MEMORANDUM

TO: Hon. John M. Huff, Chair, Reinsurance (E) Task Force and Director of Insurance for the State of Missouri
    Stewart Guerin, Chair, Valuation of Securities (E) Task Force
    Members of the Reinsurance (E) Task Force and of the Valuation of Securities (E) Task Force

FROM: Bob Carcano, Senior Counsel, NAIC Investment Analysis Office

CC: Todd Sells, Director, NAIC Financial Regulatory Services
    Charles Therriault, Director, NAIC Securities Valuation Office

DATE: December 4, 2014

RE: Joint Project — Meaning and Intent of the Phrase “Securities Listed by the SVO” in Section 3 B. of the NAIC Credit for Reinsurance Model Law (Model Law) and Section 10 A. (2) of the Credit for Reinsurance Model Regulation (Model Regulation) — Proposed Amendments to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (Purposes and Procedures Manual)

Executive Summary

Background — In the context of the captioned project, the SVO was asked to: 1) describe how the various sub-lists used to generate the compilation published as the Automated Valuation Service (AVS+) product are generated; 2) recommend measures to distinguish between “investments” and “bespoke securities”; 3) evaluate the risk that “bespoke securities” could be added to the AVS+ product; 4) discuss how NAIC staff may assist states to evaluate “bespoke securities”; and 5) make recommendations for appropriate changes to the Purposes and Procedures Manual.

Summary of Staff Report – The Purposes and Procedures Manual specifically directs insurers to file “investment securities” with the SVO unless they are filing exempt securities. The instruction to file securities with the SVO is in furtherance of an NAIC function performed by the SVO for all insurance departments. A security issued in connection with a transaction whose regulatory treatment derives from state processes that differ from NAIC processes for investment securities (such as the “bespoke” transaction discussed during the conference call that gave rise to this assignment) would not be an investment security in this sense. The SVO has long considered that a security issued as a funding solution to a company/state-specific regulatory issue is a regulatory transaction (Regulatory Transaction) ineligible for filing as an investment security.

The risk that Regulatory Transactions could be added to the AVS+ products is greatest with respect to the Filing Exempt (FE) Data File; exists to some degree in the residential mortgage-backed securities (RMBS)/commercial mortgage-backed securities (CMBS) modeled population; and is very low for the U.S. Treasuries, Government Exemption and the Valuation of Securities (VOS) database generated and maintained by the SVO.

The SVO recommends that the term Regulatory Transaction be adopted and defined as discussed above for the Purposes and Procedures Manual and that the existing reference to investment securities be more formally defined to provide a contrast with Regulatory Transactions. This would make it clearer that an investment security is eligible for listing but that a Regulatory Transaction is not. The SVO also recommends that NAIC members consider the relationship between Regulatory...
Transactions and NAIC processes and identify parameters that should govern NAIC staff involvement in their assessment. The SVO recommends a proposed procedure for review that reflects current SVO practice.

In general, investments in subsidiary, affiliated and controlled (SCA) companies are subject to a different regulatory regime focused on market or equity-based valuation reflecting that SCA investments are inter-company transactions. SCA investments also are not investment securities in the sense of this paper. However, this implies no judgment on their suitability for use as collateral under the Model Law. Some specific debt and preferred stock in SCA companies, as exceptions, may qualify as investment securities.

At the present time, the *Purposes and Procedures Manual* does not describe the SVO compilation function. The SVO proposes text to describe the SVO compilation function as a first step in providing a definitional bridge between the compilation and the meaning of the phrase “Securities Listed by the SVO” in the Model Law.

An assessment of the mechanics of the compilation process shows that the quarterly compilation is derived from 12 sub-lists, only five of which are concerned with insurer owned investments securities and of which only three are published in the AVS+ product. To be specific, the SVO does not currently compile or publish a sub-list of Government Exempt securities in the quarterly compilation. The SVO recommends that the Government Exempt securities population be identified as a sub-list for purposes of the compilation and that it be published in the quarterly compilation. The SVO generates information about U.S. Treasuries from Schedule D filings, and this information is automatically added to the quarterly compilation. The SVO recommends that U.S. Treasury securities be identified as a sub-list of the compilation.

The SVO quarterly compilation may contain populations of securities that may be unsuitable for use as collateral in reinsurance transactions. In addition, the SVO quarterly compilation contains lists that contain information, some of which pertain to securities but most of which do not. Lists of information pertaining to securities may be suitable for Model Law purposes.

Just as importantly, the SVO quarterly compilation is unlikely to contain all of the populations of securities that would be desirable for Model Law purposes. To address this issue, the SVO proposes a definitional mechanism for the use of the Reinsurance (E) Task Force that would permit the identification of populations of securities deemed eligible for use as collateral in reinsurance transactions beyond the population of insurer owned securities the SVO compiles and publishes. The proposed mechanism is illustrated in the proposed amendments in Attachment One but would require input from the Reinsurance (E) Task Force before it could be customized and implemented.

Recommendation – The phrase “Securities Listed by the SVO” in the Model Law can be defined easily in the *Purposes and Procedures Manual*. Once the SVO compilation function has been fully described, those sub-lists of securities used in the compilation that are deemed to be appropriate for use as reinsurance collateral could be identified in the proposed definitional bridge as Securities Listed by the SVO for purposes of the Model Law.

Discussion and Analysis

1. Introduction – On Oct. 29, 2014, the Reinsurance (E) Task Force and members of the Valuation of Securities (E) Task Force ("VOSTF") discussed comments received in response to the release of an Exposure Draft prepared by NAIC staff on the captioned project. The captioned project began with an SVO research paper that identified populations of securities that should be considered to be within the meaning of the phrase “Securities Listed by the SVO.” The Exposure Draft recommended that the Reinsurance (E) Task Force and the VOSTF consider whether other SVO activities should also be deemed to be within the phrase. One of the comment letters discussed on the Oct. 29 conference call¹ said it was necessary to exclude “bespoke”

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¹ See the comment letter submitted by New York Life, dated Sept. 5, 2014, signed by George Nichols III and Joel M. Steinberg.
securities from the definition of “Securities Listed by the SVO.”2 In the ensuing discussion, the SVO noted that only investment securities were eligible for filing with the SVO and that the history of the filing exempt rule indicated that filing exempt securities must also be investment securities. The SVO also stated that the bespoke transaction discussed during the conference call illustrated what the SVO called a regulatory transaction: i.e., a security issued as part of a transaction whose objective is to resolve a company/state-specific regulatory issue and governed by state processes different from NAIC processes for investment securities (Regulatory Transaction). Regulatory Transactions can be assessed by the SVO for the benefit of the NAIC member but are not eligible for inclusion in the NAIC database used to hold information about investment securities prior to the compilation and publication of that information. At the conclusion of the call, the SVO was asked to: 1) recommend measures to distinguish between “investment” and “regulatory” securities; 2) describe the compilation process, including how the various sub-lists are compiled; 3) evaluate the risk of regulatory transactions being added to the AVS+ product; and 4) discuss how NAIC staff may assist states to evaluate regulatory transactions and make proposals for appropriate changes to the Purposes and Procedures Manual.

2. Investment and “Regulatory” Securities

a. Investment Securities – The Purposes and Procedures Manual provides that any insurance company required under applicable state law to report NAIC Designations and Unit Prices for their “investments” in the NAIC Financial Statement Blank report the purchase of investment securities and other relevant transactions to the SVO.3 This is consistent with the purpose of SVO credit assessment processes, which are concerned with the likelihood that an insurer/obligor will be able to pay interest and principal on the obligation to the insurer in accordance with the terms of the agreement. Both the SVO assessment of insurer owned investments and the instruction that its determinations be entered into the AVS+ products are exclusively associated with NAIC processes identified in the definition of NAIC Financial Condition Framework and expressed in other NAIC guidance. Accordingly, SVO analytical determinations produced for an individual state intended to be used by that state outside of the NAIC Financial Condition Framework are not entered into NAIC systems. If determinations pertaining to Regulatory Transactions were entered into NAIC systems, it would convey that the security could be purchased by any insurer when in fact the insurer would first have to seek approval of its state regulator before it could use the solution the transaction was developed to provide.

b. Investments Securities, SCA Investments and Regulatory Transactions

1. SCA Common Stock – Investments that meet the definition of SCA investments are reported on the basis of a valuation derived from specified market or equity valuations and, therefore, not regulated on the basis of credit quality.10 SVO valuations for SCA investments are stored in a distinct segment of the VOS database and are not published in the quarterly compilation.11

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2 The concern is that securities on the AVS+ product would be an admitted asset for a life insurer and a “primary security” under the NAIC Principle Based Reserving Framework (Framework). Such securities are eligible reinsurance collateral to support a XXX or AXXX reserve financing. A bespoke transaction—characterized as a transaction structure that collateralizes a portion of “redundant” reserve with a contingent note or other instrument linked to the modeling of the life insurer’s reserves—is conditional and, hence, inconsistent with the expectation that a primary security unconditionally back the life insurer’s general account liabilities.
3 See Part Two, Section 2 (a). The filing instruction is narrowed through the exemptions from filing with the SVO collected in Part Two, Section 4.
4 A comprehensive statement of SVO responsibilities and analytical products is set forth in Part One, Section 2 (a) and (b).
5 Part One, Section 3 (f).
6 Part Two, Section 1.
7 Part Two, Section 1.
8 Part Two, Section 1.
9 See Part One, Section 3 (b) (v) (B), (C) of the Purposes and Procedures Manual.
10 By extension, any insurer that owns a security in NAIC systems is free to report the NAIC Designation category and other analytical values assigned to the state insurance regulator.
11 See Part One, Section 3 (b) (v) (B) of the Purposes and Procedures Manual.
2. **Affiliated Debt and Preferred** – It is possible that a debt or preferred stock issued by an insurer and purchased by an affiliate of that issuer would qualify as an investment security. That determination is made on the basis of a methodology that requires the assessment of Statement of Statutory Accounting Principles (SSAP) No. 97—Investments in Subsidiary, Controlled, and Affiliated Entities arms-length and economic transaction criteria in addition to typical credit assessment methodologies for the security.\(^{12}\) With the exception of affiliated SCA debt or preferred stock obligations, the **Purposes and Procedures Manual** concern is with investments between unaffiliated entities. To help identify affiliated transactions, during the filing process insurers are required to identify whether the security is the subject of discussion with state insurance regulators and whether the security is part of a transaction involving affiliates. The insurer filing such a transaction is advised that the transaction is ineligible for filing with the SVO.

e. **Regulatory Transactions** – Regulatory Transactions are presented to the SVO because the **Purposes and Procedures Manual** provides that state insurance regulators may request SVO and Structured Securities Group (SSG) assistance on any investment matter specific to their department.\(^{13}\) By definition, such assignments are special regulatory assignments and may involve state law and state regulatory processes outside of the NAIC Financial Conditions Framework for investment securities. Most of such regulatory transactions do not require the production of an NAIC Designation or other analytical value, but when they do, these are given to the state insurance department for their exclusive use and are not entered into NAIC systems connected to the compilation process.

3. **Describe How the Sub-Lists Are Compiled**

a. **12 Sub-Lists** – The compilation is produced from 12 sub-lists, identified below. (Please also see Attachment Two.)

   - VOS database
   - FE Data File
   - Government Exemptions
   - RMBS/CMBS Modeled Securities
   - Money Market Funds
   - Letter of Credit Banks
   - Derivative Counterparties
   - Surplus Notes (NAIC 1)
   - Surplus Notes (NAIC 2 – NAIC 6)
   - Exchange Rates
   - Ex-Dividend
   - SCA

b. **List of Securities** – Of the 12 sub-lists, ONLY five are concerned with insurer owned investment securities:

   - VOS database
   - FE Data File
   - Government Exemptions;
   - RMBS/CMBS Modeled Securities
   - SCA investments

c. But of these **five**, ONLY **three** are sub-lists of insurer owned securities published in the AVS+ product:

   - VOS database

\(^{12}\) Part Three, Section 2 (d) (i) (B) (1)
\(^{13}\) Part Two, Section 2 (b)
The information from two of these lists is NOT published in the AVS+ product:

- Government Exemptions
- SCA.

d. The SVO recommends that two additional sources of insurer owned securities be recognized as sub-lists of securities to be published quarterly in the AVS+ product:

- Government Exemption (currently produced but not published in the VOS Products)
- U.S. Treasuries (currently automatically added to the VOS database, but not formally a sub-list)

Under this approach, the quarterly compilation and the Securities Listed by the SVO would be insurer owned securities on the following sub-lists:

- VOS database
- FE Data File
- RMBS/CMBS Modeled Securities
- Government Exemption
- U.S. Treasuries

The remaining seven lists communicate information to insurers and state insurance regulators but are not lists of securities:

- Money Market Funds and Exchange Traded Funds
- Letter of Credit – Bank List
- Derivative Counterparties
- Surplus Notes (NAIC 1)
- Surplus Notes (NAIC 2 – NAIC 6)
- Exchange Rates
- Ex-Dividend

These sub-lists of Other Information would be identified as part of the SVO quarterly compilation.

The proposed distinction between lists of securities and lists of other information reflects the needs of the Valuation of Securities (E) Task Force for a quarterly compilation of insurer owned investment securities and other information. Accordingly, SCA investments would not be included because they are not investment securities for purposes of the VOSTF. This perspective is reflected in the proposed amendment to the Purposes and Procedures Manual. However, the distinction between lists of securities and lists of other information would also provide a starting place for the Reinsurance (E) Task Force. The Reinsurance (E) Task Force would use these defined terms to pick the sub-lists (whether of insurer owned securities or other information (i.e., the money market and exchange traded funds [ETF] fund lists) in the compilation process that are eligible for use as collateral in reinsurance transactions. The proposed definitional bridge could then be adjusted to

14 It is possible to argue that the Money Market Fund and ETF Lists are, in fact, lists of securities. The characterization of the list as a list of information simply reflects that the purpose of the list, from the operational perspective of the Valuation of Securities (E) Task Force, is to identify bond-like funds—not to compile insurer owned securities. Money market funds and ETFs that insurers purchase are reported as bonds in the list compiled by the SVO from the VOS Database. There is clearly no reason why the Reinsurance (E) Task Force could not determine that it wishes to permit insurers to use such funds as collateral in reinsurance arrangements.

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identify other populations of securities not part of any list used in the compilation that is eligible for use as collateral in reinsurance transactions.

4. Risk of Regulatory Transaction Making the List – The SVO was asked to opine on the likelihood that a Regulatory Transaction could be added to the SVO quarterly compilation of investment securities. Characterization of a transaction as a Regulatory Transaction can only be made after an assessment of its structure, whether its purpose is making an investment and whether it contains a promise to repay a debt obligation. The SVO, therefore, does not think it is possible to exclude such transactions through the use of electronic system processes. Viewed as a compliance issue, we believe it is unlikely a Regulatory Transaction could be added to the VOS database because the SVO analyst must assess the transaction documents and structure. We also think it is unlikely that a Regulatory Transaction could be included into the Government Exempt or U.S. Treasuries processes because these activities involve U.S. government or government-sponsored enterprise (GSE) issuers. While most RMBS/CMBS securities are subject to financial modeling, those that cannot be modeled but have credit rating provider (CRP) credit ratings can be reported using those ratings. Any RMBS/CMBS rated by a CRP that was part of a Regulatory Transaction could be filed that way, although this would seem to involve a willful noncompliance that staff would not easily attribute to any insurer. Newly purchased RMBS/CMBS transactions filed with the SSG for an Initial Information Sufficiency assessment would be subject to detailed assessment that would identify whether it is part of a Regulatory Transaction. Those in the legacy population were never subject to review by the SVO or the SSG and could not be subjected to a structural review at this time. The FE Data File is generated electronically without input by SVO or SSG personnel at any time and is potentially subject to the same risk identified for RMBS/CMBS that are regulated on the basis of CRP credit ratings. The SVO recommends that text be added to each section that identifies a sub-list process to make clear that Regulatory Transactions are not eligible for compilation as a part of the sub-list.

5. Discuss How NAIC Staff May Assist States to Evaluate Regulatory Transactions – Part Two Section 2 (b) of the Purposes and Procedures Manual authorizes state regulators to request and the SVO to provide assistance with respect to the analysis of a FE security or with respect to any investment issue before the department. This section is often used to request SVO and/or SSG assistance in the analysis of inter-affiliated transactions and in the assessment of transactions designed to resolve a regulatory issue that the state insurance department has been asked to approve. Some of these transactions are submitted under Regulatory Treatment Analysis Service (RTAS), and some are submitted by the insurer per instructions of the state insurance department. Although Section 2 (b) authorizes the request and grant of analytical assistance, it does not anticipate, we believe correctly, that there would be a relationship between the state determination for the inter-affiliated and regulatory transaction and NAIC processes. Based on the analysis shown above, the SVO has taken the position that it is not authorized to insert inter-affiliated and regulatory transactions into NAIC systems intended to hold information about investment securities. State insurance departments do not usually object to this, but some states have asked whether they are authorized to instruct the company to show the NAIC Designation and accounting determination provided by SVO and NAIC staff in their financial reporting to that or those state(s). In response to such requests, the SVO and other NAIC staff have indicated that it is appropriate for the state to do so provided that it is clear the adoption of the staff guidance on those issues is pursuant to a state determination distinct from the NAIC Financial Conditions Framework. We see no harm, and much benefit accruing to the members of the NAIC if they can leverage staff resources to resolve complex analytical issues, provided the members also distinguish between an NAIC agreed upon position and a unique state determination based entirely or predominantly on a state’s non-NAIC-related law or regulatory framework. The SVO believes more formal guidelines on this issue would help formalize staff practices and also provide guidance to states that are trying to resolve complex investment and related analytical issues. Although the suggested guidelines are concerned with SVO and SSG activity, it is clearly desirable for this guidance to be comprehensive and that it include guidance related to statutory accounting and reporting issues.

6. Summary of Proposed Amendments – The mechanism the SVO proposes for the use of the Reinsurance (E) Task Force would first require the following amendments to the Purposes and Procedures Manual:

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Part One, Section 2 – Describe the SVO compilation function as an ongoing SVO operation. Specify that to fulfill its function, the SVO must also be able to convey to an insurer that a filing is not eligible for filing with the SVO as an Investment Security reported on Schedule D, for example, because it is an Other Invested Asset or, in the context we are discussing, because it is a Regulatory Transaction.

Part Two, Section 1 – Identify and define all sub-lists or sources used to store securities or other information to compile and publish the quarterly compilation in the AVS+ product.

Part One, Section 3 (e) – Modify the FE Securities Data File section to clarify it only contains Investment Securities and to explain how it is created. Add new sections for the RMBS/CMBS Modeled Securities Process, the U.S. Treasury Securities Process and the Exempt U.S. Government Securities Process to provide the same disclosure and explanation for each of these sub-lists.

Use the names assigned to each sub-list in the compilation process to create a Reinsurance (E) Task Force-specific definition of Securities Listed by the SVO for purposes of the Model Law.

Part Two, Section 2 (a) – Amend the core instruction to insurers that they file investments with the SVO to refer to Investment Securities, define that term and prohibit the SVO from assessing a Regulatory Transaction under this section.

Part Three Section 2 (d) – Amend the SCA methodology concerned with SCA Debt and preferred stock to clarify the methodology is used to permit the SVO to determine whether an SCA Debt or SCA preferred stock is eligible for reporting as an Investment Security.

Part Three, Section 2 a – Add guidelines for NAIC staff assistance to states in the assessment of Regulatory Transactions.
Attachment One
Proposed Amendments to the Purposes and Procedures Manual

Part One – Purposes, General procedures 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 Valuation of Securities (E) Task Force or members of the regulatory community in accordance with the directives, procedures and general methodologies described in this Manual.

(v) Compile and publish the VOS PAVS+ products in accordance with instructions in this Manual.

(b) SVO Regulatory Products

(i) NAIC Designations

(ii) Valuation of Securities

(iii) Other Non-Payment Risk in Securities

(iv) Authority to Direct Insurers on Reporting

The SVO only has responsibility and authority to assess securities that are reportable on Schedule D and Schedule BA of the Annual Statement Blank. It is, therefore, part of the role of the SVO to determine when financial instruments or securities are not eligible for reporting on Schedule D and Schedule BA. The SVO may, therefore, be required to inform an insurer filer to redirect a financial instrument or security reported to the SVO to another schedule. Similarly, the SVO may also be required to inform an insurer filer that an instrument filed with the SVO pursuant to Part Two, Section 2 (a) of this Manual does not meet the definition of an Investment Security and cannot be assessed as such or that a financial transaction or security filed with the SVO meets the definition of a Regulatory Transaction eligible for assessment by the SVO under Part Three, Section 3 (e) of this Manual. In all cases in which a situation described in this subparagraph is presented, final determination as to what, but only after consulting the NAIC Accounting Practices and Procedures Manual statutory accounting and reporting applies to the instrument or security is made in consultation between NAIC statutory accounting staff and the SVO.

Section 3. Internal Administration

(d) SVO Departments

The SVO shall establish such procedures or guidelines as are necessary to delineate analytical and administrative responsibility for specific securities among departmental groups. The SVO also shall establish procedures for...
sharing administrative and analytical oversight for securities deemed to require application of methodologies from more than one department.

(e) Valuation of Securities Process

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 for an Investment Security, as defined in Part Two, Section 2 (a) of this Manual, the SVO shall enter such NAIC Designation, Unit Price and classification in the NAIC's VOS Process.

The SVO shall not add a Regulatory Transaction, as defined in Part Three Section 3 (d) of this Manual, to the VOS Process.

(fh) Monitoring of VOS Process

(g) Filing Exempt Securities Process

A filing exempt (FE) security is an Investment Security, as defined in Part Two, Section 2 (a) of this Manual, that is exempt from filing with the SVO, as otherwise required by Part Two, Section 2 (a) of this Manual, pursuant to the filing exemption in Part Two, Section 4 (d) of this Manual.

Insurance companies derive NAIC Designations for filing exempt FE securities by applying the conversion instructions in Part Two Section 4(d) (i) (A) and (B) of this Manual and the equivalency relationships disclosed in Section 7(d) (ii) of this Part.

NAIC Designations assigned to filing exempt FE securities are reported by the insurance company to the NAIC and subsequently added by NAIC staff to the FE Data File.

Insurance companies shall not report Regulatory Transactions, defined in Part Three Section 3 (d) of this Manual, as filing exempt FE securities, and the NAIC staff shall not add a Regulatory Transaction to the FE Data File.

(h) RMBS/CMBS Modeled Securities Process

An Residential mortgage-backed securities (RMBS) or a commercial mortgage-backed securities (CMBS) security are an Investment Security, as defined in Part Two, Section 2 (a) of this Manual. An RMBS or CMBS that is subject to financial modeling by the SSG and an RMBS or CMBS that is not subject to financial modeling by the SSG but has been assigned credit ratings by one or more NAIC CRPs are not filed with the SVO. An RMBS or a CMBS that is not capable of being financially modeled and is also not rated by an NAIC CRP is subject to filing with the SVO and will be added to the VOS Process by the SVO.

RMBS and CMBS are reported by the insurance company to the NAIC and subsequently added by NAIC staff to the RMBS/CMBS Modeled Securities Process, where on an annual basis and for purposes of the annual surveillance discussed in Part Seven, Section 5 (a) of this Manual, they are evaluated for eligibility to be financially modeled. RMBS and CMBS that are deemed to be subject to financial modeling are retained in the RMBS/CMBS Modeled Process. RMBS and CMBS that are deemed ineligible for financial modeling but that have been assigned credit ratings by NAIC credit rating providers (CRPs) migrate to the FE Date File. RMBS and CMBS that are deemed ineligible for financial modeling and that have not been assigned credit ratings by NAIC CRPs are filed with the SVO and accordingly migrate to the VOS Process.

Insurance companies shall not report Regulatory Transactions, defined in Part Three Section 3 (d) of this Manual, as eligible for the RMBS/CMBS Modeled Securities Process, and the NAIC staff shall not add a Regulatory Transaction to the RMBS/CMBS Modeled Securities Process.

(i) U.S. Treasury Securities Process
A U.S. Treasury Security is an Investment Security, as defined in Part Two, Section 2 (a) of this Manual, that is exempt from filing with the SVO, as otherwise required by Part Two, Section 2 (a) of this Manual, pursuant to the filing exemption in Part Two, Section 10 (c) (v) of this Manual.

U.S. Treasury Securities are added to the U.S. Treasury Securities Process automatically by electronic processes administered by the SVO and are assigned an NAIC 1 Designation by a policy-based convention.

Insurance companies shall not report Regulatory Transactions, defined in Part Three Section 3 (d) of this Manual, as U.S. Treasury Securities, and the NAIC staff shall not add a Regulatory Transaction to the U.S. Treasury Securities Process.

(i) Exempt U.S. Government Securities Process

An exempt U.S. Government Security is an Investment Security, as defined in Part Two, Section 2 (a) of this Manual, that is exempt from filing with the SVO, as otherwise required by Part Two, Section 2 (a) of this Manual, pursuant to the filing exemption in Part Two, Section 10 (c) (v) of this Manual.

An exempt U.S. Government Security is reported by the insurance company to the NAIC and subsequently added by NAIC staff to the Exempt U.S. Government Securities Process and by policy convention are assigned NAIC 1 Designation pursuant to a policy-based convention.

Insurance companies shall not report Regulatory Transactions, defined in Part Three Section 3 (d) of this Manual, as exempt U.S. Government Securities, and the NAIC staff shall not add a Regulatory Transaction to the Exempt U.S. Government Securities Process.

(e) Filing Exempt Securities

Filing exempt securities are defined in Part Two, Section 4 (d) of this Manual. The NAIC shall maintain computer system capabilities to include filing exempt securities in ISIS. The compilation will be performed in accordance with the eligibility rules set forth in this Manual as applied by the insurer holding the security or by the NAIC in comparing the security with the NAIC CRP rating feeds, except when regulatory policy set by the VOS/TF provides a different regulatory treatment for a filing exempt security than would otherwise apply based on the NAIC CRP assigned credit rating.

NAIC Designations assigned to filing exempt securities shall be derived by application of the conversion instructions in Part Two Section 4(d) (i) (A) and (B) of this Manual and the equivalency relationships disclosed in Section 7(d) (ii) of this Part except when regulatory policy set by the VOS/TF under Section 2 (f) of this Part or otherwise provides a different regulatory treatment for a filing exempt security than would otherwise apply based on the NAIC CRP assigned credit rating. ISIS shall show the name of the security, including a security identification number, the NAIC Designation and classification assigned to it and the Unit Price, if available.

(f) Valuation of Securities Process

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 Process. 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 Process in accordance with the instructions contained in Section 3 (e) of this Part above.

(g) Compilation and Publication of the SVO List of Securities Valuation of Securities Products

On a quarterly basis, the SVO shall...

2) Aggregate the content of each SVO Sub-List into a single SVO List of Investment Securities (hereafter, the “SVO List of Securities” identifying each Investment Security by name and other pertinent information and showing the NAIC Designation and/or Unit Price assigned to them by the SVO or pursuant to the methodology otherwise specified in this Manual).

3) Compile, or cause to be compiled, sub-lists from the informational content of the Derivative Counterparties Process, Exchange Rates Process, Ex-Dividend Process, Letter of Credit Process, Money Market and Exchange Traded Fund Process and Surplus Notes Process (each an SVO Sub-List bearing the name of the corresponding Process and collectively the “Other Information”).

4) Publish, or cause the SVO List of Securities and the Other Information to be published, by being incorporated into the NAIC’s AVS+ product).

Reference to SVO List of Securities

The NAIC, acting by and through its Valuation and Securities (E) Task Force and its Reinsurance (E) Task Force, acknowledges that the phrase “Securities Listed by the SVO,” used in Section 3 B. of the NAIC Credit for Reinsurance Model Law (#785) and Section 10 A. (2) of the Credit for Reinsurance Model Regulation (#786) refers to the SVO List of Securities as defined in this Part One, Section 3 (k) provided that for purposes of the Model Law, the phrase Securities Listed by the SVO also includes:

1) The money market funds on the Money Market Funds Sub-List and the exchange traded funds on the ETF Sub-List;
2) Any Letter of Credit identified in the Letter of Credit Sub-List;
3) All U.S. Treasury Securities whether or not actually owned by an insurance company; and

To avoid confusion, and for purposes of this acknowledgment, the Filing Exempt FE Process included in the definition of SVO List of Securities includes the SVO listed securities referred to as those “deemed exempt from filing” in the cited sections of the Model Law and Model Regulation.

Part Two – Filing with the SVO

Section 1. General Definitions Used in This Manual

The following definitions are intended to have relevance only for this Manual. No suggestion is intended that these definitions have any relevance to any other NAIC publication.

Derivative Counterparties Process means a file in NAIC electronic systems used to store the names of counterparties that have been applied to be added to the List of Counterparties for Schedule DB – Part D – Section 1 for purposes of netting of derivative exposures that is used in connection with the publication of the VOS AVS+ products.
Exchange Rates Process means a file in NAIC electronic systems used to store currency exchange rates used by insurance companies to convert the value of foreign investments into U.S. Dollars for reporting purposes and used in connection with the publication of the AVS+ pVOS Products.

Exempt U.S. Government Securities Process refers to a process within NAIC electronic computer systems used to store the names and descriptions of U.S. Government Securities that are exempt from filing with the SVO and that is used in connection with the publication of the AVS+ pVOS Products.

Ex-Dividend Process means a file created in NAIC electronic systems used to store information about stock dividends and that is used in connection with the publication of the AVS+ pVOS Products.

Filing Exempt Exempt Process Data File refers means the Filing Exempt Datafile and refers to an electronic file within the NAIC electronic computer systems that is used to store the names and descriptions of securities owned by state-regulated insurance companies that are exempt from filing with the SVO because they are assigned credit ratings by NAIC CRPs and that insurers: (1) have reported in quarterly or annual statements (NAIC Financial Statement Blank) filed with the NAIC; or (2) requested to be included in the Filing Exempt Data File through the Integrated Securities Information System (ISIS) and in both cases, for which an NAIC CRP rating has been confirmed by the NAIC and that is used in connection with the publication of the AVS+ pVOS Products.

Letter of Credit Process means a file in NAIC electronic systems used to store the names of banks that issue letters of credit in support of credit for reinsurance arrangements and that meet eligibility criteria to be placed on the NAIC Bank List that is used in connection with the publication of the AVS+ pVOS Products.

Money Market and Exchange Traded Fund Process refers to the component of NAIC electronic systems used to store the names of Money Market Funds and Exchange Traded Funds eligible for reporting as bonds used in connection with the publication of the AVS+ pVOS Products.

RMBS/CMBS Modeled Securities Process refers to a process within NAIC electronic computer systems used to store the names and descriptions of residential mortgage-backed securities and commercial mortgage-backed securities that have been financially modeled by the Structured Securities Group (SSG) and that is used in connection with the publication of the AVS+ pVOS Products.

Surplus Notes (NAIC 1) Process refers to the component of NAIC electronic systems used to store the names of Surplus Notes rated by CRPs at the NAIC equivalent used in connection with the publication of the AVS+ pVOS Products.

Surplus Notes (NAIC 2 – NAIC 6) Process refers to the component of NAIC electronic systems used to store the names of Surplus Notes rated by CRPs at the NAIC equivalent used in connection with the publication of the AVS+ pVOS Products.
U.S. Treasury Securities Process refers to a process within NAIC electronic computer systems used to store the names and descriptions of U.S. Treasury Securities and that is used in connection with the publication of the AVS+ pVOS Products.

VOS Process Process means the Valuation of Securities Process and refers to a process within NAIC electronic computer systems that component of the SVO’s Integrated Securities Information System (ISIS) used to store the names and descriptions of securities owned by state-regulated insurance companies, and together with the NAIC Designation categories and/Unit Price assigned to them by the SVO and that is used in connection with the publication of the AVS+ pVOS Products.

AVS+ pVOS Products refers to the quarterly compilation of the SVO List of Securities information derived from the VOS Database, the FE Datafile, Unit Prices assigned by the SVO and Unconfirmed FE’s and the Other Information as those terms are defined in Part Two, Section 3 (j) of this Manual.

Section 2. General Reporting Framework

(a) Obligation to Report

Insurance companies domiciled in any state of the United States, or any of its territories or possessions, and required by the law of their domiciliary state or territory to report NAIC Association Values for their Investment Securities in the NAIC Financial Statement Blank, shall report purchases of Investment Securities or any other relevant transaction to the SVO or, in the case of Investment Securities exempt from filing with the SVO, for example, pursuant to Section 4 (d) of this Part below, to the NAIC, as required by this Manual.

For purposes of this Part Two, Section 2 (a), an Investment Security means an instrument evidencing 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 Conditions Framework.

The SVO shall have no authority to issue NAIC Designations or any other NAIC analytical product to an insurance company for a Regulatory Transaction under this Section 2 (a).

See Part Three, Section 3 (d) below for the definition of Regulatory Transaction and a description of the processes governing their assessment.

(b) Authority to Require a Filing with the SVO

The existence of a filing exemption for a transaction, security, financial asset or investment activity in any Part of this Manual is not intended to, and shall not be read as, prohibiting a state insurance regulator from requiring its domiciled insurance company to file a transaction, security, financial asset or investment activity with the SVO for analysis.

In addition, nothing in this Manual should be read as prohibiting 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, as defined in Part Three, Section 3 (c) of this Manual, and directing an insurance company to file relevant information with the SVO or the SSG for that purpose.

Part Three – Credit Assessment
Section 2. Corporate Bonds and Preferred Stock – Special Assessment Situations

Bonds and preferred stock that fit the description set out below shall be subject to the general procedures specified above as well as the specific or special procedures identified below.

(d) SCA Debt and Preferred Stock

Part Five, Section 2 of this Manual governs valuation of Subsidiary, Controlled and Affiliated (SCA) investments in the form of common stock and in the form of preferred stock issued by an insurance company. This section applies to credit assessment of any SCA investment in the form of a debt instrument purchased (or otherwise acquired) from an insurance or non-insurance entity (“SCA debt”) and preferred stock issued by a non-insurer entity (“SCA preferred stock”). This procedure is used to determine whether an SCA debt or SCA preferred transaction is eligible for reporting as an Investment Security pursuant to Part Two Section 2 (a) of this Manual.

(e) Regulatory Transactions

i. Defined – Regulatory Transaction means a security or other instrument in a transaction designed as to solve an insurance company regulatory issue submitted to one or more state insurance departments for review and approval under the regulatory framework of the state or states.

ii. Intent – This Section provides guidance to the SVO and the SSG on how to manage requests for assistance made by a state insurance department under Part Two, Section 2 (b) of this Manual.

iii. Guidelines

The SVO or SSG is authorized to conduct an analytical assessment on behalf of any state insurance department that requests such assistance.

If an insurance company files a Regulatory Transaction with the SVO via the ATF process or under the Regulatory Treatment Analysis Service (RTAS) process, the SVO shall first contact the state insurance department of the insurance company’s state of domicile to disclose that a Regulatory Transaction has been submitted and inquire whether the state insurance department wants SVO analytical assistance.

If the state insurance department of the insurer’s state of domicile request such assistance, the SVO shall engage in the requested analytical assessments of the Regulatory Transaction. SVO determinations may include and refer to NAIC analytical benchmarks, such as NAIC Designations, valuation or classification assessments, and such determinations may be given by the SVO or SSG to the state insurance department.

SVO or SSG determinations given in connection with the assessment of a Regulatory Transaction may be given to and adopted by the state insurance department as part of that state’s internal determination of the regulatory issues presented by the Regulatory Transaction. However, SVO assessments for a Regulatory Transaction will not be entered into NAIC computer systems reserved for Investment Securities, as defined in Part Two, Section 2 (a) or added to the SVO List of Securities as defined in Part One, Section 3 (g).
Attachment Two
Identification of the Sub-Lists that Constitute the Quarterly Compilation of Insurer-Owned Investments Compiled and Published under Part One, Section 3 (g) of the Purposes and Procedures Manual

List of Insurer Owned Securities Compiled Quarterly and Published in AVS+

Valuation of Securities (VOS) Process – The Integrated Securities Information System (ISIS) contains a customized sub-system (also called VOS) allowing SVO credit analysts to review and assign NAIC Designation to certain Schedule D and Schedule BA issues owned by insurance companies. This environment mandates check-and-balance credit assessment measures among SVO analysts and managers, including formal sign-offs, data entry controls, etc. The VOS Process is accessible within the Automation Valuation Service (AVS+) product.

Filing Exempt (FE) Data File – An automated process is run daily whereby unique CUSIP numbers are identified from the NAIC Schedule D Annual and Quarterly Statements and cross-referenced against the CUSIP data feed. This resulting population is then compared to rating feeds from our eight credit rating providers (CRPs) whereby the second lowest rating from the rating vendors culminates into an NAIC FE Designation. The contents of the FE data file are electronically generated and cannot be manipulated by SVO personnel at any time. The FE Process is also accessible within AVS+.

RMBS/CMBS Modeled Securities – This population of residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS) securities are supported by the Structured Securities Group (SSG), which collaborates with third-party vendors (currently PIMCO for RMBS and Blackrock Solutions for CMBS) to determine critical data points to provide guidance to insurers on how to determine NAIC Designations and report them with the NAIC. The SVO credit staff are not directly involved in this process. The RMBS/CMBS population is accessible within AVS+.

NOTE: U.S. Treasuries are included in the quarterly compilation and published in AVS+, but it is not identified as a separate list by the compilation function because it is compiled through a process not involving filings by insurers.

List of Insurer Owned Securities Compiled Quarterly but NOT Published in AVS+

Government Exemptions – Certain U.S. Government Agency issues—including Fannie Mae, Freddie Mac, Ginnie Mae, etc.—are exempt from filing with the SVO as well as excluded from the automated FE daily process. This population is determined through insurer reporting with the NAIC and is not manipulated at any time by SVO personnel. This population is not available within AVS+.

NOTE: The staff recommend that the Government Exemptions be considered a list of securities and that it be added to AVS+. The staff also recommend that the list be identified as a list of securities eligible for use in reinsurance transactions.

Subsidiary, Controlled and Affiliated (SCA) – SCA companies are filed by insurers with the SVO and captured as an independent Process within the ISIS system. This Process is accessible for regulators within I-SITE but not for AVS+ subscribers.

NOTE: SCA investments are valued on either market or an equity basis and are not assessed for credit quality by the SVO or CRPs. The staff recommend that the Reinsurance (E) Task Force consider whether a sub-list of SCA investments should be identified as a list of securities eligible for use in reinsurance transactions.

List Containing Information – Compiled Quarterly and Published in AVS+

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Money Market Funds – Issuers of money market funds that meet certain criteria for exemption from NAIC reserve requirements submit approval applications to the SVO. The SVO staff verify the funds meet the criteria and ensure they are included the NAIC Approved Money Market Fund Listing. This list is sold as a monthly publication and posted quarterly within AVS+.

Letter of Credit Banks – Banks issuing letters of credit that meet certain criteria from the NAIC submit approval applications to the SVO. The SVO staff verifies the banks meet the criteria and ensure they are included the NAIC Approved Bank List. This list is sold as a monthly publication and posted quarterly within AVS+.

Exchange Rates – A list of currency exchange rates is captured monthly by the SVO via Olsten & Associates (OANDA) [www.oanda.com]. These rates are used by insurance for converting foreign investments into US Dollars for reporting purposes. This listing is posted quarterly within AVS+.

Ex-Dividend – A listing of stock dividends issued by companies is retrieved directly from an outside vendor and posted quarterly within AVS+.

Derivative Counterparties – This listing consists of counterparties submitted by insurance companies to the SVO for approval provided specific NAIC criteria are met. This listing is posted quarterly within AVS+.

NOTE – In the opinion of the staff, with the possible exception of Money Market Fund (and Exchange-Traded Funds [ETF] lists), these lists are not relevant to the objectives of the Reinsurance (E) Task Force because they are lists of information, not lists of insurer owned securities. The Money (and ETF) lists differ in that they identify, respectively, money market, bond and exchange traded funds that are designated for credit quality and deemed eligible by the SVO for reporting on the bond schedule. Although the lists themselves are not lists of insurer owned securities, they are nevertheless lists of investments eligible for purchase by insurers. Accordingly, the staff recommend that the Reinsurance (E) Task Force consider whether these lists should be identified as a list of securities eligible for use in reinsurance transactions.

Surplus Notes (NAIC1) – This listing consists of surplus notes submitted by insurance companies to the SVO for verification that the Note is rated by a CRP and placed on a sub-list. This listing is posted quarterly within AVS+.

Surplus Notes (NAIC2–NAIC6) – This listing consists of surplus notes submitted by insurance companies with NAIC2–NAIC6 ratings or not rated all. These securities are not assessed for credit quality. If filed, the SVO will calculate a statement factor for the insurance company used for Schedule BA reporting. This listing is posted quarterly within AVS+.

NOTE: The Investment Analysis Office does not have a view whether Surplus Notes should be identified as a list of securities eligible for use in reinsurance transactions. We would defer to the views of the Financial Regulatory Services (FRS) staff.
Part One – Purposes, General procedures 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:

- Analysis of credit risk for purposes of assigning an NAIC Designation.
- Valuation analysis to determine a Unit Price.
- 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.

Compile and publish the VOS Products in accordance with instructions in this [Manual].

(b) SVO Regulatory Products

(i) NAIC Designations …

(ii) Valuation of Securities …

(iii) Other Non-Payment Risk in Securities …

(iv) Authority to Direct Insurers on Reporting

The SVO only has responsibility and authority to assess securities that are reportable on Schedule D and Schedule BA of the Annual Statement Blank. It is therefore part of the role of the SVO to determine when financial instruments or securities are not eligible for reporting on Schedule D and Schedule BA. The SVO may therefore be required to inform an insurer filer to redirect a financial instrument or security reported to the SVO to another schedule. Similarly, the SVO may also be required to inform an insurer filer that an instrument filed with the SVO pursuant to Part Two, Section 2 (a) of this Manual does not meet the definition of an Investment Security and cannot be assessed as such or that a financial transaction or security filed with the SVO meets the definition of a Regulatory Transaction eligible for assessment by the SVO under Part Three, Section 3 (e) of this Manual. In all cases in which a situation described in this subparagraph is presented, final determination as to what statutory accounting and reporting applies to the instrument or security is made in consultation between NAIC statutory accounting staff and the SVO.

Section 3. Internal Administration

…

(d) SVO Departments

The SVO shall establish such procedures or guidelines as are necessary to delineate analytical and administrative responsibility for specific securities among departmental groups. The SVO also shall establish procedures for sharing administrative and analytical oversight for securities deemed to require application of methodologies from more than one department.

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Valuation of Securities Process

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 for an Investment Security, as defined in Part Two, Section 2 (a) of this Manual, the SVO shall enter such NAIC Designation, Unit Price and classification in the NAIC's VOS Process.

The SVO shall not add a Regulatory Transaction, as defined in Part Three Section 3 (d) of this Manual, to the VOS Process.

Monitoring of VOS Process ...

Filing Exempt Securities Process

A filing exempt security is an Investment Security, as defined in Part Two, Section 2 (a) of this Manual, that is exempt from filing with the SVO, as otherwise required by Part Two, Section 2 (a) of this Manual, pursuant to the filing exemption in Part Two, Section 4 (d) of this Manual.

Insurance companies derive NAIC Designations for filing exempt securities by applying the conversion instructions in Part Two Section 4(d) (i) (A) and (B) of this Manual and the equivalency relationships disclosed in Section 7(d) (i) of this Part.

NAIC Designations assigned to filing exempt securities are reported by the insurance company to the NAIC and subsequently added by NAIC staff to the FE Data File.

Insurance companies shall not report Regulatory Transactions, defined in Part Three Section 3 (d) of this Manual, as filing exempt securities and the NAIC staff shall not add a Regulatory Transaction to the FE Data File.

RMBS/CMBS Modeled Securities Process

An RMBS or a CMBS security is an Investment Security, as defined in Part Two, Section 2 (a) of this Manual. RMBS and CMBS are reported by an insurance company to the NAIC and subsequently added by NAIC staff to the RMBS/CMBS Modeled Securities Process where on an annual basis and for purposes of the annual surveillance discussed in Part Seven, Section 5 (a) of this Manual, they are evaluated for eligibility to be financially modeled. RMBS and CMBS that are deemed to be subject to financial modeling are retained in the RMBS/CMBS Modeled Process. RMBS and CMBS that are deemed ineligible for financial modeling but that have been assigned credit ratings by NAIC CRPs migrate to the FE Date File. RMBS and CMBS that are deemed ineligible for financial modeling and that have also not been assigned credit ratings by NAIC CRPs are filed with the SVO and accordingly migrate to the VOS Process.

Insurance companies shall not report Regulatory Transactions, defined in Part Three Section 3 (d) of this Manual, as eligible for the RMBS/CMBS Modeled Securities Process NAIC staff shall not add a Regulatory Transaction to the RMBS/CMBS Modeled Securities Process.

US Treasury Securities Process

A US Treasury Security is an Investment Security, as defined in Part Two, Section 2 (a) of this Manual, that is exempt from filing with the SVO, as otherwise required by Part Two, Section 2 (a) of this Manual, pursuant to the filing exemption in Part Two, Section 10 (c) (v) of this Manual.

US Treasury Securities are added to the US Treasury Securities Process automatically by electronic processes administered by the SVO and are assigned an NAIC 1 Designation by a policy based convention.
Insurance companies shall not report Regulatory Transactions, defined in Part Three Section 3 (d) of this Manual, as US Treasury Securities and the NAIC staff shall not add a Regulatory Transaction to the US Treasury Securities Process.

(j) Exempt US Government Securities Process

An exempt US Government Security is an Investment Security, as defined in Part Two, Section 2 (a) of this Manual, that is exempt from filing with the SVO, as otherwise required by Part Two, Section 2 (a) of this Manual, pursuant to the filing exemption in Part Two, Section 4 (c) of this Manual.

An exempt US Government security is reported by the insurance company to the NAIC and subsequently added by NAIC staff to the Exempt US Government Securities Process and by policy convention are assigned NAIC 1 Designation.

Insurance companies shall not report Regulatory Transactions, defined in Part Three Section 3 (d) of this Manual, as exempt US Government Securities and the NAIC staff shall not add a Regulatory Transaction to the Exempt US Government Securities Process.

(k) Compilation and Publication of the SVO List of Securities

On a quarterly basis, the SVO shall:

1) Compile, or cause to be compiled, a list of Investment Securities from each of the VOS Process, FE Data Process, RMBS/CMBS Modeled Securities Process, US Treasury Process and the Exempt US Government Securities Process (each an SVO Sub-List bearing the name of the corresponding Process);

2) Aggregate the content of each SVO Sub-List into a single SVO List of Investment Securities (hereafter, the “SVO List of Securities”) identifying each Investment Security by name and other pertinent information and showing the NAIC Designation and/or Unit Price assigned to them by the SVO or pursuant to the methodology otherwise specified in this Manual;

3) Compile, or cause to be compiled, sub-lists from the informational content of the Derivative Counterparties Process, Exchange Rates Process, Ex-Dividend Process, Letter of Credit Process, Money Market and Exchange Traded Fund Process and Surplus Notes Processes (each an SVO Sub-List bearing the name of the corresponding Process and collectively the “Other Information”), and

4) Publish, or cause the SVO List of Securities and the Other Information to be published by being incorporated into the NAIC’s AVS + product).

(l) Reference to SVO List of Securities

The NAIC, acting by and through its Valuation and Securities (E) Task Force and its Reinsurance (E) Task Force acknowledges that the phrase “Securities listed by the SVO”, used in Section 3 B. of the NAIC Credit for Reinsurance Model Law (#785) and Section 10 A. (2) of the Credit for Reinsurance Model Regulation (#786) refers to the SVO List of Securities as defined in this Part One, Section 3 (k) provided that for purposes of the Model Law, the phrase Securities Listed by the SVO also includes: [Please Note, the following text is inserted for purposes of illustration only]

1) The money market funds on the Money Market Funds Sub-List and the exchange traded funds on the ETF Sub-List;

2) Any Letter of Credit identified in the Letter of Credit Sub-List;

3) All US Treasury Securities whether or not actually owned by an insurance company; and
3) ....

To avoid confusion, and for purposes of this acknowledgment, the Filing Exempt Process included in the definition of SVO List of Securities includes the SVO listed securities referred to as those “deemed exempt from filing” in the cited sections of the Model Law and Model Regulation.

### Part Two – Filing with the SVO

#### Section 1: General Definitions Used in This Manual

The following definitions are intended to have relevance only for this Manual. No suggestion is intended that these definitions have any relevance to any other NAIC publication.

...  

**Derivative Counterparties Process** means a file in NAIC electronic systems used to store the names of counterparties on the List of Counterparties for Schedule DB – Part D – Section 1 for purposes of netting of derivative exposures that is used in connection with the publication of the VOS Products.

...  

**Exchange Rates Process** means a file in NAIC electronic systems used to store currency exchange rates used by insurance companies to convert the value of foreign investments into US Dollars for reporting purposes and used in connection with the publication of the VOS Products.

**Exempt US Government Securities Process** refers to a Process within NAIC electronic computer systems used to store the names and descriptions of US Government Securities that are exempt from filing with the SVO and that is used in connection with the publication of the VOS Products.

**Ex-Dividend Process** means a file created in NAIC electronic systems used to store information about stock dividends and that is used in connection with the publication of the VOS Products.

...  

**Filing Exempt Process File** refers to an electronic file within NAIC electronic computer systems used to store the names and descriptions of securities owned by state-regulated insurance companies that are exempt from filing with the SVO because they are assigned credit ratings by NAIC CRPs and that insurers: (1) have reported in quarterly or annual statements (NAIC Financial Statement Blank) filed with the NAIC or (2) requested to be included in the Filing Exempt Data File through the Integrated Securities Information System (ISIS) and in both cases, for which an NAIC CRP rating has been confirmed by the NAIC and that is used in connection with the publication of the VOS Products.

...  

**Letter of Credit Process** means a file in NAIC electronic systems used to store the names of banks that issue letters of credit in support of credit for reinsurance arrangements and that meet eligibility criteria to be placed on the NAIC Bank List that is used in connection with the publication of the VOS Products.

...  

**Money Market and Exchange Traded Fund Process** refers to the component of NAIC electronic systems used to store the names of Money Market Funds and Exchange Traded Funds eligible for reporting as bonds used in connection with the publication of the VOS Products.

...
RMBS/CMBS Modeled Securities Process refers to a Process within NAIC electronic computer systems used to store the names and descriptions of residential mortgage backed securities and commercial mortgage backed securities that have been financially modeled by the SSG and that is used in connection with the publication of the VOS Products.

Surplus Notes (NAIC1) Process refers to the component of NAIC electronic systems used to store the names of Surplus Notes rated by CRPs at the NAIC equivalent used in connection with the publication of the VOS Products.

Surplus Notes (NAIC 2 – NAIC 6) Process refers to the component of NAIC electronic systems used to store the names of Surplus Notes rated by CRPs at the NAIC equivalent used in connection with the publication of the VOS Products.

US Treasury Securities Process refers to a Process within NAIC electronic computer systems used to store the names and descriptions of US Treasury Securities and that is used in connection with the publication of the VOS Products.

VOS Process means the Valuation of Securities Process and refers to a Process within NAIC electronic computer systems used to store the names and descriptions of securities owned by state-regulated insurance companies, and the NAIC Designation categories and/or Unit Price assigned to them by the SVO and that is used in connection with the publication of the VOS Products.

VOS Products refers to the quarterly compilation of the SVO List of Securities and the Other Information as those terms are defined in Part Two, Section 3 (j) of this Manual.

Section 2. General Reporting Framework

(a) Obligation to Report

Insurance companies domiciled in any state of the United States, or any of its territories or possessions, and required by the law of their domiciliary state or territory to report NAIC Association Values for their Investment Securities in the NAIC Financial Statement Blank, shall report purchases of Investment Securities to the SVO or, in the case of Investment Securities exempt from filing with the SVO, for example, pursuant to Section 4 (d) of this Part below, to the NAIC, as required by this Manual.

For purposes of this Part Two, Section 2 (a) an Investment Security means an instrument evidencing 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 Conditions Framework.

The SVO shall have no authority to issue NAIC Designations or any other NAIC analytical product to an insurance company for a Regulatory Transaction under this Section 2 (a).

See Part Three, Section 3 (d) below for the definition of Regulatory Transaction and a description of the processes governing their assessment.
(b) Authority to Require a Filing with the SVO

The existence of a filing exemption for a transaction, security, financial asset or investment activity in any Part of this Manual is not intended to, and shall not be read as, prohibiting a state insurance regulator from requiring its domiciled insurance company to file a transaction, security, financial asset or investment activity with the SVO for analysis.

In addition, nothing in this Manual should be read as prohibiting 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, as defined in Part Three, Section 3 (e) of this Manual and directing an insurance company to file relevant information with the SVO or the SSG for that purpose.

Part Three – Credit Assessment

Section 2. Corporate Bonds and Preferred Stock – Special Assessment Situations

Bonds and preferred stock that fit the description set out below shall be subject to the general procedures specified above as well as the specific or special procedures identified below.

(d) SCA Debt and Preferred Stock

Part Five, Section 2 of this Manual governs valuation of Subsidiary, Controlled and Affiliated (SCA) investments in the form of common stock and in the form of preferred stock issued by an insurance company. This section applies to credit assessment of any SCA investment in the form of a debt instrument purchased (or otherwise acquired) from an insurance or non-insurance entity (“SCA debt”) and preferred stock issued by a non-insurer entity (“SCA preferred stock”). This procedure is used to determine whether an SCA debt or SCA preferred transaction is eligible for reporting as an Investment Security pursuant to Part Two Section 2 (a) of this Manual.

…

(e) Regulatory Transactions

i. Defined - Regulatory Transaction means a security or other instrument in a transaction submitted to one or more state insurance departments for review and approval under the regulatory framework of the state or states.

ii. Intent - This Section provides guidance to the SVO and the SSG on how to manage requests for assistance made by a state insurance department under Part Two, Section 2 (b) of this Manual.

iii. Guidelines

The SVO or SSG is authorized to conduct an analytical assessment on behalf of any state insurance department that requests such assistance.

If an insurance company files a Regulatory Transaction with the SVO via the ATF process or under the RTAS process, the SVO shall first contact the state insurance department of the insurance company’s state of domicile to disclose that a Regulatory Transaction has been submitted and inquire whether the state insurance department wants SVO analytical assistance.

If the state insurance department of the insurer’s state of domicile request such assistance, the SVO shall engage in the requested analytical assessments of the Regulatory Transaction. SVO determinations may include and refer to NAIC analytical benchmarks, such as NAIC Designations, valuation or classification assessments and such determinations may be given by the SVO or SSG to the state insurance department.

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SVO or SSG determinations given in connection with the assessment of a Regulatory Transaction may be given to and adopted by the state insurance department as part of that state’s internal determination of the regulatory issues presented by the Regulatory Transaction. However, SVO assessments for a Regulatory Transaction will not be entered into NAIC computer systems reserved for Investment Securities, as defined in Part Two, Section 2 (a) or added to the SVO List of Securities as defined in Part One, Section 3 (g).