

An Explanation of the Role and Function of the SVO in the Formulation of Policy for Insurer Investments

Note: The text below explains the role and function of the SVO in the larger NAIC process of formulating a regulatory policy or identifying risks in an investment an insurer may wish to purchase. You should read and interpret this text along with the other material contained on this page. The text is taken from the December 31, 2008 publication of the *Purposes and Procedures of the NAIC Securities Valuation Office*. An update of the *Purposes and Procedures Manual* is published in July and December of each year. Please refer to the latest update to review changes to the cited language.

Part Two: General

Section 1. The NAIC

The National Association of Insurance Commissioners ("NAIC" or "Association") traces its origin to 1871. The NAIC is a not-for-profit corporation whose members are the commissioners, directors, superintendents and other state officials who regulate the insurance business within the 50 states, the District of Columbia and the four U.S. territories. The purpose that the members of the Association seek to advance is the promotion of uniformity in their regulatory efforts. The NAIC is not itself a regulatory entity. The 56 members of the Association are supported by the Executive Headquarters, which maintains offices in Kansas City, Mo., Washington, D.C., and New York, N.Y. Committees composed of NAIC members conduct the work of the Association. Prior to regularly scheduled quarterly meetings, regulatory and administrative issues are assigned to expert groups of NAIC members for consideration and recommendation. Progress on assigned work is reported to the next level of the committee system at the quarterly meetings until the matter is disposed of without action or sent to the plenary session for consideration by the entire membership. If adopted by the Plenary, the recommendation becomes Association policy, reflecting national regulatory consensus and serving as guidance to state insurance departments and state legislatures.

Section 2. VOS/TF and SVO

The NAIC has determined that credit quality of insurance company investments and the Unit Price for a security provide a sound empirical anchor for certain regulatory functions related to financial solvency regulation.

The VOS/TF formulates and implements NAIC's credit assessment, classification and securities valuation policy.

The SVO is the professional staff of the VOS/TF responsible for day-to-day credit quality assessment and valuation of securities owned by state-regulated insurance companies. The SVO also performs such other duties as are specified by VOS/TF.

Section 3. General Directives

(a) Ongoing SVO Operations

The SVO conducts:

- (i) Credit analysis for purposes of assigning an NAIC Designation,
- (ii) Valuation analysis to determine a Unit Price,
- (iii) A number of classification assignments to determine the most appropriate reporting for a security, and
- (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.

The result of SVO's analysis, as it pertains to credit risk (hereafter defined), shall be expressed as an opinion of credit quality by assignment of an NAIC Designation.

The result of SVO's valuation analysis shall be expressed as a Unit Price.

The result of the SVO classification analysis shall be expressed as an opinion of how the insurance company should report the security (i.e., whether as bond like, preferred stock like or common stock like or otherwise) based on the applicable classification criteria.*

Reporting insurance companies may report the NAIC Designation and classification published in the latest VOS Products and may calculate fair value by multiplying the Unit Price by the number of units owned.

* **Note:** Principal classification assignments are specified in Part Seven, Sections 1 (c), 2 (b), 3 (d), 4 (a) and Section 4 (c) and in Parts Eleven and Fourteen.

(b) SVO Analytical Functions in Support of Financial Solvency Regulation

The SVO has responsibility for assisting NAIC members and individual states to assess investment risk in new securities and financial products. The SVO exercises this responsibility:

- (i) When requested to do by the VOS/TF, any of its working groups, any other NAIC task force or working group or any individual state insurance department,

- (ii) Through the Emerging Investment Vehicle Regulatory Treatment Analysis Service process discussed in Part Two, Section 3 (f),
- (iii) Through ongoing research and analysis activity aimed at identifying both broad developments in the capital markets and the introduction of specific new classes of securities that insurance companies may purchase,
- (iv) By providing bi-annual or more frequent reports to the VOS/TF on innovative structures filed by insurance companies and the risks they contain , and
- (v) By sharing information obtained through interaction with market participants with the VOS/TF.