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Mr. Joseph Fritsch, Chair
Statutory Accounting Principles (E) Working Group
National Association of Insurance Commissioners (NAIC)
2301 McGee Street, Suite 800
Kansas City, MO 64108-2604

Mr. Kevin Fry, Chair
Valuation of Securities (E) Task Force
National Association of Insurance Commissioners (NAIC)
2301 McGee Street, Suite 800
Kansas City, MO 64108-2604

RE: Comments on Staff Proposal – Permit Working Capital Finance Note (WCFN) Programs to be Invested Assets

Dear Messrs. Fritsch and Fry:

The ACLI[1] appreciates the opportunity to comment to the National Association of Insurance Commissioners (NAIC) and to provide our support for the staff proposal to permit Working Capital Finance Note (WCFN) Programs to be invested assets, including its qualification as an admissible asset.

<u>Background</u>

The Securities Valuation Office (SVO) of the NAIC has developed a process to assign NAIC designations to long-term programs that permit insurers to engage in the revolving purchase of short-term obligations. The financial instrument under discussion is called a working capital finance note (WCFN). WCFN programs have long been part of the financial landscape, but they have been almost exclusively the domain of commercial banks. These financial instruments are also known as vendor finance notes in the commercial banking sector. The SVO process was developed with the assistance of Pacific Life Insurance Company and the Nebraska Department of Insurance (NDOI). We believe these assets, which are more fully described in the presentation material opened and made available for public comment by the Valuation of Securities Task Force during the March 27th, 2011 meeting, would give insurers an important new investment alternative while safeguarding policyholder and regulatory interests.

The investment issued under WCFN programs meet the definition of a financial instrument for U.S. Generally Accepted Accounting Principles (GAAP) and Statutory Accounting Principles (SAP). An ownership interest, such as an interest created by a WCFN program, which imposes the obligation to deliver cash by one party and coveys the right to receive cash to another party is a financial instrument as defined in The Master Glossary to the FASB Accounting Standards Codification and as defined in *Statutory Accounting*

[1] The American Council of Life Insurers represents more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. These member companies represent over 90% of the assets and premiums of the U.S. life insurance and annuity industry.

*Principles (SSAP) No. 27 – Disclosure of Information about Financial Instruments with Off-Balance Sheet Risk and Financial Instruments with Concentrations of Credit Risk.* Please note that SSAP 27 is referenced because it defines a financial instrument and that the WCFN programs do not create financial instruments with off-balance sheet risks. Additionally, since the typical term of individual WCFN assets is from 90 to 180 days, they are designed to be available to meet policyholder obligations thus satisfying the recognition concept established in the Statutory Accounting Principles Preamble.

The underlying cash flow of a WCFN is created when a supplier sells goods to a buyer and delivers an invoice for payment, thus creating a receivable for the supplier; a level 1 transaction (see Exhibit 1). Banks create WCFN programs for customers (the buyer) who need to buy and pay for goods on an ongoing basis. Many suppliers to large buyers are smaller businesses and do not want to wait 90 to 180 days or longer for payment. On the other hand, the buyer needs to finance its purchases as efficiently as possible. To accommodate these conflicting objectives, a buyer might sponsor a WCFN program that will permit its key suppliers to offer the buyer's invoice for sale to a program facility. Under the terms of the program an agent confirms the invoice by verifying directly with the buyer that the invoice amount is accurate, due in accordance with it terms, and that the buyer has no defenses to payment. The agent can then purchase the confirmed invoice from the supplier (now a confirmed obligation) in exchange for an assignment of the right to receive the cash flows from the buyer, and subsequently offer the cash flows for purchase to another investor; a level 2 transaction (see Exhibit 1). This confirmed obligation representing the promise to deliver cash is the financial instrument sold by the obligor and purchased by the investor.

For nearly a decade, banks have been the primary investors in these programs with pension and endowment funds participating to a lesser degree. The banks hold little to no capital against these programs, based on the short tenor, the uncommitted nature, and investment grade ratings of the obligor.

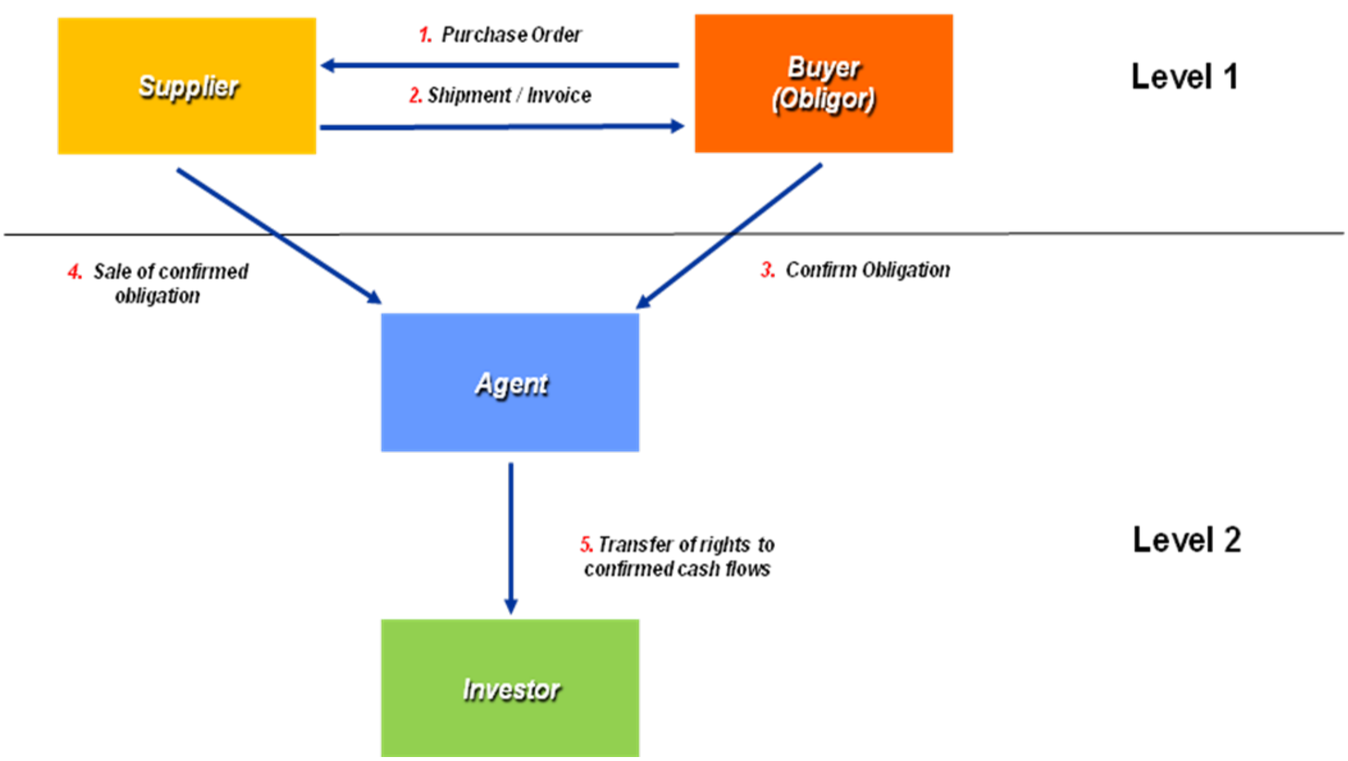
Financial instruments that begin as an aggregation of receivables is not a new concept to the insurance industry. In the structured securities world this same process is at work as with WCFNs. The credit card company allows a person to charge for a product purchase. Once the purchase is approved the credit card company has a receivable due from the cardholder. The word receivable is used as the term given to an obligation arising when one sells and another buys (a Level 1 transaction). The confirmation process under the credit card transaction occurs within the credit card agreement, signed by the cardholder that requires the acknowledgement of the responsibility to make payment and admit no defense of payment. Assuming the cardholder doesn't return the goods or assert a right not to pay (such as fraud), the credit card company has an asset; namely the financial obligation due from the cardholder. The credit card company now has the right to sell that asset and does so by assigning the right to the payment due from the cardholder (a Level 2 transaction). They do not assign the receivable itself as that term only applies to the obligation that arises when one sells and another buys a good or service. This level 2 relationship is an entirely different transaction in that the credit card company now assigns its rights to receive the cardholder's cash flow to the investor.

These structured securities have historically been recognized as admitted assets. Credit card and auto loan receivables are the most common form. The cash flows represented by credit card and auto loan receivables due from thousands of obligors are aggregated by a bank. Under the credit card and auto loan programs, the cash flows are structured, payment priorities are segmented or tranched into a seniority waterfall in order to match the return to the risk taken on by the purchasers of the various tranches.

Under a WCFN program, the aggregated cash flows are all due from one credit worthy obligor rather than the thousands of obligors under a credit card or auto loan program structure. Since only one obligor exists, the program is credit underwritten and assigned a rating based on the financial strength of the obligor; similar to a private placement obligation of an investment grade obligor, and no payment assumptions or a seniority waterfall is required. Nevertheless, the economic value available to insurers and policyholders by WCFN's is similar to that provided by credit card and auto loan programs since both types of programs provide a creditworthy and marketable short-term asset.

Since the WCFNs are financial instruments having economic value to insurers and policyholders, we looked to identify a financial instrument specifically addressed in the statutory accounting guidance that most closely matches the WCFN program framework. This search led us to commercial paper and short-term bonds. WCFN's compare very closely to commercial paper (CP) and short-term bonds; the WCFN programs (not the individual issues) and the bonds are rated, both assets are short term, credit driven and ranked pari-passu to senior unsecured obligations of the obligor. CP is purchased/traded through a broker/dealer (usually a bank) in which the obligor sells their paper to the dealer who subsequently turns around and sells to the investors such as insurance companies after taking a spread/commission. WCFN programs are executed similarly in that the agent purchases the WCFNs and turns around to sell to other investors. While CP is exchange traded, the WCFN market is more similar to a direct or over the counter transaction in a manner similar to a private placement of securities.

*Exhibit 1*




Statutory Asset Admissibility

Based on the program description above and the presentation material previously mentioned, a WCFN program qualifies as an admitted asset within the framework of the guidance in *SSAP No. 2— Cash, Drafts and Short-Term Investments* and *SSAP No. 26—Bonds, excluding Loan-backed and Structured Securities*. In addition, the WCFN program meets the definition of assets as defined in paragraph 2. of *SSAP No. 4–Assets and Nonadmitted Assets*.

Since the working capital finance notes have a maturity date of one year or less from the date of acquisition, we will focus our analysis on SSAP No. 2. Working capital finance notes share characteristics with short-term bonds and commercial paper, including a single credit worthy issuer, being pari-passu to other senior unsecured obligations, having an original maturity date of less than one year and a specified rate of interest. SSAP No. 2 states, “all investments with remaining maturities of one year or less at the time of acquisition shall be considered short-term investments. Short-term investments include, but are not limited to bonds, commercial paper, money market instruments, repurchase agreements, and collateral and mortgage loans….” It should be noted that the authors of SSAP No. 2 took care not to limit the definition of short-term investments with the use of the “are not limited” language as compared to the original statutory guidance appearing in the Life/A&H Accounting Practices and Procedures Manuals, Chapter 5, *Cash and short-term investments*. Presumably this more inclusive definition was set in place to allow for future financial instruments designed to meet the return requirements of the insurer while safeguarding the interests of the insured. The investment held by an insurer under a WCFN program is such a financial instrument clearly meeting the definition of short-term investments as defined under SSAP No. 2.

The WCFN assets are confirmed obligations that exist in the financial market place which are packaged and converted into an investment with ownership evidenced by the program documents. The WCFN program documents confer the right to the investor to receive the underlying cash flows associated with the confirmed obligations. In the proposed form, the WCFN investments meet the definition of a security as set forth in the FASB Accounting Standards Codification’s Master Glossary. We have referenced the GAAP definition of a security since SAP does not directly define a security.

Thank you in advance for the thoughtful consideration of our comments.

Sincerely,

Michael Monahan
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cc: Robert Carcano, SVO
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