). Proceedings of the Forty Ninth Session of the National Convention of Insurance Commissioners, September 10-13, 1918, page 89). Over time amply secured became linked with the amortization.
secured was linked to amortization.\textsuperscript{21} None of these methods proved entirely reliable and in 1934 NAIC members expressed concern that the methods being used had led to fictitious values, insurance company failures and policyholder losses. A resolution was introduced to create a Statistical Bureau\textsuperscript{22} - a technical staff that would compile data, perform the appraisals and publish the Valuations of Securities book. This proposal was referred for consideration but was not immediately accepted. By 1939\textsuperscript{23} the predominant uniform practice was amply secured bonds valued on an amortized basis and all other bonds valued as shown in the Book on Valuations of Securities produced by the NAIC. In 1941 the NAIC adopted guidance that a security rated in the three highest categories by one or more of the major rating agencies were amply secured.\textsuperscript{24} And shortly thereafter, in the period 1942 – 1943,

\textsuperscript{21}The rationale for this is that: “…fluctuation in the value of bond holdings may vary the rate of interest earnings over a certain period, … (and) also … affect the surplus showing at a particular time — a particularly undesirable effect in the case of life insurance companies which expect to hold their bonds to maturity — (so) it has been found advisable to value bonds by amortization. This assures that the yield of any of the bonds will remain uniformly level at the figure which, they were bought to yield, the premium or discount being absorbed as the bonds mature.” Proceedings of the Seventy-First Annual Session of the National Association of Insurance Commissioners, December 7-9, 1939, page 161. In 1920, “ … the Convention, urged the amortization of securities held by life insurance companies, and fraternal societies. … only eleven states have recognized the amortization principle in their statutes, … (though) … a great number of the states permit amortization without any express provision of law; but there are states that have laws which specifically provide that the securities must be valued at their market value, and it has been suggested that the Committee on Laws and Legislation should present a uniform bill for amortization, which could be used by any state desiring to adopt the amortization plan, …” Proceedings of the Forty Ninth Session of the National Convention of Insurance Commissioners, September 1-3, 1920, page 11.

\textsuperscript{22}The plan is clearly an early version of the SVO. The “findings” of the Statistical Bureau would be available only to Insurance Commissioners. Its function would be to 1. To appraise, value and analyze the portfolios of insurance companies transacting business in the United States, 2. To appraise, value and analyze investment portfolios of insurance companies in the process of Convention examinations, 3. To appraise, value and analyze the investment portfolios of insurance companies which are in the process of any state examination, wherever such state shall so request, 4. To compile data and publish the annual Book of Valuations of Securities of the National Convention of Insurance Commissioners … “New York urged adoption of the measure. Alabama noted “… Twelve of the companies qualified in my state failed, bringing … rather large losses to the policyholders…” New Hampshire asked that the Commissioners consider whether “…you have gone along and permitted these fictitious values to sway your wisdom and sense of reasoning to such an extent that these companies can show and have shown seventy millions in assets and a very creditable surplus in millions on the 31st day of December last, only to be in receivership within ninety days.” Illinois asked “…why kid ourselves? We are weak … There are very few Departments that have the money, the staff, or in any way have the facilities for getting the information that we all ought to have and which would be furnished by this bureau. Proceedings of the Sixty Fifth Annual Session of the National Convention of Insurance Commissioners, December 5, 6, 1934, page 8, and pages 21-37.

\textsuperscript{23}“RESOLVED, that for the inventory of stock and bonds in the annual statements of insurance companies and societies as of December 31, 1939, the following basis is recommended as fair market value: 1. All bonds amply secured and not in default shall be valued on an amortized basis wherever and in the manner permitted by law. 2. All other bonds—and where amortization is not permitted by law all bonds—should be valued as shown in the Book on Valuations of Securities published under the auspices of the National Association of Insurance Commissioners. 3. Stocks should be valued as shown in the Book on Valuations of Securities except as hereinafter provided. Proceedings of the Sixty Seventh Annual Session of the National Association of Insurance Commissioners, December 3-4, 1936, page 149; see also Proceedings of the Seventy-Fourth Annual Session of the National Association of Insurance Commissioners, November 29-30, 1943 and June 7-9, 1943, page December 7-9, 1939, page 159.

\textsuperscript{24}“RESOLVED, that for the inventory of stocks and bonds in the annual statements of insurance companies and societies as of December 31, 1941, the following basis is recommended as fair market value: 1. Bonds not in default as to principal or interest, which are certified by the insurer submitting the statement to be amply secured, and meet anyone of the following test shall be carried at the amortized values wherever and in the manner permitted by law: … (b) Bonds, other than those referred to in (a), which are rated in any of the first five grades by at least two of the recognized rating services and on which the actual sales or bid prices reached 60 per cent or higher during each of the months of September, October and November 1941. (c) Bonds, other than those referred to in (a) or (b), which are not rated or are rated by only one of the recognized rating services and on which the actual sales or bid prices reached 60 per cent or higher during each of the months of September, October and November 1941, provided they are of security equivalent to bonds which classify under (b) and satisfactory evidence thereof is submitted to and approved by the Committee on Valuation of Securities by the companies owning them. In the absence of actual sales or bid prices on a bond in each of the months of September, October and November 1941 such bond will not be amortizable unless the December 31, 1941 Association Value is 60 per cent or higher. The ratings referred to herein relate to the December 1, 1941 ratings issued by the following three recognized rating services: Moody's Investors Service, Standard & Poor's Corporation and Fitch Investors Service. (Emphasis added) 2. All other bonds — and where amortization is not permitted by law all bonds — should be valued as shown in the Book on Valuations of Securities published under the auspices of the National Association of Insurance Commissioners, December 5, 6, 1934, page 8, and pages 21-37.
the NAIC hired its own staff to “do all the work required in connection therewith and to print, publish and distribute the book on Valuation of Securities ...”

Therefore beginning on or shortly after 1943, Association Values were produced placed on the list and then distributed by the internal staff.

ii. Early Expectations of the SVO - At least until 1985, the NAIC clearly expected insurers to report an “Association Value” consisting of both a Designation (signifying eligibility for amortization) and a value for the security. An Association Value was defined as “the value determined under the appropriate NAIC procedures and recommended for use in the Annual Statement of insurers.... As applied to Bonds, an Association Value ... comprises ... a numerical notation and a statement as to eligibility for amortization. ... Applied to ... Preferred Stocks ... (it means) ... a numerical notation and a statement as to eligibility for Good Standing ... (and for) common stock ... (it means) ... a numerical notation.”

Until the mid-1990s both components of the Association Values would have been produced by the SVO which was charged with generating NAIC Designations and valuations for all insurer owned securities. Today, NAIC 1 - 5 Designations continue to have a link to statutory accounting and that link continues to tie to amortization but the NAIC Designation is no longer an opinion on amortization but an opinion on credit quality from which standards for amortization treatment (and other regulatory processes) are derived. This indicates the nature of the information the NAIC wanted to be listed - nothing in the record indicates the SVO’s compiler function was changed. We therefore believe that the initial sense of listed by the SVO would have meant both the production of Association Values and the placement on the list of the name of the security.

iii. Narrowing the Scope of SVO Analytical Duties – Beginning in the mid 1990s, the scope of SVO activity came under review. The initial focus was industry concern with the assignment of NAIC Designations to securities

25 “The Chairman of the Sub-Committee, Commissioner Harrington of Massachusetts, reported that the Sub-Committee met at 61 Broadway, New York City, on April 7 and 8, 1943, to consider the situation confronting the Association as a result of the decision of Moody's Investors Service to discontinue the work of valuing securities ... Representatives of the other two rating services appeared before the Sub-Committee ... The conference convinced the Sub-Committee that on account of the war, neither of the rating services would be able to guarantee that the work would be done in the specified time, nor could they guarantee that they would be able to complete the work ... Sub-Committee and the other two Commissioners discussed the situation thoroughly and concluded that it would be best for the Committee to do the work itself ... RESOLVED, that in lieu of contracting with statistical organization as heretofore, the Committee on Valuation of Securities ... is itself authorized to undertake the valuation of securities and determination of amortizability of bonds pursuant to the basis to be adopted by the Association and may employ such assistants and incur such expenses as may be necessary to do all the work required in connection therewith and to print, publish and distribute the book on Valuation of Securities, ... (The Sub-Committee leased the necessary office space at 61 Broadway, New York City and arranged with Mr. L. A. Griffin to become Executive Secretary to the Committee as of May 1, 1943. Since then the Committee has secured the services of one Mr. Herbert Mickelson as assistant to Mr. Griffin and two stenographers. The office has been furnished and is now functioning as a going concern. (Emphasis added.) Proceedings of the Seventy-Fourth Annual Session of the National Association of Insurance Commissioners, November 29-30 and December 1 and June 7-9, 1943. page 126-127.

26 NAIC Proceedings, 1985 - Vol. II, page 528, Attachment Three To Report of the Task Force Staff to Members of The Securities EX4 Task Force. The Purposes and Procedures Manual of the NAIC Investment Analysis Office – July 1, 2014 still defines the term “Association Value” as “collectively, an NAIC Designation and a Unit Price published in the VOS Products for a security. Since the 1930's a YES designation signified amortization eligibility. A No signified ineligibility for amortization and a requirement that the security be marked to market. This remained the standard when the internal staff valuation function was created in 1942. In 1951 and 1952 the Committee discussed and subsequently adopted the Mandatory Security Valuation Reserve. 1951 Proceedings, Mid-Winter Meeting, page 211 - 213, Minutes of the Meeting of The Subcommittee of the Committee on Valuation of Securities of the NAIC, November 27, 1951, and Minutes of January 31, 1952 at 622. This modified the YES/NO system to accommodate MSVR. NO was expanded into a NO*, NO**, and NO for life insurers. A YES, NO* and a NO** signified eligibility for amortization but required different reserve levels. YES required reserves of 2%, a NO* required reserves of 10% and a NO** required reserves of 20%. NO still meant not eligible for amortization. The minutes do not reflect any change in the SVO's mission or methodology as a result of MSVR adoption. ...” Non MSVR insurers continued to use two tier system while life companies used the new four tiers where all bonds except defaulted ones were carried at amortized cost.

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rated by the NRSROs. Industry argued that the SVO was not adding value to regulation – it was simply converting NRSRO credit ratings to NAIC Designations while insurers were incurring significant filing and personnel cost to comply with filing requirements. The NAIC responded with a provisional filing exemption which was subsequently expanded into a filing exemption for NRSRO rated securities. Part of the regulatory motivation for this change was recognition that scarce SVO resources should be focused in areas where no other reliable metric was publicly available for purchase and use by regulators. Over time, this lead to a number of other modifications to the SVO mission as follows:

- Securities assigned credit ratings by credit rating providers (CRPs) are not filed with the SVO. Insurers translate the credit ratings into their equivalent NAIC Designations. This activity is identified in the second portion of the clause.
- The Structured Securities Group (SSG), a new division of the NAIC housed in the New York office, uses financial modeling methodology to develop Price Grids for RMBS and CMBS. Insurers follow statutory accounting instructions to create an NAIC Designation from the Price Grid that reflects the insurer’s monetary exposure to the security;
- The SSG assigns NAIC Designations based on financial modeling methodology to certain securities issued by FNMA and Freddie Mac;
- NAIC 5* and 6* is a regulatory designation which permits insurers to certify that they are receiving interest and or principal for securities that are not capable of being analyzed by the SVO due to documentary deficiency. 5* are assigned by the SVO but not on an analytical basis. 6* can be assigned by an insurer instead of by SVO;
- US Government Securities (backed by the full faith and credit of the US) are exempt from filing with the SVO and are reported as NAIC 1 by convention expressed in the Purposes and Procedures Manual;
- A filing exemption for specified GSEs (not backed by the full faith and credit of the US Government) is also reported as NAIC by convention;
- Certificates of Deposit with more than a year to maturity when issued are exempt from filing. CDs are assigned NAIC 1 Designation if the amount of the obligation is fully insured by the FDIC. Otherwise the insurer assigns the NAIC Designation equivalent of the CRP credit rating assigned to the issuing bank, and
- Under rules adopted in 2005, insurers may assign a price to the securities they own provided they also identify the source of the valuation. Under this process, the SVO is one possible source that the insurer may use. (SVO is the sole valuation source for most privately issued securities).
These changes have redefined the SVO analytical role, as described in the *Purposes and Procedures Manual*, to produce NAIC Designations and valuation of securities\(^2\) when adequate alternative measures are not available. Despite these changes to the SVO analytical mission, no change was made to the SVO’s obligation to compile the list. In addition to the instructions requiring the SVO to publish its own work-product, the *Purpose and Procedures Manual* today instructs the SVO to compile and publish the portion of the final list for populations of securities it does not designate for quality or for value.\(^3\) In the absence of specific instructions, many processes for generating this information for various populations of securities, are embedded in SVO and NAIC systems. In view of the fact that the NAIC made decisions that required it to distinguish between SVO analytical and its listing functions, to conclude that listing should not be read today to refer to both analysis and placement on the list and conclude that both the listing function and the reference to the SVO in the clause refer to the SVO in its capacity of compiler of the list only. This reading is consistent with NAIC policies on the production of quality designation and values and fits both the intent of the list and of the reinsurance process under the clause; i.e., an independent assessment of quality and value of securities supporting policyholder obligations. Based on this approach, a reasonable interpretation of the clause is as follows: *As a guarantee that it will fulfill its reinsurance obligation, the reinsurer must deposit or pledge securities it owns that are identified on the most recent quarterly release of the NAIC Automated Valuation Service Plus online subscription service.*

## 5. Conclusion

- The NAIC’s *Automated Valuation Service Plus online subscription service* is the list the clause refers to.
- The plain meaning technique of statutory interpretation is only partially helpful because it does not resolve whether listing refers only to placing a security on a list or to the development of values for it as well. If we assume the latter the clause refers to a relatively small portion of the securities on the list.

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\(^2\) *Purposes and Procedures of the NAIC Investment Analysis Office July 1, 2014 - Part One – Purposes, General Policies and Instructions to the SVO Section 2. Policies Defining the SVO Staff Function (a) Directive to Conduct Ongoing SVO Operations - The SVO shall conduct the following ongoing operations: (i) Analysis of credit risk for purposes of assigning an NAIC Designation. (ii) Valuation analysis to determine a Unit Price. (iii) Identification and analysis of securities that contain other non-payment risk and communication of this information by assignment of the NAIC Designation subscript to such securities. (iv) Other analytical assignments requested by the VOS/TF or members of the regulatory community; in accordance with the directives, procedures and general methodologies described in this Manual. (b) SVO Regulatory Products (i) NAIC Designations The result of SVO’s credit analysis, as it pertains to credit risk (hereafter defined), shall be expressed as an opinion of credit quality by assignment of an NAIC Designation, notched to reflect the position of the specific liability in the issuer’s capital structure. … Credit risk is defined as the relative financial capability of an obligor to make the payments contractually promised to a lender. Credit analysis is performed solely for the purpose of designating the quality of an investment made by an insurance company to enable the NAIC member's department of insurance to determine regulatory treatment … An NAIC Designation must be interpreted by the NAIC member in context of the NAIC Financial Conditions Framework, other characteristics of the investment, and the specific regulatory status of the insurance company. (ii) Valuation of Securities The result of SVO’s valuation analysis shall be expressed as a Unit Price. The SVO does not intend, and its methodology may not be appropriate, to yield an opinion of the price at which a security could or should be bought or sold in the marketplace. (iii) Other Non-Payment Risk in Securities The result of SVO’s analysis of securities for other non-payment risk shall be expressed by assignment of an NAIC Designation subscript \(S\) and the application of the notching procedure, as described in *Part One, Section 3 (b) (ii) and (iii)* respectively of this Manual. …

\(^3\) *Purposes and Procedures of the NAIC Investment Analysis Office July 1, 2014 - Part One, Section 3. Internal Administration (g) Valuation of Securities Products - On a quarterly basis, the SVO shall publish a compilation of the … NAIC Designation and/or Unit Price assigned by the SVO as well as filing exempt securities derived from the FE Datafile with their NAIC Designation and/or Unit Price and Unconfirmed FE securities. The compilation so published shall be incorporated into the NAIC’s Automated Valuation Service Plus online subscription service (hereafter referred to as VOS Products). Part Two, Section 10 (c) (v) U.S. Government Securities. … (B) SVO Publishing Conventions for Filing Exempt U.S. Government Securities (1) U.S. Treasury Obligations - U.S. Treasury Obligations are added to the VOS Database automatically, and they appear in the VOS Product. The NAIC Designation is NAIC 1. (2) Other Filing Exempt U.S. Government Securities - A single entry is in the VOS Products in its normal CUSIP sequence, followed by the description “All Issues” for the securities listed in *Section 4 (c) (i) and (ii)* of this Part above.
To get at NAIC intent for the list we examined the development of the valuation function. The record indicates that analysis was done for the purposes of generating and publishing the list. It is therefore possible that in 1984 when the clause was adopted, the NAIC would not have drawn a distinction between these activities. However that is not evidence of actual intent.

That the NAIC has repeatedly changed the SVO’s analytical mission but has not altered the SVO list function illustrates that the two processes are not linked. Had they been linked the NAIC would have had to segregate the lists so they were compiled by the entity doing the actual analysis.

The reference in the clause to the SVO should be read to refer to the SVO as compiler. Because we assume that the reinsurance objective in the clause would favor securities owned by many insurers, we identify the following population of securities as within the clause: corporate, municipal private placements, CTLs & ETFs with SVO assigned NAIC Designations/Unit Prices; RMBS/ CMBS assigned NAIC Designations by insurers using SSG Price Grids; NAIC Designations assigned by the SSG to certain securities issued by FNMA and Freddie Mac; US full faith and credit securities assigned NAIC Designations by SVO systems using a specified convention; and Non full faith & credit GSE securities assigned NAIC Designations by SVO systems using a specified convention.

Other SVO duties were evaluated but deemed not encompassed within the intent of the clause.
Attachment One

Relationship of Current SVO Activities to “securities listed by the SVO” Per Model Law (785)

1. SVO analyzes credit risk and assigns NAIC Designations to securities many insurers may own.29
   - Broad range (by type, industry and complexity) of privately placed corporate bonds
   - Publicly or privately placed municipal securities (both GO and revenue bond structures)
   - Credit Tenant Loan (see below)
   - Exchange Traded Funds

2. SVO analyzes credit risk and assigns NAIC Designations to securities only a single insurer may own
   - BA assets with fixed income characteristics

3. SVO assigns a valuation to securities many insurers may own
   - Unaffiliated bonds, preferred and common stock when requested.

4. Valuation of SCA activity (unique to the insurer)
   - SVO checks the reasonableness of valuations claimed by insurers on subsidiary, controlled and affiliated investments. SVO can disapprove the value and assign a value the insurer must report. This activity is insurer specific and does not involve securities owned by many insurers.

5. Classification of Assets for Specified Regulatory Objectives
   - Credit Tenant Loans – This activity involves mortgages with defined characteristics that are bond like and are therefore permitted to be filed as bonds. A CTL transaction can be owned by many insurers and so has been included in paragraph 1 above.
   - Exchange Traded Funds List – The SVO verifies whether the ETF is functioning under an SEC Exemptive Order meeting specified requirements. If so, the SVO conducts a credit assessment of the fund’s portfolio. If the SVO finds the portfolio holds bonds (or preferred stock) and will at all times produce bond (or preferred stock) cash flows, it places the fund’s name on a bond (or preferred stock) list. An insurer who purchases an ETF on the bond (preferred stock) list can report it as a bond (or preferred stock). Because this activity involves credit analysis of an instrument many insurers can own, it is included in paragraph 1 above.
   - Replication (Synthetic Asset) Transactions (RSATs) – This procedure permits insurance companies to create a kind of derivative instrument in order to attain an exposure that does not exist in the markets. The role of the SVO is to assess the “effectiveness” of the transaction to create the exposure and to verify it is a permitted exposure. These are insurer specific custom designed transactions.

6. Verification Activity in Support of Special Regulatory Regimes
   - Money Market Lists – If the SVO can verify that the applicant fund meets specified criteria, it places the fund’s name on a list and insurers who purchase that fund can report it as a bond instead of as common stock. No credit analysis and no valuation are involved in this activity.
   - List of Issuers of Letters of Credit Eligible to support Credit for Reinsurance - The SVO is required to verify that the applicant meets specified financial and other criteria. If so, the SVO places the bank on the Bank List. No credit analysis and no valuation is involved in this activity and the SVO exercises no analytical discretion.
   - List of Capital and Surplus Debentures – Insurers are required to report these instruments when rated by a CRP. If it is rated it is placed on a list. Insurance regulators who wish to know if a transaction has

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29 The SVO only assigns NAIC Designations and valuations to insurer owned securities – i.e., those already purchased by insurers and reported to the SVO.
been rated by a CRP can refer to this list. No credit analysis and no valuation is involved in this activity. This activity supports valuation under statutory accounting.

- Counterparty Lists – verifies financial strength of counterparties to facilitate NAIC derivative framework. Although this activity may involve credit assessment of a new counterparty it does not involve securities that many insurers may own.

- Broker-dealers eligible to serve as custodian of insurance company assets - If the SVO can verify that the applicant meets specified criteria, it places the custodian’s name on a list and insurers or regulators interested in that custodian know it meets the standards specified. No credit analysis and no valuation are involved in this activity.

7. Regulatory Analysis

- NAIC 5*/6* - Insurers that own securities for which they claim to lack the documentation required by the SVO for credit assessment and securities for which other documentation deficiencies exist may be presented to the SVO with a certification from the insurer’s chief investment office that the obligation is current on interest and any principal payment due. If the SVO is satisfied the security exists and the certification is in order it enters the values shown (i.e., a 5*) into the VOS Database. (Assignment of a 6* means the security should be considered to be in default and is applied by the SVO when the insurer fails to report to the security in a subsequent year or by the insurer itself. This activity is not analytical in nature and does not usually involve any credit assessment.

- RTAS – This process permits anyone to file a proposed transaction with the SVO or the SSG to obtain an assessment of how it would be treated under NAIC rules if an insurer purchased and reported the security to the SVO. The SVO’s analysis is contained in a letter and includes a discussion of the NAIC Designation that would be assigned if an insurer purchased and reported it. Therefore the SVO does not assign NAIC Designations or any other official values. An NAIC Designation or other values are only assigned through the normal process after it is reported by an Insurer.