

To: Members of the Invested Asset (E) Working Group
From: Kevin Fry, Chair of the Invested Asset (E) Working Group
Re: Outline of Plan for enhancing the regulatory structure for “other than credit” investment risks
Date: July 13, 2009

1. Introduction - The objective of the IAWG call on 7/23/09 at 11am Eastern is to present a Plan for enhancing the regulatory structure for handling “other than credit (OTC)” risks that exist in fixed income investments of insurers. This Plan was developed after consultations with IAWG members and SVO staff and after taking into consideration the alternatives that were discussed on the three previous IAWG calls held on 3/24/09, 4/7/09 and 4/15/09.

As a reminder, the technical advisory group known as the Risk Subgroup identified the following risks in addition to credit as individual security risks for fixed income investments:

- Liquidity
- Deferral
- Call
- Extension
- Currency
- Leverage
- Event

These risks are more fully explained in a Risk Subgroup Report dated August 26, 2008. This report can be accessed under the IAWG area of the NAIC website.

2. Outline - The Plan to enhance the regulatory structure for better transparency of “other than credit” investment risks has three components: Disclosure, Tools, and Monitoring.

a. Disclosure - The first component of the plan is better disclosure through a requirement for a narrative that contains quantitative and qualitative information about exposure to “other than credit” risks. The disclosure requirement could be located in the Supplemental Investment Risk Interrogatories which is required to be filed yearly on or before 4/1. Instructions for this disclosure would have to be carefully developed.

b. Tools - The second component of the plan is the development of tools by the SVO to monitor “other than credit” risks that are quantifiable. The SVO would be able to leverage off the database project in the development of the tools. The following are examples of tools:

- Liquidity – Develop a tool that provides a liquidity score for an insurer portfolio. This would be accomplished by the SVO assigning a score to specific asset types ranging from most liquid to least liquid. A weighted average approach would be used to score an insurer portfolio.
- Deferral – Develop a tool that quantifies portfolio concentration to deferral risk
- Call – Develop a tool that quantifies portfolio concentration to call risk.
- Pricing – Develop a tool that highlights individual securities or groups of securities that experience changes in market value.

c. Monitoring - The third and most important component of the plan would be a monitoring process where the SVO Research Unit would report periodically to the IAWG. During this process, the SVO Research Unit would inform regulators of risks that are likely to manifest in current market environments. This process would also provide a forum for regulators to guide the SVO Research Unit in the development of tools and other analytical capabilities that are relevant to changing market environments.