

National Association of Insurance Commissioners
Statement of Policy and Procedures

Obtaining Regulatory Guidance for Investment Securities

As insurance regulators, the primary concern of the NAIC¹ is the solvency of insurers. This includes not only assessment of the financial condition of insurers, but also, like other financial regulators, concern for general financial market stability and concern that regulators' own actions do not unduly affect insurers' investment decisions. A fundamental aspect of the financial solvency function is to provide guidance on regulatory perception of risks in investment securities to insurance companies and their investment advisors in order that insurance company investment decisions incorporate an understanding of applicable regulations and that financial markets are not adversely impacted by formulation of or subsequent changes in regulation.

a. Statement of Policy - The NAIC is committed to provide guidance to the insurance industry and the investment advisor community about regulator perception of risks in investment securities. The phrase investment securities shall be given a broad meaning and shall include newly created, previously existing or modified securities or financial products. The regulatory review process for investment securities will be conducted in public and seek the participation of all interested persons.

b. The Regulatory Review Process and the NAIC Committee Structure

The NAIC will conduct and maintain a regulatory review process administered by the Invested Asset (E) Working Group (IAWG) of the Valuation of Securities (E) Task Force (Task Force) of the NAIC Financial Conditions (E) Committee. The IAWG will also serve as a point of contact into the regulatory process for interested persons, including investment advisors.

The NAIC Financial Conditions (E) Committee has overall responsibility for safeguarding the financial integrity of insurance companies. It is assisted in this objective by a number of task forces, each of which is assigned a specific area of focus and responsibility. The Valuation of Securities (E) Task Force (Task Force) is specifically tasked with considering and coordinating issues related to and making policy recommendations for investment securities. The Task Force has formed the Invested Asset Working Group (IAWG) to ensure it has the needed technical expertise to assess issues associated with investment securities.

The Task Force and the IAWG are assisted by the NAIC Securities Valuation Office (the "SVO"). The SVO is an NAIC staff division composed of credit and financial analysts,

¹ The National Association of Insurance Commissioners (NAIC) is a voluntary organization of the chief insurance regulatory officials of the 50 states, the District of Columbia and five U.S. territories. You can learn more about the NAIC at www.naic.org/press_home.htm.

investment research specialists, economists, lawyers, and other investment professionals which serve as the professional staff of the Task Force.

The policy objectives that guide SVO analysis are set, periodically reviewed and amended by the Task Force. The rules that govern the operation of the SVO are set forth in the *Purposes and Procedures Manual of the NAIC Securities Valuations Office*, a document that is readily accessible and updated twice a year. All of the policies and procedures that govern the SVO are adopted by state insurance regulators in open meetings that consider extensive comment from, and dialogue with, any industry representatives or other interested persons.

The Task Force, which consists of regulators from different state insurance departments, meets at least four times a year in open, public session. These meetings provide a forum for members of the Task Force to interact with representatives of any entity that might be affected by its policy decisions. Task Force decisions and determinations are subject to review and approval by its parent committee, the Financial Conditions (E) Committee. This committee meets at least four times per year, also in open session with ample opportunity for public comment.

c. Guiding Principles for the Regulatory Review Process

Purposes and Objectives – The regulatory review process for investment securities administered by the IAWG shall be conducted for the primary benefit of the insurance industry. In their discussions with the IAWG, insurance companies will often be assisted by investment advisors who may provide expertise about the security under review or related issues. Members of the investment advisor community may also seek guidance from regulators on investment securities or related issues directly provided there is convincing evidence of insurance company interest in the investment security or issue such that a regulatory review of the investment security or issue will clearly benefit the insurance industry. The regulatory review process administered by the IAWG is not intended to endorse investment products generally or to expend resources to approve products that investment advisors believe may be of interest to insurance companies.

Risks of Concern to Regulators – The NAIC believes that financial solvency regulation is concerned with any risk that has the potential to cause or contribute to an interruption in regulator cash-flow assumptions. Financial solvency analysis must be conducted on the basis of a comprehensive understanding of the investment risks presented in a security. It is an objective of the regulatory review process to continually update the regulatory understanding of investment risk to ensure that the financial solvency framework adequately reflects financial innovation, evolving market practices and risks in investment securities, activities and markets.

Role of Industry and Market Participants – The commitment to provide guidance about regulator perception of risks in investment securities and to do so in a public and highly visible manner assumes the active and ongoing participation of the insurance industry and of their investment advisors. Insurance companies in particular have a responsibility to

ensure timely dialogue with regulators on the nature and form of regulation applicable to investment securities. The NAIC expects that the insurance industry and their investment advisors will establish procedures to identify investment securities of interest to insurance companies and develop processes to ensure public information about the risks they contain.

Limitations on Quantification of Risks – The NAIC believes that capital market efficiency is promoted when risks in new investments can be quantified. However, where quantification of risk is not possible, the NAIC considers that it is more efficient for regulatory and market processes to base regulatory guidance on available information even when such information is not statistical or empirical in nature. When regulation cannot be firmly or reasonably linked to empirical data, the NAIC may nevertheless provide for such data to be collected with a view to a possible future readjustment of regulation based on empirical evidence. Regulatory responses by the Task Force or the IAWG may therefore include a direction that the SVO monitor asset performance over a specified time period; that expected cash flows associated with the security be modeled, that historical performance data be collected to provide for future quantification efforts or that regulatory treatment be periodically reviewed to ensure the most appropriate regulatory treatment.

Limitations on Open Meetings – The NAIC is committed to conducting its business in public subject to the discretion of the chair of a committee, subcommittee, task force and working group to decide that a specific situation renders public discussions inappropriate or inadvisable. The NAIC Policy Statement on Open Meetings identifies situations in which public discussion is inappropriate and provides that the chair may exercise a reasonable judgment that it would be inadvisable or inappropriate to have public discussions in other situations. Pertinent and reliable information about securities and the risks they contain is a prerequisite to a sound policy making process. The NAIC anticipates that the industry will work with their investment advisors to ensure that information about securities under regulatory review is publicly available. However, members of the investment advisor community may claim that information about an investment security under regulatory review is proprietary and or confidential and may refuse to discuss the specifics of such investment security publicly. Where such situations develop the chair has discretion to hold private discussions with such persons or entities to obtain the requisite information or data to complete the regulatory review.

d. Requesting a Regulatory Review of an Investment Security

SVO Risk Assessment – Anyone may request a pre-purchase evaluation of a new investment security under the Regulatory Treatment Analysis Service (RTAS) provided for the NAIC by the SVO. The service permits an insurance company or an investment advisor to ask the SVO to evaluate the likely regulatory treatment of an investment security before it is purchased by or sold to an insurance company. As part of the RTAS process, the SVO may choose or be required to consult with the Task Force prior to providing a final determination to the Applicant.

IAWG Review and Guidance – Anyone can request the Task Force to conduct a regulatory review for an investment security. The request is made directly to the Chair of the Task Force. The Chair may direct that the investment security be added to an interim or national meeting agenda. The Task Force may also refer the matter to the IAWG for analysis and recommendation.

e. Public Meetings Process

If the Task Force agrees to consider a request for a regulatory review, it will direct SVO staff to organize a meeting. The SVO may also be directed to prepare an analysis of the investment security. The person making the request for regulatory review and other interested persons may also be asked to complete an Investment Risk Assessment Worksheet. Finalizing regulatory guidance may require the participation of other NAIC groups, for example, those with expertise in statutory accounting, risk-based capital, annual statement instructions or financial statement blanks.

Once the investment security has been placed on an agenda, the person who made the request will be advised of the date and time of the meeting. Meetings are conducted in accordance with the NAIC Policy Statement on Open Meetings and are governed by Robert's Rules of Order. Public meetings are arranged to obtain information from and the views of interested persons about the risks posed by the investment security. Accordingly, the Task Force or the IAWG may release material or documents prior to the meeting for review and comment or as it progresses in its review of the security.

Comments should be in writing and on the letterhead of the entity or organization making the comments. Comments should be supported by appropriate arguments, explanation and analysis. Comments may offer proposed alternative recommendations for accomplishing the regulatory objective. Comments should be made prior to the end of the comment period. Comments received after the end of the established comment period may not be reviewed at the discretion of the chair. All written material should be submitted by electronic mail to RNewman@naic.org. Participation at the public meeting is not a prerequisite to the submission of written comments on a proposed regulatory review or the issues under discussion.